



Constellation Software (OTCMKT: CNSWF)

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CONSTELLATION
SOFTWARE
INC.

I. Investment Overview

Buy CNSWF at 1.5% allocation (FVE: \$2106.01 , Implied Upside: 22.44%)

Wide Moat Provides High Margin of Safety

- As the leader in the vertical market software industry, **strong brand name** and **market position** gives Constellation more reach and influence in various, emerging industries
- **Sticky** and **recurring revenues (over 70%)** due to the nature of the software business and **importance of VMS for niche businesses (90% of customers stay)**
- Focus on customer service and support provides increased loyalty and switching costs, making customers unlikely to switch

Serial Acquirer with Long Track Record of Success

- Constellation is an **acquisition-driven compounder**, owning and operating hundreds of decentralized VMS businesses
- Great track record of acquiring **undervalued, profitable** software companies and integrating them into their business
- VMS businesses do not require much capital to operate so excess cash flows are redeployed quickly which has created **an acquisition engine producing ROIC of 25%+**

Strong and Experienced Management Team

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- Exemplary capital allocation methods that are **value-oriented** and **decentralized**, which involves **making dozens of small investments in companies at 1/2x multiples**
- Constellation's employment structure is **highly aligned with shareholders** with 0 stock-based compensation and requirements of salary to be reinvested in shares

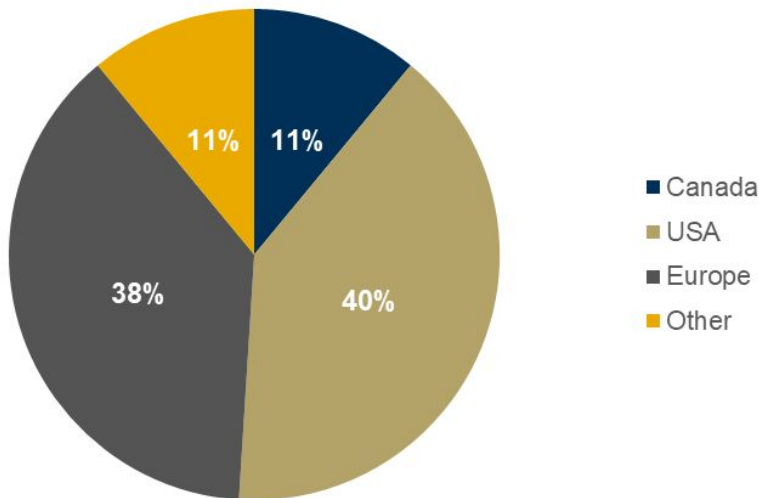
Business Description

- Constellation Software is a Canadian based company that develops and customizes software for the public and private markets.
- The firm has an **acquisitive nature**, completing over **500 acquisitions** in the past decade, in which they manage and build vertical-specific businesses.
- **Subsidiaries are given autonomy** to grow and operate independently while Constellation provides them **operational advice** and **financial support**.
- The company is **organized into two segments**: Public Sector and Private Sector. The company was founded in 1995 and headquartered in Toronto, Canada.

Key Statistics

GICS Sub-Industry	Application Software
Market Cap	\$37.49B
Revenue	\$8.3832B
Current Price	\$1696.64
52-Week Range	\$1850.16 / \$1280.00
Beta	0.88
Dividend Yield	0.20%
Credit Rating	B+

