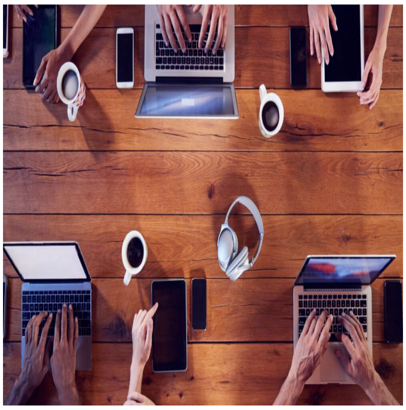

Why Canada Tech Stock Open Text (TSX:OTEX) Is the Perfect TFSA Buy!

Description

Acquisitions can be a stock price booster or a drag on shareholder value. The final outcome purchases have depends upon the financing method and the negotiated price.

When shareholders suspect that an acquisition is too costly or requires high leverage, the market value of the stock may decrease. Likewise, if investors believe that the company paid a fair price and can afford to pay the purchase price without taking on too much debt, the cost of shares may increase.

Financing method and price matters because the higher principal and interest payments will dig into shareholder returns. Investors will either project lower or higher ROI (return on investment) going to shareholders depending on these two crucial variables affecting the distribution of company returns between debtholders and shareholders.

Open Text is a solid example of a successful acquisition

In November, a fantastic Canadian technology firm, **Open Text** (TSX:OTEX)(NASDAQ:OTEX), announced the purchase of Carbonite, a U.S. cybersecurity firm based in Boston, Massachusetts. Open Text will need to temporarily increase its debt to finance the negotiated price of US$1.42 billion.

Shareholders don't seem too concerned about the temporary increase in debt; in the two weeks since first reporting the acquisition plans, Open Text's stock price has appreciated by about 4%.

Carbonite is profitable and in a high-margin industry. It sells cloud and endpoint security software, bringing in US$405 million in annual revenue per year, or about 30% of Open Text's purchase price. In effect, Open Text will pay about 3.5 years of Carbonite's yearly income in the transaction.

It isn't uncommon for companies to report the sales price as a multiple of the current annual revenue. Ideally, the premium attached to the deal should represent the net present value of the transaction plus the cost savings and revenue benefits arising from improved economies of scale and scope from the merger.

What’s great about the Carbonite deal

Individual professionals and small- to medium-sized businesses comprise the majority of Carbonite’s current sales pipeline. A multitude of smaller contracts carries the same benefits as diversification. A loss in revenue from many smaller business relationships impacts businesses less than would a single larger deal.

Open Text takes a different approach by focusing on building its enterprise pipeline. Larger contracts are no doubt worth more, which is why Open Text boasts a $58.49 stock price. The addition of Carbonite will expand upon Open Text’s consumer base to key strategic markets.

The strategic market expansion should add to shareholder value. What’s better is Carbonite’s technology complements Open Text’s current artificial intelligence services and products, contributing to more significant economies of scope. The overlap in required skills to create and maintain the products should enhance efficiency.

Past Open Text acquisitions mostly successful

Mergers and acquisitions pose many challenges for corporations. It is not a small task to integrate two companies into one unit. The process of realigning goals between new management and transitioning employees is even more difficult since people tend to resist change.

Luckily, Carbonite is not Open Text’s first acquisition. The experience of Open Text’s leadership team to effectively leverage the organizational knowledge, skills, and technology of purchased businesses will be crucial to ensure the purchase adds optimal shareholder value.

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