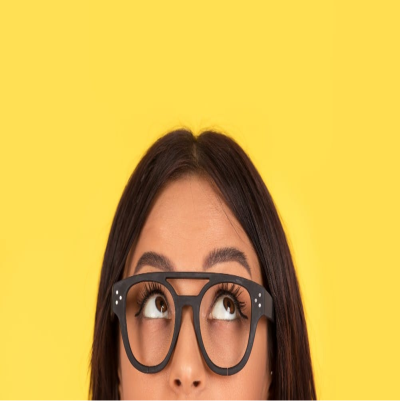

Why This Canadian Tech Stock Is a Smart Buy Today

Description

Enghouse Systems (TSX:ENGH) stock continued its slide on Friday after reporting its fiscal Q2 results. Specifically, the stock retreated 4% on the day, which already recovered partially from the 9% dip at the low.

The tech stock has now corrected 31% from its high of $75 per share in 2020. The stock's price action is understandable, which could make it a smart buy today for those with a multi-year investment horizon.

The tech stock's Q2 results explained

Management explained in the earnings call, "Our Vidyo business experienced a massive rise in volume and demand at the start of COVID in Q2 2020, followed by a fall that we've seen over the last few quarters. Demand for our Vidyo platform as a solution that technology companies integrate into their software and hardware products continues to be good and an important part of our business. VidyoRoom's hardware demand and its related hardware support, which was used primarily by enterprise customers, has declined significantly since the start of COVID."

In other words, the company did exceptionally well in this period last year, as the demand for video communication increased because of the pandemic. The results for Q2 2021 pale in comparison to Q2 2020's surge in demand.

As a result, for the quarter, Enghouse generated $117.3 million in revenue, down 17% against the same period last year. Adjusted EBITDA, a cash flow proxy, fell 18% to $40.2 million. Operating cash flow declined by 15% to $42.6 million.

Management summarized, "The decline in revenue was driven primarily by the previous year's significant increase in our Vidyo business that has now returned to levels that are more consistent with pre-COVID volumes."

The results in the first half of the fiscal year provide a bigger picture. Revenue was $236.4 million, down 6% against the same period last year. Adjusted EBITDA increased marginally by 0.1% to $84.7 million. Operating cash flow declined by 1% to $84.3 million.

Where will growth come from?

Enghouse continues to expand its cloud offerings. However, its customers can choose from the options of multi-tenant cloud, private cloud, and on-premise solutions.

You might recall that in October 2020, Enghouse announced that it signed a 12-year agreement with Norwegian Health Care for $55 million, which led to the eight-year $29 million agreement to update the National Emergency Fire Services Technology System for the Norwegian Government that was signed in April 2021. Much of the revenue recognition will occur later on.

Management also sees a strong acquisition pipeline. However, low interest rates, stimulus, and strong public markets have made it tougher to buy at the right valuation. Importantly, Enghouse is maintaining financial discipline when considering acquisition opportunities. Management believes higher global taxes and potentially rising interest rates could provide significant opportunities for it to make acquisitions within its financial parametres.

The Foolish takeaway

Enghouse remains persistently profitable and continues to generate substantial cash flow. Coupled with a strong balance sheet that ended the quarter with no debt and $169.6 million in cash, cash equivalents, and short-term investments, the company has the dry powder to fund business growth, as soon as it sees fitting acquisitions at the right price.

The meaningful +30% correction in the tech stock could be a long-term investment opportunity. The company has a track record of high returns on equity (ROE). Its five-year ROE is 18.9%.

The analyst average 12-month price target suggests 44% near-term upside potential. While you wait for price appreciation, the dividend stock pays a growing dividend. The dividend is well protected with a payout ratio of about 36% currently.

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