

# EQUITY RESEARCH

June 13, 2023

Earnings Update

## ENGHOUSE SYSTEMS

### Getting SaaS – The Impact of SaaS-based M&A

#### Our Conclusion

Enghouse has historically sold on-premise solutions, which represent ~85% of overall revenue. However, the company is tilting towards SaaS, given demand for cloud-based contact centres and an M&A pipeline that includes an increasing number of SaaS providers. We saw the impact of two recent SaaS acquisitions (Qumu and Navita) in FQ2, with margins of 26.6% down 520 bps Y/Y. While we expect that a portion of the margin decline is short term (acquisition integration/third party contractor costs), we do expect a margin impact as the company shifts to more SaaS offerings and have reduced our F24 adj. EBITDA margin assumptions by ~200 bps. We retain our Neutral rating and price target of \$34.50.

#### Key Points

**Margins Below Expectations:** Adjusted EBITDA margin of 26.6% was below consensus (28.9%) and our estimate (30.4%), and down 520 bps Y/Y. M&A integration was a portion of the lower margins, with Qumu and Navita now profitable, but not yet at Enghouse's target margin. Margins were also impacted by higher third-party contractor costs as Enghouse continues to integrate its public safety projects. We expect that both of these will continue to act as an overhang to margins for the next several quarters. As Enghouse increases its SaaS offerings, we also see a more pervasive impact to margins from the lower upfront fee and hosting costs associated with SaaS solutions. We expect that ENGH will continue to prefer on-premise to SaaS, however, we expect that SaaS-based M&A could accelerate as private firms look for exit opportunities amid a difficult funding environment. Management continues to target 30% EBITDA margins, which we expect to be achieved through a combination of SaaS scale and opex efficiencies.

**Organic Decline Stabilizing:** We calculate a currency-adjusted organic decline of ~6% in the quarter, in line with the previous quarter. The Vidyo business appears to be stabilizing, with Enghouse refocusing the business on complex workflows such as virtual nursing and virtual monitoring of patients as it looks to differentiate Vidyo from other providers such as Zoom and Teams.

**M&A Outlook:** Enghouse remains positive on the M&A pipeline, with the company seeing a large pool of targets motivated to sell given the current macroenvironment and an improving valuation environment. We expect ENGH to focus on tuck-ins that can help scale its cloud business. After completing two acquisitions in the first quarter, Enghouse has \$231MM in net cash, which we expected to be deployed on M&A and organic initiatives.

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**Neutral**

ENGH-TSX, Sector: Information Technology

Current Price (6/13/23): C\$35.06

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

#### CIBC Estimates and Valuation

(Oct. 31)	2021	2022	2023	2024
EPS diluted	1.66A	1.70A	1.09E	1.21E
Prior			1.25E	1.40E
Adj. EBITDA(mln)	168.5A	140.6A	125.9E	134.0E
Prior			131.8E	142.7E

EPS diluted	Q1	Q2	Q3	Q4
2022	0.39A	0.32A	0.33A	0.67A
2023	0.31A	0.23A	0.26E	0.30E
Prior		0.31E	0.30E	0.34E

Adj. EBITDA(mln)	Q1	Q2	Q3	Q4
2022	38.6A	33.8A	32.5A	35.8A
2023	32.3A	30.2A	30.4E	33.1E
Prior		32.9E	31.8E	34.8E

Valuation	2021	2022	2023	2024
P/E	21.1x	20.7x	32.2x	29.0x
EV/EBITDA	9.4x	11.2x	12.5x	11.8x

#### Stock Performance and Key Indicators

Enterprise Value:	C\$1,579M	Shares O/S:	55.3M
Market Cap.:	C\$1,938M	Float:	42.9M
52-wk Range:	C\$24.76 - C\$44.40	Div. / Yield:	C\$0.64/1.83%

