

# **407** *International*

**407 INTERNATIONAL INC.**

**Consolidated Financial Statements**

**Years ended December 31, 2008 and 2007**

## AUDITORS' REPORT

To the Shareholders of  
**407 International Inc.**

We have audited the consolidated balance sheets of 407 International Inc. as at December 31, 2008 and 2007 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, 2008 and 2007 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  
February 10, 2009

**407 INTERNATIONAL INC.**  
**CONSOLIDATED BALANCE SHEETS**  
**As at December 31, 2008 and 2007**  
**(in thousands of dollars)**

	<b>2008</b>	<b>2007</b>
<b>Assets</b>		
Current		
Cash and cash equivalents (note 18)	\$ 137,396	\$ 104,444
Restricted cash (note 6)	186,188	137,797
Accounts receivable and other	132,198	150,006
	455,782	392,247
Long-term restricted cash and investments (note 6)	218,088	231,192
Long-term investments (note 11 (b))	91,995	66,587
Property, plant and equipment (note 4)	2,232,617	2,256,666
Intangible assets (note 5)	1,626,533	1,625,528
Future income tax assets, net (note 10)	33,449	-
	\$ 4,658,464	\$ 4,572,220
<b>Liabilities</b>		
Current		
Accounts payable and accrued liabilities	\$ 41,103	\$ 35,889
Accrued interest on long-term debt	68,221	59,267
Current portion of long-term debt (note 6)	10,671	9,380
Current portion of obligation under capital leases (note 15)	2,328	1,547
	122,323	106,083
Long-term debt (note 6)	4,681,703	4,594,147
Obligation under capital leases (note 15)	1,683	2,077
	4,805,709	4,702,307
<b>Shareholders' deficiency</b>		
Share capital (note 7)	775,000	775,000
Contributed surplus	29,568	29,568
Deficit	(971,448)	(955,489)
Accumulated other comprehensive income (note 8)	19,635	20,834
Total deficit and accumulated other comprehensive income	(951,813)	(934,655)
	(147,245)	(130,087)
	\$ 4,658,464	\$ 4,572,220
Commitments and contingencies (note 15)		

On Behalf of the Board:

*(signed)*  
**DAVID McFADDEN**  
 Director

*(signed)*  
**GILLES LARAMÉE**  
 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, 2008 and 2007**  
**(in thousands of dollars, except per share amounts)**

	<u>2008</u>	<u>2007</u>
Revenues (note 17)	\$ 546,535	\$ 518,933
Operating expenses	132,193	111,284
Depreciation and amortization	71,968	68,617
	<u>204,161</u>	<u>179,901</u>
Income from operations	342,374	339,032
Interest and other expenses, net (note 6)	257,282	278,724
Earnings before income taxes	85,092	60,308
Income tax recovery - current (note 10)	500	-
Income tax recovery - future (note 10)	33,449	-
Net income	<u>\$ 119,041</u>	<u>\$ 60,308</u>
Other comprehensive loss		
- reclassification to income of gains and losses on cash flow hedges, net (note 8)	(1,199)	(2,306)
Comprehensive income	<u>\$ 117,842</u>	<u>\$ 58,002</u>
Net income per share basic and diluted (note 9)	<u>\$ 0.154</u>	<u>\$ 0.078</u>
Deficit, beginning of year	\$ (955,489)	\$ (895,797)
Net income	119,041	60,308
Dividends paid to shareholders	(135,000)	(120,000)
Deficit, end of year	<u>\$ (971,448)</u>	<u>\$ (955,489)</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, 2008 and 2007**  
**(in thousands of dollars)**

	<u>2008</u>	<u>2007</u>
<b>Operating activities</b>		
Net income	\$ 119,041	\$ 60,308
Adjustments for:		
Depreciation on property, plant and equipment	66,834	64,231
Amortization of intangible assets	5,134	4,386
Accrued interest - non-current and other	95,157	83,170
Fair value adjustment - Senior Bond, Series 04-A2 (notes 6 & 11)	(73,086)	(25,231)
Fair value adjustment - Long-term investments (note 11)	40,073	22,185
Future income tax recovery (note 10)	<u>(33,449)</u>	<u>-</u>
	219,704	209,049
Change in non-cash working capital items:		
Accounts receivable and other	17,683	(8,327)
Accounts payable and accrued liabilities	(56)	(8,439)
Accrued interest - current	<u>8,187</u>	<u>(4,468)</u>
	<u>245,518</u>	<u>187,815</u>
<b>Investing activities</b>		
Additions to property, plant and equipment	(37,631)	(89,950)
Additions to intangible assets	(2,512)	-
Short-term investments	-	11,386
Long-term investments	(85,373)	(67,973)
Restricted cash and investments	(15,031)	(14,996)
Non-trade receivables	<u>(558)</u>	<u>(490)</u>
	<u>(141,105)</u>	<u>(162,023)</u>
<b>Financing activities</b>		
Proceeds from issuance of long-term debt	549,399	999,688
Debt issue costs and other	(1,779)	(2,567)
Repayment of long-term debt	(481,987)	(886,613)
Repayment of obligation under capital leases	(2,094)	(3,620)
Dividends paid to shareholders	<u>(135,000)</u>	<u>(120,000)</u>
	<u>(71,461)</u>	<u>(13,112)</u>
Increase in cash and cash equivalents	32,952	12,680
<b>Cash and cash equivalents, beginning of year</b>	<u>104,444</u>	<u>91,764</u>
<b>Cash and cash equivalents, end of year</b>	<u>\$ 137,396</u>	<u>\$ 104,444</u>

