Sierra Wireless Inc. Reports Another Impressive Quarter

Description

Sierra Wireless, Inc. (TSX: SW)(NASDAQ: SWIR) has just released its second-quarter earnings results, which demonstrate continued strong growth. Let's review the company and focus in particular on those results.

Machine-to machine communication is an industry that is growing fast. It is a fragmented market where Sierra Wireless is well positioned to consolidate. In the long term, it is reasonable to expect that most machines will be connected, as this provides financial, service, and lifestyle benefits to users of these machines. Infonetics Research predicts that revenue from M2M services will more than double, from just under $15 billion in 2012 to $31 billion in 2017. As Sierra is now focused solely on the M2M space and currently boasts a 34% market share, it stands to benefit greatly from this growth.

Strong revenue growth

Revenue increased a strong 23.2% in the second quarter, driven by the company's recent $5.9 billion acquisition of AnyDATA and its recent acquisition of In Motion Technology Inc, as well as organic growth of 16.8%. This came in above company expectations, which were for an 18% increase in revenue.

Breaking down the revenue growth into Sierra's two segments, the OEM segment achieved revenue growth of 22.6%, which was driven by growing sales of 3G and 4G embedded modules. Gross margin in this segment was 28.9%. The enterprise solutions segment achieved a 27% growth in revenue, with a gross margin of 52.4%. The higher-margin segment — enterprise solutions — is also the faster growing segment, which is positive for overall gross margins if this trend continues.

Non-GAAP vs GAAP results

While I do not love it when companies need to present their numbers according to their own definition of what is relevant, I understand that for certain high-growth, fast-changing companies, this exercise does provide investors with meaningful information about the growth of the core business.

Sierra Wireless reported a net loss of $8.3 million in the second quarter. If you exclude certain onetime costs, such as stock based-compensation, restructuring, impairment, and acquisition-related amortization charges, the result is non-GAAP net earnings of $2.59 million. While this exercise does give an indication of the health of the underlying fundamentals, investors would be wise to keep monitoring this discrepancy.

Cash position increased in the quarter

During the quarter, the company increased its cash balance by U.S.$17 million, and it now stands at $168.4 million. This, coupled with the fact that the company has negligible debt, leaves Sierra Wireless in a good position to focus on growing its business, both organically and through acquisitions. The CEO has stated that the company will use the this cash for mergers and acquisitions, focusing on the enterprise solutions business unit, which, as mentioned previously, has higher gross margins, and is a more fragmented market.

Another noticeable positive for the company is the fact that, excluding changes in working capital, operating cash flow came in at $3.9 million. With capital expenditures of $2.2 million in the quarter, the company generated free cash flow of $1.7 million.

Strong company guidance

On the second-quarter conference call, management gave its third-quarter guidance. The company expects continued strong performance, with third-quarter revenue expected to increase 23% and organic growth coming in at 17%. Gross margin is expected to improve slightly due to a reduction in cost of goods sold, and non-GAAP, adjusted earnings per share is expected to increase by 50%.

The bottom line

In my view, the major caveat regarding Sierra Wireless is the fact that its valuations are high. On a GAAP basis, the company has no earnings; on an adjusted, non-GAAP basis, it is trading at a P/E ratio of 66 times its 2013 EPS and 58 times its expected 2014 adjusted EPS. The stock has a one-year return of almost 60%. Although my view is that the market in general is at least fairly valued, Sierra is one that is currently priced for perfection, and this can turn bad pretty quickly. While I like Sierra's fundamentals, performance, and outlook, it seems to me that investors would be wise to sit back and wait for a better entry point.

CATEGORY

1. Investing

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