

EQUITY RESEARCH

March 29, 2023

Earnings Update

CONSTELLATION SOFTWARE INC.

A Solid End To The Year

Our Conclusion

Constellation reported a solid Q4 with revenue 3% above consensus and EBITDA margins 90 bps above expectations. Constant-currency organic growth was 4% Y/Y, up sequentially from 2%. Free cash flow available to shareholders was up 19% Y/Y, a sequential improvement from 1% Y/Y. Constellation continues to restructure Altera and we calculate ~11% Altera EBITDA margins in the quarter and a 2% Altera-related headwind to constant-currency organic growth. Overall, we see Constellation as well positioned to execute on M&A in the current environment and see opportunities for further carve-outs (similar to Altera) and spin-outs (similar to the recently spun out Lumine Group). Constellation spent \$1.6B on M&A in 2022, above its \$1.3B in free cash flow as the company explores new financing and structuring arrangements as it continues to focus on larger deals. We retain our Outperformer rating.

Key Points

Q4 Results: Revenue of \$1,847MM was slightly above consensus (\$1,788MM) and CIBCe (\$1,770MM). Foreign exchange was a 5% headwind, with constant-currency organic growth of 4%, slightly above our 3% expectation. EBITDA of \$496MM was above consensus (\$464MM) and CIBCe (\$440MM), while margins of 26.9% were 90 bps above the Street and 200 bps above CIBCe.

Altera A Drag On Organic Growth: Altera was a 2% impact to organic growth in Q4, with Constellation recording 6% constant-currency organic growth excluding the recent acquisition. Excluding Altera, Constellation's license/professional services constant-currency organic growth was flat Y/Y, with maintenance up 7% Y/Y and hardware/other up 38%. Altera's organic decline accelerated in Q4, with the recently acquired division recording a constant-currency organic decline of 13% versus a 4% decline in Q3 and a 6% decline in Q2. Altera's maintenance declined by 7%, license by 30% and professional services by 25%. Altera's hardware/other revenue segment was the only segment that saw constant-currency organic growth (+286%) although this is off a small base.

Margins Slightly Above Consensus: While Constellation's EBITDA margins were 90 bps above consensus, this appears driven by revenue mix (higher license revenue) and other factors. We calculate Altera margins at ~11%, well below Constellation's consolidated margin, as the company works to put Altera on its business model.

Free Cash Flow Was Solid: Free cash flow available to shareholders (FCFA2S) was \$290MM, up 19% Y/Y. Altera contributed \$60MM to FCFA2S, up significantly from \$24MM in the prior quarter. Acquisition spending of \$207MM was in line with our expectations.

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Outperformer

CSU-TSX, Sector: Information Technology

Current Price (3/29/23): C\$2,432.55

Price Target (12-18 mos.): ↑ C\$2,450.00

Previous: C\$2,407.32

CIBC Estimates and Valuation

(Dec. 31)	2021	2022	2023	2024
EPS diluted	7.97A	26.00A	44.32E	53.23E
Prior	7.84A	24.06E	40.06E	51.02E
EBITDA(mln)	1,511.0A	1,699.0A	2,008.8E	2,263.8E
Prior		1,642.1E	1,895.8E	2,219.5E

EPS diluted	Q1	Q2	Q3	Q4
2022	5.24A	6.32A	6.75A	7.69A
Prior	5.15A	6.21A	6.63A	6.07E
2021	(8.26)A	3.68A	5.71A	6.84A
Prior	(8.11)A	3.62A	5.61A	6.72A

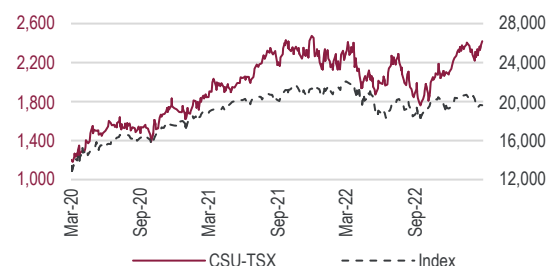
EBITDA(mln)	Q1	Q2	Q3	Q4
2022	373.0A	410.0A	419.0A	496.0A
Prior				440.1E
2021	348.0A	366.0A	387.0A	410.0A

Valuation	2021	2022	2023	2024
EV/EBITDA	19.8x	17.6x	14.9x	13.2x

Stock Performance and Key Indicators

Avg. Dly. Vol.:	32K	Shares O/S:	21.2M
Market Cap.:	C\$51,570M	Float:	14.5M
52-wk Range:	1,784.68 - C\$2,439.90	Div. / Yield:	C\$7.28/0.30%

TSX Composite Index vs. CSU-TSX



(Source: FactSet)

All figures in US dollars unless otherwise stated (C\$1.359: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.