Supplementary cash flow information (note 18)

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

**407 INTERNATIONAL INC.**  
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**  
**Years ended December 31, 2008 and 2007**  
**(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 and owns improvements to certain 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 payment charges are recognized once the account is delinquent and the late payment 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 ("HFT") 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 HFT and are carried at fair value.

**e) Restricted cash and investments**

Restricted cash and investments includes highly liquid interest-bearing investments with maturities of 10 years or less. Restricted cash and investments are designated as HFT and are carried at fair value. Pursuant to the Indenture (see note 6 – 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**  
**Years ended December 31, 2008 and 2007**  
**(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 longer than one year. Long-term investments are designated as HFT and are carried at fair value.

**g) Derivatives**

Derivatives are carried at fair value and are reported as assets where they have a positive fair value to the Company and as liabilities where they have a negative fair value to the Company. The change in fair value during the period is recorded as interest and other expenses, net. At December 31, 2008 and December 31, 2007, the only derivative outstanding is Senior Bond, Series 04-A2, which is included in long-term debt.

**h) 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, 2008 and December 31, 2007, the Company does not have any outstanding contracts or financial instruments with embedded derivatives that require bifurcation.

**i) 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.

**j) Accumulated Other Comprehensive Income**

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.

**k) Transaction Costs**

Transaction costs related to HFT financial assets and HFT financial liabilities are expensed to interest and other expenses, net as incurred. Transaction costs related to available-for-sale ("AFS") financial assets, held-to-maturity ("HTM") financial assets, other liabilities ("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.

**l) 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 that are classified as AFS, HTM or OL.

**407 INTERNATIONAL INC.**  
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**  
**Years ended December 31, 2008 and 2007**  
**(in thousands of dollars, except per share amounts)**

**2. SIGNIFICANT ACCOUNTING POLICIES (continued)**

**m) 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 treatment, 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 cash flows of the senior and junior bonds affect interest and other expenses, net.

**n) Other financial instruments**

Accounts receivable are designated as loans and receivables and are accounted for at amortized cost. Accounts payable and accrued liabilities are classified as OL and are accounted for at amortized cost.

**o) 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.

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, Grading, Granular, Asphalt & Concrete Pavement (Base) and Drainage. - Large Galvanized Steel Drainage, Bridge Bearings and Joints. - Asphalt & Concrete Pavement (Top Coat) - Tolling Civil and Electrical, Barriers and Guide Rails, Signage, Landscaping, Fencing and Utilities Relocation - Highway Tools, Cameras and Inspection Stations - Concrete Pavement Joints	60 - 99 years projected VKT's  25 - 30 years projected VKT's  8 - 15 years projected VKT's 50 - 99 years straight-line  5 - 15 years straight-line 12 years projected VKT's
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 January 1, 2008, the Company prospectively revised its estimate of the useful life of the concrete pavement joints from 99 years projected vehicle kilometres travelled ("VKT's") to 12 years projected VKT's based on additional information recently made available to the Company. Depreciation expense in 2008 is higher (before additions) by approximately \$1,700 due to the change in useful life.

**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)**

**p) 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.

**q) Interest capitalization**

Interest expense on 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.

**r) 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 (the "Concession Agreement") with the Province of Ontario (the "Province").

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.

**s) Long-term debt**

The Company classifies long-term debt as OL and accounts for long-term debt using the amortized cost method, except for Senior Bonds, Series 04-A2, which is designated as HFT and is carried at fair value.

**t) 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 apply to taxable income in the years in which the related temporary differences are expected to 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.

**407 INTERNATIONAL INC.**  
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**  
**Years ended December 31, 2008 and 2007**  
**(in thousands of dollars, except per share amounts)**

