

EQUITY RESEARCH

March 12, 2023

Earnings Update

ENGHOUSE SYSTEMS

Weak Results As Competitive Pressures Remain Elevated

Our Conclusion

Enghouse's FQ1 results were a continuation of what we had seen in prior quarters, with a structural shift to cloud contact centre software impacting the sale of on-premise solutions and weaker Vidyo revenue driving organic declines. Management's outlook included margins in the 30% range going forward, in line with historical but below the 35% range seen through the pandemic. We see upside from M&A as valuations become increasingly attractive. That said, we expect that it will be difficult for Enghouse to return the contact centre business to organic growth given its greater focus than cloud competitors on financial discipline. We retain our Neutral rating and price target of \$34.50 as we value the business at 10.5x EV/EBITDA.

Key Points

Organic Growth Declines As Competitive Pressures Ramp-up: We calculate an organic decline of ~6% in the quarter. Enghouse is facing intense competition as SaaS competitors implement price cuts to gain market share. We see Enghouse offerings, which provide different deployment options, as a competitive advantage. However, we expect that most new customers will pursue cloud deployments, with Enghouse unable to match cloud competitors on price given a greater focus on profitability than SaaS peers. As customers continue to migrate their hosting from on-premise to the cloud, we expect a challenging environment in the division in F2023. Enghouse's Vidyo video conferencing/virtual events platform also saw continued headwinds in FQ1, although management suggests that the business has been stabilizing and expects an improvement next quarter. The recent Qumu acquisition enhances the video solution for large-scale corporate events.

Focus On Acquisition Integration: Our FQ1 forecast included \$2.5MM in revenue from the acquisitions of Competella, NTW and Voiceport, roughly in line with actual results. Post FQ1, Enghouse acquired Qumu and Navita. We expect Qumu and Navita to contribute ~\$4MM in revenue in FQ2.

M&A Outlook: Enghouse closed three acquisitions in F2022 and two subsequent to FQ1. We see the valuation environment as attractive, with motivated sellers and decreasing valuations leading to a larger pool of available targets that fit Enghouse's M&A criteria. We expect the company to focus on tuck-ins that can ramp-up its cloud business to compete in a SaaS-driven world. We expect acquisitions to meet the company's profitability and payback criteria (ability to scale to healthy margins, five to six year payback period). Enghouse has a record \$251MM in net cash, which we expect to be deployed on M&A and organic initiatives. We see a special dividend as unlikely given the current M&A environment.

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Neutral

ENGH-TSX, Sector: Information Technology

Current Price (3/10/23): C\$32.75

Price Target (12-18 mos.): **C\$34.50**

CIBC Estimates and Valuation

(Oct. 31)	2021	2022	2023	2024
EPS diluted	1.66A	1.70A	1.25E	1.40E
Prior			1.39E	
Adj. EBITDA(mln)	168.5A	140.6A	131.8E	142.7E
Prior			143.0E	144.1E
EPS diluted	Q1	Q2	Q3	Q4
2022	0.39A	0.32A	0.33A	0.67A
2023	0.31A	0.31E	0.30E	0.34E
Prior	0.35E	0.34E	0.33E	0.37E
Adj. EBITDA(mln)	Q1	Q2	Q3	Q4
2022	38.6A	33.8A	32.5A	35.8A
2023	32.3A	32.9E	31.8E	34.8E
Prior	35.9E	35.5E	34.4E	37.3E
Valuation	2021	2022	2023	2024
P/E	19.7x	19.3x	26.2x	23.4x
EV/EBITDA	9.4x	11.3x	12.1x	11.1x

Stock Performance and Key Indicators

Enterprise Value:	C\$1,589M	Shares O/S:	55.4M
Market Cap.:	C\$1,813M	Float:	42.9M
52-wk Range:	C\$24.72 - C\$44.40	Div. / Yield:	C\$0.64/1.95%

TSX Composite Index vs. ENGH-TSX



(Source: FactSet)

All figures in Canadian dollars unless otherwise stated.

Please see "Price Target Calculation and Key Risks to Price Target" information on page 5.
For required regulatory disclosures please refer to "Important Disclosures" beginning on page 6.

