This Canadian Tech Stock Impressed in September: Time to Buy?

Description

Buying the stock of a business whose financial performance is showing strong signs of recovery is usually a highly rewarding investment strategy, and **Enghouse Systems** (TSX:ENGH) is one Canadian technology firm that has turned an important growth corner right under my watch this year.

The stock is up an impressive 20% since my buy-the-dip recommendation early in March this year and I still believe it's still a good long-term buy for a steady growth portfolio this September after making up for some early weakness.

The company is a leading Canadian technology firm that's expanded its businesses portfolio impressively over the past five years to report record quarterly revenue of $101.3 million for the most recent quarter (Q3 2019) ended July 31, 2019.

Double-digit growth rates were reported in both the company's revenue segments, namely the Interactive Management Group (IMG), which sells customer services management software and Asset Management Group (AMG), which primarily targets telecommunications companies.

Some early weakness

The company's share price suffered in March after posting miserable first-quarter 2019 results where a 10.2% year-over-year revenue decline in the company's biggest revenue segment shook investor confidence.

The IMG segment, which composed 55% of total corporate revenue in fiscal 2018, was hit by persistent sales declines caused by cutthroat competition from cloud offerings for several sequential quarters.

Actually, a negative growth trend persisted for another six months after a 7% revenue decline during the fourth quarter of fiscal 2018; it worsened in the first quarter of fiscal 2019 and persisted through the second quarter even after three completed acquisitions that were expected to significantly boost sales.

Growth has finally returned

Enghouse Systems impressed on September 12 when it reported fiscal third-quarter results that totally reversed earlier declines with a 19.6% year-on-year increase in IMG segment revenue and a 13.3% year-over-year increase in AMG segment revenue for the third quarter that lifted total quarterly invoices by 16.8%.

Third-quarter results were strong enough to pull the troubled IMG segment back into positive growth for the first nine months of fiscal 2019, and total corporate sales could even do better in the fourth quarter ending this October.

The pullback is thanks to two new acquisitions of Vidyo Inc. and Espial Group Inc. that closed during the quarter at a cost of nearly $69 million net of cash acquired.

I'm not usually in favour of acquisitions-led evolutions that mask organic weaknesses, but this case is an exception. This company is essentially an aggregator of smaller software companies, and internally funded acquisitions are its primary growth strategy. Management makes these purchases every now and then.

Any sustainable revenue and profitability growth from new businesses therefore deserves celebration, as long as there's continued cash flow generation to sustain future takeovers.

As for the latest two acquisitions, management skillfully turned around their fortunes in record time. The newly acquired business were making losses for several years before being bought out, and they were quickly restructured to magically contribute to positive corporate earnings right in the first quarter of consolidation.

That said, the quick turnaround came at a short-term cost of lower gross margins, compressed operating margins and lower operating cash flow generation during the quarter as the company integrates for future growth, which pulled back the share price for now.

Watch cash flow

Operating cash flow temporarily declined 52% year-over-year during the last quarter for the aforementioned reasons, but can be expected to recover back to normal historical levels going forward.

Cash flow is the life blood of the business. For Enghouse Systems, it's the fuel powering the growth strategy. Investor attention should remain focused on the bank balances.

Foolish bottom line

The company's acquisitions strategy seems to be working just fine year-in and year-out. Investors should watch cash flow closely while enjoying the capital gains and a token but fast growing quarterly dividend.

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