

EQUITY RESEARCH

August 11, 2023

Earnings Update

SOFTCHOICE CORPORATION

A Focus On Profitability And Organic Investment

Our Conclusion

Softchoice reported a mixed Q2, with net revenue that was 18% below consensus, but adj. EBITDA that was 14% above. The overall demand environment remained relatively consistent in Q2, with customers continuing to pull back hardware spending, while cloud and software demand remained strong. The revenue mix (skewed to higher-margin cloud/software) and expense management efforts have helped profitability year to date, despite salesforce headcount that was up in H1 and expected to increase further in H2. Overall, we see no change to our thesis with Q2 and we retain our Neutral rating and price target of \$17.50.

Key Points

Q2 Results Mixed: Net revenue of \$208MM was below consensus (\$252MM), with the miss driven by a 29% Y/Y decline in Hardware gross sales. Services gross sales were also down 12% Y/Y, with management attributing the decline to softer enterprise demand. Softchoice reported gross profit of \$82.9MM, up 1.5% Y/Y in constant currency, but 3% below consensus. The miss was driven by a decline in Hardware gross profit of 21% Y/Y and a decline in the Enterprise sales channel of 10% Y/Y.

Weak Hardware Demand Continues: Softchoice's demand environment remains roughly unchanged, with the company continuing to see decreased demand in the enterprise market and a pullback in hardware demand as customers look to keep hardware longer in the current uncertain macro environment. The hardware slowdown has not had a material impact on Softchoice's profitability given that ~70% of the company's gross profit is driven by software/cloud, which continue to see strong demand as clients look to optimize efficiency and innovate.

Conservatively Managing Expenses And Capital: The company reported a 0.5% Y/Y decline in gross profit, despite an 18% Y/Y decline in net revenue, which management attributes to the success of its conservative approach to expense management in a tougher macro environment. The company is also focused on cash management and shareholder return, reporting cash flow from operations that was up 26% Y/Y and maintaining its \$0.11/share quarterly dividend, which is up 22% from F22. AE headcount increased in the quarter despite these cost-reduction initiatives. Management plans to increase sales capacity and supporting resources by ~6% Y/Y in F23 in anticipation of a potentially improved demand environment next year, with talent investments focused on the SMB and Commercial channels.

AI Opportunities: Management dedicated a portion of the call to generative AI opportunities. With technology partners Microsoft and Google planning to launch genAI additions to their workplace software suites, Softchoice is seeing increased interest from customers in preparation work, such as data modernization and application improvements. The company views the genAI opportunity as an extension of its core offerings, with its current talent resources adequate to handle early-stage customer interest.

All figures in US dollars unless otherwise stated (C\$1.342:US\$1.00).

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.

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Neutral

SFTC-TSX, Sector: Information Technology

Current Price (8/11/23): C\$15.70

Price Target (12-18 mos.): C\$17.50

CIBC Estimates and Valuation

(Dec. 31)	2021	2022	2023	2024
Adj. EPS	0.65A	0.79A	0.66E	0.68E
Prior			0.60E	0.67E
Adj. EBITDA(mln)	69.1A	81.8A	84.7E	93.4E
Prior			83.7E	94.7E

Adj. EPS	Q1	Q2	Q3	Q4
2022	0.07A	0.27A	0.14A	0.32A
2023	0.12A	0.23A	0.12E	0.22E
Prior		0.17E	0.10E	0.25E

Adj. EBITDA(mln)	Q1	Q2	Q3	Q4
2022	10.0A	25.0A	15.3A	31.5A
2023	14.5A	24.9A	18.5E	26.8E
Prior		21.2E	17.7E	30.2E

Valuation	2021	2022	2023	2024
P/E	18.1x	14.8x	17.9x	17.1x
EV/EBITDA	9.2x	7.8x	7.5x	6.8x
FCF Yield	7.7%	4.9%	6.4%	7.1%

Stock Performance and Key Indicators

Enterprise Value	C\$853M	Shares O/S:	60.2M
Market Cap.:	C\$946M	Float:	55.2M
52-wk Range:	C\$13.57 - C\$23.14	Div. / Yield:	C\$0.59/3.76%

TSX Composite Index vs. SFTC-TSX



(Source: FactSet)

