



## Why Has Constellation Software Stock Surged 14% in the Last 2 Weeks?

### Description

**Constellation Software** ([TSX:CSU](#)) stock surged 14% in the last two weeks, pulling the stock price above \$2,170. The stock is edging closer towards its pandemic high of \$2,385 while other tech stocks still trade 20-70% below. What is driving Constellation's stock price? Is this growth sustainable?

### What sets Constellation apart from other software stocks?

In software, you can either grow organically or through acquisitions. Either strategy can or cannot work. It all boils down to implementation.

Constellation is in the business of software acquisitions. The company acquires small companies in niche verticals that offer mission-critical solutions and face little competition. Their products are sticky and generate regular cash flows. Unlike other acquisition companies, Constellation has no limit on which vertical or geography it wants to target. It targets micro-sized companies (\$1-\$100 million), which opens up a huge market of potential acquisition targets.

Because these companies operate in a niche market, they don't have a large addressable market. Hence, they don't attract the attention of private equity firms. But Constellation looks at them otherwise. One company may have a limited market, but a combination of 100 such companies will have a larger market.

These companies are generally available at a cheaper rate, and if there is a [market downturn](#), their prices fall even further. Constellation leverages this opportunity and accelerates its acquisition drive to get a good price for its deals, which may later be accretive to its cash flows.

### What is driving Constellation's stock price in 2022?

While all acquisitions may not be successful, a lower acquisition cost could mitigate the losses and enhance profits. **RBC** Capital Markets Analyst Paul Treiber [estimated](#) that Constellation acquired 30 companies for US\$210 million in the second quarter, increasing its acquisition total to US\$1.2 billion in

the first half of the year. That is a record growth rate in the first six months of a calendar year.

Treiber estimates these acquisitions to add US\$254 million in annual revenue and 8% to earnings per share. This has made investors bullish on Constellation's second-quarter earnings on August 4.

## Is this growth sustainable?

Constellation is in a long-term uptrend, as the stock's bottom in each downturn is higher than the previous downturn. This is because all the acquisitions made in the downturn are accretive to the company's earnings. As an umbrella company, it facilitates acquired companies with networking and management expertise where required without managing their operations. The subsidiaries take on the debt and operations while Constellation gets a share in the cash flow.

Constellation implements its deals in outright cash. It makes no share purchases, which removes the need for share buyback. One of Warren Buffett's biggest mistakes was its purchase of Dexter Shoes in exchange for **Berkshire Hathaway** shares. After 20 years, Dexter Shoes was gone for good, but those who got Berkshire Hathaway stock became millionaires. In short, Buffett aggravated his losses by exchanging something less valuable for something more valuable.

Constellation makes all-cash deals, as it knows cash is a depreciating asset (due to the [inflation rate](#)), while its stock is an appreciating asset. From a long-term perspective, a \$25 million all-cash deal five years back made the cost static for Constellation. But if it gave \$25 million worth of Constellation shares, the deal cost would be \$78 million now. Cash helps reduce its cost and increase EBITDA.

Moreover, all these acquisitions have diversified Constellation's portfolio and customer base, reducing the risk. Its organic growth is between 1% and 2%, which makes its growth as good as its acquisitions. Constellation is a stock worth buying at every dip, as its growth is sustainable in the long term.

## Should you buy Constellation stock now?

The stock has fallen 20% between April and June. That was the time I recommended buying this stock. Today, it has come closer to being oversold with a Relative Strength Index of 75, which indicates the average 14-day momentum is bullish and skewed towards buying. Don't buy the stock at the current price. Wait for it to fall again.

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