

# Descartes Systems Group

January

25

2012



TMT Sector

Macic 2011/2012



**MAC IC**  
MAC INVESTMENT CLUB

# Descartes Systems Group

## Equity Research Report

TMTSector

Date: 01/31/2012

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Stock Rating:

**BUY**

Sector Weighting:

**WEIGHTING**

Today's Date: 02/01/2012

Price Target: \$8.90

Target Price Date: 04/14/2012

### COMPANY MARKET STATISTICS

Ticker:	DSG.TO
Exchange:	TSX
52-week range (High/Low)	8.25/5.86
Avg. Daily Trading Vol.	15000
Market Capitalization	\$490M
Annual Dividend	\$0
Dividend Yield	0.0%
Price/Earnings	32.84
Price to Book	2.38
BETA	1.28

### ANNUAL EARNINGS PER SHARE (EPS)

2011	\$0.11
2010	\$0.21
2009	\$0.33
2008	\$0.42

### HIGHLIGHTS

- Global leader in logistics technology and supply chain network solutions
- Unveiled of major extensions of logistic flow control solutions
- In January 2012 acquired GeoMicro, Inc., a leading California-based provider of advanced geographic information systems (GIS) and commercial turn-by-turn navigation
- Earnings release on March 5, 2012

### OVERVIEW

Descartes Systems Group provides global logistics networks in order to help simplify and organize communications and trade for supply chains. The Ontario based firm provides its product in the form of Software as a Service (SaaS) in order to help reduce the cost and increase the efficiency of businesses with extensive networks and operations. Descartes extends the command of logistics operations, helping the world's largest and most connected logistics community to quickly reduce costs, improve service and comply with customs and transportation regulations. Descartes' Logistics Technology Platform uniquely combines the power of the world's most extensive multi-modal network, with the industry's broadest array of modular and interoperable web and wireless logistics applications.

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## PRICE CHARTS

### Descartes Systems Group 1-Year Price Chart



This chart shows the equity price of Descartes Systems group from February 2011 to late January 2012. As seen above, Descartes traded between \$6.00 and \$7.00 for the first three quarters of the year. In October, the stock price jumped from just over \$6.10 all the way to \$7.50. This was followed by a correction in November, after which Descartes would resume its rally and continue its uptrend all the way through January.

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## One-Year Price Chart with Peers



Descartes Systems Group (in thick black) is the top performer for the year among its peers. This chart shows the overall percentage gains and losses. It can be seen it reacts very similar to market conditions as does the rest of the major players in the information technology sector. All of the companies behaved similarly in reaction to market conditions through September. Starting September, Descartes rallied until the end of the year, with a correction in November, and would continue its rally all the way through January.

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## DSG with TSX



This chart compares Descartes Systems Group with the TSX. For the first half of the year the TSX outperformed DSG and then converged with mixed mid-year results. The TSX would then continue to decline while DSG began posting gains. In September the TSX continued its decline while DSG continued its uptrend. DSG would finish the year strong, climbing up almost 30% over the last four months of the year. The TSX rebounded from being down over 15% to down 7% for the year, with most of the rally happening in late December and January.

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## NEWS AND EVENTS

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-Earnings Report, March 5, 2012

-Unveils major extension of logistics flow control management

-Acquires GeoMicro

-any potential new trade regulations that emerge would only help Descartes as this would lead to new logistics systems to adapt to new regulations, allowing Descartes to achieve higher margins

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## COMPANY RISK

DSG has a credit rating of A2L which is in between A2 and A1H. The one-year price volatility is 30.22% and the Beta is 1.28. Both reflect the extremely volatile market conditions of the past year, and although viewed by many as a negative, we see the high volatility as an opportunity to execute an order near a bottom and sell near a top. Descartes is very careful about its sources of financing, and as such carries very little long-term debt, about \$30 million, and no short-term debt. The company seems to be affected much less by economic downturns, however it is not immune, thus the biggest risk facing the company remains the spread of the debt crisis in Europe. If Europe's problems spill over to other countries it could result in companies cutting spending, which would hurt DSG as it is a B2B service provider. Overall, DSG has no major risks, market or political, set against it making it an attractive security for any portfolio

<b>Credit Rating</b>	<b>WACC</b>
A2L	8.69%
<b>Volatility</b>	<b>BETA</b>
30.22%	1.28