Softchoice Corporation (SFTC-TSX) — Neutral

Price (8/11/23) C\$15.70 12-18 mo. Price Target C\$17.50

Sector: Information Technology

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Peer Comparison	2021	2022	2023E	2024E
P/E - Peer Average	-	30.3x	24.4x	20.1x
P/E - Softchoice	-	15.2x	18.4x	17.6x
EV/EBITDA - Peer Average	-	17.2x	14.6x	12.8x
EV/EBITDA - Softchoice	-	9.8x	9.4x	8.5x
Key Financial Metrics	2021	2022	2023E	2024E
Net Debt	86	105	92	68
Total Debt	89	107	100	96
Free Cash Flow	52	36	45	50
Sales Growth	7.9%	2.8%	(7.0%)	17.1%
Per Share Data	2021	2022	2023E	2024E
FCFPS	0.91	0.57	0.74	0.83
Adj. EPS Dil.	0.65	0.79	0.66	0.68
Wgt Avg # of Shares	53.4	59.1	57.8	57.8
FD Number of Shares	57.2	62.6	60.2	60.2
Income Statement	2021	2022	2023E	2024E
Revenue	903	928	863	1,011
Cost of Goods Sold	616	616	542	668
Gross Profit	287	312	321	343
Gross Margin %	31.78%	33.65%	37.24%	33.93%
Tot Operating Exp	284	258	262	283
Adj. EBITDA	69	82	85	93
Adj EBITDA Margin	24.1%	26.2%	26.4%	27.2%
D&A	21	19	18	21
Interest Expense	10	21	4	4
Pretax profit	(9)	32	55	56
Tax Expense	1	11	15	15
Adjusted Net Income	37	49	39	41
Adjusted Net Margin	4.1%	5.3%	4.6%	4.1%
Cash Flow Statement	2021	2022	2023E	2024E
Net CFO	54	40	47	53
Capex	(2)	(4)	(2)	(3)
Free Cash Flow	52	36	45	50
Balance Sheet	2021	2022	2023E	2024E
Cash & ST Investment	3	2	9	27
Goodwill	139	137	138	138
Total Assets	641	615	593	661
LT Int-Bearing Debt	101	116	137	94
Total Liabilities	583	575	547	601
Shareholders' Equity	58	40	46	61

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

Company Profile

Softchoice Corporation is a Canadian IT solutions and managed service provider. The company's technology partners include Microsoft, Cisco, VMware, Google, and AWS.

Investment Thesis

1) Leading North American IT Solutions Provider. 2) Focused On High Growth Segments. 3) Long Tenured Customer Base And A Focus On Higher-value Solution Sales.

Price Target (Base Case): C\$17.50

Our price target is calculated using 6% gross profit growth, a 27% EBITDA margin as a percentage of gross profit, and a 9.5x EV/EBITDA multiple.

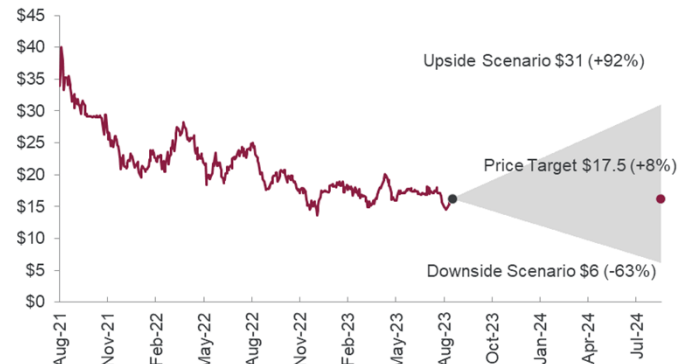
Upside Scenario: C\$31.00

Our upside scenario is calculated using 24% gross profit growth, a 33.5% EBITDA margin as a percentage of gross profit, and an 11.0x EV/EBITDA multiple.

Downside Scenario: C\$6.00

Our downside scenario is calculated using 10% gross profit growth, a 26% EBITDA margin as a percentage of gross margin, and a 4.0x EV/EBITDA multiple.

Scenario Analysis:



Financial Summary

Q2/23 Results: Net revenue of \$208MM was well below consensus (\$252MM), with the miss driven by a 29% Y/Y decline in gross Hardware sales. Softchoice reported gross profit of \$82.9MM (down 0.5% Y/Y), 3% below consensus of \$85.5MM and 2% below our estimate of \$84.6MM. Software & Cloud gross profit of \$58.4MM was up 8% Y/Y, Services gross profit of \$8.1MM was up 2% Y/Y, and Hardware gross profit of \$16.5MM was down 21% Y/Y. Gross profit for Enterprise customers declined 10% Y/Y. Revenue retention decreased to 102% compared to 105% in the TTM period. Customer count was 4,830 as of Q2/23, an increase of 3.5% Y/Y.