Enhouse Systems (ENGH-TSX) — Neutral

Price (3/10/23) C\$32.75 12-18 mo. Price Target C\$34.50

Sector: Information Technology

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Peer Comparison	2021	2022	2023E	2024E
P/E - Canadian Software Consolidated	16.8x	14.9x	18.7x	18.7x
P/E - Enhouse	15.5x	15.4x	26.5x	26.5x
EV/EBITDA - Canadian Software Consolidated	10.1x	33.3x	28.6x	28.6x
EV/EBITDA - Enhouse	1.9x	9.3x	9.6x	9.6x
P/CF - Canadian Software Consolidated	21.4x	-	-	-
P/CF - Enhouse	21.4x	-	-	-
Key Financial Metrics	2021	2022	2023E	2024E
Sales Growth	(7.3%)	(8.5%)	0.4%	1.6%
Per Share Data	2021	2022	2023E	2024E
FCFPS	2.08	1.85	1.80	1.90
Diluted EPS	1.66	1.70	1.25	1.40
Wgt Avg # of Shares	55.2	55.3	55.3	55.3
FD Number of Shares	56.0	55.7	55.3	55.3
Income Statement	2021	2022	2023E	2024E
Revenue	467	428	429	436
Gross Profit	338	297	291	304
Gross Margin	72.3%	69.6%	67.7%	69.7%
Tot Operating Exp	169	157	159	161
OpEx (% of Revenue)	36.18%	36.69%	36.99%	37.00%
Adj. EBITDA	169	141	132	143
Adj EBITDA Margin	36.1%	32.9%	30.7%	32.7%
D&A	(55)	(47)	(45)	(45)
Interest Expense	(1)	0	1	0
Pretax profit	107	96	87	98
Tax Expense	15	2	18	21
Net Income	93	94	69	77
Net Margin	19.9%	22.1%	16.1%	17.7%
Cash Flow Statement	2021	2022	2023E	2024E
Net CFO	118	103	102	108
Capex	(3)	(1)	(2)	(3)
Free Cash Flow	115	102	99	105
Balance Sheet	2021	2022	2023E	2024E
Total Current Assets	304	334	399	436
Intangible Assets	102	86	59	34
Goodwill	223	230	242	252
Total Assets	675	705	749	764
ST Int-Bearing Debt	0	0	0	0
LT Int-Bearing Debt	0	0	0	0
Total Liabilities	220	197	205	193
Shareholders' Equity	454	508	544	571

Source: FactSet, company reports & CIBC World Markets Inc.

Company Profile

Enhouse Systems is a provider of enterprise software. Its strategy is to build a diverse software company through strategic acquisitions in the Contact Centre, Networks and Transportation verticals.

Price Target (Base Case): C\$34.50

Our price target is calculated using -1% revenue growth, 32.7% EBITDA margins and a 10.5x EV/EBITDA multiple plus the present value of future acquisitions (\$3.25).

Upside Scenario: C\$55.00

Our upside scenario is calculated using 5% revenue growth, 36% EBITDA margins and a 16x EV/EBITDA multiple plus present value of future acquisitions.

Downside Scenario: C\$17.50

Our downside scenario is calculated using -5% revenue growth, 27.5% EBITDA margins and a 5x EV/Sales multiple plus the present value of future acquisitions.



Financial Summary

FQ1 Results: Enghouse reported revenue of \$106.4MM, below consensus and our estimate (\$110MM). Adjusted EBITDA of \$32.3MM was down 16% Y/Y, and below consensus/CIBCe (\$36.0MM/\$35.9MM). Adjusted EBITDA margin of 30.4% was ~240 bps below consensus (32.7%) and ~220 bps below CIBCe (32.5%). Cash flow from operations was \$29.3MM, below consensus (\$34MM).

Profitability: Adjusted EBITDA margin of 30.4% was below consensus (32.7%) and our estimate (32.5%), and down 430 bps Y/Y. The lower profitability was primarily driven by lower software licenses and lower gross margins from professional services relating to some large public transportation projects.

Cash Flow From Operations: Operating cash flow (including working capital and taxes paid) was \$29MM, up from \$24MM in the year-ago period, but below Street (\$34MM). The company ended the quarter with net cash and short-term investments of \$251MM.

