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One of the very best TSX-listed stocks has zero buy ratings

'Constellation Software" is a pretty great name if you want to describe a great company. The moniker implies that all of Constellation's operating companies are stars shining brightly, likely for years to come.

For some time, the name has been apt, with Constellation Software Inc.one of the very best TSX-listed stocks you could own. However, the shares have been caught up in the broader tech downdraft this year, which suggest there's currently a buying opportunity. The problem, however, is that the shares remain pricey, and there's mounting evidence that Constellation's years of burning so brightly are coming to an end.
Before we consider the falling-star thesis, however, let's examine a few facts that suggest Constellation has done even better than you may have realized.

Just about a year ago, wearing another journalistic hat, I was asked by a U.S. publication to craft a list of "the world's greatest stocks." These stocks had to have long-term and short-term records of outperformance, so we looked for stocks that had doubled over five years, and returned 15 per cent over the prior year. (These figures meant the stocks had outperformed the S&P 500.) Also, the companies had to be highly profitable, as measured by average return on equity over five years. And the company had to have future earnings prospects, i.e., estimated annual earnings-per-share growth of 15 per cent over the next two years.

Admittedly, these criteria are fairly arbitrary. But they can cut a list of 2,100-plus sizable U.S. stocks down to 11. And – here is where we return to our topic – every time I've used S&P Capital IQ in the last 12 months to run the screen on the Toronto Stock Exchange's roughly 1,500 companies, the only stock that has ever passed the screen is Constellation Software.

This, then, is wonderful for people who've been shareholders of Constellation for the past half-decade. But what does it mean for investors who are considering buying or holding for the next five years, or more?

Despite Constellation's track record, Bay Street analysts are surprisingly lukewarm on the company, with zero "buys," nine "holds" and one "sell" on the name. Now, to be fair, this isn't terribly different from the sentiment in March of last year, when Globe Investor looked at the case for Constellation and found a fair number of cautious analysts – who failed to anticipate a 40-per-cent run in the stock over the next several months.
Most of the 2015 gains have been given back, however, as Constellation stalled out at just under $600 a share and closed Wednesday at $473.77. What is the problem? Part of it is the broad-based damage to tech stocks, but a fair amount is due to a slowing growth story at the company, which may or may not be reversed when the company reports earnings Feb. 17.

Constellation's business has been built on constant, value-based acquisitions of small, private software companies that it then allows to run mostly autonomously; unlike other frequent buyers, it doesn't brag about whacking half the employees and rolling everything up in the name of efficiency.

In recent quarters, however, Constellation's "organic" growth – year-over-year sales gains at its existing businesses – have stalled or even turned negative. Analysts who give the company the benefit of the doubt see Constellation's excellent track record and note management's comments that the problem is simply quarter-to-quarter volatility.

The more skeptical note valuation – at its highs in 2015, it was trading at earnings multiples that were lofty even for the software sector – and the challenges of finding more acquisitions that have paid off as well as past ones. Stephanie Price of CIBC World Markets set a $425 target price in October, when the shares were at $581.50, and very nearly saw that target hit on Monday. On Wednesday, she upgraded the stock to "sector performer" from "underperformer," but her new target price of $505 implies just 6-per-cent upside.

Howard Leung of ***Veritas Investment Research***, in a late-January report named "Fading Star Power," argues that slowing organic growth is forcing Constellation into lower-quality acquisitions. Specifically, ***Veritas*** says, the mining software company Datamine has profit margins 10 percentage points lower than Constellation's existing margins; realtor-software seller Market Leader was described as a "declining franchise" by previous owner Zillow; and Springer-Miller Systems, a provider of software for hotels and spas, had an EBITDA (earnings before interest, taxes depreciation and amortization) margin of negative 20 per cent prior to Constellation's acquisition.

"Publicly, management maintains that it has not shifted its strategy towards buying distressed assets with longer integration times, but it is hard not to view these recent acquisitions as fixer-uppers that are dragging down corporate EBITDA margins," ***Mr. Leung*** says.

How many stars can burn out and die before a constellation is no more? It's a question of astronomy and, perhaps, finance as well.