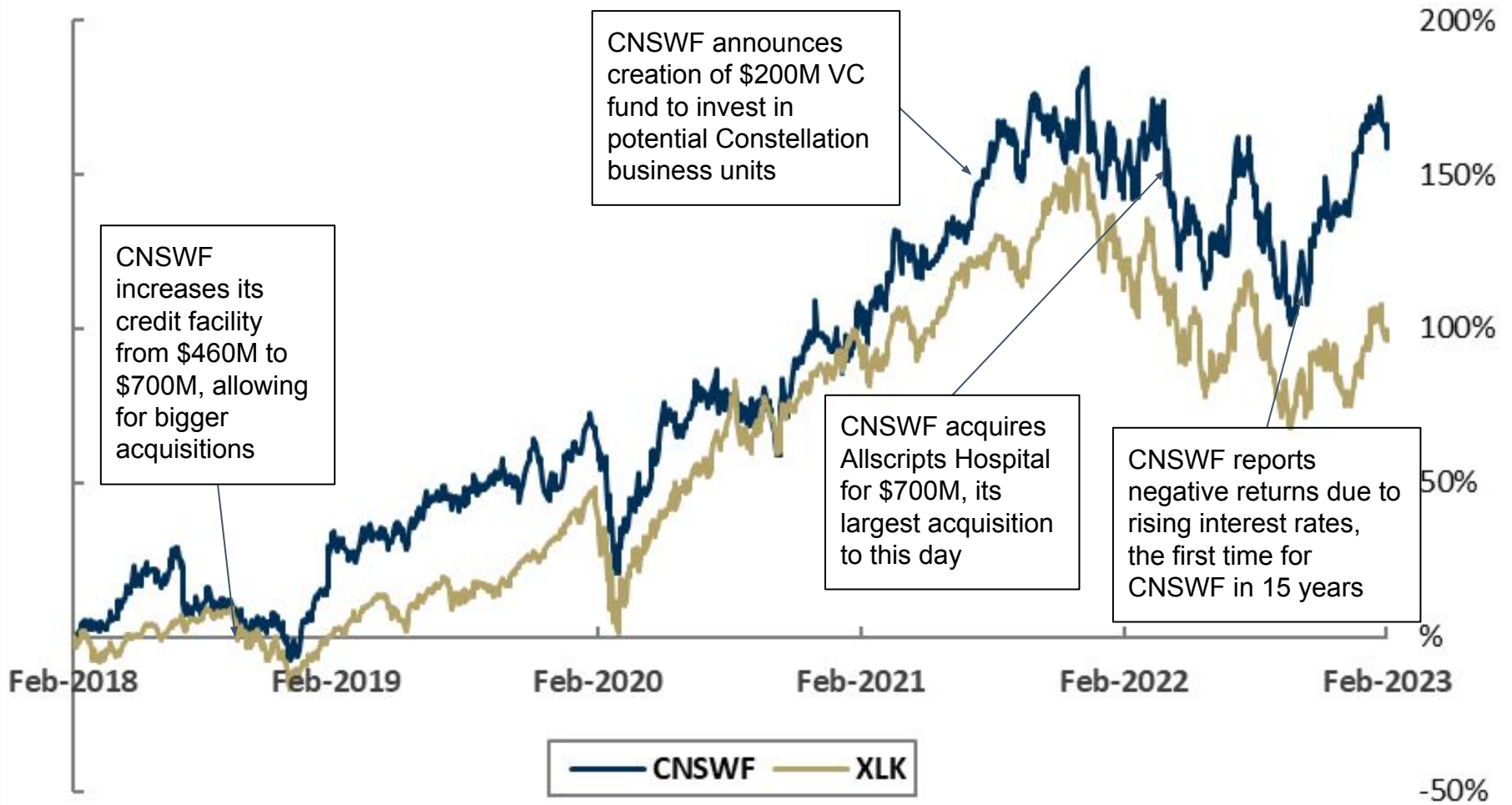
Geographic Breakdown



Operating Structure



5 Year Stock Performance





Mark Leonard, President and Founder of Constellation

- Founded Constellation in 1995 with \$25M in capital and built a multi-billion dollar business through disciplined and strategic investing; 28 years of experience leading the company
- Known on the street as a “Warren Buffet Lite”, as his focus is on deploying as much free cash flow (no dividend) as possible through the acquisition engine that creates these great returns on capital
- 430,332 shares; 2.03% stake



Mark Miller, Director & COO of Constellation, CEO of Volaris Group

- Has held positions with Constellation and subsidiaries for over 20 years
- CEO of Volaris, a buy-and-hold acquirer of software business. Decades of experience with vertical markets and acquisitions
- 279,508 shares; 1.32% stake

Sequoia Fund - Hold .005% of shares and 6% of their portfolio

- Purchased in 2015 and has consistently increased their stake in the company as a passive investment
- Huge believer in CEO Mark Leonard and the firm’s ability to continue executing its acquisition strategy
- The fund loves the nature of VMS businesses since they are a necessity (safety), highly profitable, and there is a major pool of potential acquisitions for the future



