Why Did Savaria Corporation's (TSX:SIS) Stock Plunge 18.8% After Posting Record Quarterly Revenue?

Description

Savaria Corporation (TSX:SIS) stock traded 18.78% lower on November 15 after the company reported record quarterly revenues for the third quarter late the previous day. Investors have adjusted their valuation of North America's leading manufacturer of accessibility products for the elderly and physically challenged persons, but why would the investing community punish a stock that is achieving desired business growth?

Strong revenue growth

After the recent acquisition of Garavenda Accessibility AG, that closed on August 31, 2018, Savaria Corp was on track to post record quarterly revenue. Savaria reported a record revenue figure of $72 million for the third quarter of 2018, which was 26.5% higher than that generated in the same quarter last year. The company has thus far recorded a 50.1% revenue growth in the first nine months of 2018, as compared to same period performance last year.

That was just about it for the good news.

Acquisitions led growth

The stellar top-line growth highlighted above was mainly driven by a recent acquisition spree. Savaria acquired Master Lifts in December 2017, took over H.E.S. Elevator Services Inc.'s assets in April 2018, acquired Visilift, LLC in July this year and most recently acquired Switzerland headquartered Garavenda Accessibility AG in a transaction that closed on August 31, 2018.

The consolidation of these new entities into the Savaria fold has led to significant revenue growth for the parent firm, together with other 2017 acquisitions.

Business growth is desirable, but investors were not impressed by other critical earnings numbers.

The big disappointment

The company reported impressive revenue growth and better nominal gross profits, but marginal profitability has suffered as depicted by weaker gross margins and poor operating margins, even on an adjusted basis.

Lower gross margins

Last quarter's 33.2% gross margin was marginally lower than the 34.9% gross margin realized during the same quarter last year. The same profitability measure also showed a marginal decline over the first nine months of the year, and it's most likely that margins for full year 2018 will be significantly lower than the 35.4% realized for 2017.

Declining operating profitability

Operating expenses increased 28% for the quarter, and the operating margin was down to 7% from 12% during the same quarter last year.

Profitability was weaker even when measured on an adjusted Earnings Before Interest, Tax, Depreciation and Amortization (adjusted EBITDA) basis, a much better gauge of the operating earning power of a business. The measure isn't affected by one-time charges or unusual gains.

Notably, from the record $72 million in third quarter revenue where the top-line grew by 26.5% over the same period's sales last year, adjusted EBITDA was only $9.695 million, up a mere 0.9% from $9.604 million in the comparable quarter in 2017.

Essentially, the massive revenue growth didn't flow down to the operating profit line.

Adjusted EBITDA margin fell to 13.4% from the 16.9% reported for the same quarter last year, and the first nine months of 2018 have generated an adjusted EBITDA margin of 14.4%, down from 16.8% generated by the company during the same period in 2017.

In fact, adjusted EBITDA for 2017 was 17.24% of revenue, down from 17.39% in 2016, and latest management guidance is for this margin to fall to 15.79% in 2018 and further down to 15.50% in 2019, but 2019 revenue is projected to be 40% higher at $400 million than the $285 million expected for this year.

The Foolish bottom line

Savaria stock is trading lower today because its profitability profile seems weakening after a prolonged acquisitions spree since 2017, hence the stock deserved a bit of a punishment to adjust for its lower earnings profile.

However, the stock is a promising dividend growth machine after declaring a 17% dividend raise in September this year while 2017 total dividends were 46% higher than the 2016 total pay-outs. At $0.035 a share, the new monthly dividend yields 3.17% annually and just another half cent dividend increase next year, if done, could increase the yield to a lucrative 6.35% yield by end of 2019 for investors who decide to buy the stock today.

The company's revenue has been increasing year after year to record highs over the past three years due to acquisitions, new product launches and sales volume increases and this trend could continue as the populations in its target market is rapidly ageing, making the stock a worthy buy today.

That said, Savaria Corp is facing significant competition in its business segments.

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Date
2025/08/25
Date Created
2018/11/26
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