

TO OUR SHAREHOLDERS

Q3 brought few surprises, either positive or negative. Profitability increased and our year over year revenue and profit growth was good but continues to decelerate. We made one acquisition during the quarter, and our cash position improved. The company continued to build intrinsic value at an attractive rate.

Last Quarter we introduced and defined some metrics that we find useful in interpreting our results (especially Net Revenue, Net Maintenance Revenue, Adjusted Net Income and Organic Net Revenue Growth). Below is a table that repeats and updates those metrics and adds another key measure (Average Invested Capital). We use these measures internally to analyze our performance and, with minor modifications, to determine much of our incentive compensation.

	Q1 2005	Q2 2005	Q3 2005	Q4 2005	Q1 2006	Q2 2006	Q3 2006
(\$ millions, except percentages)							
Revenue	37.5	40.7	42.6	44.6	51.2	52.2	53.8
Net Revenue	34.5	37.0	39.0	39.8	46.0	47.3	48.4
Net Maintenance Revenue	19.3	20.7	21.7	23.0	26.0	26.9	28.1
Adjusted Net Income	3.8	4.1	5.2	4.1	5.1	5.1	6.8
Net Income / (Loss)	1.1	(3.5)	2.1	0.8	(8.7)	1.3	2.3
Net Revenue Growth (Y/Y)	62%	51%	47%	35%	33%	28%	24%
Net Maintenance Growth (Y/Y)	72%	57%	48%	52%	35%	30%	30%
Organic Net Revenue Growth (Y/Y)	22%	18%	22%	13%	14%	12%	5%
Average Invested Capital	96	100	105	109	114	119	125
ROIC (Annualized)	16%	16%	20%	15%	18%	17%	22%
ROIC + Organic Net Revenue Growth	38%	34%	42%	28%	32%	29%	26%

As we mentioned last quarter, when we look at revenue trends, we use a concept that we call “Net Revenue”. Net Revenue is Gross 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. In Q3, our Net Revenue increased to \$48.4 million compared to \$47.3 million in Q2 2006 and to \$39.0 million in the Q3 2005 period. The Q3 Net Revenue growth rate compared to Q3 of last year was 24%, but the growth rate was down from the 28% rate achieved in Q2 2006 compared to Q2 of last year.

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. In Q3, our Net Maintenance Revenue increased to \$28.1 million compared to \$26.9 million in Q2 2006, and compared to \$21.7 million in the Q3 2005 period. The Q3 Net Maintenance Revenue growth rate compared to Q3 of last year was 30%. On a per share basis the Net Maintenance Revenue growth rate in Q3 was 25% compared with the Q3 2005 period. In management’s view this reflects a spectacular but unmaintainable performance for CSI.

Our revenue growth stems from both acquisitions and organic sources. While the two are difficult to separate, we regularly attempt to do so. In Q3 we estimate that Net Revenue grew organically by 5% compared with Net Revenue in Q3 of 2005. This growth rate was down from the 14% organic growth rate experienced in Q1, and the 12% experienced in Q2.

Adjusted Net Income is derived by adjusting GAAP net income for the non-cash amortization of intangibles and charges related to appreciation in common shares eligible for redemption (a charge that is no longer incurred now that Constellation is publicly traded). We use Adjusted Net Income because it is generally a better measure of cash flow than GAAP Net Income. In Q3, our Adjusted Net Income was

\$6.8 million. It increased from \$5.1 million in the Q2 2006 period, and from \$5.2 million in Q3 2005. The Q3 Adjusted Net Income Growth rate was 30% versus Q3 of last year.

This quarter we would like to begin to explain how we think about capital allocation at Constellation. In the table, we have noted Average Invested Capital. This is a non-GAAP measure that began as an 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 relating to our use of certain incentive programs, the amortization of impaired intangibles, etc. If you follow the math in the table above, you'll see that adding the quarterly Adjusted Net Income and subtracting dividends accounts for the vast bulk of the quarter to quarter changes in Average Invested Capital.

We keenly monitor our ability to put our shareholders' Invested Capital to work. In practice, the way we actually measure this is on a project by project basis using conventional after tax internal rates of return (IRR's). Periodically our board sets a hurdle rate, and we filter both prospective organic growth opportunities and acquisitions based upon those hurdle rates. IRR's are complex, future oriented, require judgement, and at any one time I'd estimate that we are tracking between 50 and 100 individual projects.

There is a simpler but cruder historical measure of the effectiveness of our capital allocation. Although it lacks the future orientation of IRR, it does eliminate some of the optimism that regrettably pervades future looking metrics. We take the sum of ROIC and our Organic Net Revenue Growth, and compare it to the hurdle rate set by our board. We measure ROIC or Return on Invested Capital by taking a ratio of Adjusted Net Income to Average Invested Capital. Our ROIC has bounced around between 15% and 22% (annualised) during the last 7 quarters, with arguably a slight upward trend. In and of itself, that is pretty good. However, there is a unique "kicker" to our business: We use very little capital to grow our business organically. Most of our businesses actually operate with negative tangible net assets. This means that as we grow organically, those businesses consume little or no incremental capital, and may even produce capital in excess of earnings. Unfortunately, organic growth isn't entirely free. We have to invest money in research and development, sales and marketing, etc. to get this growth. These expense items all depress Adjusted Net Income. The logical consequence, is that to get organic growth, we are willing to accept a lower ROIC.

As you can see from the table, the ROIC+OGr (annualised) has varied from 26% to 42% over the last 7 quarters. We are delighted with this level of performance, but are concerned that this metric continues to decline. Senior management has a very large stake in maximising both long term ROIC and Net Revenue Growth, since these two items are entirely responsible for driving their incentive compensation. Most of our other employees have incentive compensation tied to the same metrics. As we explained in our prospectus, we take capital allocation very seriously.

We have previously stated that our objective is to grow, on average, the Net Revenues per share and Adjusted EBITDA per share of Constellation by 20% per annum from January 1, 2006 to December 31, 2010. In the short term there will be economic cycles when growth slows, and others when it accelerates. We continue to believe that our objective is audacious but achievable. The IT industry is maturing, and there will eventually come a time when our targeted growth rates will no longer be achievable at attractive hurdle rates.

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.

Non-GAAP Measures

Net Revenue, Net Maintenance Revenue, Adjusted Net Income 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 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 and Organic Net Revenue Growth may differ from other issuers and, accordingly, may not be comparable to similar measures presented by other issuers.

Mark Leonard
President
November 8, 2006