Constellation Software Inc. (CSU-TSX) — Outperformer

Price (3/29/23) C\$2,432.55 12-18 mo. Price Target C\$2,450.00

Sector: Information Technology

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Peer Comparison	2021	2022	2023E	2024E
P/E - Canadian Consolidators	10.4x	-	-	-
EV/EBITDA - Canadian Consolidat	29.5x	26.0x	26.0x	26.0x
EV/Sales - Canadian Consolidators	11.1x	10.0x	10.0x	-
Key Financial Metrics	2021	2022	2023E	2024E
Free Cash Flow	1,271	1,256	1,802	1,668
Sales Growth	28.6%	29.7%	18.6%	12.9%
Per Share Data	2021	2022	2023E	2024E
FCFPS	59.98	59.27	85.04	78.72
Diluted EPS	7.97	26.00	44.32	53.23
Adj. EPS Dil.	31.14	57.05	61.92	70.82
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	1,342	1,611
Tax Expense	206	175	403	483
Adjusted Net Income	660	1,209	1,312	1,501
Adjusted Net Margin	12.9%	18.3%	16.7%	16.9%
Cash Flow Statement	2021	2022	2023E	2024E
Net CFO	1,300	1,297	1,826	1,692
Capex	(29)	(41)	(24)	(24)
Acquisitions	(1,216)	(1,566)	(800)	(800)
Free Cash Flow	1,271	1,256	1,802	1,668
Balance Sheet	2021	2022	2023E	2024E
Cash & ST Investment	763	811	1,728	2,512
Intangible Assets	3,428	4,679	4,679	4,679
Goodwill	0	0	400	800
Total Assets	5,766	7,882	9,262	10,707
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	2,787	3,831

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\$2,450.00

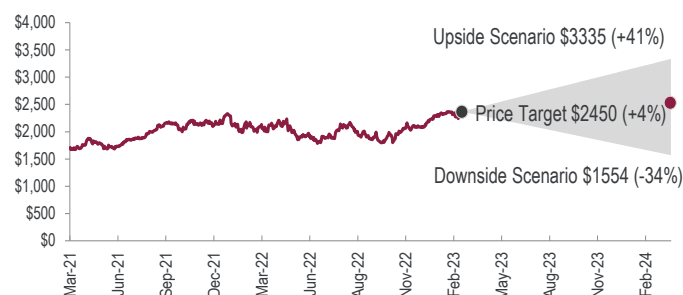
Our C\$2,450 price target is based on a sum-of-the-parts. We value CSU (ex-TOI) at 20x forward EBITDA multiple, a premium to enterprise software peers, and CSU's 30.35% ownership of TOI at market value.

Upside Scenario: C\$3,335.00

Our C\$3,335 upside scenario is based on a sum-of-the-parts. We value CSU (ex-TOI) at 25x 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.



Financial Summary

Constellation reported solid Q4 results, with revenue of \$1,847MM 4% ahead of CIBCe (\$1,770MM) and 3% above consensus (\$1,788MM). EBITDA of \$496MM was 13% above CIBCe (\$440MM) and 7% above consensus (\$464MM). EBITDA margins of 26.9% were ~90bps above consensus and 200 bps above us.

Exhibit 1: Constellation Software – Financial Summary, Q4/22

	Q4/F22						
	Actual	CIBCe	Cons	Q4/F21	Y/Y%	Q3/F22	Q/Q%
Consolidated							
Revenue	1,847	1,770	1,788	1,383	34%	1,725	7.1%
License	100	80	NA	81	23%	79	26.6%
Maintenance	1,269	1,288	NA	967	31%	1,217	4.3%
Professional Services	396	345	NA	286	38%	375	5.6%
Hardware and Other	82	57	NA	49	67%	54	51.9%
EBITDA	496	440	464	410	21%	419	18.4%
EBITDA Margin	26.9%	24.9%	26.0%	29.6%	-9.4%	24.3%	10.6%

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

Constant-currency organic growth in the quarter was 4%, down from 5% Y/Y in Q4/21, but up sequentially from 2%. Maintenance organic growth of 6% was flat Y/Y and up 100bps from the prior quarter.

Changes To Our Model: We have updated our model to reflect Q4 results and the current outlook.

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

	Revenues (\$ mln.)	EBITDA (\$ mln.)	CFO (\$ mln.)
2022A	6,622	1,699	1,297
2023E			
CIBC est. – new	7,856	2,009	1,826
CIBC est. – prior	7,393	1,896	1,511
Consensus	7,681	2,014	1,699
2024E			
CIBC est. – new	8,867	2,264	1,692
CIBC est. – prior	8,690	2,219	1,715
Consensus	8,801	2,317	1,888

Source: Company reports and 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
Sep 28, 2022

Momentum



Sustainalytics ESG Risk Rating Ranking

UNIVERSE	RANK (1 st = lowest risk)	PERCENTILE (1 st = lowest risk)
Global Universe	8271/14667	57th
Software & Services INDUSTRY	903/1000	90th
Enterprise and Infrastructure Software SUBINDUSTRY	412/419	98th

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	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	8	0	Value	181	+3
Momentum	4	0	Momentum	111	-17
Quality	1	0	Quality	1	0
Market	2	+1	Market	38	+3
Low Volatility	3	+1	Low Volatility	99	+6
Growth	9	-1	Growth	96	0

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	-4	Momentum	C
Beta	0.99	MACD	C
Volatility	↑	Alpha (Sector)	A
Trend	↓	Alpha (Index)	B
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\$2,450 price target is based on a sum-of-the-parts methodology. We value CSU (ex-TOI) at 20x forward EBITDA multiple, a premium to enterprise software peers, and CSU's 30.35% ownership of TOI at market value.

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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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.
Not Rated	NR	CIBC World Markets does not maintain an investment recommendation on the stock.
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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	131	44%	Neutral	130	99%
Underperformer	7	2%	Underperformer	6	86%
Tender	2	1%	Tender	2	100%
Restricted	12	4%	Restricted	12	100%

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