



Management Discussion and Analysis

Second Quarter Report

2006

Dated February 7, 2006. The following Management Discussion and Analysis is prepared in accordance with National Instrument 51-102F1, and should be read in conjunction with the Company's 2005 Annual Report, in particular, the Management Discussion and Analysis, and the Consolidated Financial Statements and accompanying notes. These documents along with additional information about the Company, including the Annual Information Form, are available at www.absolute.com and www.sedar.com. Certain statements in this quarterly report constitute forward-looking statements that involve risks and uncertainties. These forward-looking statements relate to, among other things, plans and timing for the introduction or enhancement of Absolute's services and products, and other expectations, intentions and plans contained in this analysis that are not historical fact. When used in this quarterly report, the words "plan," "expect," "believe," and similar expressions generally identify forward-looking statements. These statements reflect current expectations. They are subject to a number of risks and uncertainties, including, but not limited to, changes in technology and general market conditions. In light of the many risks and uncertainties readers should understand that Absolute Software cannot offer assurance that the forward-looking statements contained in this analysis will be realized.

Strategic Update of Absolute Software Corporation

Absolute's mission is to be the industry standard in Computer Theft Recovery ("Anti-Theft") and Secure Asset Tracking, and ultimately to become recognized as a world leader in security solutions for computers and other connected devices. While computer OEM partnerships and obtaining an embedded position in the computer firmware are indicators of Absolute's progress, management also focuses on the subscriber base as a quantifiable measure of success toward its industry standard mission. As a mid term objective, management has a stated goal to have one million subscribers under contract by June 30, 2007. In the first six months of fiscal 2006, Absolute signed 173,000 new and renewal subscriptions, bringing the subscriber base to approximately 550,000 at December 31, 2005 from 440,000 at June 30, 2005. During the next 18 months, approximately 750,000 new and renewal subscriptions are required to achieve the one million subscription contracts under contract target.

There are four key strategies Absolute is focusing on to drive technology advancement and subscription growth, including:

1. Embed the Computrace tracking agent laptop BIOS's (firmware) of all first tier PC manufacturers ("PC OEMs"),
2. Grow Computrace activation rates to a minimum of 5% of PC OEM partner laptops shipped,
3. Enhance and protect intellectual property, and
4. Grow the market verticals.

Embed Computrace in the BIOS:

Management believes the Embedded Strategy to be the single most important strategy for accelerating sales growth and establishing Absolute's Computrace technology as an industry standard. The Embedded Strategy refers to computer OEMs embedding Absolute's Computrace software into the basic input output system ("BIOS") of the computer hard drive.

From a technology perspective Absolute's software becomes integrated at the chip-level of the computer, making the software extremely difficult to defeat, and thereby increasing the level of protection for Absolute's customers.

Dell, HP, Lenovo, Gateway and Hewlett-Packard have all adopted the Embedded Strategy during calendar 2005. Dell and HP both adopted the strategy during Q2-F2006 and as such are expected to begin adding to sales growth in the next six months. Sales through Lenovo and Gateway have accelerated following their adoption of the Embedded Strategy, increasing to 20% of total sales contracts for the six months to December 31, 2005, up from 6% in the same period last year. Absolute will continue to pursue embedded solutions with other computer OEMs in the coming quarters.

Grow PC OEM's Sales and Activation Rates:

Absolute's distribution model is focused on generating sales through OEM channels – primarily DELL, Lenovo, HP, Gateway, Toshiba and Apple. Management believes these distribution channels are a competitive advantage for the Company, and Absolute is expanding programs to maximize market penetration through these channels. For the six months to December 31, 2006, Absolute generated \$7.2 million (or 77% of total sales contracts) through its OEM channels, compared to \$4.0 million (or 73%) in the same period last year. Note all dollar figures reported herein are in Canadian dollars unless otherwise stated.

DELL continues to be Absolute's largest channel partner, generating \$3.9 million (or 41%) of year to date sales contracts, a 36% increase from \$2.8 million (or 52%) in the same quarter of last year. Strategies to increase sales through other OEM channels have resulted in a reduction in the percent of sales through DELL.

Enhance and Protect Intellectual Property:

Absolute has 12 issued and 2 pending patents covering the Computrace technology, which it relies upon as a competitive advantage and to maintain its market leadership position. During fiscal 2005, Absolute began enforcing its patents and these efforts are expected to continue during fiscal 2006. At present, Absolute has commenced proceedings against nine competitors of which seven have been resolved and two are on-going. Resolution has taken the form of competitors exiting the business, acquiring licenses to Absolute's patent portfolio, or becoming resellers of Absolute's technology.

Grow Market Verticals:

Absolute continues to execute on strategies focused on the U.S. laptop computer marketplace in three target verticals: education, corporate and consumer. The strategies leverage the student laptop programs in the education vertical, the Embedded Strategy, security concerns and regulatory requirements in the corporate vertical, expansion of retail presence with the LoJack for Laptops consumer offering, and the general increase in mobile computers being purchased. Combined with the Embedded Strategy, the vertical strategies have led to a 71% increase in sales and a reduction in the level of seasonality originally introduced by the education vertical purchasing cycle as second quarter sales were 18% below first quarter sales this year, compared to a 30% decline last year.

Absolute generated 37% of its second quarter sales, and 43% of year to date sales, through the education vertical. Now in its third year, the education strategy is gaining momentum, resulting in increased sales and a reduction in the level of seasonality. Second quarter fiscal 2006 education sales were 36% below first quarter sales, compared to a 64% reduction in the same period last year.

Through the corporate vertical, Absolute generated 50% of second quarter fiscal 2006 sales and 42% of year to date sales. The Embedded Strategy and increased OEM sales support have significantly increased the number of corporate opportunities entering the sales pipeline and have resulted in a 41% increase in year to date corporate sales.

