

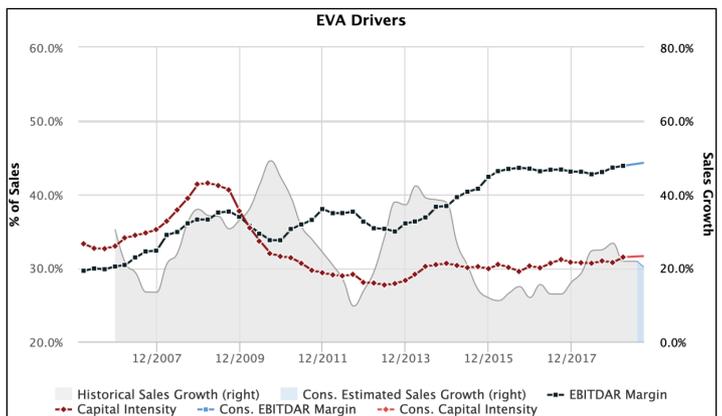
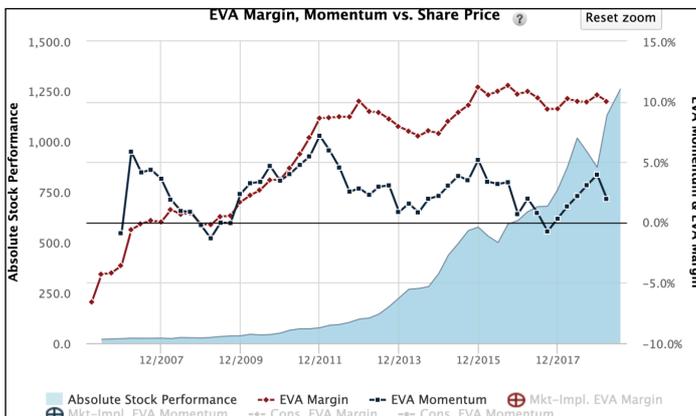
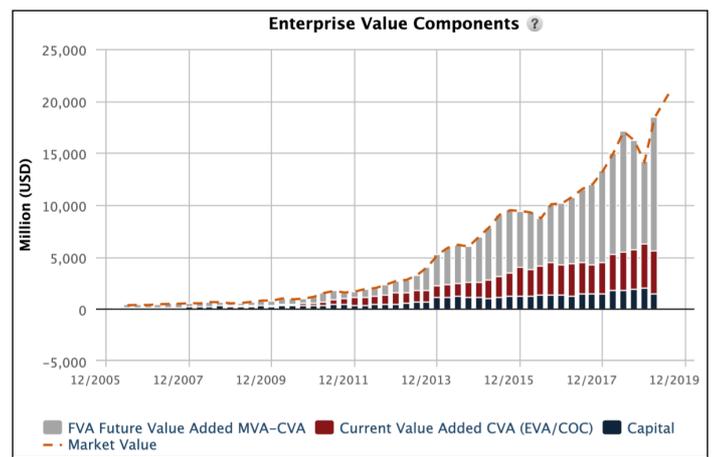
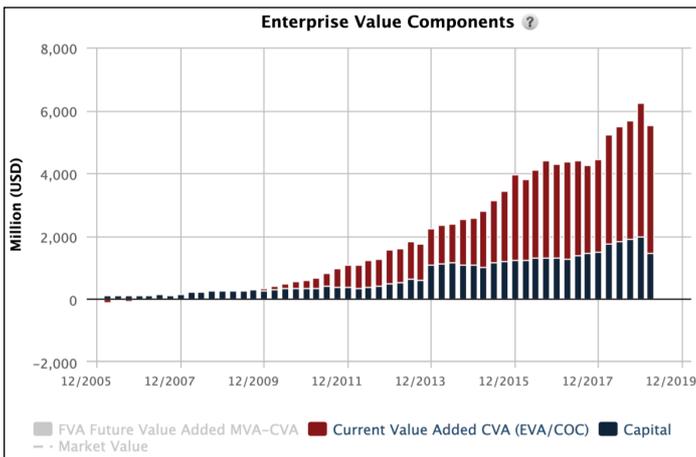
Constellation Software (CSU.TO)

Oct 14th, 2019

Moat Category Superior Capital Allocator	Fair Value Estimate -	Price \$1011.17	Enterprise Value \$22.4bn
Moat Type Efficient Scale, Switching Costs, Brand	Economic Moat Wide	Stewardship Rating Exemplary	Market Cap \$21.4bn

What does it do: "Constellation Software Inc is a Canada-based company that develops and customizes software for public- and private-sector markets. The firm acquires, manages, and builds vertical-specific businesses. Its operations are organized in two segments: Public Sector and Private Sector. The portfolio companies serve various markets including communications, credit unions,

beverage distribution, tour operators, auto clubs, textiles and apparel, hospitality, and community care. The firm has operations in North America, Europe, Australia, South America, and Africa." (Source: Morningstar)



