Why This Stock Is Soaring 16% Today and What to Do About it

Description

Open Text Corp. (TSX:OTEX)(NASDAQ:OTEX) is soaring today, as the company reported a much stronger second quarter of fiscal 2018 yesterday, which has left investors and analysts adjusting to the new reality: that this company is clearly undervalued amid its strengthening position in the software industry and its strengthening financials.

Revenue and earnings blew right past expectations in a quarter that saw 35% revenue growth, 41% earnings-per-share growth, and adjusted EBITDA margins that improved three full percentage points.

And the best news is that even though the stock is soaring today, the valuation is still very attractive, and this is still a good time for investors to get a piece of the action.

Here are more reasons why investors should buy this technology stock:

Strong free cash flow generation

Besides the strong revenue and earnings growth that the company is achieving, free cash flow generation has ramped up significantly this quarter.

Operating cash flow, the true measure of how a business is performing, increased 56% compared to the same quarter last year, and free cash flow increased 48% to $141 million.

And improving free cash flow means that the company was able to pay off debt and bring down its leverage ratios. And going forward, it can increase its dividend or make further acquisitions — all good things that are setting the company up for continued future growth and setting the stock up for continued future gains.

More economies of scale to come

The $1.6 billion Documentation acquisition closed in January. Given that this acquisition has increased the company's size by 25%, there are likely more synergies and economies of scale to come from it.

The acquisition is highly accretive to earnings, and we should expect more to come in 2018.

Organic growth

It is nice to see that the company is not solely relying on growth via acquisition, as organic revenue grew 3% this quarter.

While organic growth estimates were significantly higher a couple of years ago, these expectations have been ratcheted down, along with valuation on the stock, and are now at much more reasonable levels.

Valuation is low and momentum is strong

So, with the company firing on all cylinders, looking at the stock's valuation brings us to the conclusion that this is a great buy even after the rally today.

The stock trades at 19 times this year's consensus EPS and 17 times next year's consensus EPS.

But with estimates being increased and the potential for further increases coming from greater-than-expected synergies and economies of scale from Open Text's Documentation acquisition, and any upside from the company's uses of its ample free cash flow, such as returning cash to shareholders, debt repayment, and/or future acquisitions, we can see that the stock is in a sweet spot.

It has a low valuation and big upside.

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