

EQUITY RESEARCH

November 9, 2023

Flash Research

SOFTCHOICE CORPORATION

Q3/23 First Look: Growth In Software & Services, Cost Containment More Than Offsets Ongoing Hardware Weakness

Our Conclusion

Softchoice reported better-than-expected Q3 results, with gross profit that was 1.5% above consensus and adjusted EBITDA that was 24% above consensus. Net revenue was down 18% Y/Y as hardware demand remains weak, but growth in higher-margin software & cloud/services sales resulted in 3.2% Y/Y gross profit growth. Adjusted EBITDA grew a notable 49% Y/Y as operating leverage and cost containment efforts had a much larger-than-expected impact. On the call at 8:30 a.m. today, we expect the focus to be on the demand environment (particularly the SMB and Commercial spending outlook), whether cost-containment measures can continue to drive Adj. EBITDA margin expansion and additional details on the GenAI opportunity.

Key Highlights

Q3/23 Results: Net revenue of \$182MM was below consensus (\$195MM), with the miss driven by a 29% Y/Y decline in gross Hardware sales and a 12% Y/Y decline in Services sales. On the more important gross profit line, Softchoice reported \$78.2MM, 1.5% ahead of consensus and 3.5% above our estimate (\$77.0MM/\$75.6MM) and up 3.2% Y/Y. Software & Cloud gross profit of \$53.2MM was up 8% Y/Y, Services gross profit of \$7.9MM was up 51.4% Y/Y, and Hardware gross profit of \$17.2MM was down 19.9% Y/Y. Gross profit for Enterprise customers declined 10% Y/Y. Revenue retention decreased to 94% compared to 102% in the TTM period ending Q2/23. Customer count increased to 4,938 as of Q3/23, up 4.7% Y/Y.

EBITDA Margin: Adjusted EBITDA of \$22.7MM was 24% above consensus (\$18.3MM) and 18% above our estimate (\$19.3MM). The adjusted EBITDA margin (as a percentage of gross profit) was 29.0%, 520 bps above consensus of 23.8% and 450 bps above our estimate of 25.5%. Adjusted EBITDA margin as a percentage of gross profit was up 880 bps Y/Y, with operating leverage and cost containment the drivers of margin expansion.

Capital Allocation: Net cash provided by operating activities was negative \$11.2MM, up from negative \$58.9MM last year. Before working capital changes, CFO was \$16.7MM, up notably from \$2.5MM in the previous year. The company repurchased 51K shares in the quarter for total spending of \$0.58MM.

Conference Call Details: Management will host a conference call to discuss results today at 8:30 a.m. ET. Dial-in: [Webcast](#).

Stephanie Price, CFA
Analyst
+1 416-594-7047
Stephanie.Price@cibc.com

Scott Fletcher, CPA, CA
Analyst
+1 416-956-3229
Scott.Fletcher@cibc.com

Erin Kyle, CPA
Associate
+1 416-313-9851
Erin.Kyle@cibc.com

Sam Schmidt, CPA
Associate
+1 416-980-5448
sam.schmidt@cibc.com

Neutral

SFTC-TSX, Sector: Information Technology

Current Price (11/8/23): C\$17.70

Price Target (12-18 mos.): C\$17.50

All figures in US dollars unless otherwise stated (C\$1.380:US\$1.00).

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.

Exhibit 1: SFTC – Financial Summary, Q3/23

	Q3-F2023			Q3-F2022	Y/Y%	Q2-F2023	Q/Q%
	Actual	CIBCe	Cons.				
Consolidated							
Net Revenue (\$MM)	182	199	195	222	-18.0%	208	-12.2%
Gross Profit (\$MM)	78.2	75.6	77.0	75.8	3.2%	82.9	-5.7%
Gross Profit Margin	42.9%	38.0%	39.5%	34.1%	25.8%	40.0%	7.4%
Adj. EBITDA (\$MM)	22.7	19.3	18.3	15.3	48.6%	24.9	-8.9%
Adj. EBITDA as a % of GP	29.0%	25.5%	23.8%	20.2%	44.0%	19.5%	48.9%
Adjusted EPS	\$0.23	\$0.13	\$0.17	\$0.14	66.2%	\$0.23	-0.1%

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

Price Target Calculation

We derive our price target of \$17.50 by applying a 9.5x EV/EBITDA multiple to our 2024E EBITDA estimate based on the current capital structure. The 9.5x 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

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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