

EQUITY RESEARCH

May 9, 2023

Company Update

CONSTELLATION SOFTWARE INC.

2022 Virtual AGM Takeaways

Our Conclusion

Constellation hosted a virtual AGM on May 8 that included a question-and-answer session with the head office team and the heads of CSU's operating groups. As usual, we picked up some interesting tidbits from the AGM, including additional details around the WideOrbit investment rationale, the restructuring of Altera (which has been split into 11 business units) and the use of carve-outs as a differentiator in larger deals. We continue to see Constellation as attractive here, trading slightly below its five-year average EV/EBITDA valuation despite a significant acceleration in its capital deployment and the potential for future value-accretive spin-outs. We retain our Outperformer rating and C\$3,000 price target.

Key Points

Gaining Traction In Larger Deals: Constellation has significantly increased its capital deployment, spending ~\$1.6B in M&A on 2022 versus \$485MM in 2020. A portion of this M&A acceleration has been driven by an increase in Constellation's average deal size, which has quadrupled from \$7MM from \$28MM over the past five years. Despite increased deal sizes, the company noted that it has not seen any deviations related to hurdle rates for the larger deals, implying that the larger deals do fine versus the smaller and mid-sized deals. The company noted that with larger deals, there is more opportunities and levers to achieve or exceed the targeted hurdle rate. We believe that Constellation continues to find it difficult to compete directly against private equity for larger deals, which is why the company has focused on niches, including carve-outs and spin-outs.

Carve-outs A Differentiator: Constellation has built expertise and best practices around carve-outs, which has become a differentiator in the sale process of larger corporate assets. Lumine CEO David Nyland noted that Lumine's larger deal size versus Constellation is driven by its PE relationships and its carve-out expertise. We would note that this carve-out experience also came in useful as Lumine disentangled itself from Volaris as part of its spin-out strategy.

Spin-out Strategy: Constellation completed the spin-out of Topicus in 2021 and recently completed the spin-out of Lumine in conjunction with the WideOrbit acquisition. Spin-outs are still considered part of the Constellation ecosystem and follow Constellation business practices, with the CEOs of both companies noting a preference to follow the CSU model of generating strong cash flows and deploying it on M&A. That said, we could eventually see some differences, with Topicus CEO Robin van Poelje noting that Topicus' equity listing provides optionality.

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Outperformer

CSU-TSX, Sector: Information Technology

Current Price (5/8/23): C\$2,573.85

Price Target (12-18 mos.): C\$3,000.00

CIBC Estimates and Valuation

(Dec. 31)	2021	2022	2023	2024
EPS diluted	7.97A	26.00A	44.22E	53.09E
EBITDA(mln)	1,511.0A	1,699.0A	2,008.8E	2,263.8E

	Q1	Q2	Q3	Q4
EPS diluted	5.24A	6.32A	6.75A	7.69A
2022	(8.26)A	3.68A	5.71A	6.84A

	Q1	Q2	Q3	Q4
EBITDA(mln)	373.0A	410.0A	419.0A	496.0A
2021	348.0A	366.0A	387.0A	410.0A

	2021	2022	2023	2024
Valuation	28.0x	24.9x	21.0x	18.7x
EV/EBITDA				

Stock Performance and Key Indicators

Avg. Dly. Vol.:	34K	Shares O/S:	21.2M
Market Cap.:	C\$54,566M	Float:	14.5M
52-wk Range:	1,784.68 - C\$2,731.95	Div. / Yield:	C\$7.16/0.28%

TSX Composite Index vs. CSU-TSX



(Source: FactSet)

All figures in US dollars unless otherwise stated (C\$1.336:US\$1.00).

Please see "Price Target Calculation and Key Risks to Price Target" information on page 7.

For required regulatory disclosures please refer to "Important Disclosures" beginning on page 8.

