Finding the Way

A fertile market and good technology have allowed Absolute Software to grow "almost on auto-pilot," says one of its large investors. With a new CEO now at the controls, is the stock poised for a more thrilling ride?

To quantify the financial impact of lost or stolen laptop computers, Intel in 2010 sponsored a study of large U.S. organizations to assess the cost of a laptop gone missing. Included in the tally were replacement costs, but also estimates of the impact of such things as resulting data breaches and lost intellectual property. Among the key findings: more than 7% of all laptops were lost or stolen over their useful lives, fewer than 5% of those were recovered, and the average annual cost per organization from missing laptops was $6.4 million. "While organizations may be aware of the lost-laptop problem," concluded the study's authors, "we do not believe they understand fully the adverse effect it may be having on their bottom lines. If they did, we believe they would be more diligent in protecting these devices."

Supporting such diligence is the goal of Vancouver-based Absolute Software, whose core Computrace technology has been embedded by original-equipment manufacturers such as Dell, H-P, Lenovo and Samsung in some 500 million laptops and mobile devices since 2010. Even if a hard drive is wiped clean or removed, Computrace technology allows Absolute to locate the computer as soon as it connects to the Internet. Other products also allow enterprise IT administrators to remotely access, secure or remove data on laptops and devices under their purview, further limiting the ability of such data to fall into the wrong hands.

The strength of the company's technology and increasing market demand has allowed Absolute to grow "almost on auto-pilot," says David Barr of PenderFund Capital Management, by serving primarily educational and governmental clients that typically buy three-year service contracts paid up front and in full. Revenues over the past five years have increased more than 10% annually and customer-retention rates across the product line are around 90%.

Barr believes the company can do better, a sentiment apparently shared by Absolute's board, which installed EMC-alum Geoff Haydon as CEO in July. Haydon's primary charge: to restructure an inefficient sales and marketing effort in order to save money and expand into new vertical end markets such as financial services, aerospace and defense. Just bringing down sales and marketing expenses from today's 45% of revenues to more reasonable peer levels would increase Absolute's free-cash-flow margins from less than 15% to at least 25%, says Barr.

At today's share price of just over $7, the company's enterprise value is less than 10x the $25 million Barr believes it can earn in free cash flow next year. While that's a fair multiple given past performance, he says, it doesn't adequately reflect the revenue acceleration and margin expansion that he believes can drive 20%-plus annual earnings growth for the foreseeable future. If the market doesn't recognize that, he thinks a buyer would. "An established buyer could buy the revenues without most of the attendant costs," he says. "That wouldn't come cheap." VII

INVESTMENT SNAPSHOT

Absolute Software
(Toronto: ABT:CN)

Business: Provider to public- and private-sector enterprises of tracking and data-protection systems used to improve theft recovery for laptops, tablets and smartphones.

Share Information
(@10/30/14, Exchange Rate: $1 = C$1.119):

Price	**C$7.05**
52-Week Range	C$5.85 – C$7.70
Dividend Yield	4.0%
Market Cap	C$307.9 million

Financials (year ending 6/30/14):

Revenue	C$91.0 million
Operating Margin	6.6%
Net Profit Margin	3.9%

Valuation Metrics
(@10/30/14):

	ABT:CN	Russell 2000
P/E	72.9	71.7
Forward P/E (Est.)	43.3	18.5

ABT:CN PRICE HISTORY

THE BOTTOM LINE

With its stock trading at less than 10x his estimate of 2015 free cash flow, the market appears to be valuing the company based on its solid if unspectacular past, says David Barr, not on its improved prospects under a new CEO. He expects revenue growth and margin expansion to fuel 20%-plus annual earnings increases for the foreseeable future.

Sources: Company reports, other publicly available information