Why Sierra Wireless, Inc.'s Struggle Is the Best Thing to Happen for Long-Term Investors

Description

Sierra Wireless Inc. (TSX:SW)(NASDAQ:SWIR) has had a rough go of things in the last year. The company missed expectations in the last two quarters, in part because it had lower demand from certain large automotive OEM customers due to what management believes is just general nervousness related to macro-economic conditions.

And to add insult to injury, the company also came out with lower-than-expected 2016 guidance, which has left investors questioning what was once a very bright future for Sierra.

All of this has sent the stock tumbling. The shares have declined almost 60% in the last year, and the increased uncertainty has made investors nervous. But there is a silver lining. Valuation levels have come down back to reality and look quite attractive at this point. And this is great news for long-term investors who've been waiting to get into the stock but couldn't pull the trigger at the prior lofty, sky-high valuations.

Sierra now has both strong fundamentals and an attractive valuation, which makes it a great buy in my view.

Acquisitions strengthen Sierra's position in device-to-cloud solutions

The company completed three acquisitions in 2015: European mobile virtual network operator MobiquiThings, Sweden-based Wireless Maingate, and Accel Networks. All three acquisitions are in the cloud and connectivity business and strengthen Sierra's positioning as the company that offers the complete chain: device, connectivity, and cloud. This brings with it competitive advantages in the form of better quality, lower costs, and better distribution.

Strong balance sheet and cash flow

Sierra's balance sheet still looks good. It has no debt and a cash balance of US$9 3million. Furthermore, the company continues to generate healthy cash flows each quarter. In the fourth quarter of 2015 (the latest quarter), Sierra reported cash flow from operations of $13.1 million and free cash flow of $8.3 million.

Gross margins trending upwards

With the increased focus on the cloud and connectivity business, management is expecting margins to trend upwards. In fact, the company introduced this as a new segment in its reporting going forward, as it’s quite different with respect to the margins it is expected to generate. When this business is at scale, management expects gross margins in this segment to be over 50%. This compares to Q4 2015 gross margin of 31%.

Share buyback

Sierra introduced a share-buyback plan this year that is expected to see the company buy back up to 3.1 million shares, or 10% of the float.

Valuation

After a long period of being priced for perfection and trading at P/E levels (on adjusted EPS) of almost 60 times, the stock currently trades at a P/E ratio of a more reasonable 21 times.

So, while estimates are being reduced, 2017 is still expected to see growth in adjusted EPS of almost 35%, which I think investors can have reasonable confidence in due to many of the points discussed in this article.

Lastly, management recently spoke about the goals they have with respect to the company’s growth. In the next several years, management fully expects Sierra Wireless to grow to revenue of $1 billion and beyond through a combination of organic growth and mergers and acquisitions. This compares to 2015 revenue of $607 million.

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