

EQUITY RESEARCH

September 6, 2023

Earnings Update

DESCARTES SYSTEMS GROUP INC.

FQ2/2024 Slightly Mixed Amid A Muted Freight Environment

Our Conclusion

Descartes reported a slightly mixed FQ2, with revenue 3% above expectations but adj. EBITDA in line. Margins were 100 bps below consensus as Descartes continues to integrate its GroundCloud acquisition. Organic constant currency Services growth remained stable sequentially at 9% Y/Y, although overall constant currency revenue growth dipped to 6% given Y/Y declines in non-core license revenue. Management noted the possibility of a more muted holiday season and provided a calibration that suggests slower Q/Q growth. With Descartes trading at a ~1.5x EV/S premium to logistics peers, we see the stock as relatively fairly valued at these levels and retain our Neutral rating and \$76 price target.

Key Points

FQ2/24 Results: Revenue of \$143MM was slightly above consensus (\$139.9MM), while adjusted EBITDA of \$61MM was roughly in line. Revenue was up 17% Y/Y and ~6% Y/Y on a constant-currency organic basis. Constant currency Y/Y organic growth was down slightly from 7% sequentially. Services constant currency organic growth was ~9%, flat sequentially and above Descartes' historic mid-single-digit organic growth. Adj. EBITDA margins of 42% were down 200 bps Y/Y and 100 bps below consensus amid the GroundCloud integration. Descartes recorded \$52MM in cash flow from operations, up 12% Y/Y, representing an 85% adj. EBITDA to cash conversion, the low end of Descartes 85%-90% target.

Muted Freight Activity Expected In The Near Term: E-commerce volumes have been normalizing post-pandemic, with reduced flow through the Panama Canal and recent bankruptcies in the trucking industry leading to the potential for further capacity constraints. We expect these issues to continue to be a headwind to volume growth, with roughly 40% of Descartes revenue volume based. While contracts typically have guaranteed minimums (usually 85%-90% of typical volumes), Descartes typically has not enforced guaranteed minimums in prior downturns, instead focusing on winning additional business from the client to meet minimum spend commitments. If the freight industry continues to see headwinds, we would expect Descartes to employ a similar strategy of cross-selling and M&A to offset weaker organic revenue growth.

Calibration Implies A Q/Q Growth Deceleration: Management noted the potential for a "more muted" peak season this year given the industry issues noted above, higher interest rates, and uncertain consumer sentiment. The company's revenue calibration for FQ3 implies a 1% sequential revenue increase (versus a 5% increase for FQ2), with sequential EBITDA growth of 3% consistent with last quarter's calibration (the implied margin calibration is up 100 bps Q/Q) as the company continues to integrate GroundCloud. GroundCloud margins were up slightly sequentially in FQ2 (we estimate in the ~30% range) as the integration continues.

All figures in US 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.

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Neutral

DSGX-NASDAQ, Sector: Information Technology

Current Price (9/1/23): US\$75.51

Price Target (12-18 mos.): US\$76.00

CIBC Estimates and Valuation

(Jan. 31)	2022	2023	2024	2025
EPS diluted	1.00A	1.18A	1.29E	1.49E
Prior			1.32E	1.56E
Adj. EBITDA(mln)	185.1A	215.2A	243.9E	276.6E
Prior			243.6E	278.2E

EPS diluted	Q1	Q2	Q3	Q4
2024	0.34A	0.32A	0.31E	0.32E
Prior		0.31E	0.33E	0.35E
2023	0.27A	0.27A	0.31A	0.34A

Adj. EBITDA(mln)	Q1	Q2	Q3	Q4
2024	57.7A	60.6A	61.9E	63.8E
Prior		59.6E		64.4E
2023	51.2A	54.0A	54.5A	55.4A

Valuation	2022	2023	2024	2025
P/E	75.4x	63.9x	58.6x	50.6x
EV/EBITDA	32.5x	28.0x	24.7x	21.8x
P/FCF	37.3x	34.4x	32.4x	29.8x

Stock Performance and Key Indicators

Enterprise Value	US\$6,020M	Shares O/S:	85.1M
Market Cap.:	US\$6,425M	Float:	84.5M
52-wk Range:	JS\$62.22 - US\$81.66	Div. / Yield:	NIL/NIL

DSGX-NASDAQ



(Source: FactSet)

