



Constellation Software Stock Just Hit 52-week Highs: Should you Buy?

Description

TSX tech stocks have been weak since last year amid rapidly rising interest rates. One of the biggest of them, **Constellation Software** ([TSX:CSU](#)) stock, has been an exception though. For the last 12 months, Canadian tech stocks at large have lost 18% of their market value, while CSU stock has gained 12%. It hit a 52-week high of \$2,350 a share last week.

Why have TSX tech stocks been weak in 2022?

Interest rates and growth stocks generally move inversely to each other. Higher interest rates lower the present value of future cash flows, making them relatively less attractive. As a result, growth stocks notably lagged last year while defensives outpaced.

In comparison, Constellation stock was quite resilient and outperformed peers through most of 2022. And it was not just last year. The company has proven its vigour and outperformed better than peers for years through multiple business cycles. The main reason behind its outperformance is its consistent profitability.

Constellation Software is an umbrella company of various smaller vertical market software companies. The diversified software company acquires smaller companies with dominating market positions in some specific area. It nurtures them to scale up operations while improving efficiency and free cash flow growth. That resultant excess cash is further used for future acquisitions. The model has been extremely successful for over a decade.

What's so special about Constellation Software?

Constellation Software, with its fleet of vertical market software companies, caters to both commercial as well as government customers. In the last decade, its revenues grew by 21%, and earnings by 15%, compounded annually. Consistent growth for such a long time is indeed a feat.

It has also shown a healthy margin profile all these years. Constellation has maintained a stable gross

margin at around 37% for the last several years, underlining its core business strength. Plus, although the business model involves acquisitions, the company has managed to do them with internal accruals and therefore has little debt on its balance sheet.

Constellation Software's diversified revenue base and consistent profitability have created immense shareholder value in the long term. In the last 10 years, CSU stock delivered a 35% average annual return, notably beating peer growth stocks. To be precise, \$10,000 invested a decade ago would be worth \$212,000 today.

Valuation

Many peer [TSX tech stocks](#) saw much steeper earnings growth and, thus, similar value creation in the last few years. However, they eventually lost steam as easy money looked beyond tech markets for returns amid a rapid increase in interest rates.

CSU stood relatively resilient and kept growing. As a result, CSU stock deserves a premium [valuation](#) and trades above 70x earnings. This looks expensive against peers but is justified. Peers that traded with a premium valuation lost major value as interest rate cycles upturned in late 2021.

A tech stock built for growth

For the last several years, Constellation Software management has shown an impeccable knack for picking companies that could synergize and create value. This has been its key competitive advantage more so than its portfolio of companies or a large addressable market. Although the stock is trading at its 52-week highs, it could continue to see considerable value creation in the long term with its fleet of companies and consistently expanding profitability.

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