**2. SIGNIFICANT ACCOUNTING POLICIES (continued)**

**u) 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.

**v) 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 claims and contingencies, the valuation allowance on future income tax assets, useful lives of property, plant and equipment, projected revenues for the amortization of concession rights, the fair valuation of long-term investments and Senior Bonds, Series 04-A2, 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 for collection of overdue accounts by the Ontario Registrar of Motor Vehicles (the “Registrar”) through refusing to renew or issue vehicle permits until outstanding amounts are paid (“Plate Denial”). Plate Denial was voluntarily suspended in February 2000 and the Company did not regain access to it until November 2005 following a judicial review, and as such, a backlog of uncollected accounts developed including a number of license plates which were no longer attached to a vehicle and/or expired. Where a licence plate associated with a customer’s unpaid 407 ETR account becomes unattached from the vehicle or expired, the Registrar is required to refuse to renew another single vehicle permit issued to the same customer and/or issue a vehicle permit to that customer. On March 30, 2008, the Registrar commenced the transfer of outstanding 407 ETR charges from unattached and expired license plates in Plate Denial to another single vehicle permit issued to the same customer. The legislation affording 407 ETR the right to Plate Denial requires a series of notices to be sent to customers with delinquent accounts. This process takes a minimum of 150 days from the date an invoice is sent until a customer is subject to Plate Denial, followed by up to two years before a customer’s license plate is subject to renewal. The Plate Denial process, together with other collection strategies, is expected to result in the successful collection of net accounts receivable 151+ days past due. The Company’s provision for overdue accounts could materially change and may result in significant changes to accounts receivable balances as Management continues to monitor the collection of outstanding 407 ETR charges through the Plate Denial process with the Ontario Ministry of Transportation (the “MTO”).

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

**3. CHANGES IN ACCOUNTING POLICIES AND CRITICAL ESTIMATES**

i) As required by The Canadian Institute of Chartered Accountants (“CICA”), on January 1, 2008, the Company adopted CICA Handbook 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 is to enable users of the financial statements to evaluate objectives, policies and processes for managing capital. Sections 3862 and 3863 replaced Section 3861, *Financial Instruments – Disclosure and Presentation*, and increase emphasis on disclosure about the nature and extent of risks arising from financial instruments and how the entity manages those risks. Application of these pronouncements had no impact on reported results of operations.

**ii) Future changes in accounting policies**

The CICA issued the following new accounting standard: Section 3064, *Goodwill and Intangible assets*; which establishes standards for the recognition, measurement, presentation and disclosure of goodwill and intangible assets. The mandatory and effective date is for annual and interim periods in fiscal years beginning on or after October 1, 2008. The Company will begin application of this section effective January 1, 2009.

**iii) International Financial Reporting Standards (“IFRS”)**

In February 2008, the Accounting Standards Board confirmed that Canadian public companies will have to adopt IFRS effective for fiscal years beginning on or after January 1, 2011. Based on initial analysis performed to date, the Company has identified certain International Accounting Standards pronouncements that are different from Canadian GAAP and could impact the Company’s consolidated financial statements.

**407 INTERNATIONAL INC.**  
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**  
**Years ended December 31, 2008 and 2007**  
(in thousands of dollars, except per share amounts)

**4. PROPERTY, PLANT AND EQUIPMENT**

	As at December 31, 2008		As at December 31, 2007	
	Cost	Accumulated Depreciation	Cost	Accumulated Depreciation
Toll highway	\$ 2,253,539	\$ 135,657	\$ 2,231,970	\$ 108,974
Toll equipment	278,072	205,932	266,944	178,754
Transponders	32,634	19,396	32,700	18,300
Operations centre	25,572	5,547	24,277	4,693
Office equipment	19,098	16,482	18,657	14,792
Motor vehicles	1,657	964	1,376	830
Snow clearing equipment and motor vehicles under capital lease	3,133	1,304	2,869	1,015
Computer equipment under capital lease	25,194	21,000	23,310	18,079
	\$ 2,638,899	\$ 406,282	\$ 2,602,103	\$ 345,437
Net book value		\$ 2,232,617		\$ 2,256,666

Certain property, plant and equipment has been retired and as a result, the cost has been reduced by \$6,141 (2007 - \$4,801) and accumulated depreciation by \$6,077 (2007 - \$4,383).

As at December 31, 2008, Toll highway and Toll equipment costs include amounts not being depreciated of \$34,726 (2007 - \$10,551) as they relate to projects under design and construction such as the Highway 407 East/Highway 403 West/Queen Elizabeth Way South ramp, and, Highway 407 lane expansion between Highway 403 and Highway 401 and between Highway 404 and Regional Road 30, tolling monitoring systems, as well as certain computer system development included in Toll equipment.

**5. INTANGIBLE ASSETS**

	As at December 31, 2008		As at December 31, 2007	
	Cost	Accumulated Amortization	Cost	Accumulated Amortization
Concession rights	\$ 1,676,139	\$ 57,169	\$ 1,676,139	\$ 53,524
Other intangible assets	11,302	3,739	5,163	2,250
	\$ 1,687,441	\$ 60,908	\$ 1,681,302	\$ 55,774
Net book value		\$ 1,626,533		\$ 1,625,528

In 2008, the Company acquired a license for \$6,139 relating to the use of certain tolling technology. This amount was classified as other intangible assets.