## PEER COMPARISON

Name	Price	Market Cap	Dvd Yld	Trailing P/E	Forward P/E	Annual Revenue	1-Mo Return	3-Mo Return	1-Yr Return
CGI		USD\$4.330B	-	12.19	11.46				
MDA		USD\$1.377B	2.31	19.84	15.00				
Descartes		USD\$0.490B	-	32.67	15.1				
Softchoice		USD\$0.235B	-	9.64	9.48				
Peer 1 Network		USD\$0.225B	-	-	181.84				
Absolute		USD\$0.196B	-	95.02	-				

Descartes Systems Group is one of the major players in the information technology sector, specializing in global logistics solutions. Out of all its competitors it has the third largest market capitalization at over \$490 million. Descartes does not pay out a dividend, which appears to be the norm in the industry. Its price-to-earnings ratio is slightly above industry average, however, once adjusted, its forward looking price-to-earnings ratio is significantly lower, and looks to be below industry average. This indicates that Descartes' earnings are expected to grow substantially. Descartes also has by far the highest return over the past year. Although past performance is not a sure indicator of future success, we believe that this trend will continue and Descartes will consistently outperform its peers and provide generous returns to investors.

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## REVENUE AND EARNINGS

Both revenue and net income have seen increasing year-over-year growth. Both show increases from the same quarter of the previous year, and generally beat analyst expectations. The results generally come from the same business group, as Descartes' core focus is logistics and supply chain network management. Descartes offers immediate savings and increased efficiency, and as such macroeconomic conditions have very little effect on revenue and income because companies look for savings even more so when there is a downturn in the economy. With EPS usually spiking in January with the last couple years along with an overall higher EPS it makes for a good time to buy. This is line with analysts' outperform and hold ratings.

### Revenue

	Q1 - Apr	Q2 - Jul	Q3 - Oct	Q4 - Jan	Total
<b>2011</b>	\$ 27.10	\$ 28.80	\$ 28.50	\$	\$ 84.40
<b>2010</b>	\$ 21.30	\$ 25.20	\$ 25.80	\$ 26.90	\$ 99.20
<b>2009</b>	\$ 17.40	\$ 18.60	\$ 18.90	\$ 18.90	\$ 73.80
<b>2008</b>	\$ 16.30	\$ 17.10	\$ 17.00	\$ 15.70	\$ 66.10

### Net Income

	Q1	Q2	Q3	Q4	Annual Total
<b>Current</b>	2.1M	2.53M	\$2.73M	Upcoming	\$ 11.84
<b>2010</b>	0.2M	2.11M	1.67M	7.75M	\$ 16.16
<b>2009</b>	2.75M	0.92M	1.06M	10.89M	\$ 21.94
<b>2008</b>	1.06M	1.41M	2.55M	18.94M	\$ 23.78

### EPS

	Q1 - Apr	Q2 - Jul	Q3 - Oct	Q4 - Jan	Total
<b>2011</b>	\$0.03	\$0.04	\$0.04	\$	\$0.11
<b>2010</b>	\$0.00	\$0.04	\$0.04	\$0.13	\$0.21
<b>2009</b>	\$0.07	\$0.04	\$0.02	\$0.20	\$0.33
<b>2008</b>	\$0.02	\$0.04	\$0.05	\$0.31	\$0.42

