3 Reasons to Sell Descartes (TSX:DSG)

Description

Logistics Software-as-a-Service (SaaS) provider **Descartes Systems Group Inc.** (TSX:DSG)(NASDAQ:DSGX) has quickly become one of the best technology companies listed in Canada. The stock has returned 273% for shareholders over the past five years. After a brief dip in December 2018, DSG has recovered along with the rest of the stock market in the recent global rally.

default watermark

The company now generates US$70 million in sales, delivered a 34% earnings before interest, taxes, depreciation, and amortization (EBITDA) margin, and reported US$19.2 million in operating cash flow in its most recent quarter. By all accounts, it's a high-growth, high-margin software company.

However, this growth may be overpriced at the moment. Here are three potential sell signals for the stock before it publishes its annual report in early March:

Acquisitions are done with debt and stock

The company's growth over the years has been primarily driven by acquisitions; Descartes has gobbled up three companies every year since 2006 — a total of 41 over that period. However, its recent transactions have been fueled by issuing new shares and borrowing cash.

Of the $330 million (US$250 million) it paid for Visual Compliance, $12 million (US$9 million) was funded in Descartes common shares, while the balance was completed in $318 million ($241 million) from a revolving line of credit. That line now extends to US$500 million.

Adding that entire amount to the balance sheet could take the debt-to-equity ratio up to 1 from 0.09 now, which adds risk to the balance sheet. Meanwhile, management has been issuing shares to complete transactions which indicates that the stock is overvalued from their perspective.

Valuations are lofty

After the recent surge in stock price, DSG starts to look like an overpriced tech bet again. The stock trades at a price-to-earnings (PE) ratio of 78, a forward PE ratio of 56, and a five-year estimated price-to-earnings-growth (PEG) ratio of 3.4. The price-to-operating cash flow (P/CFO) ratio is 45.

Those valuations are somewhat in line with the rest of the DOCKS stocks, but that doesn't mean that Descartes is cheap on a fundamental basis. All traditional measures point to a stock with nearly all of its growth potential priced in.

Insiders have been selling

Finally, insider transactions can often be a signal to external investors about the company's justified value. Executive Vice President (EVP) Michael Verhoeve sold nearly $2 million worth of stock in 2017. Over the course of 2018, the EVP of Customer Support, Robert Parker and the EVP of Information Systems, Raimond Diederik collectively sold stock worth $1.3 million.

The average price for these transactions wasn't much different than the current stock price; the margin is barely 30%. In my view, insiders offloading millions in a growth company is a signal of overvaluation.

default watermark

Bottom line

Descartes is one of the most well-recognized tech stocks in Canada that's delivered incredible results for shareholders over the past decade. However, the company will need to adopt debt to keep the growth going. Meanwhile, the stock trades at a lofty valuation and insiders have been selling.

These signals should prompt investors to take a closer look.

CATEGORY

1. Investing
2. Tech Stocks

TICKERS GLOBAL

1. NASDAQ:DSGX (Descartes Systems Group)
2. TSX:DSG (The Descartes Systems Group Inc)

PARTNER-FEEDS

1. Msn
2. Newscred
3. Sharewise
4. Yahoo CA

Category

1. Investing

2. Tech Stocks

Date
2025/08/22
Date Created
2019/02/19
Author
vraisinghani

default watermark

default watermark