**407 INTERNATIONAL INC.**  
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**  
**Years ended December 31, 2008 and 2007**  
**(in thousands of dollars, except per share amounts)**

**6. LONG-TERM DEBT**

	<u>As at December 31, 2008</u>	<u>As at December 31, 2007</u>
<b>Senior Bonds:</b>		
\$400,000, Series 99-A1, 6.05%, maturing July 27, 2009	\$ 399,195	\$ 397,853
\$400,000, Series 99-A2, 6.47%, maturing July 27, 2029	389,174	388,934
\$300,000, Series 99-A3, 6.75%, maturing July 27, 2039	284,934	287,517
\$208,300, Series 99-A4, 5.328%, maturing December 1, 2016	252,104	233,157
\$208,300, Series 99-A5, 5.328%, maturing December 1, 2021	252,179	233,207
\$208,300, Series 99-A6, 5.328%, maturing December 1, 2026	252,213	233,227
\$208,300, Series 99-A7, 5.328%, maturing December 1, 2031	252,230	233,237
\$325,000, Series 00-A2, 5.29%, maturing December 1, 2039	375,773	370,696
\$340,000, Series 04-A3, 5.96%, maturing December 3, 2035	337,878	337,847
\$100,000, Series 06-A1, 3-month CDOR plus 0.12%, maturing February 11, 2008	-	99,976
\$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	623,517	622,735
\$250,000, Series 08-A1, 4.50%, maturing January 25, 2011	249,248	-
<b>Other Senior Bond:</b>		
\$162,274, Series 04-A2, 3.276%, maturing July 27, 2039 (note 11)	83,953	149,100
<b>Junior Bond:</b>		
\$165,000, Series 00-B1, 7.00%, maturing July 26, 2010, extendible to July 26, 2040, at an increased annual rate of 7.125%	164,070	163,889
<b>Subordinated Bonds:</b>		
\$480,000, Series 06-D1, 5.75%, maturing February 14, 2036	476,825	476,777
\$300,000, Series 07-D1, 3-month CDOR plus 0.15%, maturing May 26, 2008	-	299,742
\$300,000, Series 08-D1, 5.00%, maturing January 31, 2011	298,727	-
<b>Other Debt</b>	<u>354</u>	<u>708</u>
	4,692,374	4,603,527
<b>Less: Current Portion</b>	<u>10,671</u>	<u>9,380</u>
	<u>\$ 4,681,703</u>	<u>\$ 4,594,147</u>

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

Year:	<u>2009</u>	<u>2010</u>	<u>2011</u>	<u>2012</u>	<u>2013</u>
Amount:	\$410,671	\$800,787	\$561,286	\$11,814	\$12,373

**407 INTERNATIONAL INC.**  
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**  
**Years ended December 31, 2008 and 2007**  
**(in thousands of dollars, except per share amounts)**

**6. LONG-TERM DEBT (continued)**

**Interest and Other Expenses, Net**

	<u>2008</u>	<u>2007</u>
Interest expense	\$ 257,189	\$ 266,451
Non-cash inflation component of:		
Interest expense relating to RRBs	43,097	36,766
Interest expense, Senior Bond, Series 04-A2 (note 11)	7,939	5,613
Fair value adjustment, Senior Bond, Series 04-A2 (note 11)	(73,086)	(25,231)
Capitalized interest	<u>(767)</u>	<u>(1,766)</u>
<b>Total Interest Expense on Long-term debt</b>	<b><u>234,372</u></b>	<b><u>281,833</u></b>
Fair value adjustment, Long-term investments (note 11)	40,073	22,185
Interest income on held for trading financial assets	(19,655)	(25,407)
Reclassification of gains and losses on cash flow hedges	(1,199)	(2,306)
Other interest and expenses	<u>3,691</u>	<u>2,419</u>
	<u>\$ 257,282</u>	<u>\$ 278,724</u>

**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 (the "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 interests include the following:

- (i) a specific assignment of each of the Company's and 407 ETR's interest in and rights under all Project Agreements (as defined in the Indenture) 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 (as defined in the 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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**6. 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, 2008</u>	<u>As at December 31, 2007</u>
Current		
Debt service funds	\$ 67,798	\$ 59,219
Debt service reserve fund	29,390	-
Operating and maintenance reserve and renewal and replacement funds	<u>89,000</u>	<u>78,578</u>
	<u>\$ 186,188</u>	<u>\$ 137,797</u>
Long-term		
Debt service funds	\$ -	\$ 2,135
Debt service reserve funds	218,088	221,635
Operating and maintenance reserve and renewal and replacement funds	<u>-</u>	<u>7,422</u>
	<u>\$ 218,088</u>	<u>\$ 231,192</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.

As at December 31, 2008 and 2007, all reserve accounts were fully funded with Qualified Investments as required and defined by the Indenture.

**Senior Bonds**

The Company issued Series 99-A1, 99-A2 and 99-A3 in July 1999, Series 04-A3 in December 2004, Series 06-A1 in February 2006, Series 07-A1 in May 2007, Series 07-A2 in October 2007 and Series 08-A1 in January 2008 with interest payable semi-annually except for Series 99-A3, where interest became payable commencing January 27, 2005 and Series 06-A1 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. These bonds are redeemable in whole or in part, at the option of the Company.

