Why This Tech Stock Is up Nearly 60% in 1 Year

Description

Unlike the broader stock market, **Ceridian** (TSX:CDAY)(NYSE:CDAY) has been having an incredibly successful year. The stock is up a whopping 60% since August 2018. With expectations of double-digit growth in its key segment this year, this pace of expansion doesn't seem to be slowing down anytime soon.

Here's a closer look at this potential wealth builder.

Market potential

Managing people is, arguably, the most important aspect of running a business. Tax regulations, payment preferences, privacy requirements, and employee turnover are all unavoidable elements that get increasingly more complex as the business expands.

It seems inevitable that companies of all sizes will eventually invest in better technology to manage their human capital. This market for human resource management (HRM) software is expected to grow by an average of 14% every year and could be worth $11 billion by 2023.

Only a handful of public companies directly offer solutions in this niche market, with Ceridian positioned as Canada's leading provider. The company entered the HRM market in 2012, through its acquisition of Dayforce, a unified software-as-a-service (SaaS) application for HR, payroll, tax, benefits, workforce management, talent management, and several related activities.

Underlying fundamentals

Dayforce now contributes 68.5% of the company's total revenue, according to its latest quarterly report. Over 4,006 customers rely on the Dayforce platform, with the average annual revenue per customer estimated at $123,964. This segment of the business grew 27.1% in the second quarter of 2019.

In other words, Dayforce is an extraordinary growth engine that's driving the company forward. In recent years, Ceridian has parlayed the success of Dayforce to launch a payroll services platform for small businesses across Canada called Powerpay.

This new business hasn't had the same stunning growth trajectory. In its most recent quarter, revenue from Powerpay declined 1.4% year on year. It now accounts for 10.8% of the company's total sales.

The remainder of sales are generated by the company's legacy Bureau segment, which accounts for 20.7% of total sales. This segment declined 21.5% year on year this quarter.

It seems Ceridian's stellar growth through Dayforce is being offset by a flat new business and a declining legacy business. Meanwhile, the stock trades at nine times its expected annual revenue and 40 times its operating earnings. This implies that the stock is overpriced, even when the growth rate is accounted for.

Another indication of overvaluation is the fact that the company recently launched a secondary offering that allowed the company's chairman and chief executive officer to offload shares. Insiders selling significant portions of their holdings is rarely a good sign for the company's valuation.

Bottom line

Long-term Ceridian investors have had an incredible run. The stock is up 60% over the past year and has nearly doubled since its initial public offering in early 2018. However, a closer look at the underlying business reveals that the fastest growing product segment isn't offsetting declines in the legacy business enough.

If Ceridian can't replicate its Dayforce success with its new Powerpay segment, expect the stock's valuation to be readjusted downward in the near future.

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