



Constellation Software (TSX:CSU) Is up 30% in 3 Months: Can it Keep Going?

Description

Tech stocks have staged a dramatic turnaround in recent months. Some small- and mid-cap tech stocks have doubled in value since last fall. However, large-cap, blue-chip tech stocks have also experienced a respectable rally.

Enterprise software giant **Constellation Software** ([TSX:CSU](#)) is a prime example. After losing 22% of its value between January and October 2022, the stock is up 30% in just three months. It's now trading just 4% below an all-time high!

Can this tech star keep soaring in the months ahead? Here's a closer look.

Macroeconomics

One of the reasons for the tech [bear market](#) of 2022 was the sudden rise in interest rates. Higher rates made future cash flows of risky tech companies less appealing. Even mature software companies with recurring revenue are worth less if interest rates jump from nearly 0% to 5% in a matter of months.

That's probably why Constellation Software lost a fifth of its value last year. However, the Bank of Canada has now paused its rate-hiking cycle. Meanwhile, Constellation's revenue and earnings are steadily expanding. [Revenue](#) for the year ending in September 2022 was 27.85% higher than the previous year. The company registered \$1.2 billion in total free cash flow (FCF) over that period.

Valuations

Assuming free cash flow is between \$1.4 and \$1.5 billion this year, Constellation stock is trading at a price-to-FCF ratio of 33.5. That's perfectly reasonable for a company that's expanding at double digits every year.

In fact, I believe 2023 could be one of the strongest years in the company's history. The team deployed a record amount of cash in mergers and acquisitions last year. That means new assets have been

added to the portfolio at relatively attractive valuations. Once integrated, these new additions should bolster the company's earning power.

I believe investors will see higher revenue and free cash flow in the next few quarters.

Bottom line

It's difficult to predict what comes next, but there are clear signs that the tech rebound has more room to run. Interest rates have stabilized for now, and if inflation comes down sooner than expected, the tech rally could be extended.

That's great news for conglomerates like Constellation Software. The company has sustained a high-double-digit growth rate for three decades. Much of this is based on its acquisition strategy. Last year, the team deployed more cash than ever on gobbling up small software firms. That could boost earnings and revenue this year. Keep an eye on this blue-chip tech stock.

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