On January 20, 2009, the Company issued \$300,000, 4.65% Senior Bonds, Series 09-A1 and \$200,000, 5.10% Senior Bonds, Series 09-A2. Interest is payable semi-annually in respect of both Series 09-A1 and 09-A2. The maturity date of the Series 09-A1 bonds is January 20, 2012 and the maturity date of the Series 09-A2 bonds is January 20, 2014. The Series 09-A1 bonds and the Series 09-A2 bonds are repayable at maturity and are redeemable, in whole or in part, at the option of the Company. The aggregate net proceeds from the Series 09-A1 bonds and the Series 09-A2 bonds will be used to fund the 09-A1 and 09-A2 series reserve accounts of \$18,645 and \$13,089 respectively, to repay \$400,000 Senior Bonds, Series 99-A1, due July 27, 2009 on maturity or redemption, as applicable, and for general corporate purposes.

The Company redeemed Senior Bonds, Series 07-A1 at par on February 26, 2008.

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**6. 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 on December 1, 2004. During 2002, the Company increased the face value of each series of RRBs by \$45,800 to a total of \$208,300 for each series of RRBs 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 (the “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 account 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.

As at December 31, 2008, the inflation compensation component of all RRBs was \$264,309 (2007 - \$229,052), of which the Company recorded \$259,813 (2007 - \$216,716) as additional long-term debt.

**Other Senior Bond**

In December 2004, the Company issued Series 04-A2. 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. 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 06-D1 in February 2006, Series 07-D1 in May 2007 and Series 08-D1 in January 2008 with interest payable semi-annually, except for Series 07-D1, where interest is payable quarterly. Series 06-D1 and Series 08-D1 are redeemable, in whole or in part, at the option of the Company.

The Company repurchased and cancelled \$244,000 Series 07-D1 at par on February 26, 2008 and repaid the balance of \$56,000 which matured on May 26, 2008.

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**6. LONG-TERM DEBT (continued)**

**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 were no longer "Qualified Investments" as defined in the Indenture. The obligations under the credit facility ranked 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 bore 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 was also obligated to pay a commitment fee of 0.15% to the bank, calculated on the undrawn portion of the credit facility.

The credit facility remained undrawn at maturity on August 25, 2008 and the \$200,000 Series 2007-A-2 senior pledged bond was cancelled.

**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.

**7. SHARE CAPITAL**

	<u>As at December 31, 2008</u>		<u>As at December 31, 2007</u>	
	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

**8. ACCUMULATED OTHER COMPREHENSIVE INCOME**

	<u>2008</u>	<u>2007</u>
Balance, beginning of year	\$ 20,834	\$ 23,140
Other comprehensive loss	(1,199)	(2,306)
Balance, end of year	<u>\$ 19,635</u>	<u>\$ 20,834</u>

AOCI includes gains and losses on cash flow hedges. Gains and losses on cash flow hedges will be reclassified to interest and other expenses, net, over periods of up to 30 years of which approximately \$967 will be reclassified during the next 12 months.

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**9. NET INCOME PER SHARE, BASIC AND DILUTED**

The weighted daily average number of shares outstanding was 775,000,003 in 2008 and 2007 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.

**10. INCOME TAXES**

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

	<u>2008</u>	<u>2007</u>
Income tax expense at statutory rates - 33.50% (2007 - 36.12%)	\$ 28,505	\$ 21,768
Increase (reduction) in income taxes resulting from:		
Increase (decrease) in statutory rates and other	2,709	21,684
Increase (decrease) in non-taxable portion of fair value adjustment of long term investments and other	6,456	3,233
Decrease in valuation allowance	<u>(71,119)</u>	<u>(46,685)</u>
Future income tax recovery	(33,449)	-
Recovery of large corporations tax - current	<u>(500)</u>	<u>-</u>
Income tax recovery	<u>\$ (33,949)</u>	<u>\$ -</u>

As at December 31, 2008, the Company has non-capital tax losses of \$275,894, available to offset future taxable income expiring in the following years:

<b>Year:</b>	<u>2010</u>	<u>2014</u>	<u>2015</u>	<u>2026</u>	<u>2028</u>
<b>Amount:</b>	\$9,389	\$199,647	\$1,555	\$2,514	\$62,789

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**10. INCOME TAXES (continued)**

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

	<u>As at December 31, 2008</u>	<u>As at December 31, 2007</u>
Future income tax liabilities:		
Property, plant and equipment and intangible assets	\$ (38,841)	\$ (47,994)
Long-term debt, accrued liabilities and others	(9,574)	-
	<u>(48,415)</u>	<u>(47,994)</u>
Future income tax assets:		
Long-term debt, accrued liabilities and others	-	3,748
Tax losses carried over	83,826	127,901
Restricted and long-term investments	8,554	3,716
Property, plant and equipment and intangible assets	17,588	11,852
Valuation allowance	<u>(28,104)</u>	<u>(99,223)</u>
	<u>81,864</u>	<u>47,994</u>
Net future income tax assets	<u>\$ 33,449</u>	<u>\$ -</u>

The Company has taken a valuation allowance with respect to the future income tax assets relating to a portion of property, plant and equipment and intangible assets of \$17,588, long-term investments of \$9,027 and non-capital losses of \$1,489.