“We are often wary of acquisition-driven growth strategies, but Constellation is an exceptional acquirer. For over twenty years, founder and CEO Mark Leonard has managed to maintain, in the face of ever-increasing scale, high rates of acquisition-led growth accompanied by high rates of return on acquisitions. Constellation’s track record puts it in rare company, alongside some of history’s greatest acquisition-led compounders.” - Sequoia Investment Committee

II. Business Analysis

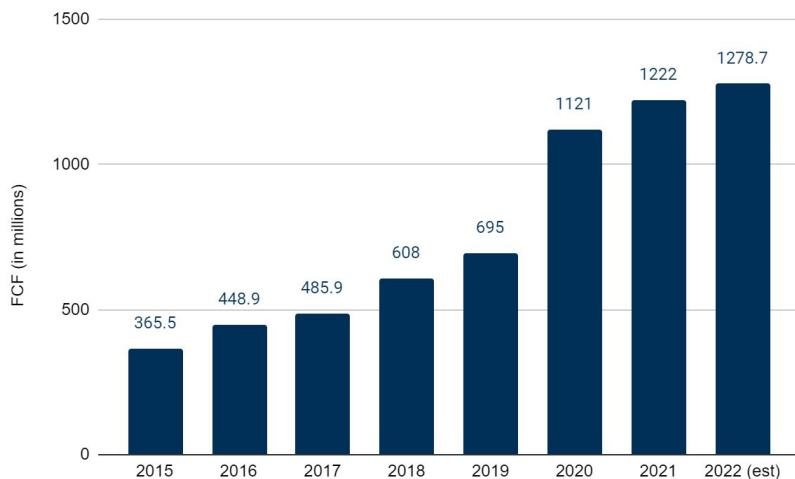
Business Model

- **Serial Acquirer** of hundreds of VMS companies
- **Reputation of decentralization and business retention** allows CNSWF to acquire companies at **lower multiples**
- **Use free cash to acquire more companies**
- **No stock based compensation**, forced after-tax bonus investment into common shares **for employees**
- **Have strict hurdle rates (25%)**, management looking at easing this to acquire larger companies as portfolio grows

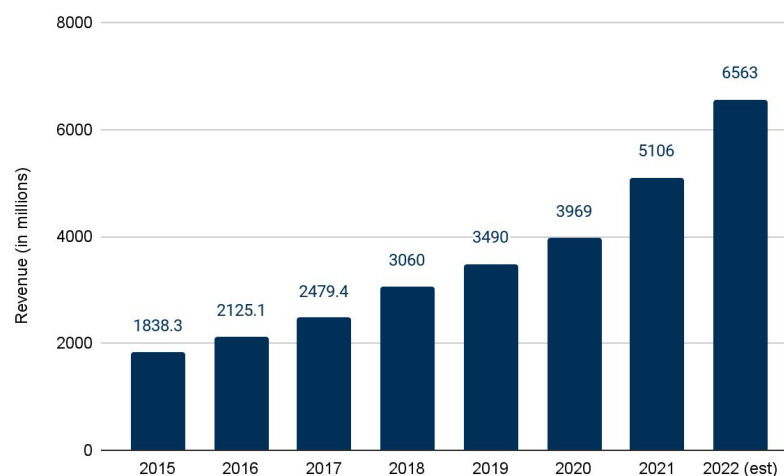
Wide Moat and Reputation

- **Reputation as a hands-off acquirer, attracting lower multiples (1-2x instead of industry average of 5.8-6.2x)**
- **Massive data pool**, giving CNSWF an information advantage on competing private equity firms
- **Reputation as a VMS-industry acquirer with a proven track record of success for incoming companies**
- CNSWF have **only sold one company**, which management publicly regrets

