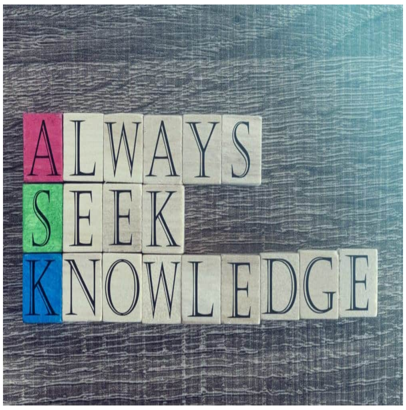

Making Sense of Sierra Wireless's (TSX:SW) Disappointing Q4 Earnings Report

Description

Vancouver-based Internet of Things (IoT) solutions and services provider **Sierra Wireless** (TSX:SW)(NASDAQ:SWIR) reported fourth-quarter and year-end results for 2018 on February 13. The company's stock responded by sinking more than -26.8% on the earnings announcement.

Since then, shares have managed to rally somewhat but remain well below the levels they had traded at prior to the earnings release.

I'll examine what exactly it was that left investors so disappointed as well as what to expect from the company (and its share price) going forward.

Putting things into context

While a -26.8% drop on earnings can't be viewed as anything other than a "negative surprise," it may help to put the company's latest earnings release into a little bit of context.

Heading into the latest earnings announcement, Sierra had been on a pretty incredible two-year winning streak, having surpassed analyst expectations for earnings and revenues 100% of the time over that stretch.

So, last week, even though Sierra's revenues were up by 10% in the quarter and were up 15% for the full year, its revenues of $201.4 million in the fourth quarter managed to fall short of what analysts were expecting — and even though those revenues only missed the mark by a mere $3.52 million. It would seem as though the pendulum had a fair amount of room to swing the other way.

Likewise, Sierra's earnings also came up short in the fourth quarter — only by a single penny, mind you — reporting Non-GAAP EPS of $0.25 versus expectations for $0.26. The company also lowered its forward guidance for 2019 versus what analysts had been expecting prior to the earnings release.

Look on the bright side…

However, if you want to take the positive out of last Wednesday's earnings announcement, it would be that management is taking a proactive approach to address some of the issues that led to the disappointing earnings result.

As part of the company's strategy going forward, CEO and President Kent Thexton said Sierra has plans to cut costs over the next 12-18 months, including centralizing its internal research and development (R&D) function, consolidating its global sales team into a centralized unit, and accelerating the organization's focus on creating recurring subscription-based revenue streams.

Sierra could be an interesting opportunity if management can execute its strategy

The company remains focused on delivering leading solutions and services to the IoT market, and there's reason to believe the next few years could be very positive for Sierra's shareholders if management is successful in executing its strategy.

Keep in mind that Sierra's revenues from IoT services were up 161% for the full year in 2018, including 89.1% growth in the fourth quarter.

I mention the point of service revenue specifically because it's not beyond the realm of possibility to believe that part of the rationale behind the company's latest decision to restructure its R&D and global sales function is that management believes at this point a fair deal of the heavy lifting in terms of creating demand for its products is already behind it –meaning that rather than a sign that demand for the company's solutions and services are in decline, it could be that the company simply feels it doesn't have to expend as much time and resources to create and sell its offerings as it once did.

If that turns out to be the case, and the company is successful in securing those lucrative recurring revenue streams for its subscription-based products, it could end up leading to a scenario where the company and its shareholders are the beneficiaries of some significant margin expansion over the next product cycle.

Bottom line

Having said all that, I wouldn't be surprised if the shares got even cheaper.

This is, after all, a company just coming off a two-year winning streak, and as evidenced by the market's reaction to last week's earnings release, there may still be a way to go before the stock ends up bottoming out.

But this is certainly a small-cap technology company that I'll continue to follow to find out if management can't capture some of the magic that's anticipated to come from the roll-out of 5G and IoT technologies.

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