Constellation Software Inc.

TO OUR SHAREHOLDERS

In Table 1, we've updated the Constellation Software Inc. (“CSI”) metrics with the 2013 results. We’ve shortened up the period presented to 10 years. A long term review is worthwhile, but CSI is a much larger business than it was 10 years ago, so it is easy to question the relevance of the older data. The definitions of Adjusted net income (“ANI”), Average Invested Capital, ROIC, Net Revenue and Maintenance Revenue appear in the Glossary at the end of this document. Unless otherwise indicated, all dollar amounts are expressed in U.S. dollars. Several of the statements included below constitute forward looking statements and should not be read as guarantees of future results. See “Forward Looking Statements”.

Table 1

	Adjusted Net Income (a.)	Average Invested Capital	ROIC	Organic Net Revenue Growth (YoY)	ROIC + Organic Net Revenue Growth
2004	13	84	15%	9%	24%
2005	17	101	17%	18%	35%
2006	26	123	21%	8%	29%
2007	33	154	22%	1%	23%
2008	54	195	28%	5%	33%
2009	62	256	24%	-3%	21%
2010	84	325	26%	-2%	24%
2011	140	394	36%	7%	43%
2012	172	491	35%	2%	37%
2013	207	585	35%	4%	39%

a. Historical figures restated to comply with revised definition.
Note: 2010 and subsequent year information is presented in accordance with IFRS

ANI increased 20% in 2013. Cash Flow from Operating Activities per Share (see Table 3) grew far faster, so we were less concerned with “quality of earnings” than we were in 2012. The shareholders’ Average Invested Capital grew 19%. This was insufficient to finance the acquisitions that we made, so we resorted to using increasing amounts of bank debt - more about this later. The high ROIC achieved over the last decade suggests that we have very good businesses. If ROIC starts to erode significantly, then either we’ve damaged our existing businesses, or our new acquisitions are less attractive than those that we have made in the past. ROIC isn’t one of those metrics that is necessarily subject to “reversion to the mean”. Some businesses seem to be able to widen their moats at reasonable cost.

Organic Net Revenue Growth and Organic Maintenance Revenue Growth (see Table 2) are good cross-checks of our business health. You can’t easily get this information from audited financial statements. CSI’s Organic Net Revenue Growth was 4% in 2013, below our long-term average but better than GNP. We’d like our Organic Net Revenue Growth to be slightly higher. Growing organically while generating a high ROIC is, to my mind, the toughest task in the software business.

We achieved a near-record combined ratio (the sum of ROIC and Organic Net Revenue Growth) of 39% in 2013. If we had to pick a single metric to reflect the performance of our businesses, this is the one that we’d choose.

Maintenance Revenue grew an impressive 42% in 2013. We wouldn't want to do that every year. Growth in Maintenance Revenue due to acquisitions was 34%, and acquiring that maintenance revenue consumed all of our free cash flow for the year, and then some. As of March 31st 2014 we had $485 million outstanding on our debt facilities. We continue to seek longer-term capital to defuse the fundamental mismatch inherent in buying permanent assets with short-term debt. We have not dismissed the idea of cutting the dividend should other attractive sources of capital not be available.

Table 2

	2006	**2007**	**2008**	**2009**	**2010**	**2011**	**2012**	**2013**
Maintenance Revenue (US$MM)	**116**	**148**	**193**	**252**	**337**	**417**	**510**	**725**
Growth from:								
Acquisitions	17%	11%	21%	27%	26%	15%	15%	34%
Organic Sources								
a) New maintenance	15%	9%	9%	7%	8%	8%	8%	10%
b) Price increases	5%	8%	8%	3%	6%	6%	5%	5%
c) Attrition - Lost Modules	-2%	-2%	-3%	-3%	-3%	-2%	-2%	-2%
d) Attrition - Lost Customers	-4%	-4%	-4%	-4%	-4%	-3%	-4%	-5%
Total Organic Growth	14%	11%	10%	3%	8%	9%	7%	8%
Total Maintenance Growth	31%	23%	31%	31%	34%	24%	22%	42%

The Total Organic Growth in Maintenance Revenue was 8% in 2013, a slight increase from 2012. Our favourite businesses are those that are growing just slightly faster than their markets, gradually adding market share and customer share (i.e. "share of wallet"), while generating a good return on the capital that they have invested to produce organic growth. Small market share gains are much less likely to trigger a scorched earth competitive response that erodes pricing and triggers wildly unproductive R&D and S&M binges. We believe that we have struck that balance at many of our businesses.