FCF by Year



Revenue by Year



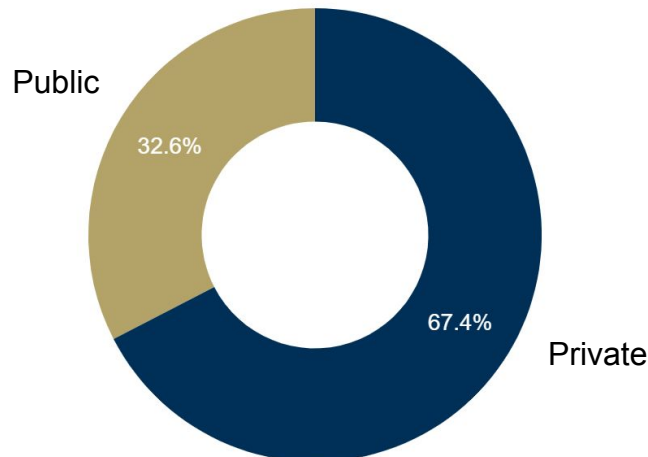
Data Advantage

- Companies report tons of data to their operating segments
- Constellation uses **data based technology** to constantly benchmark and inform acquisition and strategy decisions
- Allows CNSWF to find **'hidden gem' acquisitions** (not profitable, etc.) through data comparison
- **Data-backed acquisition strategy** allows CNSWF to **avoid competition** and pay **lower multiples** for 'hidden-gems'

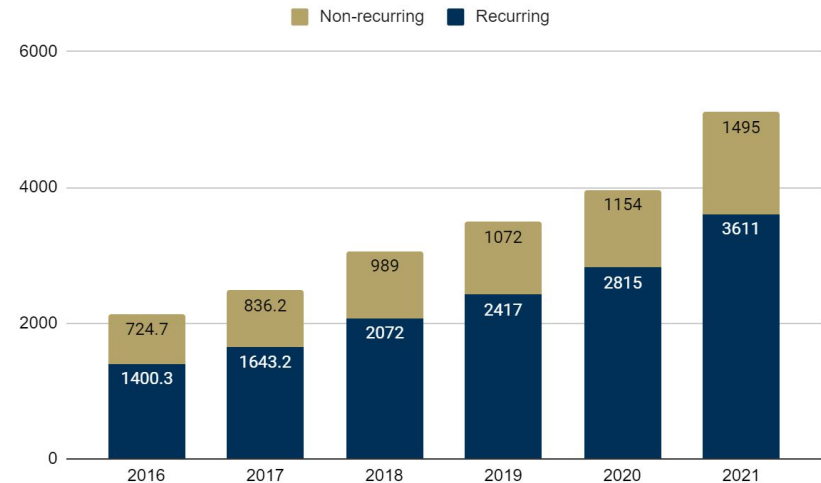
Decentralization

- **Six major operating segments that further decentralize into hundreds of autonomous business units**
- Acquisition decisions are delegated to segments (up to a threshold) enabling decision **agility and avoiding bottlenecks**
- Acquired businesses are given a high degree of **autonomy**
- Increases in **derivative, FX, and commodity activity/prices** drives revenue across the group

Segment Revenue Breakdown



Recurring v. Non-recurring Revenue



Acquisition Overview

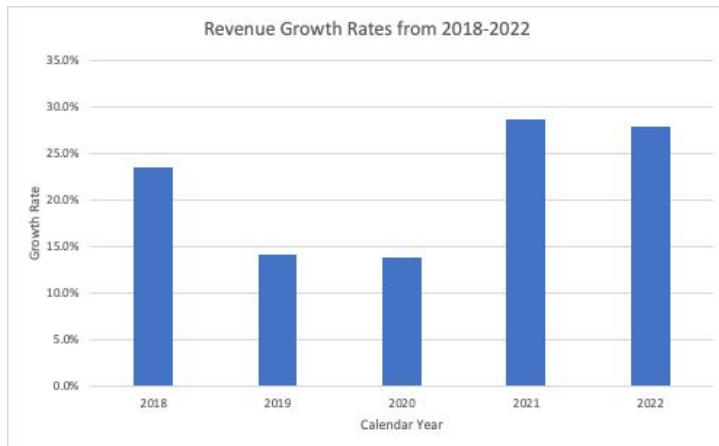
- CNSWF acquires, manages, and builds vertical market software
- The company operates on a **three-prong acquisition strategy**
 - Acquiring businesses with **growth potential**
 - **Managing** them well and **scaling** them
 - Generate **significant cash flow** and revenue growth
- Highly successful model with a solid track record of success

Acquisition Criteria

Mostly makes 100% control acquisitions, but will take less if the business is large and very attractive

- Mid-to-large sized software companies with a **minimum of \$1 million EBIT**
- Consistent earnings and growth, usually **greater than 20% per year**
- **Experienced** and **committed** management team
- **Large** market share holder
- **Diverse** customer base