Constellation Software Inc. (CSU-TSX) — Outperformer

Price (5/8/23) C\$2,573.85 12-18 mo. Price Target C\$3,000.00

Sector: Information Technology

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Peer Comparison	2021	2022	2023E	2024E
P/E - Canadian Consolidators	10.7x	-	-	-
EV/EBITDA - Canadian Consolidat	30.3x	26.7x	26.7x	26.7x
EV/Sales - Canadian Consolidators	11.1x	10.0x	10.0x	-
Key Financial Metrics	2021	2022	2023E	2024E
Free Cash Flow	1,271	1,256	1,800	1,665
Sales Growth	28.6%	29.7%	18.6%	12.9%
Per Share Data	2021	2022	2023E	2024E
FCFPS	59.98	59.27	84.95	78.58
Diluted EPS	7.97	26.00	44.22	53.09
Adj. EPS Dil.	31.14	57.05	61.82	70.69
Wgt Avg # of Shares	21.2	21.2	21.2	21.2
FD Number of Shares	21.2	21.2	21.2	21.2
Income Statement	2021	2022	2023E	2024E
Revenue	5,106	6,622	7,856	8,867
Gross Profit	5,106	6,622	7,856	8,867
Gross Margin %	100.00%	100.00%	100.00%	100.00%
Tot Operating Exp	1,964	2,653	3,180	3,589
OpEx (% of Revenue)	38.46%	40.06%	40.48%	40.47%
EBITDA	1,511	1,699	2,009	2,264
EBITDA Margin	29.59%	25.66%	25.57%	25.53%
EBIT	437	811	1,437	1,692
Pretax profit	373	725	1,339	1,607
Tax Expense	206	175	402	482
Adjusted Net Income	660	1,209	1,310	1,498
Adjusted Net Margin	12.9%	18.3%	16.7%	16.9%
Cash Flow Statement	2021	2022	2023E	2024E
Net CFO	1,300	1,297	1,824	1,689
Capex	(29)	(41)	(24)	(24)
Acquisitions	(1,216)	(1,566)	(1,000)	(800)
Free Cash Flow	1,271	1,256	1,800	1,665
Balance Sheet	2021	2022	2023E	2024E
Cash & ST Investment	763	811	1,526	2,307
Intangible Assets	3,428	4,679	4,779	4,779
Goodwill	0	0	500	900
Total Assets	5,766	7,882	9,260	10,702
ST Int-Bearing Debt	210	821	821	821
LT Int-Bearing Debt	915	1,153	1,153	1,153
Total Liabilities	4,245	5,949	6,474	6,876
Shareholders' Equity	1,521	1,933	2,785	3,826

Source: FactSet, Company Reports & CIBC World Markets

Company Profile

Constellation Software is a leading provider and acquirer of vertical market software and services.

Price Target (Base Case): C\$3,000.00

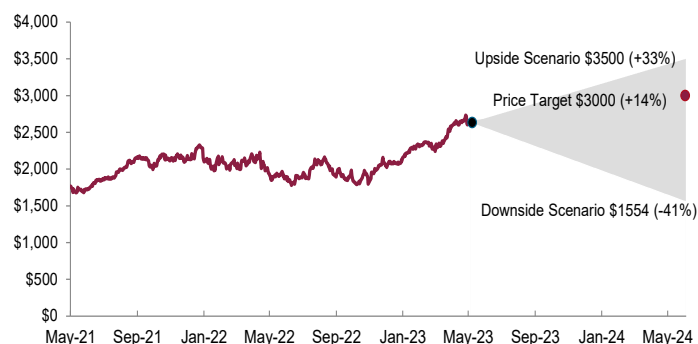
Our C\$3,000 price target is based on a sum-of-the-parts. We value CSU (ex-TOI) at 26x forward EBITDA multiple and CSU's 30% ownership of TOI and 61% ownership of LMN at market values.

Upside Scenario: C\$3,500.00

Our C\$3,500 upside scenario is based on a sum-of-the-parts. We value CSU (ex-TOI and LMN) at 30x forward EBITDA multiple, with 15% revenue growth, 27% EBITDA margins.

