Topicus.com

Information Technology
TSXV: TOI
Market Perform | Hold

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Return on Investment

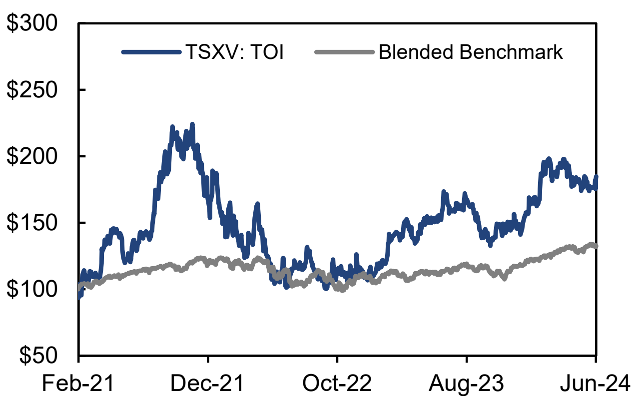
Current Share Price	$117.00
Target Price	$128.73
Dividend Yield	0.00%
Implied Return	10%
Conviction Rating	1

Market Profile

52-Week Range	$83.32 - $128.84
Market Capitalization ($mm)	$6,617
Net Debt ($mm)	$138
Minority Interest ($mm)	$186
Enterprise Value ($mm)	$6,941
Beta (5-Year Monthly)	0.69

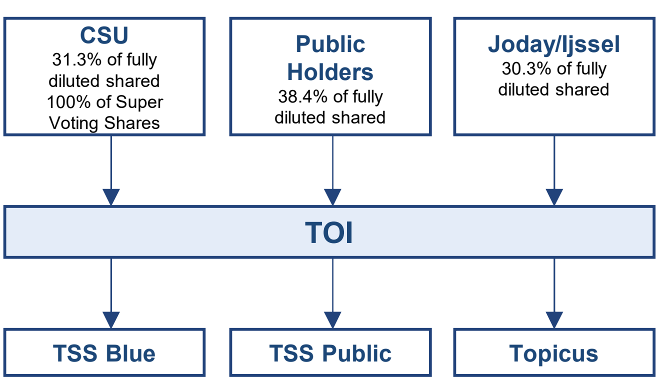
Metrics	2024E	2025E	2026E
Revenue (€mm)	$1,400	$1,740	$2,335
EBITDA (€mm)	$384	$522	$715
EPS	$1.13	$1.74	$2.63
EV/EBITDA	18.1x	13.3x	9.7x

Holding Period Trading Performance (Indexed to $100)



Source: S&P Capital IQ

Figure 1: Organization Structure



Source: Company Filings

Business Description

Topicus.com (TSXV: TOI) is a Dutch company that specializes in providing innovative Vertical Market Software (VMS) and platforms throughout Europe. TOI originated as a partial spin-off from Constellation Software (TSX: CSU), with CSU currently retaining 31.3% ownership in the Company. TOI operates through three primary groups: (1) Total Specific Solution (TSS) Public, (2) TSS Blue, and (3) Topicus. These groups serve key vertical markets, including agriculture, automotive, central government, education, healthcare, hospitality, legal, real estate, retail, and more. TSS Public focuses on the public and healthcare sectors in the Netherlands and Central Europe. TSS Blue serves private markets in Germany, the Netherlands, and the Nordics.

The Company offers a wide array of software products that are sold, serviced, and enhanced. Each of its vertical markets is supported by at least one software product, and often multiple product lines are developed and maintained within a single vertical market. Additionally, TOI complements its acquired and internally developed software products by licensing certain technologies from third parties, typically on a non-exclusive basis.