#### 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.

**Enghouse Systems (ENGH-TSX) — Neutral**

Price (6/13/23) C\$35.06 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	17.2x	22.4x	27.4x	28.0x
P/E - Enghouse	20.9x	17.7x	32.6x	27.2x
EV/EBITDA - Canadian Software Consolidated	22.3x	20.9x	18.1x	15.7x
EV/EBITDA - Enghouse	10.6x	12.5x	13.6x	12.3x
P/CF - Canadian Software Consolidated	21.4x	-	-	-
P/CF - Enghouse	21.4x	-	-	-
Key Financial Metrics	2021	2022	2023E	2024E
Sales Growth	(7.3%)	(8.5%)	3.7%	1.5%
Per Share Data	2021	2022	2023E	2024E
FCFPS	2.08	1.85	1.35	1.79
Diluted EPS	1.66	1.70	1.09	1.21
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	444	450
Gross Profit	338	297	299	306
Gross Margin	72.3%	69.6%	67.3%	67.9%
Tot Operating Exp	169	157	173	172
OpEx (% of Revenue)	36.18%	36.69%	38.97%	38.13%
Adj. EBITDA	169	141	126	134
Adj EBITDA Margin	36.1%	32.9%	28.4%	29.8%
D&A	(55)	(47)	(48)	(50)
Interest Expense	(1)	0	1	0
Pretax profit	107	96	74	84
Tax Expense	15	2	14	18
Net Income	93	94	60	67
Net Margin	19.9%	22.1%	13.5%	14.8%
Cash Flow Statement	2021	2022	2023E	2024E
Net CFO	118	103	77	102
Capex	(3)	(1)	(2)	(3)
Free Cash Flow	115	102	75	99
Balance Sheet	2021	2022	2023E	2024E
Total Current Assets	304	334	359	390
Intangible Assets	102	86	87	58
Goodwill	223	230	264	274
Total Assets	675	705	761	765
ST Int-Bearing Debt	0	0	0	0
LT Int-Bearing Debt	0	0	0	0
Total Liabilities	220	197	216	203
Shareholders' Equity	454	508	545	561

Source: FactSet, Company Reports &amp; CIBC World Markets Inc.

**Company Profile**

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

**Price Target (Base Case): C\$34.50**

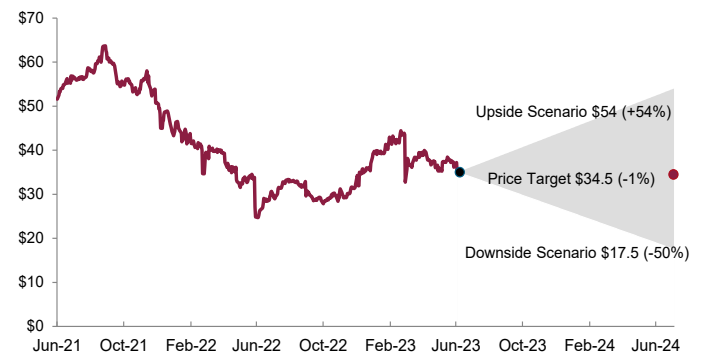
Our price target is calculated using 1.5% revenue growth, 29.8% EBITDA margins and an 11x EV/EBITDA multiple plus the present value of future acquisitions (\$3.25).

**Upside Scenario: C\$54.00**

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.

**Scenario Chart**

## Financial Summary

**FQ2 Results:** Enghouse reported revenue of \$113.5MM, above consensus and our estimate (\$112MM/\$108MM). Adjusted EBITDA of \$30.2MM was down ~11% Y/Y, and below consensus and CIBCe (\$32.2MM/\$32.9MM). Adjusted EBITDA margin of 26.6% was 230 bps below consensus (28.9%) and 380 bps below CIBCe (30.4%). Cash flow from operations was \$19MM, below consensus (\$29MM) and above our estimate (\$15MM).

