

Why Constellation Software Stock Was up 42.9% in 2021

## Description

Toronto-based tech giant **Constellation Software** (<u>TSX:CSU</u>) is Canada's third-best creation after poutine and Ryan Reynolds. Constellation stock has created more <u>wealth for shareholders</u> than residential real estate. It's up 12,725% since 2006. That's a compounded annual growth rate (CAGR) of 35.4% over 16 years!

In 2021, it outperformed its long-term average. Constellation stock surged a whopping 42.9% this past 12 months. There are plenty of factors driving this performance, but I'll attempt to highlight the three main reasons below.

## **Cash flow growth**

Revenue, net income, and free cash flow available to shareholders all grew this year. According to its most recent quarterly report, Constellation's revenue surged 30% over the past year. Free cash flow available to shareholders expanded 25% over the same period.

Steady double-digit growth could be the primary reason why Constellation stock delivered such impressive performance.

# **Tech valuations**

2021 was a bad year for most tech stocks. Valuations were stretched in 2020, and the hype dissipated quickly. Unlike other tech stocks, Constellation is reliably profitable and steadily expanding. That's what made it an ideal target for investors in 2021.

While tech stocks dipped lower, Constellation's strong fundamentals helped it outperform. The stock now trades at a price-to-free cash flow ratio of roughly 58. That's fair value for a company delivering double-digit growth every year.

However, lower tech valuations benefit the company in another way. It makes acquisition targets

cheaper. Constellation simply had more attractive options in 2021. This trend could continue in 2022.

## **Upgraded strategy**

At the start of 2021, Constellation's CEO Mark Leonard made a big announcement. The company was modifying its growth strategy. In 2021, the team decided to cut back on shareholder payouts via dividends. This allowed the team to reinvest more of the capital it generated.

Leonard also announced that the team's investment universe will be broadened. For the first time since its inception, Constellation will target companies beyond the vertical software industry.

Put simply, Constellation Software is no longer just an enterprise software company. It's doubling down on all acquisition targets to drive further growth. This is another reason why the stock performed so well.

"Hopefully, we have built enough credibility to warrant your patience as we explore new and underappreciated sectors," Leonard told investors in his recent letter.

Bottom line Few other tech stocks have the pedigree and track record of Constellation Software. Mark Leonard's team has had exceptional success as capital allocators. This strategy played out well in 2021, which is why fundamentals and the stock price are up significantly.

But investors are also excited about the path ahead. The team has slashed its dividend and is now targeting bigger companies in newer industries. The target market is now much larger, which means there's more room to grow. It seems likely that Constellation stock will keep delivering double-digit growth for the foreseeable future.

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2025/09/11 Date Created 2022/01/03 Author vraisinghani

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