Is Constellation Software (TSX:CSU) Stock a Buy and Hold?

Description

The last decade saw the rise of technology by leaps and bounds. Those who invested early in tech stocks are now reaping the huge returns from their investments. **Constellation Software** (TSX:CSU) is one of the success stories of the last decade.

In June 2010, if you had invested $10,000 in Constellation, your portfolio value after dividend reinvestment would be $436,000. Similarly, if you had invested $10,000 in **Enghouse Systems**, your portfolio value after dividend reinvestment would be $172,000.

What drove Constellation stock in the last 10 years? Can the share replicate this growth in the next 10 years?

Constellation grew through acquisitions in the last decade

Constellation's business model is to acquire small companies providing mission-critical software to one or two verticals. As these companies cater to niche markets, there is limited competition, especially from large, well-funded software companies. With these acquisitions, Constellation looks to improve profitability and recurring revenue rather than gain market share.

Since its inception in 1995, Constellation has acquired over 260 vertical-specific software (VSS) providers, with 93 providers acquired in 2019.

The acquired companies offer software that is critical to their customer's operations, making it costly to replace. Moreover, because of limited competition, many customers continue to renew their maintenance contracts.

Over the years, new acquisitions brought new contracts, increasing Constellation's recurring revenue from maintenance contracts.

In 2019, the company earned 69% of its revenue from maintenance, up from 54% in 2010. It has a retention rate of over 90%.

Year	**2010**	**2011**	**2012**	**2013**	**2014**	**2015**	**2016**	**2017**	**2018**	**2019**
Constellation's YoY Revenue Growth	45%	22%	15%	36%	39%	10%	15%	17%	23%	14%

Over the last 10 years, Constellation's revenue rose 550%, and its stock price rose by 3,360%. Its revenue grew at a compound annual average growth rate (CAGR) of 18.5%, and almost all its growth came from acquisitions. Its organic growth stands at around 2%.

As the company grew in size, its growth rate diminished. Its revenue CAGR slowed from 22% in the 2010-2014 period to 14% in the 2015-2019 period.

This growth has made Constellation the biggest name in the Canadian software market, with US$3.5 billion in annual revenue and over $30 billion in market capitalization.

The competition is rising in the vertical software market

All these years, Constellation has been trying to avoid competition. But its growth-by-acquisition model attracted competition. Its rival Enghouse acquires VSS providers focused on customer engagement, logistics management, telecom services, and geographic information systems. It is a smaller player with US$2.7 billion in revenue and $3.5 billion in market capitalization.

In the wake of growing competition, Constellation cancelled its quarterly earnings calls in 2018 to maintain secrecy around its future acquisitions.

How will the next 10 years be for Constellation?

Until now, the company's average acquisition size was US$5- US$8 million and included a few larger deals of over US$100 million. Now, that the company has grown in size, it will require bigger

In May, Constellation agreed to acquire Netherlands-based diversified VSS provider Topicus.com and combine it with its Total Specific Solutions Operating Group. It will rename the group as Topicus.com.

Although Constellation did not disclose the deal amount, it is likely to be above US$200 million, given Topicus.com's annual revenue size of €100 million.

The above deal gives Topicus.com the option of exploring opportunities to list its shares on the stock exchange sometime in the future. Constellation would remain a significant shareholder and benefit from the stock price movement.

Public listing can also help the subsidiary raise capital for more significant acquisitions, thereby reducing the risk of leverage that comes along with big deals. If Constellation succeeds in generating higher returns, it could publicly list its other subsidiaries as well.

Is Constellation a buy and hold?

While Constellation's growth rate will slow in the next 10 years, it will continue to give substantial returns because of its stable revenue base.

If you are a risk-averse investor, it is a stock to buy and hold for long-term as it can outperform the market and give stable returns.

CATEGORY

1. Investing
2. Tech Stocks

TICKERS GLOBAL

1. TSX:CSU (Constellation Software Inc.)

PARTNER-FEEDS

1. Business Insider
2. Msn
3. Newscred
4. Sharewise
5. Yahoo CA

Category

1. Investing
2. Tech Stocks

Date
2025/09/28
Date Created
2020/06/04
Author
pujatayal