Source: www.evaexpress.com

Past 10-year performance metrics

Profitability	CSU CN's exceptionally strong return on capital and its combine for a first rate, 95th percentile P score								
	011TFQ2	2012TFQ2	2013TFQ2	2014TFQ2	2015TFQ2	2016TFQ2	2017TFQ2	2018TFQ2	2019TFQ2
1 Sales	700	817	1,050	1,460	1,763	1,996	2,254	2,811	3,259
2 EBITDAR (EBITDA+Rent+R&D+Ad+Etc)	252	306	371	539	712	867	977	1,202	1,451
3 NOPAT (Net Operating Profit After Tax)	75	107	136	190	256	317	338	411	480
4 Capital (Net Operating Assets)	408	375	647	1,157	1,135	1,284	1,393	1,812	2,073
5 Return on Capital (ROC) (NOPAT/Capital)	22.0%	29.4%	29.2%	20.4%	23.7%	26.1%	25.9%	26.3%	26.5%
6 Cost of Capital (COC)	10.3%	9.7%	8.7%	9.2%	8.8%	8.2%	8.1%	8.3%	8.1%
7 EVA (ROC-COC) x Capital)	40	72	96	105	161	217	233	282	333
9 EVA Spread (EVA/Capital = ROC-COC)	11.7%	19.7%	20.5%	11.2%	14.9%	17.9%	17.9%	18.0%	18.4%
10 EVA Margin (EVA/Sales)	5.7%	8.8%	9.1%	7.2%	9.1%	10.9%	10.3%	10.0%	10.2%
11 EBITDAR Margin (EBITDAR/Sales)	35.9%	37.5%	35.3%	36.9%	40.4%	43.5%	43.4%	42.8%	44.5%
12 Sales Growth	31.3%	16.7%	28.5%	39.1%	20.7%	13.2%	13.0%	24.7%	15.9%
13 EVA Momentum (Δ EVA/Sales)	4.8%	4.5%	3.0%	0.8%	3.9%	3.2%	0.8%	2.2%	1.8%
14 EVA Momentum (Δ EVA/Capital)	9.3%	9.4%	6.7%	1.9%	6.0%	5.2%	1.3%	3.8%	3.2%
15 3 Year Trend (Δ EVA/Capital)	5.5%	8.2%	8.5%	5.6%	4.7%	5.1%	4.1%	3.2%	2.9%
16 Last Quarter (Δ EVA/Capital)	13.2%	2.2%	9.0%	1.3%	5.8%	5.5%	-2.3%	3.9%	2.8%

Source: www.evaexpress.com

Figures in USD millions.

Wide Moat Checklists

Competitive Strengths	Does CSU have it?	Evidence
Product or service is needed or desired (and will continue to do so)	<input checked="" type="checkbox"/>	The market for vertical market software (VMS) is needed for respective industries, the demand of which is likely to grow.
Product is perceived by its customers to have no close substitute	<input checked="" type="checkbox"/>	There might be many developers for the vertical market software, and many others that, like Constellation, are interested in acquiring them. However, the synergies Constellation can bring to companies are unmatched, because of its existing portfolio and its management's expertise. It would be in a VMS business' best interest to be acquired by Constellation.
Product is not subject to price regulation	<input checked="" type="checkbox"/>	Industry is not price regulated.
Strong barriers to entry	<input checked="" type="checkbox"/>	It is relatively easy for a potential entrant to enter the market of acquiring small VMS firms. They are capital-light, and are usually sold in the \$2-\$5 million range. However, these are niche markets. Constellation has gotten terribly good at occupying many little niches, and its dominating position stops competitors from entering their space. Bigger companies don't bother to enter as the market size is too small for them. This is called the Efficient Scale moat. Lastly, software businesses are generally sticky, and Constellation's customers experience high Switching Costs from using their respective VMS services.
Loyal customers	<input checked="" type="checkbox"/>	Constellation's reputation is similar to Berkshire Hathaway's, in its dicentric organizational structure, autonomous business managers in full control of their business units, and transparent communication with all its stakeholders. Constellation has built a brand that represents quality, transparency and synergy.
Low risk of technological obsolescence	<input type="checkbox"/>	Inherent to the software business, pace of change in technology is high. Constellation's businesses constantly need to improve their products in order to maintain market share in their respective industries.
Abundant growth possibilities	<input checked="" type="checkbox"/>	Mark Leonard, Constellation's CEO, is famous for his candid writing in his letters to shareholders. In his 2018 letter, Leonard stated that the market is expensive for VMS businesses, and their rate of acquisition might reduce due to the fact. He has claimed to explore businesses outside the VMS space. More research is required to know what that could result in. One can safely assume that more software products are going to enter the market, and Constellation will likely be adding some of those to its portfolio.
Limited capital requirements	<input type="checkbox"/>	VMS businesses acquired by Constellation are usually capital-light. However, CSU continuously reinvest their FCF back into the business to continue making acquisitions. If the VMS market becomes more expensive, Constellation's need for deeper pockets may rise.
Significant and growing free cash flows (and EVAs)	<input checked="" type="checkbox"/>	More research is required. Constellation is likely to continue with its proven strategy of dominating niche markets, creating valuable synergies and in result produce growing amounts of EVA.