The most significant percentage increase came from the consumer vertical where the LoJack for Laptops brand name and expanded retail and OEM channels have increased sales contracts by 352% over the prior year. However, second quarter sales were 30% lower than first quarter sales, which management believes reflects differences in buying patterns of the back-to-school and Christmas season purchasers. Absolute is continuing to expand the number of U.S. and Canadian retail stores carrying LoJack for Laptops and the number of OEM programs.

| Quarterly Sales Contracts by Market Vertical (In millions of dollars, except % increase) | 3mo Q2-F2006 | % Increase over Prior Year | 6mo Q2-F2006 | % Increase over Prior Year |
|---|-----------------|-------------------------------|-----------------|-------------------------------|
| Education | \$ 1.56 | 88% | \$ 4.00 | 70% |
| Corporate (all non-education and non-consumer sales) | 2.10 | 64% | 3.99 | 41% |
| Consumer | 0.58 | 243% | 1.41 | 352% |
| Total sales contracts | \$ 4.24 | 86% | \$ 9.40 | 71% |

Corporate Development

Absolute has begun exploring additional strategies to accelerate sales and subscription growth. Subsequent to December 31, 2005, the following changes were made to help facilitate this process:

- Bob Chow has changed his role to focus more exclusively on driving new sales in North America and internationally, and business development opportunities as part of Absolute's growth strategy. To enable this re-focus, he will no longer serve as Absolute's COO, but will remain as President of Absolute Software Inc. Mr. Chow's operational responsibilities will be assumed by other members of the management team.
- A number of new development team members were recently hired to assist with second and third level support, and new market, product and device development. In particular, Bill Gordon, formerly of Intrinsic Software, will leverage his Windows CE expertise to determine the feasibility of solutions for the PDA ("personal digital assistant") market, among other things; and Glyn Lewis, founder of Oxygen UK and creator of "WebDetect", a former competitor, will now assist with expansion of Absolute's international business, which today accounts for less than 5% of sales contracts.

Business Model

Absolute sells its computer asset tracking (AbsoluteTrack) and theft recovery (ComputraceComplete, ComputracePlus and LoJack for Laptops) solutions primarily in a subscription for services model. Subscription sales contracts are available with service terms of 1 to 5 years, with non-refundable payment in full due upon signing. While the entire value of the sales contract is due at the beginning of the contract, the revenue from the contract is recorded as deferred revenue on the balance sheet and amortized to income ratably over the contract term, starting in the month following the invoice date. From a cash flow perspective, a majority of the cash costs associated with servicing the subscriptions are incurred at the beginning of the contract term. The deferral of sales contracts means revenue and gross margin will lag behind sales contracts and operating cash flow (see the Contractual Commitments section of this management discussion and analysis for the amortization schedule of deferred revenue). As a result, management relies upon sales contracts and operating cash flow as the indicators of performance and profitability. Refer to the Net Loss section below for further analysis of this metric. Sales contracts are not a measure under Canadian generally accepted accounting principles ("GAAP") and do not have a standardized meaning prescribed by GAAP. See Note 5 to the December 31, 2005 Interim Consolidated Financial Statements for GAAP reconciliation of deferred revenue to sales contracts and revenue. In general, achieving positive cash from operations by generating sales contracts in excess of operating costs is expected to translate into profitability as GAAP revenues begin to reflect increased sales contract levels. Readers are encouraged to refer to Absolute's 2005 Annual Report for further discussion of the business model.

Selected First Quarter Information For the Three Months Ended December 31

| (In millions, except percent and per share data) | Q2-F2006 | Q2-F2005 | YTD-F2006 | YTD-F2005 |
|--|-----------|-----------|-----------|-----------|
| Sales Contracts | \$ 4.24 | \$2.28 | \$ 9.40 | \$5.50 |
| % increase over prior year | 87% | 61% | 71% | 43% |
| Revenue | \$ 2.76 | \$2.15 | \$ 5.34 | \$4.02 |
| % increase (decrease) over prior year | 29% | 10% | 33% | 5% |
| Net Loss | \$ (0.71) | \$ (0.47) | \$ (1.63) | \$ (1.47) |
| Basic and diluted loss per share | \$ (0.03) | \$ (0.03) | \$ (0.08) | \$ (0.09) |
| Cash from operations | \$ 1.16 | \$ 0.24 | \$ 2.13 | \$ 0.81 |

Revenue and Sales Contracts

The increases in revenue are a result of sales contract growth. With contract terms averaging nearly 30 months, revenue will reflect the changes in sales contracts over the past three fiscal years. In general, with a 30-month average contract term, 15% to 20% of current fiscal year sales contracts are recognized in revenue in the year of sale.

Second quarter new and renewal sales contracts of \$4.2 million increased 87% over \$2.3 million Q2 of last year. For the year to date, new and renewal sales contracts increased 71% to \$9.4 million from \$5.5 million last year. The increases reflect the Embedded Strategy with Lenovo and Gateway, increased penetration in the education market vertical and expanded consumer strategies with LoJack for Laptops.

Over 90% of sales contracts continue to be denominated in U.S. dollars, while the Company reports in Canadian dollars. As a result of the continued devaluation in the U.S. dollar, the underlying business actually increased at faster rates than reported in Canadian dollars. In U.S. dollar terms second quarter fiscal 2006 sales contracts were U.S. \$3.6 million, a 95% increase from U.S. \$1.9 million generated in the second quarter last year. For the six months to December 31, 2005 sales contracts were U.S. \$8.0 million, up 84% from U.S. \$4.3 million last year.

Sales contracts are recorded at the value received by Absolute from either the reseller or directly from the customer. The value received from the reseller is net of reseller discounts. Accordingly, the retail price paid for Absolute's solutions is higher than the amount reported by Absolute as sales contracts. In the first quarter of fiscal 2006, the average price per unit increased over the prior year due to an increase in the proportion of theft recovery sales. The first quarter of last year included an unusually high proportion of asset tracking sales, a lower priced product.

| | Q2-F2006 | Q2-F2005 | YTD-F2006 | YTD-F2005 |
|--|-----------|-----------|-----------|-----------|
| Total subscriptions in units | 76,942 | 45,063 | 173,167 | \$144,504 |
| Theft recovery sales as a percent of total units | 74% | 69% | 82% | 46% |
| Average selling price | \$ 55.13 | \$50.40 | \$ 54.31 | \$38.03 |
| Average contract term | 32 months | 25 months | 29 months | 24 months |