Industry Overview

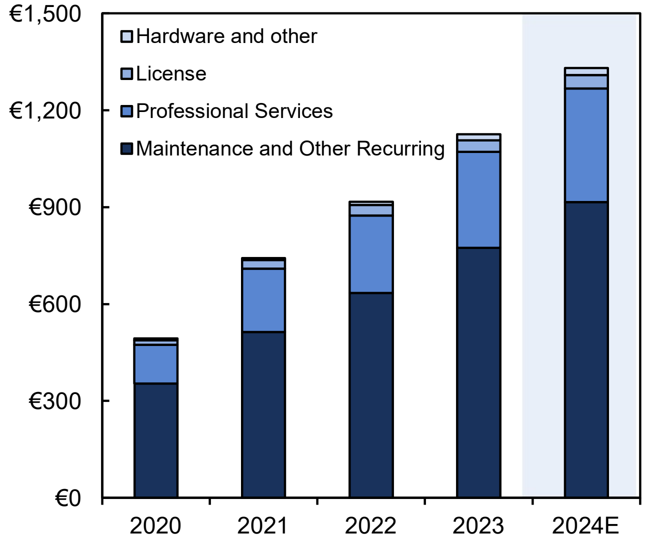
TOI operates within the European VMS market, a highly fragmented and niche industry comprised of local market leaders. VMS-based companies are characterized by low customer churn and pricing power, given the high switching costs associated with VMS software. Fragmentation within the industry exists between countries, where regulations, payment systems, and language barriers inhibit cross-border VMS integration. As a result, companies are bound to acquire a suite of VMS businesses that have products in nearly identical verticals, but little overlap in customers, leading to a larger volume of VMS acquisition targets existing in Europe.

As a software consolidator, TOI competes with Lagercrantz Group (STO: LAGR-B), Temenos AG (SWX: TEMN), Teqnion (STO: TEQ), and Vitec Software Group (STO: VIT-B). Firms acquiring VMS businesses frequently compete with private equity buyers. In addition to private equity dollars growing faster in North America than Europe partly due to differences in fundraising, there are fewer private equity dollars chasing deals in Europe than in North America. In 2023, there were over 754[1] funds in North America actively investing compared to 306[1] funds in Europe. Consequently, competition to acquire VMS businesses in Europe is likely weaker, allowing TOI to scale acquired businesses more easily than its counterpart, CSU.

VMS acquirers often operate a decentralized structure where portfolio company management holds autonomy over operating decisions while small centralized teams provide financial and strategic guidance. Common characteristics of acquisition targets include strong market position, recurring revenue growth, and market expansion opportunities. In addition to acquiring established businesses, firms invest in organic growth by building new VMS businesses from scratch and acquiring VMS intellectual property to integrate it into existing platforms. High switch costs and a decentralized organizational structure help keep churn low allowing firms like TOI to build out new VMS businesses.

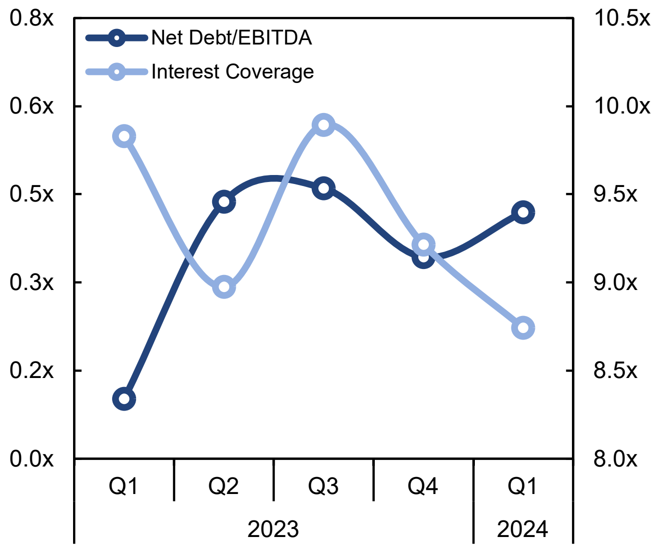
(1) Includes buyout, growth, and venture funds with a 2020 vintage