The Company anticipates that its accumulated non-capital tax losses will be partially utilized prior to their expiration dates. As a result, the Company has recorded a net future income tax asset in relation to these non-capital losses that was previously provided for with a valuation allowance based on Management's assessment that it is more likely than not that the net tax benefit recognized will be utilized.

**11. 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:

**Current financial assets and liabilities**

Financial assets and liabilities classified as current 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**

The fair values were reported in the consolidated financial statements using quotations provided by financial institutions.

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**11. FINANCIAL INSTRUMENTS (continued)**

**Long-term debt**

The fair value of the long-term debt (including the current portion) as at December 31, 2008 was \$4,402,978 (2007 - \$5,137,634) using quotations provided by a major Canadian financial institution, except for Senior Bond, Series 04-A2, which Management determined by using a valuation technique.

**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 Senior Bond, Series 04-A2 as a derivative financial instrument in accordance with GAAP and reports Senior Bond, Series 04-A2 at its fair value. The fair value of Senior Bond, Series 04-A2 as at December 31, 2008 was \$83,953 (2007 - \$149,100) determined by using a valuation technique. During the year ended December 31, 2008, the expectation of future inflation decreased significantly and corporate credit spreads in general widened significantly and the fair value of Senior Bond, Series 04-A2 decreased by \$23,921 due to the change in the Company's corporate credit spread.

The inflation component of interest expense of Senior Bond, Series 04-A2 was \$7,939 for the year ended December 31, 2008 (2007 - \$5,613). In addition, the fair value adjustment interest recovery was \$73,086 for the year ended December 31, 2008 (2007 - \$25,231). The net amount of \$65,147 was recorded as an interest expense recovery for the year ended December 31, 2008 (2007 - \$19,618).

**b) Long-Term Investments**

As at December 31, 2008, the Company held long-term investments of \$147,007 principal amount of non-bank sponsored ABCP ("Montreal Proposal ABCP") and \$6,309 principal amount of other non-bank Series-E Notes (the "Other Non-Bank Series-E Notes"). 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 and the Other Non-Bank Series-E Notes (collectively, the "Notes").

On March 17, 2008, the Pan-Canadian Investors Committee for Third-Party Structured Asset-Backed Commercial Paper (the "Committee") filed an application (the "Committee Restructuring Plan") in the Ontario Superior Court of Justice (the "Court") under the *Companies' Creditors Arrangement Act* ("CCAA") asking the Court to call a meeting of Montreal Proposal ABCP holders to vote on the Committee Restructuring Plan. Following the CCAA application, DBRS Limited ("DBRS") withdrew its ratings of the Montreal Proposal ABCP. On March 20, 2008, the Committee released details of the Committee Restructuring Plan. On April 25, 2008, the Montreal Proposal ABCP holders voted in favour of the Committee Restructuring Plan and on June 5, 2008, Justice Colin Campbell of the Court sanctioned the Committee Restructuring Plan (the "Sanction Order"). On June 25 and 26, 2008, the Court of Appeal for Ontario heard motions from a group of Montreal Proposal ABCP holders (the "Group of Holders") seeking leave to appeal, and an appeal of the Sanction Order (the "Appeal"). On August 18, 2008, the Court of Appeal for Ontario upheld the Sanction Order. On September 19, 2008, the Supreme Court of Canada denied the Group of Holders leave to appeal the Court of Appeal for Ontario decision. On December 24, 2008, an agreement was reached with all key stakeholders to amend the terms of the Committee Restructuring Plan (the "Amended Plan").

There is a significant amount of uncertainty in estimating the amount and timing of cash flows associated with the Montreal Proposal Long-Term Notes. The Company estimates the fair value of the Montreal Proposal Long-Term Notes using a valuation technique which incorporates a probability weighted approach applied to the discounted estimated future cash flows considering the terms of the Montreal

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**11. FINANCIAL INSTRUMENTS (continued)**

Proposal Long-Term Notes and other available data regarding market conditions for such investments as at December 31, 2008. The discount rates consider factors including the BA rate, credit spread applicable to the anticipated credit rating, premiums for lack of liquidity, uncertainty of future payments, lack of transparency and nature of underlying assets.

The valuation technique used by the Company to estimate the fair value of the Montreal Proposal Long-Term Notes incorporates a discounted cash flow model considering the best available public information and market conditions. The interest rates, discount rates, maturity dates and probability of recovery modelled are:

Weighted average interest rate:	1.83 % <sup>1</sup> (ranging from 1.48% to 4.98%)
Premiums for lack of liquidity:	Ranging from 1.50% to 3.00% <sup>1</sup>
Weighted average discount rate:	7.69 % <sup>1</sup> (ranging from 2.72% to 10.41%)
Maturity dates:	Ranging from 2012 to 2017
Probability of recovery:	98% on the A-1 and A-2 Notes 10% on the B Notes 0% on the C Notes 98% on the TA Tracking Notes 10% on the IA Tracking Notes

1.Excludes Class C Notes as the Company estimates that the fair value is nil.

