



3 Canadian Tech Darlings

Description

While **Constellation Software** ([TSX:CSU](#)) shares [continue to surge](#), the company is certainly not alone. There have been plenty of Canadian tech companies in the past three years that have yielded very impressive returns for shareholders.

Many of these share price gains have been fueled by hype about a new technology. Those kinds of bets are risky to make. But others, like Constellation, have been powered by profitable growth, and a real track record of creating value. Three in particular are worth highlighting.

Enghouse Systems

Enghouse Systems (TSX:ESL) provides software and services through three segments: Interactive Management, Transportation, and Networks. Growth has been impressive (revenue grew 32% in 2013), but even more importantly, it has been profitable. Excluding working capital items, Enghouse's cash flow margins were nearly 25% last year.

Solium Capital

Solium Capital (TSX:SUM) sells software that helps companies run share ownership plans. Like Enghouse, growth has been impressive. In the first three quarters of 2013, revenue increased by 37% to \$50 million. Solium is not quite as profitable as Enghouse, but still generated cash flow margins greater than 12%.

QHR Technologies

QHR Technologies (TSXV:QHR) provides software for the healthcare sector, mainly electronic medical records. It is a high-growth area, and QHR has certainly been taking advantage. Through the first three quarters of 2013, revenue growth was 18% and cash flow margins were 12%.

So what do these companies have in common?

Besides strong growth, margins, and management teams, the three companies share a lot in common.

First, they all have high levels of recurring revenue. This can either come from subscriptions or maintenance contracts, but the important thing is that customers make regular payments. These payments tend to have high renewal rates, are very high margin, and are not overly dependent on just a few customers.

Secondly, the companies all generate a lot of cash. Normally one judges a company's profits by its net income line. But these companies all have large non-cash expenses that depress net income. So it's more useful to pay attention to cash flow.

Finally, the companies all have very expensive stock prices. Enghouse's shares have tripled in just over two years. Solium's have almost quintupled over the last three years. And QHR's shares have tripled in a year and a half. On average, the three companies now trade at about four times revenue.

Foolish bottom line

These are all traits that Constellation Software has as well. So the success of these three companies can hardly be called a coincidence. And they certainly provide valuable lessons for anyone brave enough to invest in technology companies.

CATEGORY

1. Investing

TICKERS GLOBAL

1. TSX:CSU (Constellation Software Inc.)

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