Downside Scenario: C\$1,554.00

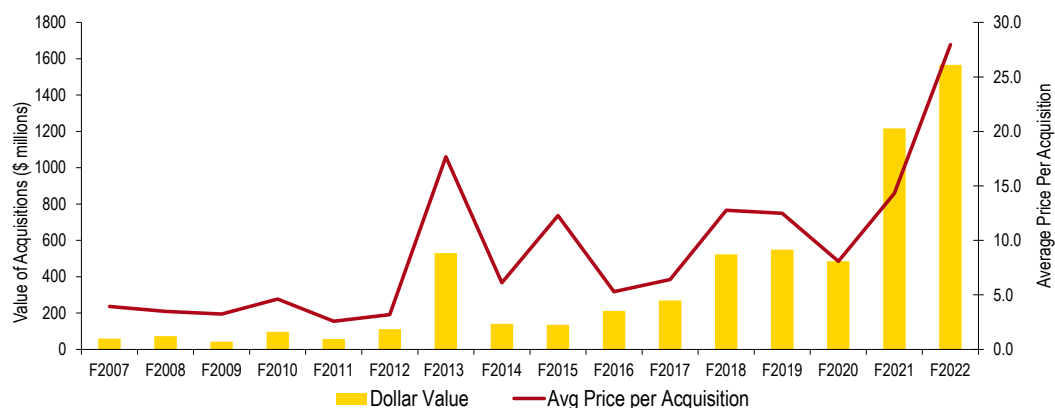
Our C\$1,554 downside scenario is based on a sum-of-the-parts. We value CSU (ex-TOI) at 19x forward EBITDA multiple, with 5% revenue growth, 19% EBITDA margins.



2023 AGM Takeaways

Looking for Its Niche In Large Deals: Even in the current interest rate environment, we believe that Constellation finds it difficult to compete directly against private equity. In these cases, we believe that Constellation looks for a differentiator. Its differentiators have evolved over time, initially incorporating Constellation's expectation to hold the software company for life (which we believe still resonates with many founders), and now including a number of other differentiators, including carve-outs and spin-cos. While the company declined to provide the percentage of large deals Constellation is being invited into (the 2021 President's Letter had noted 16%), Constellation appears to be being invited into more and more large deal processes. As noted in Exhibit 1, Constellation's average deal size has risen from ~\$7MM to \$28MM over the past five years.

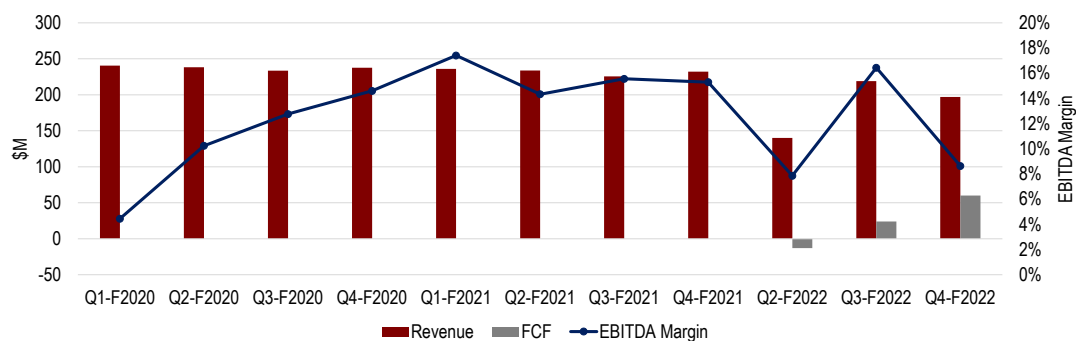
Exhibit 1: Constellation – Acquisitions Value & Average Deal Size, 2007-2022



Source: Company reports, FactSet and CIBC World Markets Inc.

Altera Restructuring Ongoing, Broken Into 11 Business Units: Constellation's largest acquisition to date, the purchase of Altera from Allscripts is an example of its carve-out expertise. Constellation noted that it inherited one business and has since broken it up into 11 business units with their own focus customers and products. Given the size of the organization, management noted that there are more levers that they can pull to get to or exceed their M&A hurdle rates. We continue to view Altera as a typical Constellation acquisition, but at a larger scale. We are unsurprised that revenue growth has lagged the prior owner's estimates post acquisition, nor that FCF has come in stronger than initially estimated. As with all Constellation acquisitions, we believe that the focus at Altera is on cash flow, which can then be reinvested in additional acquisitions.

Exhibit 2: Constellation – Altera Financial Results Q12020-Q42022



Note: Q1-F2022 information is unavailable. Segmented FCF disclosed as of Q2-2022.

Source: Company reports, FactSet and CIBC World Markets Inc.

Lumine & WideOrbit Update: Lumine CEO David Nyland participated in the Constellation AGM for the first time. Nyland noted that despite Lumine's focus on media/communications acquisitions, the spin-out has a very large and active pipeline. He expects the focus to remain on the media/communications VMS vertical for the foreseeable future and sees a solid pipeline for at least 10 years before they need to look at other adjacencies. Management noted that WideOrbit was an attractive acquisition given its market share, profitability, high level of recurring revenue and solid management team. While TV advertising is declining, it is at a slow rate, as the market moves to digital. WideOrbit has digital offerings, won a contract with Amazon last year and Nyland sees WideOrbit as well positioned to gain further market share.

