Avigilon: Is it Time to Catch the Falling Knife?

Description

Avigilon's (TSX: AVO) stock closed at $26.13 on May 6. Only three days later, the stock closed at $19.26, for a 26.3% decrease. So while the stock was trading at a P/E multiple of 32 times 2014 expected earnings (mean expectation based on nine analysts) on May 6, it is now trading at a P/E ratio of 23.8 times 2014 expected earnings. EPS is expected to grow 53% in 2014.

Why did the stock get hit so hard and is this a good time for investors to step in?

More than the numbers

The issue that seems to have spooked the market is the recent resignation of CFO Bradley Bardua. His resignation is being attributed to health reasons and Mr. Wan Jung, a director of Avigilon and former CFO who retired a few years ago, has been named interim CFO. It seems that the fact that there have been a number of senior people who have resigned in the last few months has investors worried that it is a red flag for the company.

Only time will tell, but we know that expensive stocks are prone to overreactions. When stocks are trading at such lofty valuations as Avigilon had been, they are notorious for tanking even when the market gets even the slightest hint of trouble.

There is no shortage of expensive momentum stocks nowadays. **Sierra Wireless** (TSX: SW)(NASDAQ: SWIR), for example, has fallen over 16% since the beginning of May, but there is a clearer explanation as to why it has fallen. The company's first-quarter results came in lower than expectations and the second quarter will be below expectations as well. Even after the decline, Sierra is trading at a P/CF ratio of 37 times.

What do the financial results tell us?

The results that Avigilon posted were once again quite impressive. Revenue growth of 74% was accompanied by net income growth of 187% due to strong margin improvements and economies of scale as the business grows.

Gross margin increased to 57% from 51% in the same period last year, while operating margin increased to 15.4% from 13% in the same period last year. The company saw revenue growth in all regions, with U.S. revenues (the largest region, at 16% of total revenue) growing at 67% and Asia-Pacific and Latin America growing at 113% and 115% respectively, albeit off of much smaller bases.

Cash from operations more than doubled, yet there was a noticeable build in inventories on the balance sheet, which management attributed to seasonality.

Management reiterated its goal to have a revenue run rate of $500 million by 2016. And this goal is only taking into account organic growth. Any acquisition that the company makes will add to this number. Management is confident that they will be able to achieve this goal.

As of the end of the first quarter, the company had $60 million in cash and negligible debt, so it is still in a good position to take advantage of attractive acquisition opportunities, which management is ready and willing to act upon.

Focus for 2014

The focus for 2014 will be to capture market share in the global security market. Once video IQ solutions integration is complete, users will be able to combine surveillance, access control, and video analytics for a user-friendly security solution. No competitor can do this at this time.

So the question we have to ask ourselves is whether the market's reaction in the last few days is reasonable. Has the market been spooked because the stock was trading at levels that made investors nervous (as they have been with highly valued momentum stocks recently) and this was just an excuse to take some profits? In any case, there are two things that investors can be certain of: the numbers are still impressive and valuation is now looking much better and I dare say, reasonable.

CATEGORY

1. Investing

TICKERS GLOBAL

1. NASDAQ:SWIR (Sierra Wireless)
2. TSX:SW (Sierra Wireless)

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