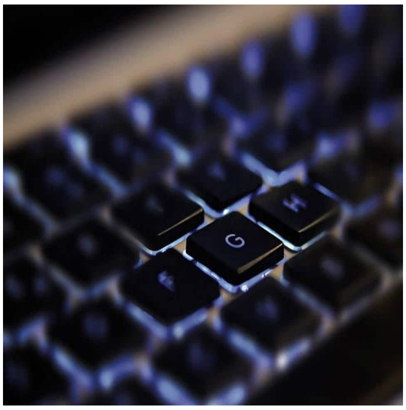

Kinaxis Inc.: Notable Takeaways From the Latest Financial Results

Description

Cloud concurrent planning software provider **Kinaxis Inc.** (TSX:KSX) is a possible outperform candidate for 2018 after releasing its full-year 2017 financial results, which showed profitability growth and some gross margin expansion, and it's guiding for stronger revenue growth this year.

Here are some notable takeaways from the company's latest full-year 2017 financial results released on February 28.

Improved revenue diversification

Kinaxis managed to reduce the magnitude of a negative impact from a loss of any single customer to its financial health last year.

In 2017, Kinaxis's 10 largest customers accounted for about 44% of total revenue, with no single customer bringing in greater than 10% of the company's total revenues. This was a marked improvement from 2016, where the top 10 largest customers accounted for 47% of revenues, with one large client accounting for 12.3% of the company's top line.

Business concentration risk is lower now, and the loss of any one large client no longer threatens to cripple Kinaxis's operations.

This is especially important, considering that Kinaxis's market value plummeted nearly 22% in a day in August last year when it reported the loss of a large Asian customer. The stock's valuation multiples have failed to recover to prior levels since then.

Strong subscription revenue growth

Subscription revenues continued on a strong growth path, rising 23% from 2016 levels, and management is guiding for a further 23-26% growth in this revenue line this year.

Professional services revenue declined 5% from 2016, probably due to the new business model the company adopted mid-year in 2017; its technical partners took over the deployment of Kinaxis's business solutions, thereby earning the professional services revenue from the new clients.

Total revenue growth rate, at 15% year on year, was far below the three-year compound annual growth rate (CAGR) of 24% achieved in the past, mainly as a result of the decline in professional revenue and compounded by the loss of a large Asian customer mid-year 2017. However, subscription revenue growth, at 23%, was much closer to the 25% CAGR trend line over the past three years.

Subscription revenue is the main growth driver going forward.

Profitability growth

Kinaxis saw some significant improvement in profit margins during 2017, with the gross margin rising from 68% in Q1 to 70% in Q2 and hitting 71% in Q3 before topping out at 72% last quarter. Annual gross margin was 70% — better than the 69% achieved in 2016.

The adjusted EBITDA margin grew 40% from 25% of total revenue in 2016 to 30% of revenue last year.

Potential for further margin expansion

There's a possibility for a further gross margin expansion to +71% this year, as subscription revenue continues to constitute a bigger component of total revenue after the recent change in business arrangement with technical partners.

Subscriptions attract higher gross margins than professional services. However, planned capital expenditures, including the construction of a new data centre in Japan this year, will increase the depreciation charge and limit margin growth.

Should you buy Kinaxis stock today?

It may not be surprising to see a further price-to-earnings (P/E) multiple expansion on Kinaxis stock in 2018, as the company becomes more profitable and growth investors pour into the stock. Kinaxis's business model is becoming more profitable, with a projected long-term revenue growth rate of 23% — good for a sustained high valuation.

The company is gaining more growth momentum in the large automotive space after signing on **Toyota Motor Corporation** and **Nissan** as its clients recently, which were huge votes of confidence in Kinaxis's software offering by some of the world's largest auto manufacturers.

Kinaxis's flagship product, Rapid Response, is gaining traction in the life sciences and consumer packaged goods industries too, and the company's stellar 100% revenue-retention rate makes it a potentially reliable growth stock.

While management recently guided for an 18.5-22.3% growth in total revenue for 2018, subscription revenue, a major component of the top line, could grow 26% or more for the year.

The stock trades at an expensive valuation today, with a trailing P/E of 83 times and a forward P/E multiple of 60 times, but it's rated an outperform candidate by nine out of the 13 analysts recently polled by **Reuters,** with three analysts confident enough to rate it an outright buy.

Long-term growth investors may consider buying any dips in Kinaxis's stock during this year.

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Date
2025/08/18
Date Created
2018/03/09
Author
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