Up 60% in 2019, This Tech Stock Could Have 10% Upside Left

Description

Kinaxis (TSX:KXS) stock has had a wild ride this year. After substantial declines in late 2018, the stock has been steadily appreciating since the start of the year and is now up 60% since January.

Earlier this month, the company delivered stunning results ahead of analyst expectations. Revenue for the quarter ended September 30 was up 29% year over year, while profit was up 70% to $4.5 million over the same period.

If you think this upsurge is over, think again. Management has raised their guidance for next year, while analysts have raised their expectations for the company. **CIBC** and **National Bank Financial** currently have price targets of $110 to $115, 10% to 15% higher than the market price.

Can Kinaxis meet these expectations in 2020? Here's a closer look.

Potential market size

Kinaxis has a straightforward business model; it creates supply chain software and provides it as a service to corporate clients through long-term contracts. These contracts tend to last multiple years and entail impressive margins, which makes the business remarkably robust.

According to Statista, this global market for supply chain software could be worth US$8.5 billion by 2022. Kinaxis' revenue currently hovers around $156 million, so it has plenty of room to expand. As such, management expects to keep signing up new corporate customers every year.

However, new contracts are not the only way Kinaxis can grow. Another way to expand is simply to reinvest cash in acquiring smaller software companies and their intellectual property to bolster the core service.

Potential acquisitions

Kinaxis is in a remarkably strong financial position. The company's long-term debt is worth less than 5% of its equity, while cash flows are around $35 million a year. All of that is retained within the company, as management doesn't pay a dividend to shareholders.

According to its latest statement, the company has $202 million in cash and cash equivalents on the book. That sizable cash hoard could be used for research and development, but also allows the management to gobble up smaller startups with interesting software that can add value to their core product: RapidResponse.

If Kinaxis doesn't start paying a dividend shortly, I would expect it to announce some major mergers or acquisitions over the next few years to keep its expansion going.

In fact, as the world gets more data-dependent and digitally enabled, analysts expect Kinaxis' growth rate to exceed 19% annually for the next five years.

The stock is pricey by conventional metrics, but it deserves a premium if it can deliver that ambitious growth target.

Foolish takeaway

Software-as-a-service is a splendid business model. The right team can create seemingly endless cash flow and a wide competitive moat by focusing on a product that isn't very capital-intensive to produce.

Kinaxis has deployed this strategy with success for years. Now it's a dominant player in the supply chain market that could be worth US$8.5 billion within a few years. The company has enough resources to keep its current pace of expansion going for the foreseeable future, making it an ideal opportunity for growth-seeking investors.

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