Is This Small Cap a Potential 10-Bagger?

Description

Peter Lynch, the legendary fund manager from Fidelity, originally coined the term '10-bagger' to refer to a stock with considerable potential for growth or in baseball terms, two home runs and a double, the stock equivalent of a hugely successful baseball play.

Sandvine (TSX: SVC) is a Waterloo-based technology company that was co-founded in 2001 by current CEO David Caputo and listed on the Toronto Stock Exchange in 2006.

Sandvine provides network policy control solutions (deep-packet inspection hardware and software) that allow high-speed internet service providers to manage traffic over their networks. The company's network policy control solutions are present in more than 250 internet service provider networks in over 90 countries, serving hundreds of millions of fixed line and mobile broadband internet subscribers worldwide.

According to industry analyst Infonetics, operator spending on deep packet inspection solutions grew by 23% to US$728 million in 2013, and is forecast to top US$2 billion in 2018. Sandvine had a leading market share in 2013 buoyed by a surge of new customers and a number of follow-on orders; **Allot**, **Cisco Systems**, and **Procera** are the other major players.

The company performed poorly in recent years. A profit of US$17.5 million in 2007 was followed by losses in three of the next five years as the global debt crisis curtailed the spending plans of telecommunication companies. However, the industry eventually started to improve. The company reaped the benefits and reported record revenue of US$107 million and a profit of US$13 million in 2013 with 51 new customer gains for the year as well as large follow-on orders from existing customers.

The good news continued in fiscal 2014 with excellent results in the first quarter and also now for the second quarter as reported on July 10. Revenue for the first six months of the fiscal year increased by 26% compared to the previous year, a considerable number of new customers were added and new orders were received from existing customers with increased capacity or additional product requirements. Net income jumped by 358% from a low base and operating cash flow doubled.

The balance sheet of the company carries US$145 million of cash, which is supported by strong operating cash flow. Curiously, the company also issued new shares in 2014 to raise US$28 million, probably explained by a comment in the 2014 annual report that stated the company “anticipates throughout fiscal 2014 it will continue to selectively assess acquisition opportunities to strengthen its market position and augment its growth.”

According to the Thomson Reuters consensus estimates, the company is expected to make a net profit per share of around $0.18 in 2014 and $0.26 in 2015. That results in a forward price/earnings ratio of 19 times in 2014 and 13 times in 2015 respectively, which does not seem expensive given the rapid improvement in the profitability of the company. Also of note is the almost $1 per share of low yielding cash held by the company and which certainly can be employed more productively.

Sandvine’s share price had a rough ride over the past 10 years, peaking at over $7 in 2007, bottoming at $0.64 in March 2009 and recovering to the current level of $3.37. Should the profitability of the business continue to improve with the expected growth in the industry, the price could move ahead a long way – perhaps not a 10-bagger but certainly considerably ahead of current levels.

CATEGORY

1. Investing

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