Based on the discounted cash flow model as at December 31, 2008, the fair value of the Company's Montreal Proposal Long-Term Notes was \$87,281, which included accrued interest of \$6,349 (2007-\$125,758 of which \$159,171 was classified as long-term restricted cash and investments and \$66,587 was classified as long-term investments). The Company recorded a reduction in fair value of \$60,662, of which \$38,477 is included in interest and other expenses, net for the year ended December 31, 2008 (2007 - \$22,185). The decrease in fair value during the year ended December 31, 2008 was primarily due to a different allocation of notes, coupled with lower expected investment returns, deterioration in the credit markets and a reduction in the DBRS credit rating of the MAV2 Class A-1 Notes and the MAV2 Class A-2 Notes from AA to A. The decrease in fair value of \$16,517 during the three-month period ended December 31, 2008 was primarily due to lower expected investment returns, coupled with deterioration in the credit market, a reduction in the DBRS credit rating of the MAV2 Class A-1 Notes and the MAV2 Class A-2 Notes from AA to A and increases in liquidity premiums resulting in higher discount rates.

On January 12, 2009, the Court granted the Amended Plan Implementation Order. On January 21, 2009, the Amended Plan restructuring was completed. Upon closing of the Amended Plan, the Company received \$77,520 of MAV2 Class A-1 Notes, \$42,575 of MAV2 Class A-2 Notes, \$7,729 of MAV2 Class B Notes, \$3,953 of MAV2 Class C Notes, \$14,062 of MAV2 IA Tracking Notes, \$377 of MAV3 IA Tracking Notes and \$791 of MAV3 TA Tracking Notes (collectively, the "Montreal Proposal Long-Term Notes") and \$5,698 of accrued interest. The MAV2 Class A-1 Notes, MAV2 Class A-2 Notes and MAV2 Class B Notes will accrue interest at the BA rate less 0.50%. The MAV2 Class C Notes will accrue interest at the BA rate plus 20%. The MAV2 IA Tracking Notes, MAV 3 IA Tracking Notes and MAV3 TA Tracking Notes will bear interest at the rate equal to the net rate of return generated by the related specific tracking assets but capped at the BA rate plus 11%. The Company also estimates that the maturity of the Montreal Proposal Long-Term Notes will range from 3.5 years to 7.5 years from December 31, 2008. As there has been no active market for the Montreal Proposal Long-Term Notes since closing on January 21, 2009, the Company has determined that as at February 10, 2009 there is no material change to the market conditions reported as at December 31, 2008, other than from normal market fluctuations.

On July 8, 2008, the Company exchanged the Other Non-Bank Series-A ABCP notes for Other Non-Bank Series-B Notes and on December 19, 2008, the Company exchanged the Other Non-Bank Series-B

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**11. FINANCIAL INSTRUMENTS (continued)**

Notes for Other Non-Bank Series-E Notes. The Other Non-Bank Series-E Notes are rated AA by DRBS and bear interest at the BA rate plus 0.35% and will mature in September 2016.

Similar to the Montreal Proposal Long-Term Notes, the Company estimates the fair value of the Other Non-Bank Series-E Notes as at December 31, 2008 using a valuation technique which incorporates a probability weighted approach applied to discounted future cash flows considering the terms of the Other Non-Bank Series-E Notes and other available data regarding market conditions for such investments.

The Company included factors taking into consideration current market conditions surrounding the Other Non-Bank Series-E Notes such as liquidity and credit risks. The discount factor was assumed to be 6.35%. Based on these assumptions as at December 31, 2008, the fair value of the Other Non-Bank Series-E Notes was \$4,714. The Company recorded a fair value adjustment of \$1,595 which was included in interest and other expenses, net for the year ended December 31, 2008 (2007 – \$ NIL).

Since the fair values of the Notes are determined using a probability-weighted approach employing the foregoing assumptions and are based on the Company's assessment of market conditions as at December 31, 2008, the fair values reported may change materially in subsequent periods. A 1.0% increase in the discount rate will decrease the fair value of the Montreal Proposal Long-Term Notes by approximately \$5,254 and the fair value of the Other Non-Bank Series-E Notes by approximately \$308.

**c) Allowance for Doubtful Accounts**

Changes in the allowance for doubtful accounts are as follows:

	<b>2008</b>	<b>2007</b>
Balance, beginning of period	\$ 89,728	\$ 77,151
Provision for doubtful accounts	38,328	20,923
Bad debts written off, net of recoveries, and other	(1,090)	(8,346)
Balance, end of period	\$ 126,966	\$ 89,728

The provision for doubtful accounts has been included in operating expenses in the consolidated statements of operations, and is net of any recoveries that were provided for in a prior period.

**d) Risks Arising from Financial Instruments**

See "Risks Arising from Financial Instruments" under "Risks and Uncertainties" in the Company's Management's Discussion and Analysis dated February 10, 2009, available on SEDAR ([www.sedar.com](http://www.sedar.com)).

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**12. CAPITAL DISCLOSURE**

The Company defines its capital as follows:

1. long-term debt, including the current portion; and
2. cash and cash equivalents, short-term investments and long-term investments.

