Lumine Group: Growing in the Shadow of Constellation Software

“Something extraordinary happens when you create a distinct new company. The team settles into an open office where communication is efficient and there are no unnecessary administrative expenses. People cover for each other and leave all the bureaucracy and paperwork behind.” These are some of the remarkable words spoken by Mark Leonard, President and CEO of Constellation Software (CSU, $3600.21), about the spin-off of divisions from the Toronto-based software company, such as Lumine Group (LMN, $33.75), which was finalized just over a year ago.

Constellation’s exemplary economic performance has been well rewarded in the stock market. Since the initial stock purchases we made for our clients, around $91 twelve years ago, the stock has delivered a compounded annual return of over 40%, including dividends and spin-offs.

Such a track record naturally leads us to scrutinize all major capital allocation decisions made by Mark Leonard, such as giving certain divisions the opportunity to fly on their own and be separately listed on the stock market.
This has been the strategy implemented by the leader in recent years to more rapidly deploy the abundant capital generated by Constellation’s activities. The conglomerate sent its first division to the stock market in 2021 when it combined its European operations, Total Specific Solutions, with a fast-growing Dutch company, Topicus, to form Topicus.com (TOI, $119).

Mark Leonard repeated the same formula over a year ago with Lumine Group. This division, specialized in software used by media and telecommunications groups, was merged with the American software provider WideOrbit at the same time it was listed on the stock market.

Lumine shares many characteristics with Constellation. Like its parent company, it is a true acquisition machine. Over the past four years, it has deployed approximately $USD 850 million in acquisitions. Since 2014, the group has acquired nearly 30 companies, including the significant acquisition of WideOrbit, valued at $USD 505 million.

Like Constellation, Lumine benefits from significant competitive advantages. It would indeed be difficult for a potential rival to steal its clients, given the essential nature of the software that manages the daily operations of television stations, radio stations, and call centres. The costs associated with a system change and the training required by such a decision make Lumine’s clients captive.

Lumine’s management also adopts Constellation’s idea of aiming to remain the owner of the companies it acquires “forever.” This approach is particularly useful in

convincing executives looking to divest activities to favour Lumine over opportunistic rivals, whose investment horizon is often only a few years.
Imagine the undesirable scenario for an executive looking to divest a division: a large telecommunications group like Bell (BCE, $32.53) sells a division to a private fund that, a few years later, resells the same entity to... Telus (T, $21.25). Thanks to the successful integration of numerous divisions from large groups, Lumine has built a reassuring reputation for a selling executive.

Acquisition Potential

At the end of 2023, Lumine announced two significant acquisitions. It first announced it would spend approximately $USD 34 million to acquire two divisions of Synchronoss. This transaction was, in our opinion, carried out on very advantageous terms, as the selling company was forced to quickly divest non-priority activities due to excessive debt.

Then, in December, it ratified an agreement to acquire certain activities from telecommunications equipment supplier Nokia for over $USD 200 million. In early April, Lumine announced another acquisition that seems extremely advantageous to us: two growing divisions from Casa Systems, a key supplier to the telecommunications industry placed under bankruptcy protection.

Acquiring a division from a larger group is a complex task that many acquirers avoid like the plague. The creation of a host legal entity or the establishment of a transition agreement for employees are among the additional tasks required for such an acquisition. As the list of contenders is generally short, the prices paid are all the more reasonable. This leads us to believe that Lumine aspires to a return on invested capital superior to Constellation Software's already exemplary performance.

If Lumine is similar to its parent company in many ways, it also presents some differences. Its size is relatively smaller. Its activities are diversified, but Lumine remains active in a smaller number of sectors than Constellation.
Since Constellation remains the main shareholder of Lumine, it does not fully control its destiny. Its parent company could, for example, prevent it from carrying out certain transactions. However, it greatly benefits from Constellation's presence in its circle of influence. The sharing of best practices and the ability to borrow capital from its parent company contribute to its rapid evolution.

Lumine still has to prove itself as a distinct company, but it shows strong growth potential in the short and long term. Even if it remains in Constellation's shadow, investors appreciate what it has demonstrated so far and give it an evaluation that no longer looks like a bargain.

The clients and employees of Medici hold shares in Constellation Software and Lumine Group.

This is translated from French. If you are a subscriber, you can read the original version on lesaffaires.com.