Descartes Systems Group Inc. (DSGX-NASDAQ) — Neutral

Price (9/1/23) US\$75.51 12-18 mo. Price Target US\$76.00

Sector: Information Technology

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Peer Comparison	2022	2023	2024E	2025E
EV/EBITDA - Logistics/Supply C	26.2x	25.8x	27.3x	-
EV/EBITDA - Descartes	28.7x	25.3x	22.3x	-
EV/Sales - Logistics/Supply Cha	11.7x	9.7x	8.3x	-
EV/Sales - Descartes	12.7x	10.8x	9.8x	-
Key Financial Metrics	2022	2023	2024E	2025E
Sales Growth	21.8%	14.4%	17.8%	9.4%
Per Share Data	2022	2023	2024E	2025E
FCFPS	2.03	2.20	2.33	2.54
Diluted EPS	1.00	1.18	1.29	1.49
Wgt Avg # of Shares	84.6	84.8	85.1	85.7
FD Number of Shares	86.2	86.5	86.8	87.2
Income Statement	2022	2023	2024E	2025E
Revenue	425	486	572	626
Gross Profit	323	373	431	470
Tot Operating Exp	154	177	210	217
OpEx (% of Revenue)	36.24%	36.34%	36.64%	34.68%
Adj. EBITDA	185	215	244	277
Adj EBITDA Margin	43.6%	44.3%	42.6%	44.2%
D&A	(64)	(65)	(65)	(63)
Net Interest Income	(1)	3	2	1
Pretax profit	103	134	160	196
Tax Expense	16	31	48	66
Net Income	86	102	112	130
Net Margin	20.3%	21.0%	19.6%	20.8%
Cash Flow Statement	2022	2023	2024E	2025E
Net CFO	176	192	205	223
Capex	(5)	(6)	(6)	(6)
Free Cash Flow	171	186	199	217
Balance Sheet	2022	2023	2024E	2025E
Cash & ST Investment	213	276	289	435
Intangible Assets	230	230	292	315
Goodwill	609	676	765	765
Total Assets	1,185	1,316	1,471	1,646
ST Int-Bearing Debt	0	0	0	0
Total Liabilities	186	217	233	251
Shareholders' Equity	1,000	1,099	1,238	1,395

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

Company Profile

Descartes is a provider of value-added IT solutions to the logistics and transportation markets. The company primarily offers its solutions through a pay-for-use arrangement rather than up-front license fees

Investment Thesis

We see growth opportunities in several areas: 1) introducing new services; 2) consolidating a highly fragmented market; 3) increasing customer share of wallet, converting in-house processing

Price Target (Base Case): US\$76.00

Our Price Target is calculated using 11% revenue growth, 45% EBITDA margins and a 22.5x EV/EBITDA multiple

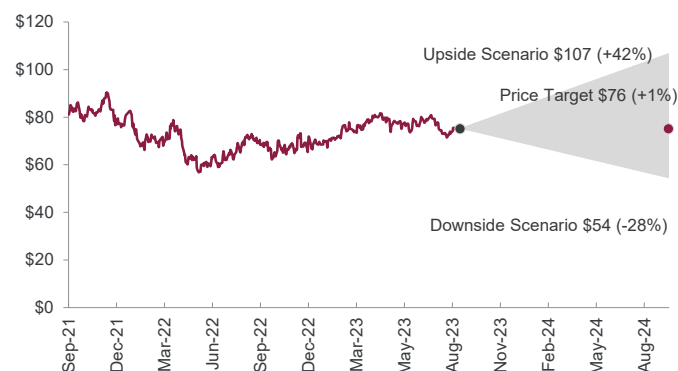
Upside Scenario: US\$107.00

Our upside scenario is calculated using 17% revenue growth, 46% EBITDA margins and a 29.5x EV/EBITDA multiple

Downside Scenario: US\$54.00

Our downside scenario is calculated using 5% revenue growth, 38.3% EBITDA margins and a 19.50x EV/EBITDA multiple

Scenario Analysis:



Financial Summary

Revenue: Revenue of \$143.4MM was up 17% Y/Y and up 5% sequentially given recent acquisitions, organic growth and a normalizing FX environment. Services revenue of \$130.7MM was up 20% Y/Y and comprised 91% of total revenue. Professional Services and other revenue of \$11.3MM and license revenue of \$1.4MM were up 9% and down 57% Y/Y, respectively.

Profitability: Adjusted EBITDA of \$60.6MM was up 12% Y/Y and up 5% sequentially. Adjusted EBITDA margin was 42%, compared to 44% in Q2/F23 and 42% in Q1/F24, down 200 bps Y/Y. Descartes maintained its adj. EBITDA margin guidance at 40%-45% for F2024 and reiterated its focus on 10%-15% annual adj. EBITDA growth from both organic and inorganic sources.

