Avigilon Corp. Is a Growth Puzzle

Description

Avigilon Corp. (TSX:AVO) is one of a select few Canadian growth gems in the technology space that has puzzled investors over the past few years. The company has been trading on the TSX for just over five years, and in that span, the business' stock price has gone through a number of boom and bust cycles, based on how the company managed to meet, exceed, or underperform growth expectations set internally and by the market.

Growth company

As a growth company, Avigilon has done a relatively good job of hitting its own preset targets over the medium term. At the time of the company's initial public offering (IPO), management set a target revenue run rate of $500 million as the goal to be achieved in five years; five years later, the company has accomplished mission #1 and is now moving on to bigger and better things.

The issue that management has had in meeting its revenue run rate target is that the industry has evolved over the past five years, resulting in increased competition and squeezed margins, factors which have led to an overall stock price decline from the valuation reached in 2014 despite growth numbers largely meeting expectations over the long-term.

From 2014 to 2016, the company's gross margin has decreased from 56.6% to 52% for a number of reasons linked to the company's revenue growth model. While going after market share in the growing surveillance systems market seems to be a prudent long-term strategy, eroding margins and increased competition for market share has led to less-enticing results over the past couple years on the whole.

Growth slowing

As Avigilon and its competition are finding out, achieving high levels of growth year over year becomes more and more difficult the larger the business grows. Capturing low-hanging fruit out of the gate enabled Avigilon to grow at hyper-speed, and the company is starting to see these growth rates slow down in recent years, although the trend is still positive.

In 2016, the company grew EBITDA by 6% and in 2015, the growth rate was 4.9%, a far cry from EBITDA growth rates in the 300%-600% range from 2009 through 2013. Growth in EBITDA has been slowed partly due to the aforementioned deterioration in margins of late; over the past eight quarters, gross margin has declined from 59% in Q1 2015 to 51% in Q4 2016, finding what appears to be a "new normal" gross margin closer to 50% than 60%.

Bottom line

Avigilon is an atypical stock, one which provides long-term investors continued headaches due to the changing characteristics of the industry and underlying business, making forecasting assumptions opaque and financial modeling efforts difficult. In my opinion, Avigilon is at a stage where margin preservation means more to me than capturing market share, and as a result, I remain on the sidelines.

Stay Foolish, my friends.

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