Key Takeaways From Descartes (TSX:DSG) Fiscal Q1 2021 Earnings

Description

Descartes Systems (TSX:DSG)(NASDAQ:DSGX) stock ended May with a new 20-year high of $65.71 after its fiscal 2021 first-quarter earnings revived investors' confidence. Its stock rose 5%, while those of peers **Kinaxis** and **Shopify** rose 4.4% and 1.8%, respectively. This stock rally comes as no surprise, as Kinaxis stock rose 10% post-earnings in early May.

Descartes is not immune to the COVID-19 pandemic

Descartes offers cloud, device, and data-based software solutions that help companies make their logistics and supply chain operations efficient and flexible. The very design of its Logistics Application Suite helps it diversify its business across different geographies, modes of transport, types of customers, industries served, and services offered. The company has shifted from the perpetual licensing model to cloud-based services that generate recurring revenue.

The COVID-19 pandemic had a mixed impact on Descartes. On the one hand, it saw a sudden surge from customers operating in the food, grocery, medical supplies, personal protective equipment, and e-commerce industries. On the other hand, it saw a steep decline from customers operating in retail, shopping malls, and passenger airlines. The pandemic-driven lockdown also impacted cross-border shipments. The company's broad customer base has mitigated the overall impact of the pandemic.

Below are the four key earnings highlights that reassured Descartes's investors about its growth.

Strong EBITDA

In the first quarter of fiscal 2021 ended April 2020, Descartes's revenue rose 7.3% YoY (year over year) to US$84 billion, driven by acquisitions. Its services revenue rose 11% YoY to a record US$74.1 million, even though its April recurring revenue run rate fell by 5%.

As most of Descartes's revenue is recurring, it has greater visibility around future cash flows, which helps it manage expenses accordingly. This visibility has enabled it to grow its adjusted EBITDA by 10-

15% every year for the last 10 years. When the pandemic began in March, Descartes immediately reduced its operating costs. This helped it increase its adjusted EBITDA by 15% YoY to US$33 million in the first quarter of fiscal 2021.

Restructuring plan

Descartes is restructuring its business to adjust its costs and operations to the current economic environment that is influenced by the pandemic. Assuming that its April revenue rate replicates in the next quarter, the company is reducing its workforce by 5% and closing several offices. It expects to save US$6-US$7 million annually by spending US$2 million on the restructuring over the next six months.

If businesses recover in the second quarter of fiscal 2021, Descartes can maintain its profit margin with its current cost structure. But if there is a second wave of COVID-19 and lockdowns are extended, the above restructuring will help it adjust its costs to expected revenue.

Earnings guidance

In these uncertain times, when many companies have suspended their earnings guidance, Descartes quantified the COVID-19 impact on its earnings. For fiscal 2021 second quarter, it expects revenue to fall 4.4% YoY to US$77 million, assuming that the 5% decline in April recurring revenue continues in the next three months. It expects operating expenses to increase by 60% YoY to $50.5 million after adding the restructuring cost.

It would be challenging for the company to maintain its adjusted EBITDA growth rate of 10-15%. But it will continue to convert 80-90% of adjusted EBITDA into operating cash flow.

Balance sheet

Descartes also has ample liquidity in the form of $46 million in net cash and $500 million in debt facility. If the need arises, it can also raise an additional $500 million in shares or debentures. This high liquidity will enable the company to undertake acquisitions in the current economic downturn when many companies are undervalued.

Descartes has substantial long-term growth opportunities

Descartes's diversified business operations and its flexibility to adapt to the pandemic have made it resilient to the current crisis. The pandemic has forced many retailers to accelerate their move to e-commerce. It has become inevitable for companies to optimize their supply chain and logistics operations to the changing market dynamics. Descartes is well positioned to tap the e-commerce opportunity.

The company is also benefiting from the U.S.-China trade war. There is a strong demand for its tariff and duty content and Denied Party Screening solutions. Economic challenges are presenting long-term growth opportunities for Descartes, making its stock a buy, even at its current high.

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