Avigilon Corp.: Growth at a Bargain Price?

Description

They say "it's always darkest before dawn," and things can't get any darker for **Avigilon Corp**. (TSX:AVO). The Vancouver-based video surveillance equipment designer/manufacturer was once the tech darling of the TSX, soaring over 875% between 2012 and 2014 as investors flocked to its tremendous sales growth and innovative line up of products.

However, just as quickly as it rose, the stock returned all of its gains as members of the c-suite began to exit the company, margins contracted, competition in the security space heated up, and–worst of all–its much-lauded growth began to falter. Now, following a Q2 2016 earnings report that was as ugly as it gets, the stock is trading at a level not seen since 2012. For those looking to pick up growth at a *very* reasonable price, Avigilon becomes quite hard to ignore.

Vision versus reality

Avigilon shareholders are currently stuck between CEO ambition and market expectations. On one hand, CEO Alex Fernandes has made sacrosanct his vision of Avigilon reaching an annual run-rate revenue of $500 million by the end of 2016. On the other hand, much to the chagrin of the market, this goal comes at the expense of contracting gross and EBITDA margins and aggressive capital expenditures.

That being said, Fernades's tunnel vision has largely come to fruition. Avigilon has increased its quarterly revenues on a year-over-year basis for 34 consecutive quarters, while annual revenue has grown 84% on a compounded annual rate between 2008 and 2015 from $5.2 million to $369.4 million.

However, the margin issue came back to haunt Avigilon with the Q2 report highlighting a 50% gross margin (versus 57% in Q1) stemming from higher than expected operating expenses and price cuts to the H3 camera line.

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Avigilon exhibited tremendous revenue growth across all geographic segments from 2012 to 2015. Source: Author generated based on company reports.

avo-2

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At the expense of margins. Source: Author generated based on company reports.

Sell-off presents a buying opportunity

The disappointing Q2 numbers have led Avigilon to trade at a heavy discount to its peers. Currently, the stock is valued at just 9.7 times FY 2016 EBITDA and 1.1 times 2016 sales (Thomson Reuters estimates) versus sector averages of 18.7 times EBITDA and two times sales for the surveillance vendors, and 8.7 times EBITDA and 1.5 times sales for the Canadian hardware names (**Bank of Nova Scotia** Equity Research).

This discounted valuation is expected to last into second half of 2016, as margin contractions continue to prevail in the face of product discounts, fixed costs related to its new U.S. manufacturing facility and increasing workforce. In the interim, however, Avigilon's appetite for PP&E should be largely satiated as the $42 million purchase of the Vancouver office complex and the completion of its U.S. manufacturing facility are in the rear-view mirror with the boost to cash flow put towards paying down its debt load.

Buyout likely?

Finally, at these valuations, Avigilon could very well be the target of an acquisition, especially as mergers and acquisitions in the surveillance space have started to heat up. Based on precedence transactions in in the sector, such as the takeout of Axis AB by Canon, we can expect a suitor to pay three to four times projected FY 2016 sales for Avigilon, which works out to about $25 per share–a nice premium to the September 8 closing price of $8.93.

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