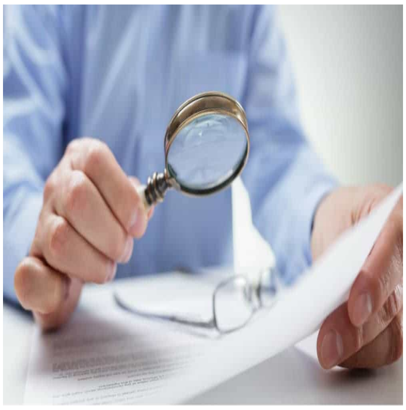

Why Did Kinaxis's Stock Price Fall 17% on Thursday?

Description

I expected **Kinaxis's** (TSX:KXS) earnings guidance for 2021 to be interesting. Unfortunately, it wasn't, and Kinaxis's fourth-quarter-of-2020 earnings were mixed too much for stock traders' desire on Thursday. Even worse, the company reported its first-ever revenue decline and quarterly operating loss since going public in 2014. Even so, the bad news is temporary, and Kinaxis's stock price could recover from Thursday's 17% plunge.

What happened?

Top Canadian supply chain management software provider Kinaxis released its latest earnings results after markets closed on Wednesday. The top **TSX** tech firm's latest financial results installment covered the final quarter of a difficult year to December 31, 2020. Fourth-quarter revenues beat analyst estimates, but net earnings were weaker than expected. The company's first operating loss in eight years was enough to shake investor confidence.

Kinaxis generated US$54.95 million in revenue during the fourth quarter of 2020. Sales were 2% lower than comparable revenue for the same period in 2019. However, analysts were expecting a worse decline of 4.1% at US$54 million, as potential customers delayed purchase decisions during a pandemic. Gross margins shrank dramatically during the fourth quarter to 63.4% — the lowest ever reading for Kinaxis's gross earnings since 2013. Adjusted EBITDA was weaker too, and the company reported a net loss per share of US$0.06 for the quarter.

That said, total revenue for 2020 increased by 17% to a record US$224.19 million. The company was mostly unaffected by the COVID-19 business slump due to the protection from its subscription contracts. Most noteworthy, Software-as-a-service (Saas) revenue (the company's most stable revenue line,) increased by a strong 25% during the past year. High revenue retention rates and new customer wins during the fourth quarter boosted the top line.

I wish the good news had extended to the bottom line, too.

Why did Kinaxis's earnings underperform?

The company made two cash acquisitions in 2020. One transaction was a US$4 million acquisition of an India-based technical sales partner Prana Consulting, which was concluded in January. The other acquisition was a US$60 million cash deal for an AI tech firm Rubikloud Technologies, which closed in July.

Both acquisitions increased Kinaxis's operating costs more than they impacted its revenue generation for 2020. Acquisitions immediately increased salaries and compensations for expensive engineering skills.

Moreover, Kinaxis has been investing heavily in its data centre capacity and its research and development functions. I would expect these investments to support a stronger operating backbone going forward. Adjusted EBITDA margins are still expected to range between 11% and 14% for 2021 — down from 24% for 2020. Profitability has declined currently. High revenue growth is required for margins to improve in the medium term.

A deserved correction?

Kinaxis has been an expensive stock with an earnings multiple higher than 160. Such high multiples were OK during the COVID-19 stay-at-home trade in 2020, but that period is over, and valuations for tech stocks are correcting market wide.

Declining revenue-growth rates and weaker earnings do add negative valuation momentum to an expensive KXS's stock price right now. Perhaps the latest "correction" is warranted.

Moreover, management's guidance for 2021 shows lukewarm enthusiasm for this year. Total revenue is forecast to grow by 8-10% year on year in 2021 to US$242-$247 million. However, management still believes that annual SaaS revenue growth rates of 23-25% "is achievable in the mid-term."

Can you buy the dip on Kinaxis stock?

A 17% decline in one trading session is painful, but this isn't the first time that investors have seen such shocks on KXS's stock price. Shares tumbled in a similar fashion in 2018 after a fallout with one Asian customer. The business remained intact, and shares have more than doubled since then.

Investors will notice that SaaS, the company's largest, most stable, and recurring revenue component, is still expected to grow at 17-20% this year. We are used to higher growth rates, and recent investments and acquisitions will contribute to success soon.

Kinaxis expanded its sales force and technical support base and enhanced its product by adding AI capabilities. These could future-proof its RapidResponse platform, though at the cost of near-term pain. The company remains a potent cash flow generation machine, with strong moats.

I still rate Kinaxis's stock a long-term buy and hold since my first coverage in April 2017. Holding the position for another five years could make investors rich.

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