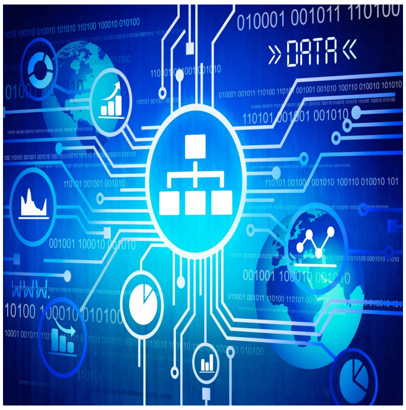

Sierra Wireless Is Still Waiting for a Rebound in the Internet of Things

Description

The increasing acceptance of the Internet of Things (IoT) trend hasn't been good to **Sierra Wireless** (NASDAQ: SWIR). The stock is back to plumbing new multiyear lows after its third-quarter 2019 update showed another year-over-year decline and a lackluster outlook.

It's been a long road to no recovery so far, and hardware is to blame. However, the company is still waxing positive, as IoT adoption still holds promise for the software and service side of the business.

The rebound is still on hold

First off, I'd like to address my "too cheap to ignore" thesis after Sierra's midyear 2019 update a few months back. Turns out shares could get much cheaper, as shares are down nearly 20% as of this writing after that Q3 update.

Besides a 25% decline to $80.6 million for embedded broadband segment revenue — which includes connectivity devices for mobile computing, autos, and networking customers — the culprit was that the IoT segment *also* declined.

During the quarter, IoT solutions revenue fell 2% year over year to $93.4 million. Breaking the results down further, management said services — software and other recurring revenue sources — increased 6.7% but were offset by weakness in IoT chips. Some customers delayed making 4G mobile network upgrades, but the delays also largely affected 2G and 3G legacy sales. Put simply, it would appear Sierra suffered from others' decisions to hold on to cash rather than invest in network upgrades.

Paired with the first-half results, we find business down across the board — taking management's end-of-year rebound forecast at the beginning of 2019 off the table.

Metric	9 Months Ended Sept. 30, 2019	9 Months Ended Sept. 30, 2018	YOY Change
Revenue	$539 million	$592 million	(9%)

Metric	9 Months Ended Sept. 30, 2019	9 Months Ended Sept. 30, 2018	YOY Change
Gross profit margin	31.3%	33.5%	(2.2 pp)
Operating expenses	$214 million	$213 million	0%
Earnings (loss) per share	($1.65)	($0.58)	N/A
Adjusted earnings per share	$0.08	$0.65	(88%)

Data source: Sierra Wireless. YOY = year over year. pp = percentage point.

The IoT is unkind to hardware makers

Among other factors, one of the reasons the IoT movement is happening in the first place is that connectivity chip costs have gotten so cheap. That’s showing up in Sierra’s revenue and gross profit margins on products sold, which is falling even though the company continues to add higher-margin services into the mix.

It looks as if life will continue to be hard for this IoT chip maker. Full-year revenue guidance was downgraded to a range of $708 million to $712 million, a 10.5% decline from 2018 at the midpoint. The previous outlook was for sales to be “slightly down.”

Despite the poor showing, though, there still could be long-term value in this stock. CEO Kent Thexton reminded investors that his company’s goal is to deliver “$200 million in annualized recurring revenue by the middle of 2022, and $400 million by the middle of 2024.” The company made progress toward that goal, but it’s not showing up in the sales numbers. Sierra internally measures the lifetime value of new service contracts as a yardstick for those goals. Thexton explained on the earnings call:

> To help in measuring the long-term impact of the new recurring revenue business we are generating, we measure the lifetime value of our recurring revenue wins to provide visibility of future recurring revenue. The lifetime value of recurring service wins in Q3 continued to accelerate and was more than twice the value of wins in the second quarter this year. And the cumulative value of wins in the first nine months of this year was 170% of all of 2018.

So if the IoT hardware business has you feeling glum, there’s hope that the service side of the equation will be much more promising — eventually. After all, putting new connected devices into action is only the first step; ongoing monitoring of the hardware still needs to happen, and the billions of new connections expected in the next few years could mean Sierra’s service segment plans aren’t just a pipe dream. In the meantime, though, Sierra Wireless shareholders should expect further volatility, as chip sales are still the largest portion of this business.

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nicholas-rossolillo