

# EQUITY RESEARCH

August 16, 2023

Flash Research

## CONSTELLATION SOFTWARE INC.

### Company Declares Warrant Dividend

**Our Conclusion:** Constellation announced a warrant dividend to all common shareholders of record on August 24, 2023, with payment on August 29, 2023. The warrants are exercisable only if Constellation exercises its call option on the Series 1 debentures and we do not believe the warrants will ever be exercisable. Instead, we believe they were issued to make the company's new \$700MM debenture offering more marketable, removing investor concern around Constellation potentially calling the debentures early. With the warrants, Constellation has no incentive to call the Series 1 debentures early, given that the warrants allow investors to receive a Series 2 debenture (with no call option) for each Series 1 debenture Constellation called.

### Key Highlights:

**What do the warrants entail?** Constellation announced a warrant dividend, with one warrant for every common share. The warrants are exercisable if Constellation exercises the redemption rights on its Series 1 debentures. Each warrant, if exercised, allows the holder to receive C\$100 principal amount of Series 2 debentures for each C\$100 principal amount of Series 1 debentures tendered for repurchase by the company. The two series will be identical except the Series 2 debentures will not include a company redemption right. The warrants will not be listed on the public exchanges and will be listed if and when the company redemption right is exercised. Following the distribution of the warrant dividend, there will be 21,191,530 warrants outstanding, versus 2,822,869 Series 1 debentures outstanding.

**Why Issue Them?** We believe the warrants are being issued to make Constellation's new debenture issue more marketable. Last week the company announced a rights offering to purchase up to \$700MM in floating rate debentures. The company intends to use the proceeds on future M&A (it recently announced the \$700MM acquisition of Optimal Blue). The debentures will initially have a 13.3% interest rate up to March 31, 2024. Post March 31, 2024 it will be reset on an annual basis and will be equal to 6.5%+ CPI. Maturity date is March 31, 2040. The new \$700MM debenture is being issued as an additional tranche of the Series 1 debentures. We believe investors have been concerned that Constellation could exercise its call option on the debentures, so we see the warrants as a way to provide investors comfort that the call option on the debentures will not be exercised (and if it is, it will not negatively impact investors' yields).

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### Outperformer

CSU-TSX, Sector: Information Technology  
Current Price (8/16/23): C\$2,669.94  
Price Target (12-18 mos.): C\$3,000.00

All figures in US dollars unless otherwise stated (C\$1.348:US\$1.00).

Please see "Price Target Calculation and Key Risks to Price Target" information on page 2.  
For required regulatory disclosures please refer to "Important Disclosures" beginning on page 3.

## **Price Target Calculation**

Our C\$3,000 price target is based on a sum-of-the-parts methodology. We value CSU (ex-TOI and LMN) at a 26x forward EBITDA multiple, and CSU's 30% ownership of TOI and 61% ownership of LMN at market values.

## **Key Risks To Price Target**

The primary risks we see to our price target include: 1) ability to scale, 2) ability to acquire, 3) vertical market exposure, and 4) lack of detailed disclosure.

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|----------------|--------------|---|
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| Neutral        | NT           | Stock is expected to perform in line with similar stocks in the coverage universe during the next 12-18 months.       |
| Underperformer | UN           | Stock is expected to underperform similar stocks in the coverage universe during the next 12-18 months.               |
| Tender         | TR           | Shareholders are advised to tender shares to a specific offer as we do not believe a superior offer will materialize. |
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|----------------|--------------|---|
| Overweight     | O            | Sector is expected to outperform the broader market averages.               |
| Marketweight   | M            | Sector is expected to equal the performance of the broader market averages. |
| Underweight    | U            | Sector is expected to underperform the broader market averages.             |
| None           | NA           | Sector rating is not applicable.  |

Note: Broader market averages refer to S&P 500 in the U.S. and S&P/TSX Composite in Canada.

## CIBC World Markets Inc. Price Chart

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