Figure 2: Revenue Segmentation (€mm)



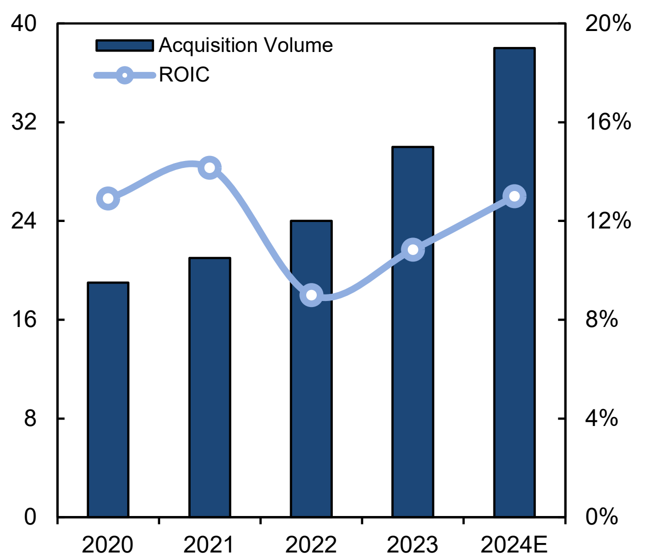
Source: Company Filings

Figure 3: LHS Net Debt/EBITDA vs RHS Interest Coverage



Source: Bloomberg, Company Filings

Figure 4:LHS Acquisition Volume vs RHS ROIC



Source: Company Filings, FactSet

Mandate Fit

Quality Management: TOI operates through a decentralized management structure, allowing operating groups and respective management teams to retain niche industry knowledge. Robin van Poelje, Director, Chairman, and CEO of TOI, joined CSU in January 2014 following CSU's acquisition of TSS. Daan Dijkhuizen has been with TOI since 2013 and assumed the role of CEO of Topicus Operating Group in 2017. Han Knooren is the CEO of TSS Public, while Ramon Zanders serves as CEO of TSS Blue.

As of Q1 2024, CSU owns 31.3% of TOI, while the Joday Group own 30.3%. CSU holds a Super Voting Share with 50.1% voting power and can appoint six out of ten directors if it maintains at least a 15% interest in the Company. All directors are appointed by CSU or the Joday Group. Anytime after December 2023, CSU has the right to buy all of TOI shares held by the Joday Group at a price determined in accordance with the IRGA, a contractual governance document created after the spin-off. This could bring CSU's ownership stake in TOI up to 61.6%.

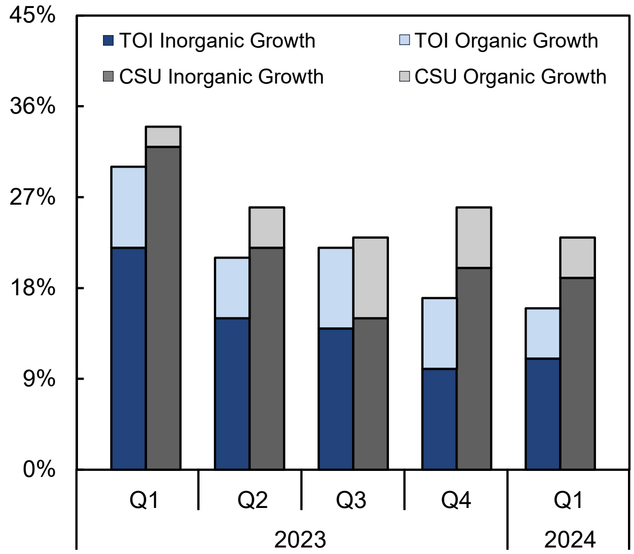
The Fund views TOI's current management structure and IRGA clauses as a potential concern but is comfortable with CSU's ownership stake and influence on the board given its successful track record and industry expertise.