Operating Expenses (in millions, except employee data)

| In millions, except employee data | Q2-F2006 | Q2-F2005 | YTD-F2006 | YTD-F2005 |
|---|----------|----------|-----------|-----------|
| Cost of goods sold ("COS") | \$ 0.95 | \$ 0.55 | \$ 1.73 | \$ 1.09 |
| Sales and Marketing ("S&M") | 1.38 | 0.95 | 2.87 | 2.02 |
| Research and development ("R&D") | 0.46 | 0.34 | 0.89 | 0.75 |
| General and administration ("G&A") | 0.94 | 0.52 | 1.68 | 1.11 |
| Share-based compensation | 0.11 | .03 | 0.19 | 0.05 |
| Total operating expenses | \$ 3.84 | \$ 2.39 | \$ 7.36 | \$ 5.02 |
| % increase (decrease) | 61% | (10%) | 47% | (5%) |
| Number of employees, end of period | | | 91 | 70 |
| Units under subscription, end of period | | | 0.55 | 0.37 |

Total operating expenses have increased as the employee base and selling and marketing efforts have been expanded in order to effectively execute on Absolute's strategic plan. On a percentage basis, operating expenses have increased at a lower rate and from a lower base than have sales contracts. Management believes it is critical that Absolute invest in the business in order to support its operations and accelerate growth to a critical mass level. However, management intends to keep the rate of investment increase to levels below the rate of sales growth.

The increase in COS primarily reflects costs associated with the theft guarantee program launched in the fourth quarter of fiscal 2004, and with expansion of the consumer strategy and theft recovery team. The estimated cost of the guarantee program is accrued and charged to deferred contract costs at the beginning of each sales contract and amortized to cost of sales over the contract life. Now in its second year, the full impact of this program is beginning to be reflected in cost of sales. In addi-

tion, the consumer program carries increased costs associated with delivering a box product to retailers, which includes amortization of the branding costs associated with warrants granted to LoJack Corporation. Finally, recovery costs have increased as the volume of theft recoveries and files has increased with the subscriber base, and due to the addition of Lyle Singular, a 25 year RCMP veteran, as Director of Recovery Services at the end of Q1-F2006.

S&M expenditures reflect increases in the size of the sales team to support OEM and vertical programs, marketing expenditures for rollout of LoJack for Laptops, and increased average sales compensation per employee. The average compensation has increased due to both changes in market rates and improved sales performance.

R&D expenditures have been increased in order to support the BIOS-embedded status with OEM partners and increased subscriber base. Resources will be added in coming quarters as the company looks to expand into international markets and develop other solutions that leverage its core technology.

G&A expenses have increased over last year and the prior quarter primarily due to an increase in legal expenses associated with enforcing the patent portfolio, the hire of in-house legal counsel in Q1-F2006, improved operational performance and graduation to the TSX in December 2005.

Other Income (Expense)

Absolute earns interest income on its cash resources beyond immediate operating requirements. These cash balances are invested in treasury bills, bankers' acceptances and investment grade bonds. Interest income increased to \$177,000 in the six months to December 31, 2006 from \$46,000 in the same period last year as a result of increased cash balances and interest rates.

Absolute reports foreign exchange gains and losses primarily on the translation of cash and receivable balances carried in U.S. dollars. Generally, foreign exchange losses will be reported in periods where the U.S. dollar declines relative to the Canadian dollar. The U.S. dollar devalued relative to the Canadian dollar in the first six months of fiscal 2006 and 2005, with the decline being larger in fiscal 2005. As a result, Absolute reported foreign exchange losses of \$61,000 in the six months to December 31, 2006 compared to \$512,000 last year. During the second quarter for fiscal 2006, Absolute reported an exchange gain as it was able to capitalize on a temporary increase in the U.S. dollar value in October 2005.

At December 31, 2005 Absolute held U.S. dollar cash balances of U.S. \$2.4 million and account receivable balances of U.S. \$2.5 million, compared to U.S. \$1.0 million and U.S. \$3.2 million respectively at June 30, 2005. Approximately 50% of Absolute's costs are denominated in U.S. dollars, and excess cash balances are converted to Canadian dollars on a regular basis. Accordingly, Absolute has not entered into hedging arrangements as management believes the cost would outweigh the benefit. However, as over 90% of sales contracts are denominated in U.S. dollars, changes in the value of the U.S. dollar relative to the Canadian dollar will impact the rate of sales contract growth in future periods.

Net Loss Before Income Taxes

For the second quarter of fiscal 2006, the Company's net loss before income taxes was \$833,000, a 78% increase compared to the pre-tax loss of \$467,000 in the same quarter last year. For the six months to December 31, 2005, the pre-tax loss was \$1.6 million, a 31% increase over \$1.47 million last year. The increases were expected due to the deferral of sales contracts as revenue levels have yet to reflect the 71% increase in sales contracts over the prior year. Conversely, Absolute has increased its cost infrastructure in order to support current growth strategies. Generally, in periods of expansion and rapid sales growth, the loss is expected to increase until revenue levels begin to reflect the increased sales contract levels.

Since inception, Absolute has invested in establishing the market for Computer Theft Recovery and Secure Asset Tracking, building an effective distribution channel, and evolving its product offering. This investment has resulted in the Company operating in a net loss position to date. The primary strategy for becoming profitable is to grow revenue through sales contract growth. With sales contracts increasing 71% in the first six months of fiscal 2006 and 50% in fiscal 2005, the model is now producing cash positive operations and setting the stage for profitability. The following table is produced to illustrate the importance of sales contracts and cash flow as key performance metrics:

| (In millions of dollars) | Q2-F2006 | Q2-F2005 | YTD-F2006 | YTD-F2005 |
|--------------------------------|-----------|-----------|-----------|-----------|
| Sales contracts | \$ 4.24 | \$ 2.28 | \$ 9.40 | \$ 5.50 |
| Revenue | \$ 2.76 | \$ 2.15 | \$ 5.34 | \$ 4.02 |
| Net (loss) before income taxes | \$ (0.83) | \$ (0.47) | \$ (1.92) | \$ (1.47) |
| Cash from operations | \$ 1.16 | \$ 0.24 | \$ 2.13 | \$ 0.81 |