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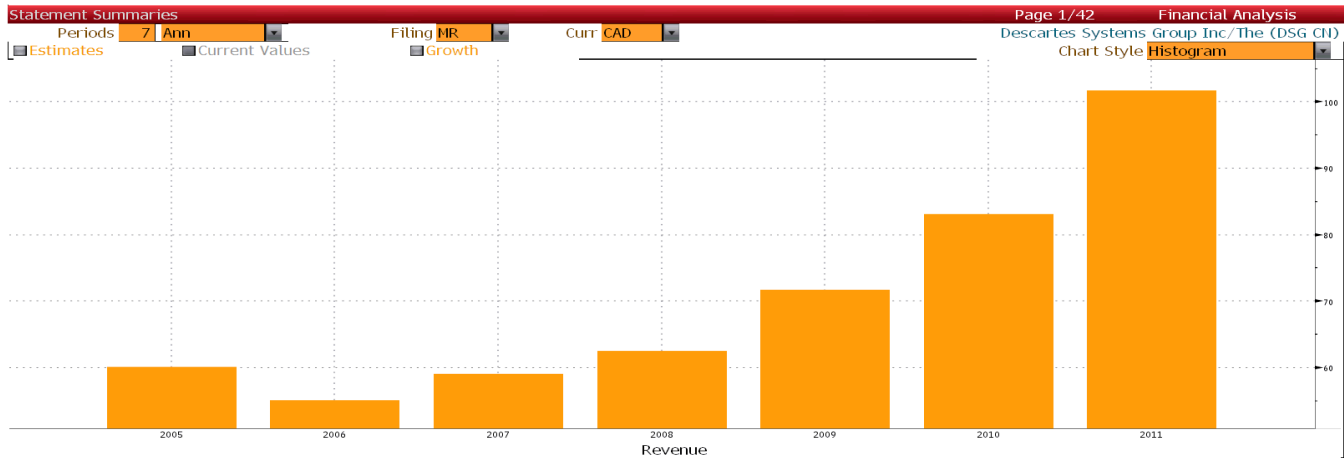
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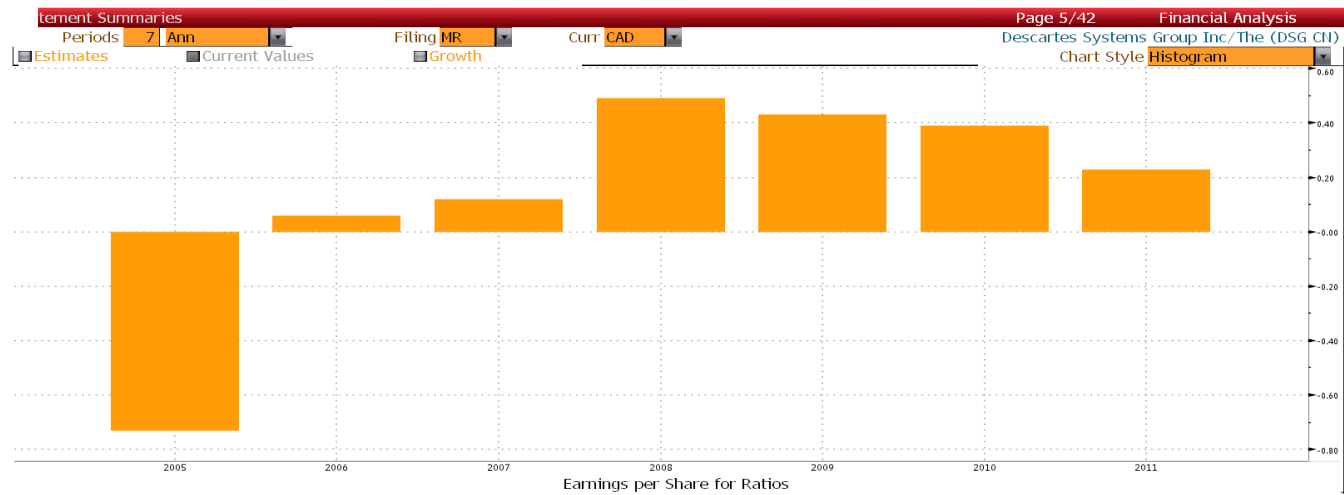
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## Annual Revenue Chart



## EPS ANNUAL



Annual Earnings per Share have greatly increased since 2006; however since 2009 they have been on a steady year-over-year decline. In our opinion, this decline is artificial and should not be attributed to company's ability to generate profit. Instead, we believe this trend can be explained by the many recent acquisitions carried out by Descartes Systems Group, six major ones since March 2010.

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## FUNDAMENTAL RATIO ANALYSIS

Descartes Systems Group has a very healthy revenue growth of 34.40%, and a whopping gross margin of 66.30%. Its net margin is significantly lower, which we actually see as a positive. If DSG can manage to minimize its operating expenses then its net profit has a lot of room to grow, given that its gross margin is 66.30%. Descartes also has an above-industry-average return on equity of 7.33%. The price-to-earnings ratio is slightly above industry average, but that can be attributed to its plethora of acquisitions over the past two years. Once these acquisitions start paying off earnings will jump, resulting in a lower P/E ratio, and even more likely a higher stock price. The current and quick ratio tell us two things: both the ratios are well above 1.0 meaning Descartes has more than enough short-term assets to pay off its current liabilities, and more importantly, only a small portion of these short-term assets are tied up in inventory, as the quick ratio is marginally less than the current ratio. Both are signs of a very healthy balance sheet.

