3 Reasons to Buy This Tech Stock Now

Description

The Canadian stock market has made an all-time high recently. So, Canadian investors must do a little more digging to find value on the stock market.

One tech stock that has a track record of growth is curiously trading at a nice bargain. The stock is out of favour for now, but it's only a matter of time before its growth will resume.

This tech stock has a track record of strong returns

Enghouse Systems's (TSX:ENGH) track record of growth historically led to incredible long-term returns. In the past five-, 10-, and 15-year periods, Enghouse increased its earnings per share by about 25%, 24%, and 14%, respectively. These drove five-, 10-, and 15-year total returns of approximately 13%, 27%, and 17%, respectively, per year.

Although excellent past returns don't necessarily lead to similar outstanding performance in the future, they are indicative of future return potential.

In 2007, the company also started paying a dividend, which has increased every year since 2009 at a compound annual growth rate of 21.9%. Investors are always delighted to see a track record of growing dividend payments. This suggests that management is committed to paying dividends that provide a more consistent way of returning value to shareholders than price appreciation.

For example, an investor who'd bought ENGH stock in 2011 for an initial yield of 2.3% would be sitting on a yield on cost north of 14% today thanks to the dividend increases during the decade. In other words, as long as ENGH's payout is sustainable, this investor would get a +14% return on their initial investment every year.

Moreover, it's more likely that the company will continue increasing its dividend, as its 2021 payout ratio is estimated to be about 35%, and its earnings are expected to grow in the long run.

While it's nice to sit on a big yield on cost, investors will get higher returns (in dollar amounts) and more income by adding to winners opportunistically.

The return on equity (ROE) is calculated by dividing the company's annual earnings by its stockholder's equity. Therefore, a track record of high ROE indicates persistent profitability and management excellence.

Enghouse Systems's five-year ROE is about 19%, while its trailing-12-month ROE is 22%. Both are very good.

A strong balance sheet

Enghouse maintains a strong balance sheet with essentially no debt. It had so much cash on its balance sheet that it paid out a special dividend of $1.50 per share in February.

Management noted that "With low interest rates and the ability to acquire additional funding, as needed … it continues to have the necessary funding available for its acquisition activities." The special dividend was big compared to its current annualized payout of $0.64 per share, which totals about $35.5 million a year.

Enghouse ended fiscal Q2 with no debt and $169.6 million in cash, cash equivalents, and short-term investments. And it continues to generate substantial operating cash flow. So, the company has the dry powder to fund business growth through fitting acquisitions.

A cheap valuation

Enghouse posted exceptional results in the last fiscal year. Revenue increased by more than 30%, EBITDA rose 44%, and adjusted earnings per share climbed by 37%. These results were helped by an increased demand for video communication during the pandemic — demand that reduced in the last few quarters.

As the investing community waits for the company's next leg of growth, the tech stock has fallen to an attractive valuation. At $51.61 per share at writing, analysts estimate a nice margin of safety of 30% or 12-month upside potential of about 44% to the near-term fair value of the stock.

The Foolish takeaway

The expected slow growth in Enghouse in the near term has created an opportunity to accumulate shares of the proven tech stock at a contracted valuation for long-term growth.

Management sees a strong acquisition pipeline. Enghouse is a disciplined acquirer that looks for the right acquisitions at the right valuation. Its prudent M&A strategy is what helped drive wonderful long-term returns.

Management believes higher global taxes and the prospect of rising interest rates would provide significant opportunities for it to make acquisitions within its financial criteria.

Patient investors should be handsomely rewarded when the company resumes high growth.

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