EBITDA Margin: Adjusted EBITDA of \$24.9MM was 14% above consensus of \$21.8MM and 17% above our estimate (\$21.2MM). The adjusted EBITDA margin (as a percentage of gross profit) was 30.0%, flat Y/Y, ~450 bps above consensus of 25.5%, and ~490 bps above our estimate of 25.1%.

Exhibit 1: SFTC – Financial Summary, Q2/23

	Q2/23			Q2/22	Y/Y%	Q1/23	Q/Q%
	Actual	CIBCe	Cons.				
Consolidated							
Net Revenue (\$MM)	208	247	252	254	-18.4%	209	-0.6%
Gross Profit (\$MM)	82.9	84.6	85.5	83.3	-0.5%	74.2	11.7%
Gross Profit Margin	39.9%	34.3%	33.8%	32.8%	21.9%	35.5%	12.4%
Adj. EBITDA (\$MM)	24.9	21.2	21.8	25.0	-0.4%	14.5	71.4%
Adj. EBITDA as a % of GP	30.0%	25.1%	25.5%	30.0%	0.1%	19.6%	53.4%
Adjusted EPS	\$0.23	\$0.17	\$0.21	\$0.27	-14.8%	\$0.12	91.7%

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

Changes To Our Model: We have updated our model to reflect the Q2 results. We have reduced our net revenue assumptions given the continued hardware slowdown, and adjusted our H2/23 seasonality to reflect management commentary around flat Y/Y gross profit growth in Q3 and H2/23, representing 51% of FY gross profit.

Exhibit 2: SFTC – Changes To Our Model, 2022A-2024E

	Revenues (\$MM)	Gross Profit (\$MM)	EBITDA (\$MM)	EPS	CFO (\$MM)
2022A	928	312	82	\$0.79	40
2023E					
CIBC est. – new	863	321	85	\$0.66	47
CIBC est. – prior	952	332	84	\$0.60	62
Consensus	941	333	86	\$0.79	63
2024E					
CIBC est. – new	1,011	343	93	\$0.68	53
CIBC est. – prior	1,031	350	95	\$0.67	62
Consensus	1,022	358	96	\$0.92	67

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

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

CIBC ESG Metrics

Governance Metrics	2017	2018	2019	2020	2021
Insider Ownership	NA	NA	NA	NA	49.3%
Board Gender Diversity	NA	NA	NA	NA	25%
Separation of Chair & CEO	NA	NA	NA	NA	YES
Dual-class Ownership?	NA	NA	NA	NA	NO
Disclose ESG Data?	NA	NA	NA	NA	NO
Social Metrics	2017	2018	2019	2020	2021
CEO Comp./Mkt Cap*	NA	NA	NA	NA	NA
Diversity Targets	NA	NA	NA	NA	NO
Women Managers	NA	NA	NA	NA	NA
Environmental Metrics	2017	2018	2019	2020	2021
Emissions Intensity**	NA	NA	NA	NA	NA
Net-zero Targets?	NA	NA	NA	NA	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

21.6 **+0.0** **Medium Risk**

Updated on
May 30, 2022

Momentum



Sustainalytics ESG Risk Rating Ranking

UNIVERSE	RANK	PERCENTILE
	(1 st = lowest risk)	(1 st = lowest risk)
Global Universe	4726/15536	31st
Software & Services INDUSTRY	374/1074	35th
IT Consulting SUBINDUSTRY	86/235	37th

CIBC Quantitative Scorecard

Within S&P/TSX Comp.			Within Sector		
Style	Rank	Delta	Style	Rank	Delta
Quality	NA	NA	Value	NA	NA
Market	NA	NA	Growth	NA	NA
Low Volatility	NA	NA	Market	NA	NA
Momentum	NA	NA	Quality	NA	NA
Growth	NA	NA	Momentum	NA	NA
Value	NA	NA	Low Volatility	NA	NA

Note: Ranking out of NA stocks

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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	NA	Momentum	D
Beta	0.92	MACD	D
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

We derive our price target of \$17.50 by applying a 9.5x EV/EBITDA multiple to our 2024E EBITDA estimate based on the current capital structure. The 9.5x multiple is in line with software-focused IT Solution providers including Softcat, Crayon, Bytes and SoftwareOne.

Key Risks To Price Target

The primary risks we see to our price target include the following: 1) volatility in the global IT environment; 2) increasing competition from other IT solutions providers; 3) the company's ability to introduce new or updated technology in a timely manner; 4) the company's ability to partner with leading technology providers; and 5) the loss of key management or other employees.

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