Exhibit 1: ENGH – Financial Summary, FQ1/22 To FQ2/23

	Q1/F23			Q1/F22	Y/Y%	Q4/F22	Q/Q%
	Actual	CIBCe	Cons				
Consolidated							
Revenue (\$MM)	106.4	110	110	111.1	-4.2%	108	-1.5%
License	20.7	23	27	23.8	-12.8%	26	-19.0%
Hosted and maintenance services	66.5	67	67	66.4	0.1%	65	3.0%
Professional services	16.9	18	17	18.0	-5.9%	16	5.1%
Hardware	2.3	3	1	2.9	-21.7%	2	25.9%
EBITDA (\$MM)	32.3	35.9	36.0	38.6	-16.3%	36	-9.8%
EBITDA Margin	30.4%	32.5%	32.7%	34.7%	-12.6%	33.1%	-8.5%
Adjusted EPS	0.31	0.35	0.35	0.39	-20.4%	0.67	-53.9%
Operating Cash Flow (\$MM)	29	6	34	24	20.4%	19	58.0%

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

Changes To Our Model: We have updated our model to reflect the weaker-than-expected FQ1 results and have recalibrated our top-line assumptions for slower transition to the cloud and elevated churn. We have also reduced our adjusted EBITDA margin by 230 bps in F2023 given M&A integration and the expectation of increased spending related to the cloud transition.

Exhibit 2: ENGH – Changes To Our Model, F2022A To F2024E

	Revenues (\$MM)	EBITDA (\$MM)	Adjusted EPS	CFO (\$MM)
2022A	428	141	1.70	103
2023E				
CIBC est. – new	429	132	1.25	102
CIBC est. – prior	434	143	1.39	98
Consensus	450	146	1.55	124
2024E				
CIBC est. – new	436	143	1.40	108
CIBC est. – prior	440	144	1.40	123
Consensus	488	162	1.75	140

Source: Company reports and CIBC World Markets Inc.

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

CIBC ESG Metrics

Governance Metrics	2017	2018	2019	2020	2021
Insider Ownership	29.8%	27.6%	26.9%	27.1%	22.5%
Board Gender Diversity	0.0%	0.0%	14.3%	14.3%	28%
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*	\$3.3	\$3.1	\$2.6	\$3.3	\$2
Diversity Targets	NO	NO	NO	NO	NO
Women Managers	20%	13%	13%	13%	13%
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

24.2 **+2.6** **Medium Risk**

Updated on
Sep 6, 2022

Momentum



Sustainalytics ESG Risk Rating Ranking

UNIVERSE	RANK (1 st = lowest risk)	PERCENTILE (1 st = lowest risk)
Global Universe	6340/15536	41st
Software & Services INDUSTRY	618/1074	58th
Enterprise and Infrastructure Software SUBINDUSTRY	285/451	63rd

Sustainalytics Material ESG Issues

These are the Material ESG Issues driving the ESG Risk Report

Issue Name	ESG Risk Exposure Score Category	ESG Risk Management Score Category	ESG Risk Rating Score Category	Contribution to ESG Risk Rating
Corporate Governance	9.0 High	47.2 Average	4.8 Medium	19.6%
Human Capital	7.2 Medium	12.6 Weak	6.3 High	26.1%
Product Governance	2.0 Low	7.5 Weak	1.8 Negligible	7.6%
Resource Use	1.8 Low	4.0 Weak	1.7 Negligible	7.2%
Business Ethics	2.7 Low	12.5 Weak	2.4 Low	9.8%
Data Privacy and Security	6.8 Medium	25.0 Average	5.4 Medium	22.4%
Carbon -Own Operations	1.8 Low	4.0 Weak	1.7 Negligible	7.1%
Overall	31.3 Low	24.3 Weak	24.2 Medium	100%

CIBC Quantitative Scorecard

Within Sector			Within S&P/TSX Comp.		
Style	Rank	Delta	Style	Rank	Delta
Value	4	0	Value	93	-4
Momentum	7	+3	Momentum	177	+40
Quality	2	+1	Quality	14	-2
Market	13	0	Market	209	-1
Low Volatility	6	0	Low Volatility	117	-3
Growth	11	0	Growth	173	+2

Note: Ranking out of 14 stocks

Note: Ranking out of 235 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	-1	Momentum	C
Beta	0.94	MACD	A
Volatility	↑	Alpha (Sector)	D
Trend	↔	Alpha (Index)	D
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

Using the company's current capital structure we value Enghouse at 10.5x EV/2023E EBITDA. In addition, we add the present value of a future acquisition spend (\$3.25/share). This equates to a \$34.50 price target.

Key Risks To Price Target

The primary risks to our price target include the following: 1) ability to acquire; 2) retention of key personnel; 3) competition; 4) ability to scale.

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Outperformer	OP	Stock is expected to outperform similar stocks in the coverage universe during the next 12-18 months.
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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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	130	44%	Neutral	129	99%
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Tender	2	1%	Tender	2	100%
Restricted	12	4%	Restricted	12	100%

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