DOCKS: Valuing Canada's Tech Leaders

Description

I've talked about Canada's leading technology companies, the so-called DOCKS, which rival America's FANGs. They include **Descartes** (TSX:DSG)(NASDAQ:DSGX), **OpenText** (TSX:OTEX)(NASDAQ:OTEX), **Constellation Software** (TSX:CSU), **Kinaxis** (TSX:KXS), and **Shopify** (TSX:SHOP)(NYSE:SHOP).

Besides the fact that Canada's technology companies are smaller, less well-known, and more industrial, there's another crucial difference between our innovators and America's finest: valuation.

At the moment, all the companies included in the FANG basket are mature companies with steady cash flows, sizable dividends, and saturated markets. The average price-to-earnings ratio of a FANG company hovers around 49. That's mostly skewed by **Netflix**, which trades at a PE ratio of 135.

By comparison, Canadian tech companies are valued much higher. The average PE ratio of a stock included in DOCKS is 74.75. That doesn't include Shopify because the company doesn't yet make a profit.

It's worth noting that each of the DOCKS stocks are inherently unique and trade at wildly different valuations with strikingly different fundamentals. Here's a closer look at each of them:

Descartes

Descartes trades at a trailing PE and forward PE ratio of 78 and 56 respectively. Adjusted for growth, the price-to-earnings-growth (PEG) ratio of 3.4. The price-to-operating cash flow (P/CFO) ratio is 45.

In my opinion, that valuation isn't too high when compared to other growth stocks in the same industry, but much of the sector's growth has been already priced in with this stock.

OpenText

Similar to the other stocks on this list, OpenText has a solid and expanding base of recurring income. Recent changes to the company's leadership team and its long-term strategy could restart the growth engine with a wider customer base and a higher gross margin over the next few years.

OTEX trades at a PE ratio of 39 and offers a dividend yield of 1.6%. Given that OpenText is a market leader in its niche, has a track record of stable earnings, and is deploying a legitimately exciting growth plan, I think this stock is fairly valued.

Constellation Software

I consider Constellation Software the technology company Warren Buffett would have started if he were more comfortable with enterprise software. Like Buffett's company, Constellation is a holding company that's focused on maximizing shareholder return through carefully planned acquisitions.

The stock trades at a price-to-operating cash flow ratio of 35.84. The company's return on invested capital and organic growth has been 33% over the past year. If you use operating cash flow instead of earnings for this holding company, the price-to-earnings (PEG) ratio is 1.086. Fairly valued.

Kinaxis

Kinaxis' forward PE ratio (65) is half its trailing ratio (135). This implies significant growth expectations over the near term. 2019 is likely to be an eventful year for KXS shareholders, as any positive development in the ongoing U.S.-China trade war or the addition of a new client could act as a catalyst for the stock.

Shopify

Perhaps the most well-known and richly valued stock on this list is Canada's homegrown ecommerce giant. Shopify's growth has slowed in recent years and the stock has been as volatile as ever. Meanwhile, competitive forces could stymie the company's long-term growth prospects. Currently trading at a price-to-sales (PS) ratio of 25, I think investors are exposed to significant downside risk.

CATEGORY

1. Investing
2. Tech Stocks

TICKERS GLOBAL

1. NASDAQ:DSGX (Descartes Systems Group)
2. NASDAQ:NFLX (Netflix, Inc.)
3. NASDAQ:OTEX (Open Text Corporation)
4. NYSE:SHOP (Shopify Inc.)
5. TSX:CSU (Constellation Software Inc.)
6. TSX:DSG (The Descartes Systems Group Inc)
7. TSX:KXS (Kinaxis Inc.)
8. TSX:OTEX (Open Text Corporation)
9. TSX:SHOP (Shopify Inc.)

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