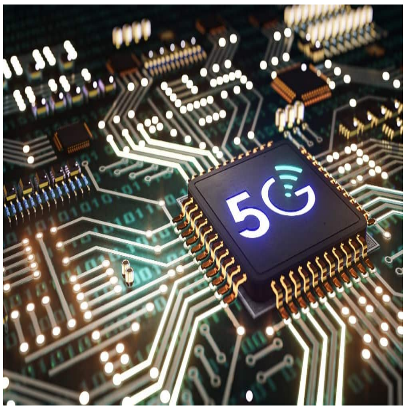


# Will Warren Buffet Buy This Tech Stock Now?

## Description

One performance metric that Warren Buffett looks highly upon is the return on equity (ROE). Specifically, he invests in companies with an above-average ROE. Companies that consistently earn returns on equity of 15% are good. Earning 20% would be incredible.



This *Forbes* article explained, “Return on equity indicates how much the stockholders earned for their investment in the company… Return on equity can be simply stated as net income divided by common stockholder’s equity.”

If you want to study the return on equity metric in more detail, the article also noted that the ROE is affected by three components. Specifically, the ROE can be calculated by multiplying net profit margin, asset turnover, and financial leverage together. The conclusion is that “The ideal firm would maintain a high net profit margin, utilize assets efficiently and do it all with low risk, low financial leverage.”

That is, Warren Buffett would love to invest in companies that have high net profit margins, high asset turnover, and low leverage and are trading at good valuations.

Here is a timely Canadian stock that has a track record of high returns on equity and other goodies!

## Why Warren Buffett would love Enghouse Systems

Buffett would love **Enghouse Systems** (TSX:ENGH) now for multiple reasons. First, the tech firm’s five-year return on equity is about 18.9%, while its trailing 12-month ROE is close to 24.5%.

Second, shares are cheap. According to the analyst consensus 12-month price target, they have a 30% margin of safety with a near-term upside potential of almost 44% at yesterday’s market close price of $52.44 per share.

Third, Enghouse has a nice dividend growth streak, delivering dividend growth at a compound annual growth rate of 21.9% from 2009 to 2021. In the period, it generated more than double the market returns and three times the market income.

Specifically, a $10,000 investment in ENGH stock at the start of the period would have delivered annualized returns of 27.3%, turning into $208,528, including generating $11,584 dividends. This compares to the same investment in **S&P 500 Composite Index** that has generated 11.6% annualized returns that turned into $39,777, including generating $3,713 dividends.

## The tech stock's recent results

Enghouse reported Q1 results on March 11 that saw revenue growth of 7.6% to $119 million versus the same quarter in the prior year. Net income increased 28% to $20.6 million. This translated to diluted earnings per share rose +27% to $0.37.

The adjusted EBITDA, a cash flow proxy, climbed 26% to $44.5 million with the adjusted EBITDA expanding to 37.4% versus 31.9% a year ago thanks to the realization of efficiencies related to increased scale after integrating acquisitions and reduced travel costs. Adjusted EBITDA per diluted share increased by 25% to $0.80.



Revenue growth wasn't impressive, but Enghouse still managed to deliver incredible earnings and adjusted EBITDA growth on a per-share basis.

The tech company ended the first quarter with $230.4 million of cash, cash equivalents, and short-term investments. The cash could be used for share buybacks or acquisitions to spur growth.

## Enghouse isn't losing its mojo

Don't be deterred by Enghouse's small yield of 1.2%. Its last dividend increase, which was declared in March, was 18.5% — clearly above average. Its 2021 payout ratio is estimated to be approximately 36% and surely sustainable. Moreover, the company should deliver improved results post-pandemic, which will allow for the resumption of normal M&A activity that has been slowed during the pandemic.

In the Q1 earnings call, Enghouse Chairman and CEO Stephen Sadler noted that "…completing acquisition transactions are taking longer than they did historically due to the pandemic. The acquisition pipeline remains consistent with historic levels, although valuations have increased slightly due to public market influences and low interest rates. We continue to maintain our discipline in terms of financial objectives on valuations when reviewing acquisition opportunities."

**CATEGORY**

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**Date**
2025/07/21
**Date Created**
2021/06/03
**Author**
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