



## Update: 3 Trends to Watch on This Top Canadian Tech Growth Stock

### Description

Supply chain management software vendor **Kinaxis** ([TSX:KXS](#)) stock is on a strong price recovery path since May after the RapidResponse platform creator reported a revenue and earnings beat in its first-quarter 2019 results and management adjusted its annual earnings guidance.

I had [earlier highlighted](#) some concerning developments that investors need to watch closely over their long-term investment horizon on the growth stock, and an item-by-item update may be warranted after new information was provided in the most recent quarterly results.

### Revenue growth

A seemingly slowing revenue-growth rate can be a worrisome development on a high-growth stock, and a slowdown to 19% year-on-year top-line compound growth rate over three years (from 24% previously) could have been a natural slowdown that weakens investor enthusiasm.

I'm happy that Kinaxis managed to pull off a 24.2% year-on-year revenue growth in the first quarter of this year, propelled by a surprise 87% growth in subscription term licences, as new customers adopt the firm's cloud-based software model.

Management hasn't increased its total revenue guidance for the full year though, as there's likely to be more volatility in the term licences revenue line from quarter to quarter. Management maintained its revenue guidance for 2019 at US\$183-188 million — a sequential growth of 21-25% over 2018. If achieved, this would be a better show than what was achieved during the most recent year.

That said, guidance for the company's most stable revenue component, Software as a Service (SaaS), is now expected to grow by 20-22% over the 2018 reading, down from a 22-24% growth guidance given in February 2019. This could imply a growing volatility in the top line, as more unpredictable revenue lines occupy higher proportions in billed invoices.

Kinaxis investors should love the fact that the company is recognizing increases in quarterly unsolicited inbound inquiries from its addressable market base. This leading key growth indicator jumped 60%

year over year during the first quarter of this year, as the company's marketing activities are increasing its brand awareness globally. This could propel strong growth going forward.

## **Declining margins with increased investment**

Profit margins expanded across the board during the first quarter.

There have been some sequential declines in one important and reliable operating profitability measure: adjusted EBITDA, which adjusts corporate operating earnings for non-recurring expenses and potentially arbitrary amortization expenses.

Adjusted EBITDA seasonally increases during the first quarter, as most customers renew their annual subscriptions, and the margin shot up to 35% of revenue for the quarter from 33% in a comparable quarter last year.

This was a momentary margin growth. Management's updated guidance for 2019 is for the margin to come in between 25% and 27% for 2019, marginally better than the 23-25% guidance for the year provided in March but potentially weaker than the 27% reported last year.

This potentially temporary margin shrinkage is a result of increasing engineering headcount and increasing costs, as the company invests in sales, marketing, and other support functions to propel further business growth.

I would applaud management if the company manages to achieve the guided revenue growth for this year, while at least maintaining the 2018 adjusted operating margins.

## **Earnings quality**

A massive 104% jump in trade and other receivables at the end of 2018 rang some alarm bells in March, as the company's reported revenue growth appeared unsupported by improving cash flow generation.

Trade receivables at the end of last year were 37% of annual revenue, up from 21% for 2017, and that wasn't a good development; investors may associate such developments with earnings management and a deteriorating earnings quality.

I'm glad to note that the company significantly addressed this concern by increasing collections during the first quarter of this year as trade receivables, excluding unbilled receivables, had declined by 44% during the quarter and operating cash flow increased by 80%.

## **Foolish bottom line**

The company's latest financials were redeeming for the high-growth stock. Its double-digit growth rate seems likely to be maintained, at least for the next few years if Asia and Europe customer wins continue in the near term.

That said, investors should continue to watch top-line growth, as management reported that large

active deals have taken longer than expected to close. Watch operating margins closely too, as any continued margin compression may result in lower valuation multiples and a P/E contraction.

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