Cash Flow: Cash provided by operating activities was \$52 million, up 12% from \$46 million in the year ago period and up from \$49 million in the previous quarter. DSG continues to expect conversion of 85% to 90% in the subsequent quarters. The company exited the quarter with \$227MM in cash and \$350MM available on the line of credit, which can be extended to \$500MM to execute on its capital allocation strategy.

Exhibit 1: DSG – Financial Summary Q2/24

	Q2-F2024			Q2-F2023	Y/Y%	Q1-F2024	Q/Q%
	Actual	CIBCe	Cons				
Consolidated							
Revenue (\$MM)	143.4	138.6	139.9	123.0	17%	136.6	5%
License	1.4	1.7	1.3	3.3	-57%	1.0	46%
Professional Services	11.3	10.4	11.6	10.4	9%	11.5	-2%
Services	131	127	127	109	20%	124	5%
EBITDA (\$MM)	60.6	59.6	60.1	54.0	12%	57.7	5%
EBITDA Margin	42%	43%	43%	44%	-4%	42%	0%
EPS	0.32	0.31	0.33	0.27	22%	0.34	-4%

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

Changes To Our Model: We have updated our model for FQ2/24 results, and have made minimal other changes to our estimates.

Exhibit 2: Changes To Our Model 2023A-2025E

	Revenues (\$MM)	EBITDA (\$MM)	EPS	CFO (\$MM)
2023A	486	215	1.18	192
2024E				
CIBC est. – new	572	244	1.29	205
CIBC est. – prior	564	244	1.32	196
Consensus	551	241	1.41	194
2025E				
CIBC est. – new	626	277	1.49	223
CIBC est. – prior	621	278	1.56	224
Consensus	605	272	1.65	233

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

Environmental, Social and Governance (ESG) Metrics for DSGX-NASDAQ

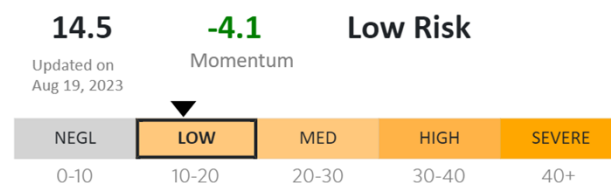
CIBC ESG Metrics

Governance Metrics	2017	2018	2019	2020	2021
Insider Ownership	0.4%	0.4%	0.3%	0.3%	0.4%
Board Gender Diversity	25.0%	25.0%	25%	25%	25%
Separation of Chair & CEO	YES	YES	YES	YES	YES
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*	\$1.4	\$1.2	\$1.4	\$1.2	\$1.6
Diversity Targets	NO	NO	NO	NO	NO
Women Managers	NA	NA	14%	0%	17%
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



Sustainalytics ESG Risk Rating Ranking

UNIVERSE	RANK (1 st = lowest risk)	PERCENTILE (1 st = lowest risk)
Global Universe	1354/15361	10th
Software & Services INDUSTRY	53/1063	6th
Enterprise and Infrastructure Software SUBINDUSTRY	19/435	5th

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	62.7 Strong	3.4 Low	23.1%
Human Capital	7.2 Medium	32.0 Average	5.0 Medium	34.4%
Product Governance	1.9 Low	6.0 Weak	1.8 Negligible	12.3%
Business Ethics	2.7 Low	46.2 Average	1.5 Negligible	10.4%
Data Privacy and Security	7.2 Medium	75.0 Strong	2.9 Low	19.8%
Overall	28.0 Low	51.6 Strong	14.5 Low	100%

CIBC Quantitative Scorecard

Within Sector			Within S&P/TSX Comp.		
Style	Rank	Delta	Style	Rank	Delta
Value	7	0	Value	192	+1
Momentum	7	+1	Momentum	85	-20
Quality	5	-1	Quality	47	+3
Market	6	0	Market	129	-2
Low Volatility	6	-2	Low Volatility	111	-6
Growth	6	-1	Growth	60	-1

Note: Ranking out of 11 stocks

Note: Ranking out of 227 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	-3	Momentum	D
Beta	0.92	MACD	C
Volatility	↗	Alpha (Sector)	D
Trend	↓	Alpha (Index)	C
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 \$76 by applying a multiple of 22.5x to our F2025E EBITDA using the current capital structure. The multiple is in line with logistics software peers. This is supported by a discounted cash flow (DCF) using a 7.01% WACC with 2.3% terminal growth.

Key Risks To Price Target

The primary risks to our price target include the following: 1) economic slowdown; 2) competition; 3) commoditization and price pressure; and 4) changing technology and industry dynamics.

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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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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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Restricted	10	3%	Restricted	10	100%

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