Net Loss After Income Taxes

The Company reported a second quarter net loss after income taxes of \$709,000 or \$0.03 per share, compared to \$467,000 or \$0.03 per share in the same quarter last year. For the six months to December 31, 2005, the loss was \$1.6 million, or \$0.08 per share, compared to \$1.47 million, or \$0.09 per share, for the same period last year. The fiscal 2006 loss includes future income tax benefits of \$125,000 for Q2-F2006 and \$288,000 for the year to date. Absolute began recording the future period benefits from current and prior period losses in fiscal 2004, and began recording the tax benefits on a quarterly basis in fiscal 2006. Absolute has total potential future tax assets in excess of \$12.9 million, including tax losses of \$8.2 million in Canada and U.S. \$10.6 million in the U.S., available to reduce taxable income in future years. Of this value, \$2.4 million is recognized on Absolute's balance sheet as future income tax assets.

Cash From (Used In) Operations

Absolute reported positive cash from operations of \$1.16 million in Q2-F2006, its sixth consecutive quarter of cash positive operations, compared to cash from operations of \$243,000 in the same quarter last year. For the year to date, cash from operations was \$2.1 million, or 22% of sales contracts, up from \$805,000 last year. The increased cash from operations reflects sales contract growth in excess of the rate of increase in operating expenses.

Liquidity and Capital Resources

Cash position

Absolute is in a strong financial position, with the financial resources necessary to fund its operating and capital requirements and to execute on its growth strategies. At December 31, 2005 Absolute carried cash, cash equivalents and short-term investments of \$14.5 million, up from \$11.9 million at June 30, 2005. The increase is primarily due to Absolute generating positive cash from operations in the first six months of fiscal 2006.

Accounts receivable

Accounts receivable balances of \$3.4 million at December 31, 2005 are down from \$4.1 million at June 30, 2005, reflecting the seasonality in sales contracts between second and fourth quarters. Sales contracts tend to be concentrated toward the end of each quarter, and as a result, receivables balances tend to average between 75% and 85% of sales for the quarter. Receivable balances at December 31, 2005 were 81% of Q2-F2006 sales contracts, compared to 82% at June 30, 2005.

Deferred contract costs

Direct contract costs are capitalized as deferred contract costs on the balance sheet and are charged to income over the term of the contract to which they relate. Direct contract costs include expenditures incurred at the beginning of the contract period (commissions, prepaid service fees, prepaid contract insurance, direct delivery costs, etc.), plus the amount of warranty costs estimated over the life of each contract.

At December 31, 2005, deferred contract costs of \$4.2 million (21% of deferred revenue) increased from \$3.2 million (20% of deferred revenue) at June 30, 2005. The overall increase is consistent with the increase in deferred revenue. The increase as a percent of deferred revenue reflects an increasing proportion of deferred revenue from products that include Absolute's theft recovery guarantee. At present, sales of these products represent approximately 60% of total sales contracts. Management expects deferred contract costs as a percent of deferred revenue to climb toward 25% as the overall deferred revenue balances begin to reflect the current product mix.

Accrued warranty

With the introduction of guaranteed theft recovery services, Absolute began recording a warranty provision for potential guarantee payments under the program. Warranty costs for each sales contract are estimated at between 15% and 20% of the sales contract value based on Absolute's experience across its subscriber base. A portion of this warranty exposure is underwritten with third-party contract insurance, and the remainder is included in accrued warranty. The corresponding expense is recorded as deferred contract costs and charged to cost of sales over the term of each contract. The accrued warranty accrual is reduced as payments are incurred for insurance premiums and net warranty claims.

Accrued warranty increased to \$1.8 million at December 31, 2005 from \$1.3 million at June 30, 2005. During the first six months of fiscal 2006, a total of \$520,000 was paid in insurance premiums and guarantee claims, net of insurance proceeds, compared to warranty accrual on new sales of \$1.06 million. Each period, management evaluates its guarantee payment experience and considers whether changes are required to the estimated warranty provision. Experience to date suggests that a change in the accrual rate is not required. Management expects the Embedded Strategy to enable the Company to achieve actual warranty costs below the current estimated accrual rate over time.

Deferred revenue

Deferred revenue represents sales contracts invoiced for which the non-refundable payment is received or due to be paid in full, but for which the revenue is not yet recognizable under GAAP. Refer to Note 5 of the Notes to the Interim Consolidated Financial Statements of December 31, 2005 for a reconciliation of deferred revenue to sales contracts and revenue.

Deferred revenue grew to \$20.3 million at December 31, 2005 on six month sales contracts of \$9.4 million, up from \$16.3 million at June 30, 2005. Future sales contracts will continue to increase this balance and will generate increases in revenue in future periods. This provides considerable visibility for future period revenues, with the current portion showing the amount that will be included in revenue over the next twelve months. See the commitments section below for a schedule of deferred revenue amortization.

Quarterly Operating Data

Past 8 Quarters, Un-audited (in millions of dollars, except per share data)

| | Q2-'06 | Q1-'06 | Q4-'05 | Q3-'05 | Q2-'05 | Q1-'05 | Q4-'04 | Q3-'04 |
|---|-----------|-----------|-----------|-----------|-----------|-----------|-----------|-----------|
| Sales contracts | \$ 4.24 | \$ 5.16 | \$ 5.03 | \$ 2.70 | \$ 2.27 | \$ 3.22 | \$ 3.20 | \$ 1.78 |
| Revenue | \$ 2.76 | \$ 2.58 | \$ 2.34 | \$ 2.21 | \$ 2.15 | \$ 1.87 | \$ 1.84 | \$ 1.93 |
| Operating expenses | \$ 3.84 | \$ 3.53 | \$ 3.12 | \$ 2.81 | \$ 2.39 | \$ 2.63 | \$ 2.84 | \$ 2.75 |
| Net (loss) income | \$ (0.71) | \$ (0.92) | \$ (0.54) | \$ (0.51) | \$ (0.47) | \$ (1.00) | \$ 0.94 | \$ (0.72) |
| Basic and diluted (loss) income per share | \$(0.03) | \$ (0.04) | \$ (0.03) | \$ (0.03) | \$ (0.03) | \$ (0.06) | \$ 0.06 | \$ (0.04) |
| Cash from (used in) operations | \$ 1.16 | \$ 0.96 | \$ 0.31 | \$ 0.21 | \$ 0.24 | \$ 0.56 | \$ (0.77) | \$ (0.42) |

Shareholder's Equity and Outstanding Share Data

At December 31, 2005, Absolute had shareholder's equity of \$2.8 million. In evaluating shareholder's equity, management believes it is important to consider the \$20.3 million of deferred revenue carried on the balance sheet. This represents prepaid and non-refundable revenue, which management expects to deliver high margins as much of the associated contract costs are already included in the operating deficit.

