$1,000 in This Stock Could Be Worth $35,000 in 10 Years

Description

Constellation Software (TSX:CSU) has had an incredible run over the past decade. As the company gobbled up small- and mid-sized software companies, Constellation Software stock soared 3,400% over the past 10 years. Now, investors are concerned the company's growth engine is running out of steam. Here's why they're wrong.

Robust portfolio

Over the course of its existence, the company has targeted small- and mid-sized enterprise software companies for acquisition. Since 1995, the list of acquisitions has expanded beyond 260 firms. Buying these firms at below fair value is the core engine of Constellation Software stock's rapid escalation.

While these small firms target different markets and offer different solutions, diversification isn't the only thing that makes Constellation's portfolio robust. Instead, it's the client list. Roughly half of the company's 125,000 clients are government institutions and public agencies.

The governments across the world, of course, are not cutting back on spending. In fact, most government agencies have ramped up spending during the pandemic. Also, governments are less likely to default or fail than corporations, which means Constellation's cash flows are well protected.

Growth story far from over

Over the past 25 years, the company has focused on acquiring software businesses in the developed world. Europe and North America have been prime targets. However, there are plenty of emerging opportunities in the developing world.

Software companies from India, Kenya, and Vietnam could be solving the same problems as their developed counterparts. Meanwhile, governments and corporations in these regions need sophisticated software to move away from their legacy systems. This means Constellation Software's growth story is far from over.

In fact, even the company's recent acquisitions were focused on its home turf. Constellation added two startups from the Netherlands and the United States during the pandemic. Rarely has the company acquired startups in Asia, Africa, or Latin America. Changing that and broadening its horizons could deliver stunning returns for shareholders.

There's nearly infinite potential for new acquisitions and software solutions across the world.

Constellation Software's stock valuation

Constellation's revenue increased at an average annual rate of 14% between 2015 and 2019. The company operates at an adjusted EBITDA margin of 24-25%. Since the acquisition-driven growth strategy is far from tapped out, investors can assume similar growth rates for the next 10 years.

Constellation Software stock is currently trading at 36.5 times forward earnings per share. This means the company will have to expand at an annual rate over 36.5% to justify its valuation. At that rate, the price-to-earnings-growth (PEG) ratio drops to one, which is fair value.

A combination of acquisitions and organic growth could deliver this growth rate. After all, Constellation Software stock has delivered a compounded annual growth rate (CAGR) of 42.7% over the past 10 years. A similar rate over the next 10 years could turn $1,000 into $35,000 or more.

Bottom line

Constellation Software stock has been a wealth-creation phenomenon. Investors who bought the stock in 2010 are now sitting on a 35-fold gain. However, the company's growth story is far from over. There's always new software companies to acquire across the world. This means another 35-fold gain in the next 10 years is just as likely.

Investors could turn $1,000 into $35,000 with this stock.

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vraisinghani