

EQUITY RESEARCH

September 22, 2022

Flash Research

CONVERGE TECHNOLOGY SOLUTIONS CORP.

To Acquire Stone Group For C\$60 Million

Converge announced the acquisition of Stone Group for \$59.6MM or ~6.6x TTM EBITDA. Headquartered in the UK, Stone Group is an IT solutions provider for education institutions as well as public and private sector organizations in the UK. Converge is acquiring an 89% stake of the company, and the transaction, which is subject to conditions including regulatory approval, is expected to close in Q4/22. The 6.6x EV/EBITDA multiple is above Converge's typical 5x, with management continuing to build out Converge's European/UK business. Post the transaction, Converge has exceeded its target of acquiring \$1B in gross revenue in 2022, and we calculate net debt of ~\$88MM or 0.7x leverage.

Key Highlights

Target Overview: Headquartered in the UK, Stone Group focuses on IT support services for the education and healthcare sectors in the UK and EU. The company offers a range of services and solutions across network and cabling, managed services and cloud computing. This acquisition will strengthen the MSP and Cloud offering for Converge's European customers. The target generated revenue of \$212.9MM and EBITDA of \$9.0MM in the TTM period (4.2% EBITDA margin). In addition to the cash purchase price of \$59.6MM, Converge expects to pay out positive net working capital at transaction close.

Acquisitions Target Met For F22 – Focus Turns To Integration: With this acquisition, CTS has acquired ~\$1.1 billion in gross revenue YTD, above management's \$1B target. We expect the focus for the remainder of the year and H1/23 to be on integration, logo growth, and cross-selling. We do expect Converge to resume its acquisition strategy of \$1 billion spend in H2/23, giving the company the next three quarters to focus on acquisition integrations.

Acquisition Structure & Financing: The purchase price of \$60MM will be for an 89% stake in the company, with Converge requiring key management at Stone Group to reinvest a portion of the proceeds from the sale of their shares into a new Converge UK Holding Company. CTS will have the option to acquire the minority stake after a period of three years. The transaction will be financed by Converge's global revolving credit facility (available credit of \$500MM). Post this acquisition, we calculate that Converge will have net debt of ~\$88MM with leverage of 0.7x. We are forecasting \$43MM in free cash flow for the remainder of the year, suggesting the company will remain comfortably below its targeted 2x leverage range in the absence of additional acquisitions.

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Neutral

CTS-TSX, Sector: Information Technology
Current Price (9/22/22): C\$6.03
Price Target (12-18 mos.): C\$8.00

All figures in Canadian dollars unless otherwise stated.

Please see "Price Target Calculation and Key Risks to Price Target" information on page 2.
For required regulatory disclosures please refer to "Important Disclosures" beginning on page 3.

Price Target Calculation

We derive our price target of \$8.00 by applying a 9x EV/EBITDA multiple to our 2023E EBITDA estimate based on the current capital structure. The 9x multiple is in line with hardware VAR peers.

Key Risks To Price Target

The primary risks to our price target include the following: 1) the company's ability to acquire ITSPs at reasonable valuation; 2) increasing competition from other IT solutions providers; 3) volatility in the global IT environment; 4) the company's ability to partner with leading technology providers; 5) the loss of key management or other employees.

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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.
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.
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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

For price and performance charts, please visit CIBC on the web at <https://researchcentral.cibccm.com/#/disclaimer-central-new> or write to CIBC World Markets Inc., 161 Bay Street, 4th Floor, Toronto, ON M5H 2S8, Attn: Research Disclosure Chart Request.

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