

EQUITY RESEARCH

August 14, 2022

Earnings Update

SOFTCHOICE CORPORATION

Staffing Up For Growth

Our Conclusion

Softchoice staffed up in H1, adding the capacity for higher growth and reaching its target for full-year account executive headcount by mid-year. However, the company has begun to see some softness in the Enterprise channel, noting a slower-than-expected ramp in territorial expansion and a reduction in spending from some Enterprise customers. In an uncertain macro environment, the company's 2022 guide remains back-end loaded, despite an adjusted EBITDA margin guide that was reduced by 350 bps at the mid-point. We see recent headcount additions as positioning the company well for future growth, but expect it to take several quarters for new hires to become productive, especially given the current environment. We retain our Neutral rating and C\$21 price target.

Key Points

Slowdown In Enterprise: Softchoice updated its 2022 expectations with Q2 results, with gross profit of >\$320MM now expected to be closer to \$320MM and adjusted EBITDA margin of ~30% now expected to 25%-28%. The company cited a slowdown at some Enterprise customers as the reason for the revision, with a decline in spend at a few of its larger accounts. Enterprise customers comprise ~10% of Softchoice's customer base, but about a quarter of the company's gross profit. Management noted that the decline was based on company-specific factors (M&A, etc.) versus a broader slowdown in the market.

Investing In Sales: Softchoice is tracking ahead of its account executive (AE) hiring plan, reaching a total of 424 AEs at the end of Q2, already within its year-end target range of 423-433. In the current environment, the company has also seen some wage inflation in certain pockets of the organization. Combined, we expect a near-term drag on earnings as new hires move up the productivity curve. That said, Project Monarch benefits should partially offset, with gross profit per AE up 20% on a TTM basis and up slightly from year-end 2021. Total customer count was roughly flat Q/Q, but LTM net dollar retention remained strong at 113% as gross profit per customer increased on an LTM basis.

EBITDA Expected To Be Back-half Weighted: Even with the margin guidance reduction, the company's adjusted EBITDA is expected to be back-half weighted, with our forecast suggesting that a little under 60% of annual EBITDA will fall in the second half. This appears roughly in line with historic seasonality, with second-half EBITDA contributions in 2020 and 2021 of 60% and 55%, respectively. Given the uncertain macro-economic climate, we do see more risk to the full-year guide than in prior years.

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Neutral

SFTC-TSX, Sector: Information Technology

Current Price (8/12/22): C\$23.95

Price Target (12-18 mos.): C\$21.00

CIBC Estimates and Valuation

(Dec. 31)	2020	2021	2022	2023
Adj. EPS	0.64A	0.65A	0.51E	0.86E
Prior			0.72E	0.88E
Adj. EBITDA(mln)	65.5A	69.1A	81.1E	110.3E
Prior			94.3E	112.3E
Adj. EPS	Q1	Q2	Q3	Q4
2021	0.06A	0.22A	0.09A	0.27A
Prior		0.23A		
2022	0.07A	0.27A	0.06E	0.27E
Prior		0.16E	0.20E	0.30E
Adj. EBITDA(mln)	Q1	Q2	Q3	Q4
2021	10.5A	20.9A	11.3A	26.5A
2022	10.0A	25.0A	14.8E	32.6E
Prior		22.6E	26.7E	35.8E
Valuation	2020	2021	2022	2023
P/E	29.2x	29.0x	36.6x	21.7x
EV/EBITDA	15.1x	14.3x	12.2x	8.9x
FCF Yield	NM	4.8%	4.7%	6.8%

Stock Performance and Key Indicators

Enterprise Value:	C\$1,262M	Shares O/S:	62.9M
Market Cap.:	C\$1,505M	Float:	57.0M
52-wk Range:	C\$18.42 - C\$40.00	Div. / Yield:	C\$0.36/1.50%

TSX Composite Index vs. SFTC-TSX



(Source: FactSet)

All figures in US dollars unless otherwise stated (C\$1.280: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.

Softchoice Corporation (SFTC-TSX) — Neutral

Price (8/12/22) C\$23.95 12-18 mo. Price Target C\$21.00

Sector: Information Technology

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Peer Comparison	2020	2021	2022E	2023E
P/E - Peer Average	-	31.4x	24.9x	22.3x
P/E - Softchoice	-	29.4x	26.5x	21.8x
EV/EBITDA - Peer Average	-	20.4x	15.8x	14.1x
EV/EBITDA - Softchoice	-	19.0x	14.0x	11.7x
Key Financial Metrics	2020	2021	2022E	2023E
Net Debt	228	86	76	21
Total Debt	229	89	102	97
Net Debt/EBITDA	3.5x	1.2x	0.9x	0.2x
Free Cash Flow	(19)	52	56	80
Sales Growth	(12.3%)	7.9%	11.0%	5.5%
Per Share Data	2020	2021	2022E	2023E
FCFPS	(0.33)	0.91	0.88	1.27
Adj. EPS Dil.	0.64	0.65	0.51	0.86
Wgt Avg # of Shares	45.1	53.4	59.3	59.6
FD Number of Shares	56.4	57.2	63.1	63.3
Income Statement	2020	2021	2022E	2023E
Revenue	837	903	1,003	1,057
Cost of Goods Sold	598	616	681	712
Gross Profit	238	287	322	345
Gross Margin %	28.48%	31.78%	32.07%	32.63%
Tot Operating Exp	223	284	269	268
Adj. EBITDA	65	69	81	110
Adj. EBITDA Margin	27.5%	24.1%	25.2%	32.0%
D&A	23	21	21	21
Interest Expense	12	10	8	3
Pretax profit	3	(9)	45	74
Tax Expense	1	1	12	20
Adjusted Net Income	36	37	32	55
Adjusted Net Margin	4.3%	4.1%	3.2%	5.2%
Cash Flow Statement	2020	2021	2022E	2023E
Net CFO	(11)	54	58	83
Capex	(8)	(2)	(2)	(3)
Free Cash Flow	(19)	52	56	80
Balance Sheet	2020	2021	2022E	2023E
Cash & ST Investment	1	3	26	76
Goodwill	139	139	139	139
Total Assets	602	641	625	671
LT Int-Bearing Debt	0	101	116	96
Total Liabilities	630	583	563	580
Shareholders' Equity	(27)	58	62	91