The Company's common shares trade on the TSX (TSX: ABT), and at December 31, 2005, the Company had 21,579,305 (21,616,555 at February 6, 2006) fully issued and outstanding common shares.

The following common share stock options and warrants are issued and outstanding:

- **Broker Warrants:** The Company issued 440,000 Broker Warrants in conjunction with a private placement on March 22, 2005, of which 145,343 were outstanding at December 31, 2005 and February 6, 2006. The Broker Warrants have an exercise price of \$1.40 and expire on September 22, 2006.
- **LoJack Warrants:** Effective July 1, 2005, the Company issued 500,000 warrants to acquire rights to the "LoJack" brand name. All 500,000 warrants were outstanding at December 31, 2005. The warrants have an exercise price of \$2.00 per share, vest 20% per year starting on July 1, 2006 and expire the earliest of two years after each vesting, termination of the agreement, or July 1, 2010.
- **Employee Stock Options:** At December 31, 2005, a total of 2,717,485 (2,734,235 at February 6, 2006) common stock options were granted and outstanding under the Company's Employee Share Option Plan. The options have a weighted average strike price of \$1.29 per share, and a weighted average term to expiry of 2.8 years. During the first six months of fiscal 2006, a total of 734,500 stock options were granted to employees at an average strike price of \$2.46. Of these, 365,000 were granted to insiders at an average strike price of \$2.55 per share.

Critical Accounting Policies and Estimates

Management considers the Company's accounting for sales contracts, deferred contract costs, warranty accruals and future tax assets to be critical accounting policies. An understanding of the accounting policies for these items is important for meaningful analysis of Absolute's business.

Sales contracts and deferred contract costs represent sales receipts and expenses that are generated or incurred at the start of each sales contract. These items are recorded on the balance sheet as deferred revenue or deferred contract costs, and are recognized as revenue or expense ratably over the contract term.

Warranty accruals require management estimates of the amount of warranty claims that will be paid over the life of each sales contract. The value of the accrued warranty estimate is recorded with deferred contract costs and charged to cost of sales ratably over the contract term. Accrual estimates are established based on Absolute's experience with loss and recovery rates, and are reviewed for reasonableness based on actual experience on a regular basis.

The Company had future tax assets of \$12.9 million at June 30, 2005, of which \$2.4 million have been recognized on the balance sheet at December 31, 2005. The remaining future tax assets have not been recognized in the financial statements. Each reporting period, management assesses the likelihood of realizing future tax assets. Where management considers it is more likely than not that some portion or all of the future tax assets will be realized, the estimated realizable value of the future tax asset is recognized on the balance sheet. The net income or loss after income taxes can vary widely in periods where tax assets are recognized.

Contractual Commitments

The Company does not have minimum purchase commitments and does not have significant contractual commitments except its leased premises, LoJack branding agreement (see subsequent events) and fulfillment of services under its sales contracts. There has been no change in the lease and LoJack commitments since June 30, 2005. The following table presents the deferred revenue amortization schedule at December 31, 2005 relating to contractual commitments for the provision of monitoring and recovery services under the Company's sales contracts:

| (In millions of dollars) | Remainder of Fiscal 2006 | Fiscal 2007 | Fiscal 2008 | Fiscal 2009 | Fiscal 2010 | Fiscal 2011 to 2015 | Total |
|---|-----------------------------|----------------|----------------|----------------|----------------|------------------------|----------|
| Sales contract revenue to be recognized | \$ 5.68 | \$ 8.03 | \$ 4.93 | \$1.44 | \$ 0.26 | – | \$ 20.34 |

Off Balance Sheet Arrangements

The Company has not entered into any off balance sheet arrangements.

Related Party Transactions

The Company does not generally enter into related party transactions. The only material related party transactions relate to loans to directors and employees agreed to as part of financing arrangements during the fiscal years ended June 30, 1999 and 2000.

Subsequent Events

Up to the date of this report, February 6, 2006, there have not been any significant subsequent events or transactions that would require disclosure in, or adjustment to, the consolidated financial statements as at December 31, 2005.

Evaluation and Effectiveness of Disclosure Controls and Procedures

The Company has established and maintains disclosure controls and procedures over financial reporting. The certifying officers have evaluated the effectiveness of the issuer's disclosure controls and procedures as of June 30, 2005 and have concluded that such procedures are adequate and effective to ensure accurate and complete disclosures in annual filings. There have not been any material changes in these controls to the date of this report.

Risks and Uncertainties

The Company is selling and developing products and services for new and emerging markets and, as a result, faces a number of risks. See the Company's Fiscal 2005 Management Discussion and Analysis for discussion of these risks.

Financial Statements

The interim consolidated financial statements included herein dated December 31, 2005 have not been reviewed by the Company's external auditors, nor have the external auditors been involved in the preparation of these interim financial statements.