The Company's objectives when managing capital are to:

1. maintain a capital structure and an appropriate rating that provides financing options to the Company when a financing or a refinancing need arises to ensure access to capital, on commercially reasonable terms, without exceeding its debt capacity or resulting in a downgrade to the credit ratings of the existing indebtedness;
2. maintain financial flexibility in order to preserve its ability to meet financial obligations, including debt servicing payments and dividend payments;
3. satisfy covenants set out in the Indenture and Supplemental Indentures; and
4. deploy capital to provide an appropriate investment return to its shareholders.

The Company's financial strategy is designed and formulated to maintain a flexible capital structure consistent with the objectives stated above and to respond to changes in economic conditions. In order to maintain or adjust its capital structure, the Company may issue additional debt, issue debt to replace existing debt with similar or different characteristics, and adjust the amount of dividends paid to shareholders. The Company's financing and refinancing decisions are made on a specific transaction basis and depend upon such factors as the Company's needs, and market and economic conditions at the time of the transaction.

Under the terms of the Indenture and Supplemental Indentures, the Company may not incur additional indebtedness resulting in a downgrade to the credit ratings of its existing indebtedness. The Company may only make interest payments relating to subordinated debt and dividend payments to shareholders upon the satisfaction of certain financial covenants. The Board of Directors of the Company reviews the level of dividends paid to the Company's shareholders on a quarterly basis. The Company is in compliance with all financial covenants.

There were no changes in the Company's approach to capital management during the period.

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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	2008	2007
SNC-Lavalin Engineers & Constructors	Subsidiary of shareholder	Property, plant and equipment	Payment for design costs	\$ 1,076	\$ 2,113
SNC-Lavalin Engineers & Constructors	Subsidiary of shareholder	Operating expenses	Payment for administration costs	\$ 439	\$ 430
CINTRA	Parent of shareholder	Operating expenses	Payment for administration costs	\$ 659	\$ 568
CINTRA	Parent of shareholder	Property, plant and equipment	Payment for construction costs	\$ 5	-
CINTRA	Parent of shareholder	Operating expenses	Reimbursement of administration costs	\$ (158)	\$ (83)
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, 2008	As at December 31, 2007
SNC-Lavalin Engineers & Constructors	Subsidiary of Subsidiary of shareholder	Accounts payable and accrued liabilities	\$ 176	\$ 179
CINTRA	Parent of shareholder	Accounts payable and accrued liabilities	\$ 310	\$ 95
CINTRA	Parent of shareholder	Accounts Receivable	\$ (189)	\$ (32)
MICI	Shareholder	Accounts Receivable	\$ (25)	\$ (25)
Grupo Ferrovial	Parent of shareholder	Accounts Receivable	\$ (4)	\$ (4)
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 \$640 during 2008 (2007 - \$594).

**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 an agreement dated March 31, 2006 (the "2006 Settlement Agreement").

Pursuant to the 2006 Settlement Agreement, 407 ETR commenced to extend benefits of at least \$40,000 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 a 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:

	<b>Obligations under capital leases</b>
2009	\$ 2,502
2010	1,083
2011	434
2012	168
2013	120
Total minimum lease payments	4,307
Interest included in minimum payments at rates varying between 3.98% and 8.63%	(296)
Present value of net minimum lease payments	4,011
Less: current portion	(2,328)
Long-term portion	\$ 1,683

***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 \$687, 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 winter 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.

As at December 31, 2008 payments under these agreements for the next five years are as follows:

<b>Year:</b>	<b>2009</b>	<b>2010</b>	<b>2011</b>	<b>2012</b>	<b>2013</b>
<b>Amount:</b>	\$11,050	\$8,406	\$6,615	\$6,725	\$2,834

On January 1, 2009, the Company entered into a capital lease agreement with a supplier for new hardware equipment amounting to \$4,500 replacing the Company's existing development mainframe and storage devices. At the end of the lease, the Company has the right, but not the obligation, to purchase the equipment.

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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 2008 totalled \$20,078 (2007 - \$18,029).

**18. SUPPLEMENTARY CASH FLOW INFORMATION**

	<u>As at December 31, 2008</u>	<u>As at December 31, 2007</u>
Cash and cash equivalents consist of:		
Cash	\$ 35,832	\$ 9,224
Bankers' Acceptances	31,676	95,220
Treasury Bills	49,918	-
Provincial Promissory Notes	19,970	-
	<u>\$ 137,396</u>	<u>\$ 104,444</u>

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**18. SUPPLEMENTARY CASH FLOW INFORMATION (continued)**

	<u>2008</u>	<u>2007</u>
Interest paid	<u>\$ 202,795</u>	<u>\$ 226,234</u>
Property, plant and equipment acquired by capital lease	<u>\$ 2,481</u>	<u>\$ 661</u>
Change in accrued property, plant and equipment and other intangible assets in accounts payable and accrued liabilities	<u>\$ 8,930</u>	<u>\$ (555)</u>

**19. COMPARATIVE FIGURES**

The 2007 consolidated financial statements have been reclassified from statements previously presented to conform to the presentation of the 2008 consolidated financial statements.