Revenue Growth Rates



Consistent revenue growth (organic + non-organic)

Notable Acquisitions



CNSWF purchased FICO's Collection and Recovery Business



CNSWF purchased SSP, a supplier of software for casualty insurance companies



CNSWF purchased Topicus, a mission-critical software provider

Compensation Objectives

- Designed to **attract** and **retain** highly skilled executives
- Major focus on creating **long-term value**
- Two main performance metrics: **return on invested capital** and **revenue growth**
- **Base Salary**: set by board committee based on responsibilities and skills
- **Annual Incentive Bonus**: rewards employees for increasing shareholder value

Annual Incentive Bonus

- Executives are assessed based on **individual** performance and **company** performance
- Executive officers are **required** to invest **75%** of their incentive bonus into CNSWF shares
- Cannot be sold for until **four years** after purchase
- Designed to encourage **long-term decision making** and **ownership**

Stock Ownership by Insiders

Person	Role	Value of Stake
Mark Leonard	Founder and CEO	\$1B
Barry Symons	Executive	\$355M
Mark Miller	Executive	\$648M
Dexter Salna	Executive	\$584M
Jeff Bender	Executive	\$181M

Well-invested management team with significant equity stakes

Commentary on Mark Leonard

- Founder and CEO Mark Leonard **does not** take a salary or bonus
- Has a **significant equity stake** in the company
- He is a **former venture capitalist** with a keen eye for finding great companies



III. Valuation

Company	Market Cap	5 Year Rev CAGR	P/E	Net Debt/ EBITDA	EBITDA Margin	FCF Yield	ROIC
Constellation Software	\$37.49B	22.1%	76.9x	0.38x	24.3%	3.0%	24.3%
Roper Technologies	\$44.84B	3.1%	46.3x	2.62x	39.9%	1.5%	5.1%
Workday	\$47.17B	23.6%	-	-9.04x	4.2%	2.6%	-3.9%
Intuit	\$113.60B	23.3%	61.5x	1.44x	25.5%	3.4%	10.7%
CGI Inc.	\$521.91M	4.14%	-	1.00x	19.3%	6.2%	13.4%
Median	\$46.01B	13.74%	53.9x	1.2x	22.39%	3.02%	7.90%

Positives

- **5 Year CAGR:** They have seen steady growth and returns with respect to their comps
- **Net Debt/EBITDA:** Not facing too much debt and should be able to easily pay it off
- **ROIC:** Seeing solid returns on invested capital, much better than comps. WACC to ROIC spread is best in class

Negatives

- **P/E:** High P/E, although not too much higher than comps and historic levels - still pretty expensive

Sensitivity Analysis (22% Implied Upside)

		Exit Multiple				
		28.0x	28.5x	29.0x	29.5x	30.0x
WACC	8.30%	\$ 2,135.31	\$ 2,169.25	\$ 2,203.19	\$ 2,237.12	\$ 2,271.06
	8.80%	\$ 2,087.61	\$ 2,120.77	\$ 2,153.94	\$ 2,187.11	\$ 2,220.27
	9.30%	\$ 2,041.18	\$ 2,073.59	\$ 2,106.01	\$ 2,138.42	\$ 2,170.84
	9.80%	\$ 1,995.98	\$ 2,027.66	\$ 2,059.35	\$ 2,091.03	\$ 2,122.71
	10.30%	\$ 1,951.97	\$ 1,982.95	\$ 2,013.92	\$ 2,044.89	\$ 2,075.86

Model Assumptions

- Conservative exit multiple based off historical EV/EBITDA and industry averages
- Revenue growth comes from Bloomberg estimates, slightly declining Y/O/Y
- EBITDA margins and growth are very conservative, implying EBITDA growth to slow
- Tax rate pulled from previous 10-K

WACC Calculation

Assumptions	
Tax Rate	22%
Exit Multiple (EBITDA)	29.0x
WACC Calculation	
Risk Free Rate	4.00%
Beta	0.88
Market Risk Premium	6.50%
Cost of Equity	9.7%
Pre-Tax Cost of Debt	5.00%
Market Cap	\$ 36,958
BV of Debt	\$ 2,853
Equity-to-Value	92.8%
Debt-to-Value	7.2%
WACC	9.30%