Competitive Advantage: TOI benefits from a decentralized operating structure to scale the number of transactions the Company completes each year, while keeping acquisition size low. The decentralized model also allows TOI to invest more in organic growth by building new VMS businesses from scratch. The Company invests in customized mission-critical VMS, making it difficult for customers to justify switching vendors. This leads to low customer churn, better pricing power, and higher organic growth opportunities. Additionally, a substantial portion of TOI's revenue comes from customers in the public sector, which generally has much lower churn than the private sector. Finally, the Company boasts a strong reputation, making it easier to source VMS acquisition targets while avoiding competitive auctions.

Strong Balance Sheet: TOI has maintained strong capital discipline and low leverage since its spin-off in Q1 2021. The Company's Net Debt/EBITDA ratio has averaged 0.5x since September 2021, significantly lower than the peer average of 1.5x over the period. This ratio can undergo significant fluctuations due to the Company's frequent M&A activity, as TOI often funds acquisitions using a combination of CFO and debt. However, the Company's consistent EBITDA growth and debt repayment ensures leverage remains within reasonable levels. Furthermore, TOI's interest coverage ratio comes in slightly above peers, at 8.7x versus the peer average of 8.4x. Overall, TOI's low leverage relative to competitors provides the Company with the financial flexibility to continue to pursue organic and inorganic growth opportunities moving forward.

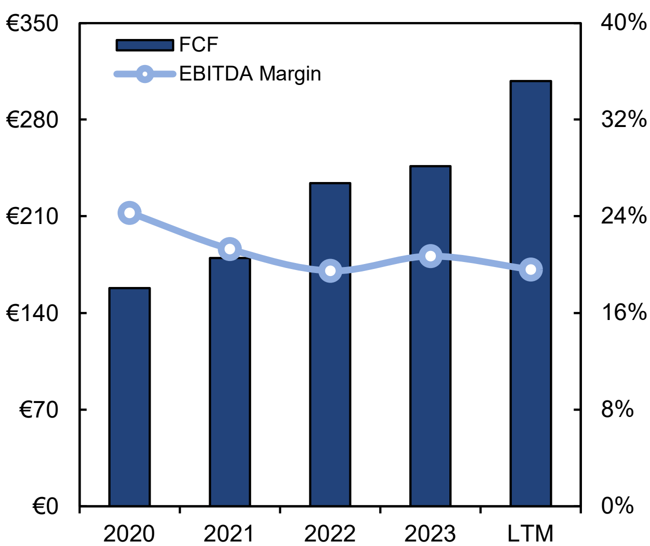
Growing Free Cash Flow: Since its spin-off, TOI has exhibited robust, double-digit FCF growth, reaching a 16% FCF CAGR from FY2020 to FY2023. This growth was mostly driven by accretive M&A and supplemented by modest organic growth from integrated companies. Additionally, the Company's business model facilitates consistent cash flows, with TOI focusing on recurring revenue. In FY2023, ~69% of the Company's revenues were derived from the Maintenance and Recurring Segment, which earns predictable fees through customer support, software as a service, subscriptions, and other recurring fees. TOI's reliable revenue streams alongside its M&A-based growth strategy will facilitate future FCF growth.

Figure 5: Organic vs Inorganic Growth



Source: Company Fillings

Figure 6: LHS FCF (€mm) vs RHS EBITDA Margin



Source: S&P Capital IQ

Risks

Elevated Interest Rates: due to TOI's size and business model, increased borrowing costs present a risk to the Company's operations and shareholder returns. Higher interest rates increase the Company's cost of capital, subsequently elevating the required return for TOI's transactions, which decreases the number of feasible acquisition targets. Considering that the majority of TOI's growth is driven inorganically through frequent M&A activity, a decrease in the number of available target companies due to higher borrowing costs could materially impact on the Company's growth.