**Profitability:** Adjusted EBITDA margin of 26.6% was below consensus (28.9%) and our estimate (30.4%), and down 520 bps Y/Y. The IMG group had adjusted operating profit margins of 32.4%, below our 40% estimate, contributing to the margin miss. The AMG group had an operating profit margin of 33.3%, roughly in line with our 32% estimate.

**Cash Flow From Operations:** Operating cash flow was \$19MM, down from \$31MM in the year-ago period. The company ended the quarter with net cash and short-term investments of \$234MM. Enghouse spent \$25.6MM on acquisitions this quarter and \$10.2MM on dividends.

### Exhibit 1: ENGH – Financial Summary FQ2/22-FQ2/23

	Q2-F2023			Q2-F2022	Y/Y%	Q1-F2023	Q/Q%
	Actual	CIBCe	Cons.				
Consolidated							
Revenue (\$MM)	113.5	108	112	106.3	6.7%	106.4	6.6%
License	22.0	20	21	21.4	2.8%	20.7	6.2%
Hosted and maintenance services	71.6	67	70	63.7	12.4%	66.5	7.7%
Professional services	18.0	18	18	17.9	0.6%	16.9	6.5%
Hardware	1.8	3	3	3.3	-44.4%	2.3	-21.2%
EBITDA (\$MM)	30.2	32.9	32.2	33.8	-10.6%	32.3	-6.4%
EBITDA Margin	26.6%	30.4%	28.9%	31.8%	-16.2%	30.3%	-12.2%
Adjusted EPS (\$)	0.23	0.31	0.32	0.32	-29.0%	0.31	-26.4%
Operating Cash Flow (\$MM)	19	15	29	31	-40.0%	29	-36.1%

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

**Changes To Our Model:** We have updated our model to reflect the weaker-than-expected FQ2 results. We have also reduced our adjusted EBITDA margin by 200 bps in F2024 as the company shifts to more SaaS offerings.

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

	Revenues (\$MM)	EBITDA (\$MM)	Adjusted EPS	CFO (\$MM)
<b>2022A</b>	428	141	1.70	103
<b>2023E</b>				
CIBC est. – new	444	126	1.09	77
CIBC est. – prior	429	132	1.25	102
Consensus	449	137	1.40	114
<b>2024E</b>				
CIBC est. – new	450	134	1.21	102
CIBC est. – prior	436	143	1.40	108
Consensus	491	161	1.77	138

Source: Company reports, FactSet 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

24.3

-0.2

Medium Risk

Updated on  
Apr 13, 2023

Momentum



## Sustainalytics ESG Risk Rating Ranking

UNIVERSE	RANK	PERCENTILE
	(1 <sup>st</sup> = lowest risk)	(1 <sup>st</sup> = lowest risk)
Global Universe	6683/15361	44th
Software & Services INDUSTRY	666/1063	63rd
Enterprise and Infrastructure Software SUBINDUSTRY	281/435	65th

## 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	23.8 Weak	5.5 Medium	22.7%
Carbon -Own Operations	1.8 Low	4.0 Weak	1.7 Negligible	7.1%
Overall	31.3 Low	24.1 Weak	24.3 Medium	100%

## CIBC Quantitative Scorecard

Within Sector			Within S&P/TSX Comp.		
Style	Rank	Delta	Style	Rank	Delta
Value	5	0	Value	113	-1
Momentum	8	-1	Momentum	94	+30
Quality	3	0	Quality	12	+3
Market	11	0	Market	198	+8
Low Volatility	7	0	Low Volatility	132	+2
Growth	11	-1	Growth	176	0

Note: Ranking out of 12 stocks

Note: Ranking out of 231 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	0.86	MACD	B
Volatility	↗	Alpha (Sector)	B
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

Using the company's current capital structure we value Enghouse at 11x EV/2024E EBITDA. The multiple represents a slight discount to consolidator peers given weaker organic growth. 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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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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Underperformer	6	2%	Underperformer	5	83%
Tender	0	0%	Tender	0	0%
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