ABSOLUTE SOFTWARE CORPORATION**Consolidated Balance Sheets (Unaudited)**

(Expressed in Canadian dollars)

| | As At | |
|--|----------------------|----------------------|
| | December 31, 2005 | June 30, 2005 |
| ASSETS | | |
| CURRENT | | |
| Cash and cash equivalents | \$ 2,887,196 | \$ 11,778,412 |
| Short-term investments | 11,595,818 | 133,809 |
| Accounts receivable | 3,455,415 | 4,132,004 |
| Prepaid expenses and deposits | 249,608 | 190,379 |
| Current portion of deferred contract costs (Note 2) | 2,132,932 | 1,626,747 |
| Current portion of future income tax assets (Note 3) | 469,537 | 469,537 |
| | 20,790,506 | 18,330,888 |
| DEFERRED CONTRACT COSTS (Note 2) | 2,054,343 | 1,570,438 |
| PROPERTY AND EQUIPMENT | 706,463 | 790,407 |
| FUTURE INCOME TAX ASSETS (Note 3) | 1,907,438 | 1,619,604 |
| INTANGIBLE ASSET (Note 4) | 574,986 | - |
| | \$ 26,033,736 | \$ 22,311,337 |
| LIABILITIES | | |
| CURRENT | | |
| Accounts payable and accrued liabilities | \$ 1,063,798 | \$ 1,617,019 |
| Current portion of accrued warranty (Note 5) | 803,092 | 546,287 |
| Current portion of deferred revenue (Note 6) | 10,267,404 | 8,067,891 |
| | 12,134,294 | 10,231,197 |
| ACCRUED WARRANTY (Note 5) | 990,111 | 707,776 |
| DEFERRED REVENUE (Note 6) | 10,068,235 | 8,274,109 |
| | 23,192,640 | 19,213,082 |
| SHAREHOLDERS' EQUITY | | |
| Share capital and other equity (Note 7 (a)) | 36,509,621 | 35,967,000 |
| Contributed surplus (Note 7 (b)) | 7,615,966 | 6,784,681 |
| Loans to directors and employees | (634,154) | (630,660) |
| Deficit | (40,650,337) | (39,022,766) |
| | 2,841,096 | 3,098,255 |
| | \$ 26,033,736 | \$ 22,311,337 |

APPROVED ON BEHALF OF THE BOARD:



John Livingston
Director



Ian Reid
Director

ABSOLUTE SOFTWARE CORPORATION
Consolidated Statements of Operations and Deficit (Unaudited)
Three and six months ended December 31, 2005 and 2004
(Expressed in Canadian dollars)

| | Three Months | | Six Months | |
|---|------------------------|------------------------|------------------------|------------------------|
| | 2005 | 2004 | 2005 | 2004 |
| REVENUE | | | | |
| Monitoring revenue | \$ 2,730,336 | \$ 2,107,710 | \$ 5,202,209 | \$ 3,917,854 |
| Installation, licensing fees and other revenues | 34,188 | 38,127 | 140,760 | 102,958 |
| | 2,764,524 | 2,145,837 | 5,342,969 | 4,020,812 |
| COST OF GOODS SOLD | | | | |
| Monitoring, support and recovery | 716,378 | 318,549 | 1,255,100 | 589,403 |
| Technical support and product maintenance | 233,951 | 229,950 | 475,765 | 495,823 |
| | 950,329 | 548,499 | 1,730,865 | 1,085,226 |
| GROSS MARGIN | 1,814,195 | 1,597,338 | 3,612,104 | 2,935,586 |
| EXPENSES | | | | |
| Sales and marketing | 1,381,985 | 951,300 | 2,874,154 | 2,021,121 |
| Research and development | 463,112 | 340,246 | 885,008 | 754,654 |
| General and administration | 937,076 | 519,614 | 1,681,849 | 1,103,747 |
| Share-based compensation | 105,668 | 25,405 | 192,412 | 53,225 |
| | 2,887,841 | 1,836,565 | 5,633,423 | 3,932,747 |
| OPERATING LOSS | (1,073,646) | (239,227) | (2,021,319) | (997,161) |
| OTHER INCOME (EXPENSE) | | | | |
| Interest and other income | 109,048 | 23,440 | 176,956 | 46,113 |
| Interest and bank charges | (7,872) | (1,960) | (13,840) | (6,433) |
| Foreign exchange gain (loss) | 138,642 | (249,567) | (60,694) | (512,434) |
| | 239,818 | (228,087) | 102,422 | (472,754) |
| LOSS FOR PERIOD BEFORE INCOME TAXES | (833,828) | (467,314) | (1,918,897) | (1,469,915) |
| FUTURE INCOME TAXES (Note 3) | 125,074 | - | 287,834 | - |
| NET LOSS FOR THE PERIOD | (708,754) | (467,314) | (1,631,063) | (1,469,915) |
| DEFICIT, BEGINNING OF PERIOD | (39,945,829) | (37,520,230) | (39,022,768) | (36,515,709) |
| INTEREST AND EXCHANGE ON LOANS TO | | | | |
| DIRECTORS AND EMPLOYEES | 4,246 | (612) | 3,494 | (2,532) |
| DEFICIT, END OF PERIOD | \$ (40,650,337) | \$ (37,988,156) | \$ (40,650,337) | \$ (37,988,156) |
| BASIC AND DILUTED LOSS | | | | |
| PER COMMON SHARE | \$ (0.03) | \$ (0.03) | \$ (0.08) | \$ (0.09) |
| WEIGHTED AVERAGE NUMBER OF COMMON | | | | |
| SHARES OUTSTANDING | 21,260,950 | 16,257,455 | 21,147,574 | 16,253,539 |

See accompanying Notes to the Interim Consolidated Financial Statements.

ABSOLUTE SOFTWARE CORPORATION
Consolidated Statements of Cash Flows (Unaudited)
Three and six months ended December 31, 2005 and 2004
(Expressed in Canadian dollars)