Moreover, TOI's relatively low market cap further exacerbates interest rate risk, as small cap companies are typically more sensitive to fluctuations in rates. This was evidenced through the Company's significant underperformance in 2021 and 2022, as interest rates were expected to increase due to rising inflation.

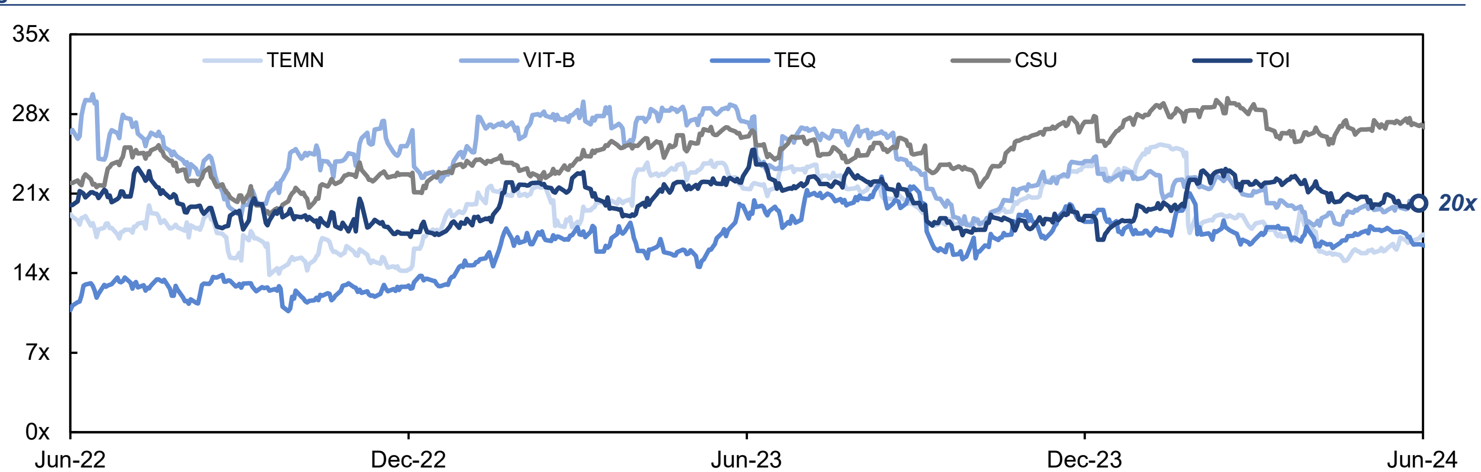
Investment Thesis and Valuation

TOI was valued at $128.73 using a seven-year DCF, a WACC of 6.59%, and a terminal growth rate of 3.0%. This provides an implied return of 10%.

The CPMT received shares of CSU's spin-off, TOI, and initiated a position at a conviction of 1 in FQ2 2021. Despite estimating an implied return of 9%, the Company has outperformed CPMT estimates with a holding period return of 17.12%, exhibiting its operational excellence and industry expertise. TOI provides favourable exposure to fragmented and scalable European VMS markets, which present less private equity competition compared to North America. The Company is able to scale VMS businesses quicker as compared to CSU given its robust average M&A growth of 30%. From 2022 to 2023, the Company, much like the rest of the IT industry experienced a decline in its share price due to rising interest rates with the Canadian and U.S. 10-yr yield curves rising above 4.8%. TOI's size and scale makes it more susceptible to interest rate swings when compared to CSU which is relatively larger.

Despite TOI's sensitivity to interest rates and significant CSU management overlap, the Company represents an attractive investment opportunity with its robust future FCF growth, coupled with its ability to compound this capital through further acquisitions across Europe. TOI's strong operations and reputable status in the European VMS industry reinforce the Fund's confidence in management's ability to execute and grow. The CPMT will continue to monitor TOI's performance and recommend a hold on the name.

Figure 7: EV/EBITDA vs Peers



Source: Bloomberg