Attrition increased in 2013, up more than 1% during the year, but as you can see in Table 2, this was more than offset by organic increases in Maintenance. That is encouraging, but bears monitoring. Over the last few years we have purchased a number of software businesses (usually SaaS) that have a much higher "churn" in their client bases because of factors inherent in their industry. By high churn, we mean that they acquire a greater proportion of new clients each year, and lose a higher percentage of existing accounts, than our average business. Sometimes the higher churn is because the clients' switching costs are low. Sometimes the higher churn is because lots of new potential clients are being created, and old ones are going bankrupt and merging. If it is the latter, these software businesses may be very attractive. If it is the former, then the software businesses are likely to be unpleasant, requiring tremendous effort to stay in much the same place. When we analyse the attrition and customer acquisition economics at the individual business unit level, the jury is still out on whether our high churn businesses are as attractive as our low churn businesses.

A note of caution with regard to the organic and acquired Maintenance Revenue growth numbers… while the analysis in Table 2 is materially the same as our reported Maintenance Revenue for financial reporting purposes, the individual components reflected in this table are generated by examining and categorising thousands of records. This analysis isn't perfect, but we believe it is a fair illustration of the trends in our maintenance base and, ultimately, the trends underlying the intrinsic value of our business.

A few years ago we added some GAAP/IFRS metrics to our regular letters to shareholders. We've updated them in Table 3.

In 2013, revenue per share increased 36% and Cash Flow from Operating Activities per Share ("CFO/Shr") increased 52%. We don't aspire to grow revenue per share at this sort of rate in the future. The growth in 2013 CFO/Shr was wonderful, but really reflects a catch up after a very disappointing 2012.

Table 3

	Total Revenue per Share		Cash Flow from Operating Activities per Share		Total Share Count (000's)
		YoY △		YoY △	
2003	4.16	29%	0.74	72%	19,428
2004	5.49	32%	0.59	-20%	19,891
2005	8.11	48%	1.21	106%	20,392
2006	10.01	23%	1.36	12%	21,065
2007	11.47	15%	1.62	19%	21,192
2008	15.60	36%	2.96	83%	21,192
2009	20.67	32%	3.85	30%	21,192
2010	29.92	45%	5.06	32%	21,192
2011	36.49	22%	6.49	28%	21,192
2012	42.05	15%	6.83	5%	21,192
2013	57.13	36%	10.40	52%	21,192
CAGR		30%		30%	

Note: 2010 and subsequent year information is presented in accordance with IFRS

Having had the chance to review the tables, we hope you'll join us in thanking the CSI employees for a wonderful decade.

Ideally, we'd like CSI's stock price to appreciate in tandem with our fundamental economics. At any point in time, we'd prefer the price to be high enough to discourage a takeover bid and low enough so that our sophisticated long term oriented investors are not tempted to sell. It takes lots of time and effort to attract and educate competent shareholder/partners. The last thing we want them to do, is sell.

If a stock is over-priced and sophisticated investors sell, they are generally replaced by unsophisticated investors who are ultimately disappointed. This may lead to a stock price that over-corrects and in turn precipitate either a takeover bid, or more insidiously, a significant and predatory share buyback. Buybacks are tempting to management and boards: they tend to improve the lot of managers and insiders, while being applauded by the business press. I think they are frequently a tolerated but inappropriate instance of buying based upon insider information. Instead of shareholders being partners, they become prey.

In addition to our long term sophisticated investors, we also have a second constituency of less financially oriented long-term investors, including some of our employee shareholders. Our employee bonus plan requires that all employees who make more than a threshold level of compensation invest in CSI shares and hold those shares for an average of at least 4 years. In practice, their average hold period has been much longer. We feel an enormous obligation to protect our non-professional investor constituency. One way we can do that is by trying to making sure that the stock price stays in a fair range at all times.

CSI's stock price has appreciated something like 68% per annum over the last two years while our revenue per share and CFO/Shr have increased by only 25% and 27% per annum respectively. The divergence between the appreciation in the stock price and the fundamentals prompted us to do an experiment to see if the multiple expansion could be rationalized (revenue per share and ANI per share multiples have roughly doubled during that period).