| | Three Months | | Six Months | |
|--|--------------|--------------|----------------|----------------|
| | 2005 | 2004 | 2005 | 2004 |
| OPERATING ACTIVITIES | | | | |
| Net loss for the period | \$ (708,754) | \$ (467,314) | \$ (1,631,063) | \$ (1,469,914) |
| Items not involving cash | | | | |
| Amortization | 83,847 | 90,646 | 175,471 | 184,549 |
| Share-based compensation to employees | 105,668 | 25,405 | 192,412 | 53,225 |
| Warrant expense | 31,943 | - | 63,887 | - |
| Future income taxes | (125,074) | - | (287,834) | - |
| Change in non-cash operating working capital | | | | |
| Accounts receivable | 515,337 | 567,267 | 535,112 | 821,309 |
| Prepaid expenses and deposits | (16,065) | (12,790) | (59,231) | 23,874 |
| Deferred contract costs | (313,267) | (186,897) | (990,090) | (479,199) |
| Accounts payable and accrued liabilities | (45,999) | 54,540 | (411,744) | (109,692) |
| Accrued warranty | 200,857 | 44,009 | 539,140 | 267,780 |
| Deferred revenue | 1,428,866 | 127,656 | 3,993,639 | 1,513,322 |
| Cash from operating activities | 1,157,359 | 242,522 | 2,119,699 | 805,254 |
| INVESTING ACTIVITIES | | | | |
| Property and equipment purchased | (31,802) | (28,771) | (91,527) | (83,141) |
| Intangible assets acquired (Note 4) | - | - | (638,873) | - |
| Short-term investments (acquisition) disposal | (2,597,405) | 994,920 | (11,462,009) | 1,908,096 |
| Cash (used in) from investing activities | (2,629,207) | 966,149 | (12,192,409) | 1,824,955 |
| FINANCING ACTIVITIES | | | | |
| Common shares issued on exercises of options and warrant | 413,505 | 3,838 | 542,621 | 5,683 |
| Warrants issued under LoJack branding agreement (Note 7(d)) | - | - | 638,873 | - |
| Cash from financing activities | 413,505 | 3,838 | 1,181,494 | 5,683 |
| NET CASH INFLOW (OUTFLOW) | (1,058,343) | 1,212,509 | (8,891,216) | 2,635,892 |
| CASH AND CASH EQUIVALENTS, BEGINNING OF PERIOD | 3,945,539 | 4,443,714 | 11,778,412 | 3,020,331 |
| CASH AND CASH EQUIVALENTS, END OF PERIOD | \$ 2,887,196 | \$ 5,656,223 | \$ 2,887,196 | \$ 5,656,223 |
| COMPOSITION OF CASH AND CASH EQUIVALENTS: | | | | |
| Cash | | | \$ 2,887,196 | \$ 1,155,577 |
| Cash equivalents | | | - | 4,500,646 |
| | | | \$ 2,887,196 | \$ 5,656,223 |
| SUPPLEMENTAL DISCLOSURE OF NON-CASH INVESTING AND FINANCING ACTIVITY: | | | | |
| Intangible asset acquired | \$ - | \$ - | \$ (638,873) | \$ - |
| Warrants issued under LoJack branding agreement | \$ - | \$ - | \$ 638,873 | \$ - |

See accompanying Notes to the Interim Consolidated Financial Statements.

ABSOLUTE SOFTWARE CORPORATION

Notes to the Interim Consolidated Financial Statements (Unaudited)

Three months ended December 30, 2005 and 2004 (Expressed in Canadian dollars)

1. SIGNIFICANT ACCOUNTING POLICIES

The accompanying unaudited interim consolidated financial statements do not include all information and footnote disclosures required for an annual set of financial statements under Canadian generally accepted accounting principles. In the opinion of management, all adjustments (consisting solely of normal recurring adjustments) considered necessary for a fair presentation of the financial position, results of operations and cash flows as at and for the three and six months ended December 31, 2005 have been included. Interim results for the three and six months ended December 31, 2005 and 2004 are not necessarily indicative of the results that may be expected for the fiscal year as a whole.

These interim consolidated financial statements include the accounts of Absolute Software Corporation and its wholly owned subsidiaries, Absolute Software Inc., Computer Recovery Inc., and 609713 BC Ltd. All intercompany balances and transactions have been eliminated. These interim financial statements follow the same accounting policies and methods of application as the most recent audited financial statements, and should be read in conjunction with the annual consolidated financial statements and notes thereto included in the Company's 2005 Annual Report for the year ended June 30, 2005.

2. DEFERRED CONTRACT COSTS

| | As at | |
|--|----------------------|---------------------|
| | December 31, 2005 | June 30, 2005 |
| Prepaid sales commissions | \$ 2,038,146 | \$ 1,767,115 |
| Accrued warranty and prepaid insurance costs | 1,968,894 | 1,358,405 |
| Other prepaid / accrued contract costs | 180,235 | 71,665 |
| | <u>4,187,275</u> | <u>3,197,185</u> |
| Less: Current portion | (2,132,932) | (1,626,747) |
| | <u>\$ 2,054,343</u> | <u>\$ 1,570,438</u> |

3. FUTURE INCOME TAX ASSETS

At June 30, 2005 Absolute reported total future tax assets of \$12.9 million, of which \$2.1 million had been valued and recorded on the Company's balance sheet. The future tax assets relate to, among other things, timing differences relating to deferred revenue balances and to tax losses carry forward balances. Based on actual performance for the three months ended September 30, 2005, management determined that the value of tax assets that are more likely than not to be realized has increased to \$2,251,902. The increase of \$162,761 represents previously unrecognized tax assets.

4. INTANGIBLE ASSET

In the three months ended September 30, 2005, the Company acquired an intangible asset relating to common share purchase warrants issued for acquisition of a consumer product brand-name. The intangible asset is amortized to cost of sales on a straight line basis over a five year period, which matches the life of the warrants granted for acquisition of the of the brand name.

Under the branding agreement with LoJack® Corporation, Absolute retained the worldwide rights to brand its consumer offering "LoJack for Laptops" for a 10 year period ending June 30, 2015. In addition to an annual and per unit royalty, Absolute issued 500,000 common share purchase warrants to LoJack. The fair value of each warrant was estimated on the date of grant using the Black-Scholes option pricing model with the following assumptions: risk-free interest rate of 3.25%, dividend yield of 0%, expected life of five years, and volatility of 77%

5. ACCRUED WARRANTY AND GUARANTEE

| | As at | |
|---|----------------------|-------------------|
| | December 31, 2005 | June 30, 2005 |
| Balance at the beginning of the period | \$ 1,254,063 | \$ 185,071 |
| Warranty accrual on new sales contracts | 1,059,540 | 1,433,683 |
| Insurance premiums and warranty claims paid, net of insurance proceeds | (520,400) | (364,691) |
| | <u>1,793,202</u> | <u>1,254,063</u> |
| Less: Current portion | (803,092) | (546,287) |
| Balance at the end of the period | <u>\$ 990,110</u> | <u>\$ 707,776</u> |