IV. Conclusion

	Risk	Mitigation
<p>1</p> <p>Acquisition Dependence</p>	<ul style="list-style-type: none"> • Growth and business strategy is heavily focused on acquisitions, which inherently has risk • May be difficult to continue to find profitable acquisitions in the future • May not realize synergies from future acquisitions 	<ul style="list-style-type: none"> • Have seen great success in the past, which gives us faith for the future • Even with a period of no acquisitions, they have a wide moat and should be able to maintain revenue growth • Analysts and management still see a large pool of potential acquisitions
<p>2</p> <p>Market Competition</p>	<ul style="list-style-type: none"> • They operate in a highly competitive market, facing well-established competitors • Increased competition could lead to lower-than-usual profits 	<ul style="list-style-type: none"> • Constellation has a wide moat and operates in niche markets • No other competitor has the VMS scale that Constellation obtains • Even with an increase in competition, Constellation is in a good position to out-compete other companies
<p>3</p> <p>Valuation</p>	<ul style="list-style-type: none"> • Technically, CNSWF is trading at a nearly all-time high price • P/E ratio is high when looking at comps, could limit future growth potential 	<ul style="list-style-type: none"> • Although P/E ratio is high, it cannot be the sole factor we consider • According to our DCF, Constellation is trading at a discount and has plenty of implied upside

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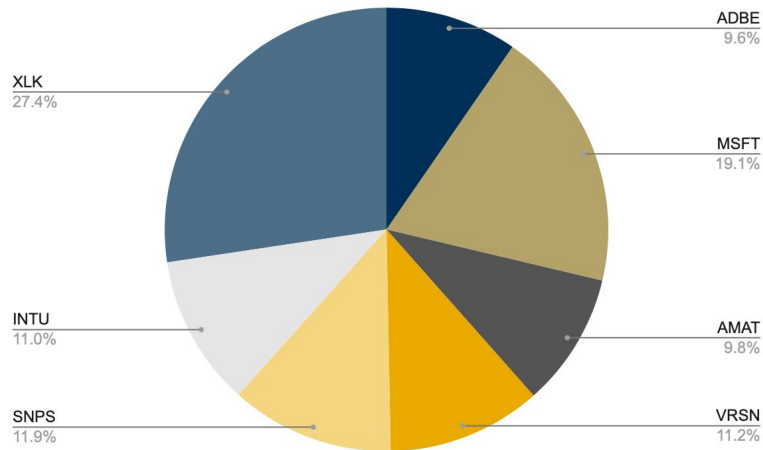
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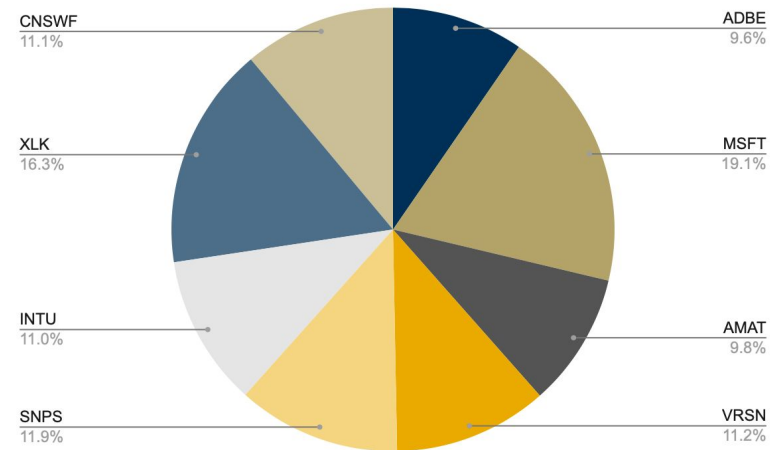
Replace XLK allocation with CNSWF

- Invest in a company with a **wide moat and high proportion of recurring revenues (70%+)**
- Constellation is heavily reliant on **acquisitions**, which **diversifies** our portfolio based on **growth strategy**
- They are Canadian based which diversifies our portfolio **geographically**
- Overall, Constellation has a **high margin of safety** and will be a **great addition** to our portfolio

Current Portfolio



Proposed Portfolio



<u>Name</u>	<u>Position</u>	<u>Phone Number</u>	<u>Email</u>
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Caleb Adams	Analyst	470-219-9516	calebadams@gatech.edu
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