

# CONSTELLATION SOFTWARE INC.

## Q2 2008

### TO OUR SHAREHOLDERS

Q2 was a good quarter for Constellation, particularly in light of the difficult economic environment. We achieved record levels of Adjusted EBITDA (\$14 million) and Adjusted Net Income (\$12 million), and 5% Organic Net Revenue growth.

In Q2 of 2006, Constellation became a public company. Net Revenue during that quarter was \$47 million. Net Revenue in Q2 of this year was \$71 million – a 23% compound annual growth rate since the IPO. While some of this growth was organic, the majority of it was acquired. We issued no new shares during the IPO nor have we issued any since then, so the intervening acquisitions were financed from our earnings (~\$73 million), and borrowings/cash reductions (~\$26 million).

Until recently, we had avoided using significant amounts of debt. Circumstances, however, may dictate a change in our capital structure. The economy is slow, credit and equity markets are in rough shape, and buyers for vertical market software businesses are increasingly scarce. Concurrently, and for some of the same reasons, quite a number of vertical market software businesses are for sale at attractive prices. We may not be the successful bidders for these assets, but if we are, we will almost certainly be increasing Constellation's financial leverage. In support of our acquisition pursuits, we negotiated an increase in our revolving bank line to \$105 million during Q2 and are currently in discussions with our lenders to further increase the size of this facility. We are also examining other financing alternatives.

Rapid acquired growth is not an imperative, it is a choice. For most of the last decade we struggled to find enough attractive acquisitions to consume our operating cash flows. We believe that the situation has now reversed, and we are sorely tempted to buy as many attractive vertical market software businesses as and while we can.

A table containing our quarterly Performance Metrics is appended. We have discussed the definitions and implications of the various metrics in previous letters to shareholders, and a glossary is also provided. This quarter, I was pleased with our performance across all of the metrics but wanted to draw your attention to one in particular. When economic times are tough, and bonuses are tied to financial performance, there's a strong incentive for the managers of any business to aggressively recognise revenue. I believe that our people are largely inured to such temptations, but there's a quick way to cross-check. Aggressive revenue recognition nearly always gives rise to an associated increase in accounts receivable and work in process. We should be able to see any such movements in our Tangible Net Assets/Net Revenue metric. In Q2 of 2008, this metric was -58%, down from -45% and -51% in Q2 of 2007 and 2006 respectively. This improvement over prior years suggests that, if anything, our businesses are being conservative about the earnings that they are reporting.

Mark Leonard  
President  
Constellation Software Inc.

August 7<sup>th</sup>, 2008

	Q2 2006	Q3 2006	Q4 2006	Q1 2007	Q2 2007	Q3 2007	Q4 2007	Q1 2008	Q2 2008
	(\$ millions, except percentages)								
Revenue	52.2	53.8	53.5	55.9	60.5	60.6	66.1	73.6	77.7
Net Income / (Loss)	1.3	2.3	3.8	2.6	3.5	3.3	1.6	4.3	3.4
Net Revenue	47.3	48.4	48.6	50.7	54.9	55.3	60.2	66.6	71.0
Net Maintenance Revenue	26.9	28.1	29.6	31.2	33.3	34.5	37.8	41.7	43.8
Adjusted Net Income (1)	4.4	7.5	9.0	6.9	8.4	8.5	9.4	11.1	12.0
Average Invested Capital	119	125	135	143	149	158	167	176	188
Net Revenue Growth (Y/Y)	28%	24%	22%	10%	16%	14%	24%	31%	29%
Organic Net Revenue Growth (Y/Y)	12%	5%	3%	-1%	0%	2%	3%	6%	5%
Net Maintenance Growth (Y/Y)	30%	30%	29%	20%	24%	23%	28%	34%	32%
Adjusted Net Income Growth (Y/Y)	5%	49%	115%	43%	91%	13%	5%	62%	43%
Average Invested Capital Growth (Y/Y)	20%	20%	24%	25%	25%	26%	24%	24%	26%
Tangible Net Assets / Net Revenue	-51%	-59%	-73%	-57%	-45%	-53%	-74%	-58%	-58%
ROIC (Annualized)	15%	24%	27%	19%	23%	22%	22%	25%	26%
ROIC + Organic Net Revenue Growth	27%	29%	30%	18%	23%	24%	26%	32%	31%

(1) Historical figures restated to comply with revised definition.

## Performance Metrics Glossary

“Net Revenue” means Revenue for GAAP purposes less third party and flow-through expenses. We use Net Revenue since it captures 100% of the license, maintenance and services revenues associated with Constellation’s own products, but only includes the margin on our lower value-added revenues such as commodity hardware or third party software.

“Net Maintenance Revenue” is derived from GAAP Maintenance Revenue by subtracting third party maintenance costs. We believe that Net Maintenance Revenue is one of the best indicators of the intrinsic value of a software company and that the operating profitability of a low growth software business should correlate tightly to Net Maintenance Revenues.

Effective Q1 2008, the term “Adjusted Net Income” is derived by adjusting GAAP 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 Constellation’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 net income and it is closely aligned with the calculation of net income 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 Constellation. 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.

“Tangible Net Assets / Quarterly Net Revenue” provides a measure of our Tangible Net Assets as a proportion of Quarterly Net Revenue. Tangible Net Assets is calculated by taking Total Assets for GAAP purposes, and subtracting (i) intangible assets and goodwill, (ii) cash and short term investments, (iii) future income tax assets, (iv) all customer, trade and government liabilities that do not bear a coupon, excluding future income tax liabilities and acquisition holdbacks.

“ROIC (Annualized)” represents a ratio of Adjusted Net Income to Average Invested Capital.

“ROIC + Organic Net Revenue Growth” provides a historical measure of the effectiveness of our capital allocation.

#### Forward Looking Statements

Certain statements herein may be “forward looking” statements that involve known and unknown risks, uncertainties and other factors that may cause the actual results, performance or achievements of Constellation or the industry to be materially different from any future results, performance or achievements expressed or implied by such forward-looking statements. These statements reflect current assumptions and expectations regarding future events and operating performance and speak only as of the date hereof. 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. These forward looking statements are made as of the date hereof and Constellation assumes no obligation to update any forward looking statements to reflect new events or circumstances except as required by law.

#### Non-GAAP Measures

Net Revenue, Net Maintenance Revenue, Adjusted Net Income, Adjusted EBITDA and Organic Net Revenue Growth are not recognized measures under GAAP and, accordingly, shareholders are cautioned that Net Revenue, Net Maintenance Revenue, Adjusted Net Income Adjusted EBITDA and Organic Net Revenue Growth should not be construed as alternatives to revenue or net income determined in accordance with GAAP as an indicator of the financial performance of the Company or as a measure of the Company’s liquidity and cash flows. The Company’s method of calculating Net Revenue, Net Maintenance Revenue, Adjusted Net Income, Adjusted EBITDA 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 Constellation’s most recently filed Management Discussion and Analysis for a reconciliation, where applicable, between the GAAP and non-GAAP measures referred to above.