3 Reasons You Should Add Enghouse Systems (TSX:ENGH) to Your TFSA

Description

Markham-based **Enghouse Systems** (TSX:ENGH) is an underrated technology stock that deserves more attention. The developer and marketer of enterprise-oriented applications software has a long track record of consistent growth, attractive margins, and a 12-year history of annual dividend increases.

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The company operates through two segments: Interactive for software that helps major corporations streamline customer interactions and Asset Management, which offers services for business support, operational support, and transportation management services. In other words, the business is well diversified across several verticals.

Some of the company's corporate clients include household names such as GE Capital, **Telus**, **Willis Towers Watson**, and **Toyota**. In its most recent quarter, the company reported $86 million in revenue and $15 million in net profit, indicating a profit margin of 17.4%.

The stock has had a rough year and is now 20% lower than its 2018 peak, which means it's an ideal time to take a closer look at the underlying fundamentals driving Enghouse. Here are three reasons this enterprise tech powerhouse deserves a spot in your Tax-Free Savings Account (TFSA).

Low payout ratio

Despite consistent growth in dividends, Enghouse isn't a high-yield dividend stock. At its current price, the stock yields a paltry 1.5%. However, this could be the result of the company's conservative dividend policy rather than a lack of profits. Over the past year, the company only paid out $24 million in dividends — a payout ratio of 29%.

In fact, the firm has enough of cash on its book to cover the dividend for eight years. The company has 10% of its market capitalization in pure cash, which means the balance sheet is on solid footing.

Steady growth

Part of the reason Enghouse doesn't pay higher dividends is because it retains most of its free cash flow for acquisitions of niche software companies. Over the past four years, sales have expanded at a rate of 11.7% while dividends have expanded at a rate of 17.2% compounded annually.

According to the management team, this steady rate of growth is powered by acquisitions of new customers and smaller companies every year. Their target universe of potential acquisitions includes software companies with a minimum annual revenue of $5 million, dominance in their niche, and a track record of profitability.

Since this strategy has delivered double-digit compounded growth over the past two decades, there's no reason to believe future growth won't follow a similar trajectory.

Recurring income

Another reason Enghouse is an ideal tech stock is its robust base of recurring income. It had 29% of revenue last year from software licences, while 43% was derived from long-term maintenance contracts. Like other enterprise software providers, Enghouse tends to sign long-duration deals with companies that gradually become reliant on its software platforms.

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Enghouse also tends to target smaller companies with recurring revenue streams for potential acquisitions or investment, solidifying its base of cash flows further.

Bottom line

Enghouse is halfway on its journey to becoming a Canadian Dividend Aristocrat. After 24 years of consistent revenue growth, dividend expansion, and savvy acquisitions, I believe the market underestimates the value of the company's stock, and investors seeking steady long-term growth should consider accumulating it at current prices.

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