6. DEFERRED REVENUE

| | December 31, 2005 | June 30, 2005 |
|--|----------------------|---------------------|
| Balance at the beginning of the period | \$ 16,342,000 | \$ 11,743,300 |
| Add: Sales contracts during the period | 9,404,800 | 13,227,582 |
| Less: Revenue recognized during the period | (5,342,969) | (8,567,729) |
| Other adjustments | (68,192) | (61,153) |
| | <u>20,335,639</u> | <u>16,342,000</u> |
| Less: Current portion | (10,267,404) | (8,067,891) |
| Balance at the end of the period | <u>\$ 10,068,235</u> | <u>\$ 8,274,109</u> |

7. SHAREHOLDERS' EQUITY*(a) Issued*

| | Number of Shares | Number of Warrants | Amount |
|--|---------------------|-----------------------|----------------------|
| Common shares | | | |
| Balance at June 30, 2005 | 20,985,773 | 440,000 | \$ 35,967,000 |
| Shares issued on options exercised (c) | 298,875 | - | 130,101 |
| Shares issued on broker warrants exercised | 294,657 | (63,100) | 412,520 |
| Warrants issued on LoJack agreement (d) | - | 500,000 | - |
| Balance December 31, 2005 | 21,579,305 | 876,900 | \$ 36,509,621 |

(b) Contributed surplus

| | December 31 2005 | As at June 30, 2005 |
|--|-----------------------------|------------------------------------|
| Contributed surplus, beginning of the period | \$ 6,784,681 | \$ 6,665,707 |
| Stock compensation expense recorded on stock options granted to employees | 192,412 | 118,974 |
| Intangible asset recorded on granting of Warrants under LoJack agreement (d) | 638,873 | - |
| Contributed surplus, end of the period | \$ 7,615,966 | \$ 6,784,681 |

(c) Stock options

The 2001 Employee Share Option Plan provides that a maximum of 4,065,206 common shares may be allocated to participants. After adjusting for options exercised under the Plan, there are a total of 3,103,456 available to be allocated to participants under the Plan, all but 395,971 of which have been granted. At December 31, 2005, the total share options outstanding were:

| | |
|--|------------------|
| Share options outstanding, beginning of period | 2,309,860 |
| Exercised during the period | (298,875) |
| Forfeited during the period | (38,000) |
| <u>Granted during the period</u> | <u>744,500</u> |
| Outstanding, end of period | 2,717,485 |
| Weighted average exercise price | \$ 1.29 |
| <u>Weighted average term remaining</u> | <u>2.8 years</u> |
| Number of options exercisable at December 31, 2005 | 835,756 |
| <u>Weighted average price of exercisable options</u> | <u>\$ 1.02</u> |

(d) LoJack Warrants

Effective July 1, 2005, the Company issued 500,000 warrants in connection with a 10 year branding agreement entered with LoJack Operating Company L.P. whereby the Company acquired the rights to use "LoJack" as a brand name for certain of its consumer theft recovery products. Each warrant is exercisable for one common share at an exercise price of \$2.00 per share. The warrants vest 20% per year on June 30, 2006, 2007, 2008, 2009 and May 31, 2010. All exercised warrants expire on the earlier of 2 years after the vesting date, June 30, 2010 or termination of the branding agreement.

(e) Pro forma fair value stock-based compensation expense

The Company has adopted the amended recommendations of the CICA Handbook Section 3870 prospectively from July 1, 2003. Accordingly, the Company only recognized compensation expense for stock options granted to employees and directors commencing July 1, 2003. Had the Company determined compensation expense for options granted to employees and directors since adoption of the new stock-based compensation standard on July 1, 2002 based on the fair value method of accounting for stock-based compensation, the Company's pro forma loss and loss per share for the six months ended December 31, 2005 and 2004 would have been as follows:

| | Six Months Ended December 30, | |
|---|--|-----------------------|
| | 2005 | 2004 |
| Loss for the period | \$ (1,631,063) | \$ (1,469,915) |
| Add: share-based compensation included in operations for the period | 192,412 | 53,225 |
| Less: share-based compensation determined for all awards from the original effective date of July 1, 2002 | (219,661) | (81,089) |
| Pro forma loss for the period | \$ (1,658,312) | \$ (1,497,779) |
| Pro forma basic and diluted loss per share | \$ (0.08) | \$ (0.09) |

8. SEGMENTED INFORMATION

The Company carries on business in the computer security monitoring industry and all sales are made in this segment. Its activities are carried out in the United States, Canada and internationally through resellers in the United Kingdom, Australia and South Africa. For the six months ended December 31, 2005, total revenues in the United States were \$4,707,105 (2004 - \$3,706,643), in Canada were \$266,194 (2004 - \$221,962). A majority of the Company's long-lived assets are located in Canada.

BOARD OF DIRECTORS

John Livingston

Chairman, Chief Executive Officer
Absolute Software Corporation
Vancouver, BC

Christian Cotichini*

Vancouver, BC

Terry Libin

Calgary, AB

Ian Reid**

Vancouver, BC

OFFICERS AND SENIOR MANAGEMENT

John Livingston

Chief Executive Officer

Bob Chow

President of Absolute Software, Inc.

Phil Gardner

Chief Technology Officer

Rob Chase

Chief Financial Officer

Rich Cohen

Vice President, Sales

Ben Haidri

Vice President, Marketing and Business Development

Don Hughes

Area Vice President, Channel Sales

CORPORATE INFORMATION

Auditors

Deloitte & Touche LLP
Vancouver, BC

Trust Agent

CIBC Mellon Trust
www.cibcmellon.com

Legal Counsel

Lang Michener
Vancouver, BC

Common Shares

Absolute Software common shares are traded on the Toronto Stock Exchange (TSX) under the trading symbol ABT.

ADDITIONAL INFORMATION

Rob Chase – Chief Financial Officer

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Dave Mason – The Equicom Group

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Absolute[®]Software

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* Chairman of Compensation Committee

** Chairman of Audit Committee