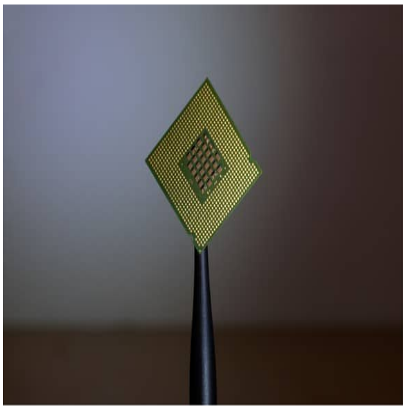

Why Did This Tech Growth Stock Fall 16% on Friday?

Description

Kinaxis (TSX:KXS) stock plunged by 16.47% in a single trading day on Friday, November 9, after releasing some not-so-inspiring quarterly financial results after market close on the previous day. Whether this acute decline was warranted or overdone remains a big question, but there are a few observations that can be noted about the tech growth stock's latest earnings report.

Kinaxis's latest quarterly financial results installment reported total revenue growth of only 9% over the same quarter last year and much lower profitability, with net profit for the quarter falling to just US$2.67 million as compared to US$5.22 million during the same period last year. And adjusted operating earnings (EBITDA) fell to 26% of revenue from 32% last year.

Not as bad…

At face value, it would seem like the company grossly underperformed its 2017 results, but the the above comparisons could be very misleading, as the figures are based on slightly different revenue accounting standards. The latest results may not be as bad as they seem.

The adoption of a new revenue recognition standard since January 2018 — namely the International Financial Reporting Standard (IFRS) 15: *Revenue from Contracts with Customers* — has severely affected the direct comparability of Kinaxis's financial results, as opposed to a previous quarter when the new rules blessed the quarterly report.

The new revenue accounting standard accelerated the recognition of some portion subscription revenue to earlier accounting periods of this year, resulting in lower total revenue for the third quarter.

Without IFRS 15 adoption, Kinaxis would have reported total revenue growth of 18% above that generated during the same quarter in 2017, and the net profit for the period would have doubled to US$0.20 per share.

A 16% growth in professional services revenue during the third quarter of this year promises to quell my prior concerns registered when the company opted to share this revenue line with its channel partners. However, the sudden growth in this revenue component appears to be due to timing as professional revenue grew by only 1% over the comparable first nine months of last year.

There’s some weakness though

There are indeed some signs of weakness in Kinaxis’s performance this year, although these may not justify the 16% tumble on the stock that occurred on Friday.

The company generated a three-year compound annual growth rate in subscription revenue of 25% per annum over the three years to December 2017, but so far this year, even on a pre-IFRS 15 basis, the year-on-year growth rate of just 22% over the comparable first nine months of 2018 falls short of prior average performance, and if the current scenario extends for much longer, then the company’s growth rate could fall below 20% sooner than what investors would prefer, and that warrants lower valuation multiples on the growth stock.

Kinaxis’s total revenue-growth rate has fallen to 18% over the first nine months of 2018, way below the 24% CAGR recorded over the past three years, and that’s concerning.

Further, the company’s operating cash flow generation declined by 40% last quarter compared to the same quarter last year. Operating cash flow growth is a highly desirable attribute for any stock, and a negative trend is a punishable offence. However, cash and cash equivalents have grown 11% since December 2017, and this is a positive.

Most noteworthy, the company adjusted downwards its revenue guidance for 2018 “to reflect the delays in closing certain new business,” said the chief financial officer. Total revenue for 2018, on a pre-IFRS 15/16 basis is now expected to fall between US$155 and US$157 million from a guidance of US$158-163 million given in August. This is a significant climb down by management that warrants a revision in investor expectations, and the purported “delays” in capturing new business deals generate anxiety in investors’ minds.

Foolish bottom line

Kinaxis has fallen victim to changes in accounting rules, especially without a complete restatement of prior financial results, although management has done its best to aid prior period comparisons. New reporting shows low top-line growth and sequentially declining profitability over three quarters, making growth investors somewhat jittery and punishing the share price as a result.

However, Kinaxis is still growing its business steadily while maintaining healthy operating margins and growing its operating cash flow. The latest dip in the share price could present a good entry point on a high-quality stock with no long-term debt on its balance sheet.

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