Source: FactSet, Company Reports & 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\$21.00

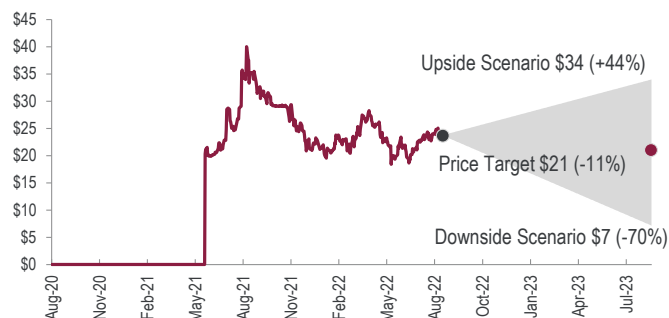
Our price target is calculated using 10% gross profit growth, 31.5% EBITDA margin as a percentage of gross profit, and a 10.5x EV/EBITDA multiple.

Upside Scenario: C\$34.00

Our upside scenario is calculated using 24% gross profit growth, 33.50% EBITDA margin as a percentage of gross profit and a 13.5x EV/EBITDA multiple.

Downside Scenario: C\$7.00

Our downside scenario is calculated using 10.0% gross profit growth, 26.0% EBITDA margin as a percentage of gross margin and a 5x EV/EBITDA multiple.



Financial Summary

Gross Profit By Segment: Softchoice reported gross profit of \$83.3 million (consensus \$79.5 million). Hardware gross profit of \$20.9 million (our estimate \$22.3 million) was up 8% Y/Y, and software and cloud gross profit of \$54.1 million (14% above our estimate of \$47.5 million) was up 16% Y/Y due to strong demand for public cloud solutions. Professional services gross profit was \$8.3 million (our estimate \$8.8 million), up 20% Y/Y.

Gross Profit Efficiency Increases: Softchoice reported gross profit per account executive (GP/AE) of \$771,000 (TTM), up 20% Y/Y from \$645,000. The average number of account executives decreased from 391 to 394 (TTM), down 1% Y/Y. Management noted it had reached its year-end AE target as at quarter-end with 424 AEs. Gross profit per customer was up 20% from \$54,000 to \$65,000 (TTM) while the total number of customers decreased slightly from 4,675 to 4,667.

EBITDA Growth: Adjusted EBITDA of \$25 million was notably above consensus and our estimate (\$23.2 million/\$22.5 million) on improving gross margins, which is primarily attributed to lower administrative expenses. Adjusted EBITDA margins (as a percentage of gross profit) were 30.0%, 80 bps above consensus expectations and 130 bps above our estimate (29.2%/28.7%).

Exhibit 1: SFTC – Financial Summary, Q2/22

	Q2-F2022			Q2-F2021	Y/Y%	Q1-F2022	Q/Q%
	Actual	CIBCe	Cons.				
Consolidated							
Net Revenue (\$M)	254	239	237	213	19.6%	223	14.1%
Gross Profit (\$M)	83.3	78.6	79.5	73.0	14.1%	67.1	24.2%
Gross Profit Margin	32.8%	35.2%	33.5%	34.3%	-4.6%	30.1%	8.9%
Adj. EBITDA (\$M)	25.00	22.5	23.2	20.9	19.7%	10.0	151.2%
Adj. EBITDA as a % of GP	30.0%	28.7%	29.2%	28.6%	4.9%	14.8%	102.2%
Adjusted EPS	\$0.27	\$0.16	\$0.21	\$0.23	19.5%	\$0.07	269.0%

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

Changes To Our Model: We have updated our model to reflect the stronger-than-expected Q2 results and the revised margin outlook.

Exhibit 2: SFTC – Changes To Our Model, 2021 - 2023E

	Revenues (\$MM)	Gross Profit (\$MM)	EBITDA (\$MM)	EPS (\$)	CFO (\$MM)
2021A	903	287	69	0.65	54
2022E					
CIBC est. – new	1,003	322	81	0.51	58
CIBC est. – prior	1,000	321	94	0.72	52
Consensus	1,289	322	123	1.15	90
2023E					
CIBC est. – new	1,057	345	110	0.86	83
CIBC est. – prior	1,054	354	112	0.88	103
Consensus	1,418	354	146	1.41	113

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

Medium Risk

Updated on
May 30, 2022

Momentum



Sustainalytics ESG Risk Rating Ranking

UNIVERSE	RANK (1 st = lowest risk)	PERCENTILE (1 st = lowest risk)
Global Universe	4354/14443	31st
Software & Services INDUSTRY	355/979	37th
IT Consulting SUBINDUSTRY	82/204	41st

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	A
Beta	NA	MACD	A
Volatility	↔	Alpha (Sector)	A
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.

Price Target Calculation

We derive our price target of \$26.00 by applying a 10.5x EV/EBITDA multiple to our 2023E EBITDA estimate based on the current capital structure. The 10.5x multiple is in line with software-focused IT Solution providers including Softcat, Crayon, Bytes and SoftwareOne.

Key Risks To Price Target

The primary risks 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; 5) the loss of key management or other employees.

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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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