Exhibit 3: Constant Currency Organic Growth – Overall And Maintenance, Q4/20 – Q4/22

Overall	Q4-2020	Q1-2021	Q2-2021	Q3-2021	Q4-2021	Q1-2022	Q2-2022	Q3-2022	Q4-2022	Average
Constellation (incl Altera)	-3%	0%	8%	5%	4%	4%	2%	2%	4%	3%
Lumine Group	-1%	3%	7%	19%	4%	1%	1%	-11%	-2%	2%
Maintenance										
Constellation (incl Altera)	0%	0%	7%	6%	5%	7%	5%	5%	6%	5%
Lumine Group	7%	5%	7%	6%	3%	3%	3%	-4%	-2%	3%

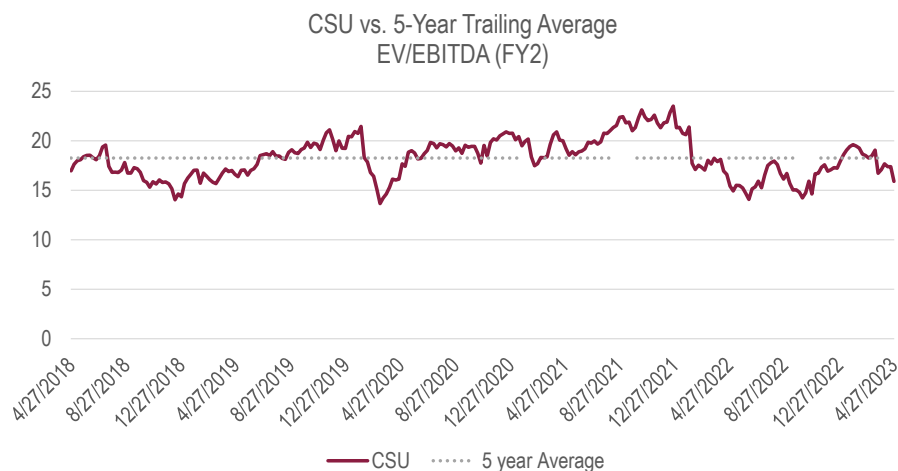
Source: Company reports and CIBC World Markets Inc.

Organic Growth: Constellation continues to monitor organic growth. Organic constant currency growth remains in the low-single-digit range, while constant currency organic maintenance growth has remained in the mid-single-digit range over the past two years, consistent with historic levels. Management has considered increasing R&D spend (which has remained around ~14% of sales since the IPO) and Topicus is currently experimenting with a new bonus structure at one of its three operating groups where the bonus is based on organic growth rather than overall revenue growth. That said, we expect Constellation will continue to focus on M&A versus organic growth given greater certainty in the ability to meet projected hurdle rates on M&A transactions.

Constellation's Valuation Remains Attractive

At current levels we see Constellation as relatively attractively valued. The company is trading below with its 2- and 5-year EV/EBITDA average, despite the increasingly attractive M&A market and increasing M&A spend.