We contacted 8 analysts from the investment banks and brokerage firms that cover CSI and asked them for their discounted cash flow valuation ("DCF") models. The analysts also use peer comparisons, market multiples and other methods as part of their valuation process, so their DCF results don't entirely explain their valuations for CSI. Nevertheless, the analysts' models do tend to highlight their underlying assumptions about the company. When we examined the average of the analysts' assumptions for organic growth, acquired growth, acquisition pricing, cost of capital, margins, tax rates, and terminal growth rates, we found that we felt reasonably comfortable with most of their assumptions. The assumptions with which we felt least comfortable were the future cash tax rates and terminal growth rates (both of which seemed low to us). We adjusted for these changes to create a DCF model consisting of the average of the analysts assumptions plus a couple of CSI tweaks, which I'll call the "Consensus Model". The Consensus Model generated a stock price that was at a slight premium to the current share price, though without the margin of safety that we would seek when investing CSI's capital. The upshot of the exercise was that one could mathematically justify the current stock price based on assumptions similar to those achieved by the company in the past.

The more interesting part of the experiment was using the Consensus Model to do some sensitivity analysis and to look at alternative strategies. In all of the following examples, we assume that only one variable changes. In reality, our businesses are dynamic and changing one variable has an impact throughout the business.

Varying the organic growth assumption has a tremendous impact on the intrinsic value of a CSI share. Add in another 2.5% organic growth to the base line assumption and you get more than double the intrinsic value. Subtract 2.5% from the base line organic growth assumption and you lose almost half the intrinsic value of the stock. You can see why so many software company CEO's are growth junkies.

For anyone who's studied the industry, it is difficult to imagine a 5% perpetual swing in organic growth that doesn't have an offsetting impact upon operating margins. That said, there's still tremendous valuation and strategic leverage if organic growth can be increased with reasonable levels of investment. If managers have the discipline to monitor the IRR's on their investments in organic revenue growth, then they've taken a critical step towards understanding the most powerful lever in software. Some of our managers are there. I suspect others are using crude heuristics like "make 20% EBITA, and you can invest the rest". I dislike the latter approach, but many managers change their hard-won beliefs at glacial speed.

If we assume that CSI makes no further acquisitions, the Consensus Model calculates an intrinsic value that is roughly half of the current price. The magnitude of this valuation change surprised me, and suggests that our stock price could suffer very significantly if our acquisition activities slow down or the acquired businesses perform poorly. In the early days of CSI, I assumed that shareholders would be somewhat ambivalent between receiving all of CSI's free cash flow as a dividend, and having us invest a portion of it in acquisitions. According to the model, that is resoundingly not the case.

Another scenario that we tried in the Consensus Model was doing large TSS style acquisitions, at prices similar to that which we paid for TSS. The underlying assumptions continued to be that we are able to get these larger acquisitions to generate operating margins and growth equivalent to the small

acquisitions. Not surprisingly, the Consensus Model forecasts that making large acquisitions adds significant intrinsic value, but not as much as doing "many small" acquisitions at lower purchase price multiples. It also confirms our belief that if we can't make more small acquisitions, then doing the occasional large one seems to make sense.

The final scenario that we ran involves the use of non-common share capital (i.e. debt or something similar). The assumption is that we raise enough capital to maintain revenue growth rates in excess of 20%, and that we operate with a balance sheet that is not highly levered. The Consensus Model for that scenario adds hugely to shareholder value, even if we use high cost debt.

Models are only as good as the assumptions that go into them, and there's no substitute for thinking through the above scenarios on your own, with your own underlying assumptions.

The biggest surprise for me in the modeling exercise was that our multiple expansion over the last two years can be justified by our "acquisition engine". I'd rather the market was paying for our acquisition capabilities in retrospect rather than in prospect. Nevertheless, it is clear that acquisitions have added tremendous shareholder value over the years, particularly during times of economic crisis and/or recession.

Which brings us to the topic of funding. We'd like to be in a position to acquire aggressively should attractive opportunities arise. We've asked CSI's Board for permission to raise non-common share capital to replace our revolving line of credit. They've given us that mandate.

Last year I mentioned that I'd feel comfortable using debt to finance our growth if it were long term, non-callable and the interest payments could be deferred for short periods. I followed up in the letter to shareholders with an invitation to potential investors to work with us to design such an instrument. During the course of the ensuing year we've had discussions with a variety of institutions and investment bankers. And while we got past a few hurdles, we inevitably came up against the institutional imperative: no matter how logical and appealing an instrument may be, if it is novel and works, the sponsor gets a pat on the back. If it is novel and doesn't work, the sponsor loses their job.

