



TFSA Investors: 1 Growth Stock to Hold Forever

Description

Constellation Software ([TSX:CSU](#)) acquires, manages, and builds [vertical market software](#) (VMS) businesses. Generally, these businesses provide mission critical software solutions that address the specific needs of the company's customers in particular vertical markets. Constellation focuses on acquiring businesses with growth potential and businesses capable of generating significant cash flow and revenue growth.

Using a combination of proprietary software and market expertise, Constellation provides software solutions that are designed to enable the company's customers to boost productivity, operate more cost effectively, increase sales, and improve customer satisfaction. Many of the VMS businesses that the company acquires have the potential to be leaders within particular markets.

Attractive industry economics

The company targets the VMS sector, because of the [attractive economics](#) that it provides. Given the company's extensive acquisition experience and successful track record, Constellation is well positioned to identify, acquire, manage, and build attractive VMS businesses in new markets. The company seeks acquisitions that provide software solutions to either the public or private sectors.

Constellation often enter new vertical markets through acquisitions of VMS businesses in markets in which it does not currently operate. The company looks to expand existing businesses through organic growth initiatives aimed at gaining market share and product breadth.

Effective decentralized model

The company's decentralized VMS management teams have extensive knowledge of software markets and deep customer relationships. This enables the teams to successfully identify, pursue, structure, acquire, and then coach businesses post-acquisition. Constellation also seeks to acquire attractive VMS businesses in new markets to deploy free cash flow at attractive returns.

Historically, the company has retained the majority of the managers from the businesses that it has acquired. This has allowed us to retain the knowledge needed to manage and successfully build VMS businesses.

Constellation's decentralized management structure is key to the company's continued revenue growth. The company has a small corporate head office, which provides financial and strategic expertise with respect to capital allocation, acquisitions, finance, tax, and compensation policy, and attempts to identify and share best practices. Constellation has six operating groups which currently service customers in more than 100 different vertical markets worldwide.

There are many VMS business units within each of the company's operating groups. Constellation monitor and measure each VMS business unit's performance through operating ratios and metrics including profitability and growth. The company's corporate head office sets investment return objectives.

Disciplined capital allocation

Constellation's decentralized management structure allows it to have business unit management teams with strong customer relationships and deep market knowledge that are more focused and responsive than would be the case under a centralized management model. These teams provide the corporate head office and operating group managers with the ability to concentrate on issues such as capital allocation, identifying best practices, and helping recruit and coach high potential employees.

Capital is allocated amongst individual management teams based upon projected after-tax internal rate of return, which is influenced by the relative attractiveness of a market, the strategic position of the VMS business, and the management team's performance. Constellation's discipline in capital allocation should serve shareholders well over the long term.

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Author

nikhilwaterloo

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