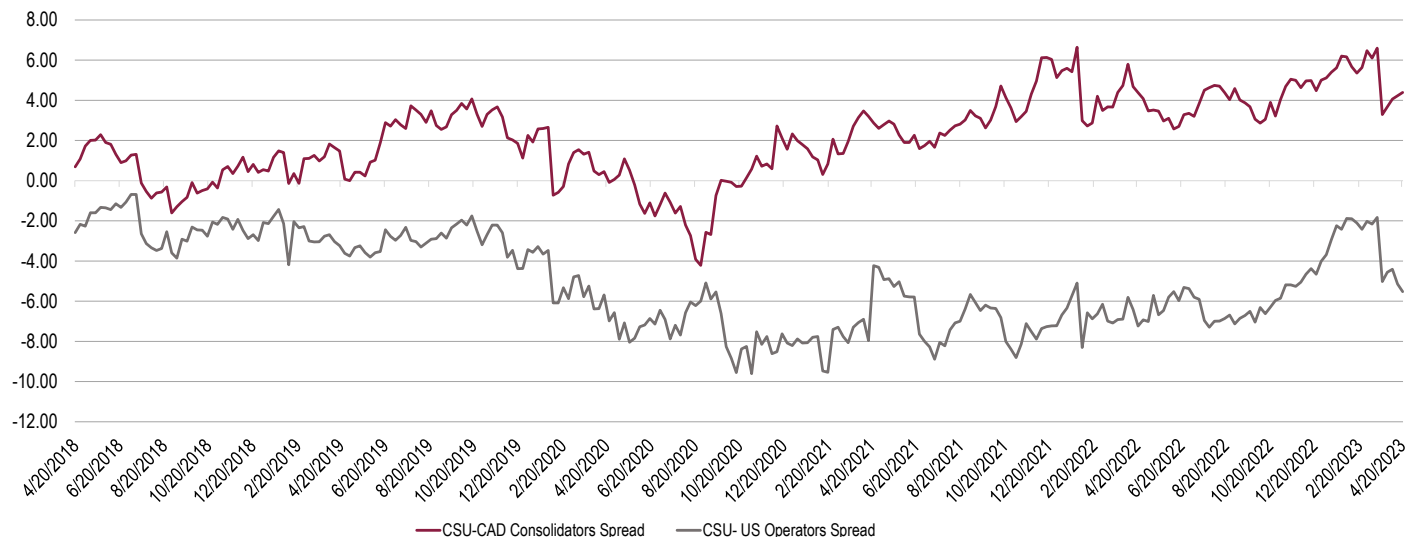
Exhibit 4: CSU vs. 5-Year Trailing Average EV/EBITDA (FY2)



Source: FactSet and CIBC World Markets Inc.

Constellation also looks attractive from an operating peer perspective. Constellation has historically traded at a 3.5x discount to its global operating peer group, however the company is currently trading at 5.5x discount which we view as unwarranted. Constellation screens as less attractive against its Canadian consolidator peers, although we view this as more an issue within the peer set, with Open Text, Enghouse and Dye & Durham all seeing recent re-ratings amid concerns around recent acquisitions (OTEX) and organic growth (ENGH/DND).

Exhibit 5: North American Consolidators, Valuation Spread, 2018-2023, As of April 30



CAD Consolidators include: OTEX, ENGH, DSGX, DND

US Operators include: SGE, TYL, ROP.

Source: FactSet and CIBC World Markets Inc.

We value Constellation on a sum-of-the-parts basis, removing the EBITDA attributable to Topicus and Lumine and valuing those businesses at market value. Our sum-of-the-parts valuation is illustrated in Exhibit 6.

Exhibit 6: Constellation Sum-of-the-parts Valuation

	2024 EBITDA	Multiple	SoTP Value	Per Share
CSU ex-TOI	1,694	26	44,050	2,078.64
TOI 30% owned			1,740	82.12
LMN 61% owned			2,189	103.31
Plus Net Cash			-1079.1	-50.92
Total				2,213.14 USD
C\$ Price Target				2,956.21 CAD

Source: CIBC World Markets Inc.

Environmental, Social and Governance (ESG) Metrics for CSU-TSX

CIBC ESG Metrics

Governance Metrics	2017	2018	2019	2020	2021
Insider Ownership	6.1%	6.0%	7.1%	7.8%	6.0%
Board Gender Diversity	10.0%	10.0%	17%	20%	33%
Separation of Chair & CEO	NO	NO	NO	NO	NO
Dual-class Ownership?	NO	NO	NO	NO	NO
Disclose ESG Data?	NO	NO	NO	NO	NO
Social Metrics	2017	2018	2019	2020	2021
CEO Comp./Mkt Cap*	\$0.0	\$0.0	\$0.0	\$0.0	\$0.0
Diversity Targets	NO	NO	NO	NO	NO
Women Managers	0%	0%	0%	0%	0%
Environmental Metrics	2017	2018	2019	2020	2021
Emissions Intensity**	NA	NA	NA	NA	NA
Net-zero Targets?	NO	NO	NO	NO	NO

*CEO Compensation is shown as per thousand dollars of market capitalization

**Emissions Intensity calculated as total emitted CO2e divided by million \$ of CAD revenue

Sustainalytics ESG Risk Rating

27.6 +3.6 Medium Risk

Updated on
Apr 13, 2023

Momentum



Sustainalytics ESG Risk Rating Ranking

UNIVERSE	RANK	PERCENTILE
	(1 st = lowest risk)	(1 st = lowest risk)
Global Universe	8449/15536	55th
Software & Services INDUSTRY	921/1074	86th
Enterprise and Infrastructure Software SUBINDUSTRY	420/451	93rd