That led us back into a dialog with our investment bankers. They began to understand what we wanted: a very long term instrument that we could issue in tranches whenever we needed, that was liquid and would trade at close to intrinsic value at all times so that our investors could get liquidity without taking a haircut, that was tax deductible for CSI as we expect to otherwise pay lots of cash tax, and that can be redeemed by CSI with reasonable amounts of notice if we are producing more cash than we can intelligently invest elsewhere. I'll refer to this as a Non-Traditional Instrument or "NTI". The novelty of the NTI was still a concern to the investment banks, but they felt that they could overcome that and sell it to retail investors if the yield were sufficiently high and the transaction fees sufficiently large. Once the first tranche of the NTI was sold, there would be a precedent trading in the market, and the investment bankers felt that the terms of subsequent NTI issues would likely be more attractive to CSI.

As our discussions progressed, the yield and the transaction fees proposed by the investment banks got higher and the terms less attractive. Based on my previous experience during the CSI IPO, I expected further concessions would be required before an offering was completed. I approached our board with an alternative: make the terms of the NTI even more attractive than those proposed by the investment banks, and market it to our existing shareholders. Any overpricing would accrue to our own investors rather than strangers and intermediaries. If our investors have appetite for an NTI issued at a discount to face value with an above average coupon by a company with a strong balance sheet, they could purchase the NTI and subsequently liquidate at close to face value whenever they choose.

My experience selling CSI shares over the years is that you can sell a novel investment to the sophisticated few, and that over time both the size of the audience and the level of trust grow. I think that will also be the case with the NTI.

Finishing on a quite different note: I'm happy if I "find" one good book to recommend to friends, family and employees each year. Currently, I'm shamelessly flogging Daniel Kahneman's Thinking Fast and Slow. His book is about a life (actually two) well spent. He tells the tale of his intellectual journey via a series of behavioural economics experiments. He helped me appreciate the efficiency, speed, and inherent conceit of intuitive judgment, and its infrequent but often abject failures. Understanding the major findings in behavioural economics provides profound insights into investing and managing, and this book is the most pleasant way I've found to acquire that knowledge.

We will be hosting the annual general meeting on Thursday May 1st. Many of our Directors and Officers and a number of our employees will be in attendance. We look forward to talking about our business and answering your questions. We hope to see you there - perhaps with a camera.

Mark Leonard
President
Constellation Software Inc.

April 30th, 2014

Glossary

Effective Q1 2008, the term ‘‘Adjusted net income’ is derived by adjusting GAAP or IFRS net income for the non-cash amortization of intangibles, future income taxes, and charges related to appreciation in common shares eligible for redemption (a charge that we no longer incur now that CSI's common shares are publicly traded). Prior to Q1 2008, Adjusted net income was derived by adjusting GAAP net income for the non-cash amortization of intangibles and charges related to appreciation in common shares eligible for redemption. The computation was changed to include future income taxes since the majority of future income taxes relate to the amortization of intangible assets, and thus are being added back to more closely match the non-cash future tax recovery with the amortization of intangibles. All previously reported Adjusted net income figures have been restated in the table above to reflect the new method of computations. We use Adjusted net income because it is generally a better measure of cash flow than GAAP or IFRS net income and it is closely aligned with the calculation of net income that we use for bonus purposes.

"Average Invested Capital" is based on the Company's estimate of the amount of money that our shareholders had invested in CSI. Subsequent to that estimate, each period we have kept a running tally, adding Adjusted net income, subtracting any dividends, adding any amounts related to share issuances and making some small adjustments, including adjustments relating to our use of certain incentive programs and the amortization of impaired intangibles.

"ROIC" represents a ratio of Adjusted net income to Average Invested Capital.

"Net Revenue" is gross revenue for GAAP or IFRS purposes less any third party and flow-through expenses. We use Net Revenue since it captures 100% of the license, maintenance and services revenues associated with CSI's own products, but only the margin on the lower value-added revenues such as commodity hardware or third party software. "Maintenance Revenue" primarily consists of fees charged for customer support on our software products post-delivery and also includes, to a lesser extent, recurring fees derived from software as a service, subscriptions, combined software/support contracts, transaction-related revenues, and hosted products.

Forward Looking Statements

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

Non-GAAP/IFRS Measures

Adjusted net income and Organic Net Revenue Growth are not recognized measures under GAAP or IFRS and, accordingly, shareholders are cautioned that Adjusted net income and Organic Net Revenue Growth should not be construed as alternatives to net income determined in accordance with GAAP or IFRS as an indicator of the financial performance of the Company or as a measure of the Company's liquidity and cash flows. The Company's method of calculating Adjusted net income and Organic Net Revenue Growth may differ from other issuers and, accordingly, may not be comparable to similar measures presented by other issuers. Please refer to CSI's most recently filed Management's Discussion and Analysis for reconciliation, where applicable, between the IFRS, GAAP and non-GAAP/IFRS measures referred to above.