Sustainalytics Material ESG Issues

These are the Material ESG Issues driving the ESG Risk Report

Issue Name	ESG Risk Exposure	ESG Risk Management	ESG Risk Rating	Contribution to ESG Risk Rating
	Score Category	Score Category	Score Category	
Corporate Governance	9.0 High	48.2 Average	4.7 Medium	16.9%
Human Capital	8.0 High	19.5 Weak	6.5 High	23.6%
Product Governance	2.2 Low	0.0 Weak	2.2 Low	8.0%
Resource Use	2.0 Low	7.3 Weak	1.9 Negligible	6.8%
Business Ethics	3.0 Low	10.0 Weak	2.7 Low	9.8%
Data Privacy and Security	8.0 High	5.0 Weak	7.7 High	27.8%
Carbon -Own Operations	2.0 Low	4.0 Weak	1.9 Negligible	7.0%
Overall	34.2 Low	20.9 Weak	27.6 Medium	100%

CIBC Quantitative Scorecard

Within Sector			Within S&P/TSX Comp.		
Style	Rank	Delta	Style	Rank	Delta
Value	7	0	Value	190	0
Momentum	5	0	Momentum	37	-2
Quality	1	0	Quality	1	0
Market	1	0	Market	34	0
Low Volatility	2	0	Low Volatility	65	+1
Growth	6	-1	Growth	70	0

Note: Ranking out of 12 stocks

Note: Ranking out of 233 stocks

General Notes Behind the Quantitative Scorecard

Delta refers to the change in the ranking over the past month. Number of stocks "Within Sector" is defined by the number within the GICS. In the "Within S&P/TSX" category, we use all stocks in the S&P/TSX Composite. For detail on the Quant Factors included in each style above, please contact the CIBC Portfolio Strategy Team.

The table above is based upon quantitative, statistical, and mathematical analysis and is not intended to serve as a fundamental recommendation.

CIBC Technical Scorecard

Factor	TSM Score	Factor	TSM Score
TSM	9	Momentum	A
Beta	1.03	MACD	B
Volatility	↓	Alpha (Sector)	D
Trend	↑	Alpha (Index)	A
RSI	Neutral		

General Notes Behind the Technical Scorecard

TSM: The Trendspotting Matrix uses technical factors to score uptrend durability.

Momentum and alpha metrics compare performance over one-month, one-quarter and one-year timeframes, outputting a rating from A to D.

Trend/Volatility metrics measure price deviations relative to underlying moving averages.

RSI is an oscillator that provides mean-reversion estimations.

MACD is a momentum indicator rated from A to D based off the strength of its signal.

The table above is based upon a technical methodology that examines the past trading patterns and trades and is not intended to serve as a fundamental recommendation.

Source: Sustainalytics, Compustat, FactSet, Bloomberg and CIBC World Markets Inc.

Price Target Calculation

Our C\$3,000 price target is based on a sum-of-the-parts methodology. We value CSU (ex-TOI and LMN) at 26x forward EBITDA multiple and CSU's 30% ownership of TOI and 61% ownership of LMN at market values.

Key Risks To Price Target

The primary risks to our price target include the following: 1) ability to scale; 2) ability to acquire; 3) vertical market exposure; 4) lack of detailed disclosure

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Neutral	NT	Stock is expected to perform in line with similar stocks in the coverage universe during the next 12-18 months.
Underperformer	UN	Stock is expected to underperform similar stocks in the coverage universe during the next 12-18 months.
Tender	TR	Shareholders are advised to tender shares to a specific offer as we do not believe a superior offer will materialize.
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Overweight	O	Sector is expected to outperform the broader market averages.
Marketweight	M	Sector is expected to equal the performance of the broader market averages.
Underweight	U	Sector is expected to underperform the broader market averages.
None	NA	Sector rating is not applicable.

Note: Broader market averages refer to S&P 500 in the U.S. and S&P/TSX Composite in Canada.

CIBC World Markets Inc. Price Chart

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Neutral	126	43%	Neutral	125	99%
Underperformer	7	2%	Underperformer	6	86%
Tender	0	0%	Tender	0	0%
Restricted	11	4%	Restricted	11	100%

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