<b>Revenue Growth</b>	<b>ROE</b>	<b>Current Ratio</b>	<b>Price to Book</b>
34.40%	7.33%	4.38	2.38
<b>Gross Margin</b>	<b>ROA</b>	<b>Quick Ratio</b>	
66.30%	6.24%	3.63	
<b>Net Margin</b>	<b>P/E</b>	<b>Debt/Capital</b>	
13.70%	32.84	0	

## CASH FLOW ANALYSIS

Cash flows for DSG have been fairly consistent over the past few years. There has been a fluctuation of cash flow from operating activities. Descartes generated about \$20.41 million from its operating activities in its current fiscal period with another quarter yet to report. This compares to \$18.62 million over the whole last period, \$20.28 million in the one preceding and \$12.65 million in 2008. There has been a constant out flow of cash from its investing activities since 2007 which we attribute to all the recent strategic acquisitions. There are no immediate plans for the company to distribute dividends or to conduct any share repurchases.

<b>Net Cash Position</b>	<b>Div. Yield</b>	<b>Div. Growth Rate</b>
\$18,71	0.0%	0
<b>FCF Per Share</b>	<b>FCF Yield</b>	<b>Price/Cash Flow</b>
\$ 0.30	\$4.26	21.52

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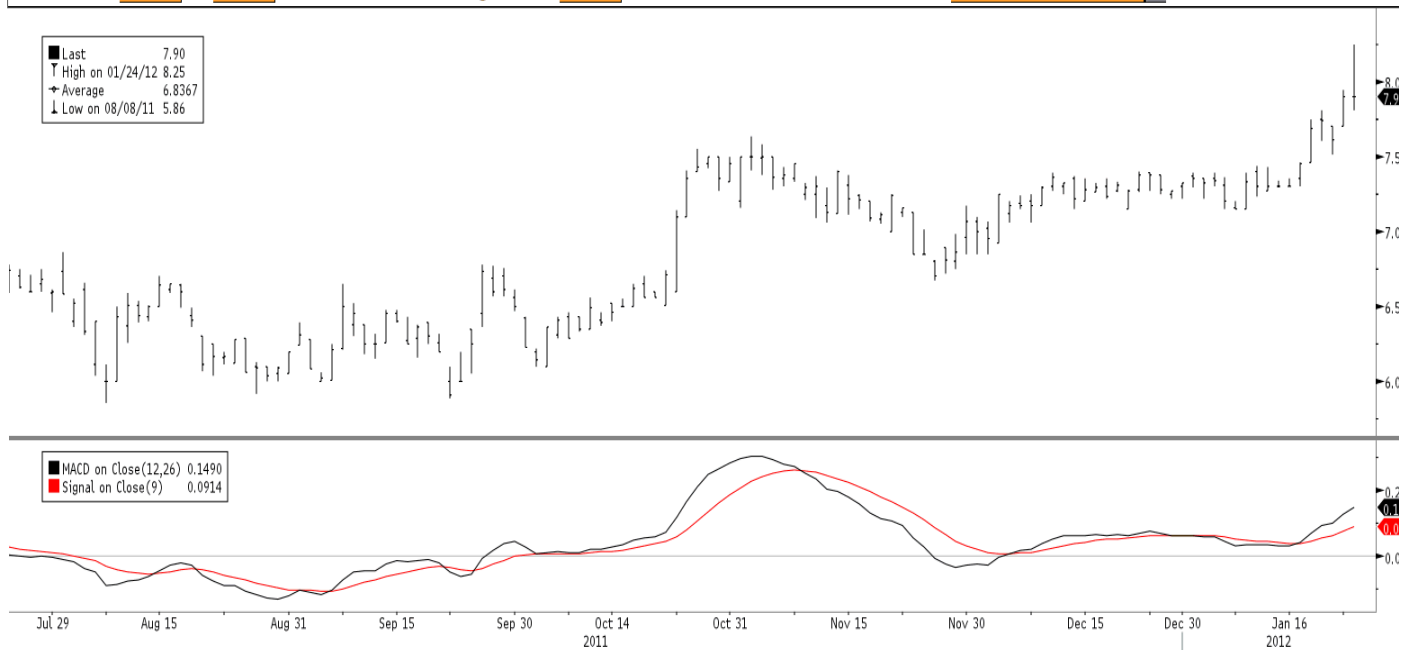


## TECHNICAL ANALYSIS

### MACD

**DSG** CN C\$ C **7.90** unch T 7.88/8.25 1x15 Equity**MAC**  
 As of Jan 24 DELAYED Vol 131,935 Op 7.90 T Hi 8.25 T Lo 7.81 T

DSG CN EQUITY		Save Chart	Hide	Moving Avg Conv/Div			Page 1/11
Range	07/25/11 - 01/24/12	Upper	Bar Chart	Mov. Avgs			Currency CAD
Period	Daily	Lower	None	Mov. Avg			Events
MACD	12 - 26	Signal	9	MACDdiff	None		

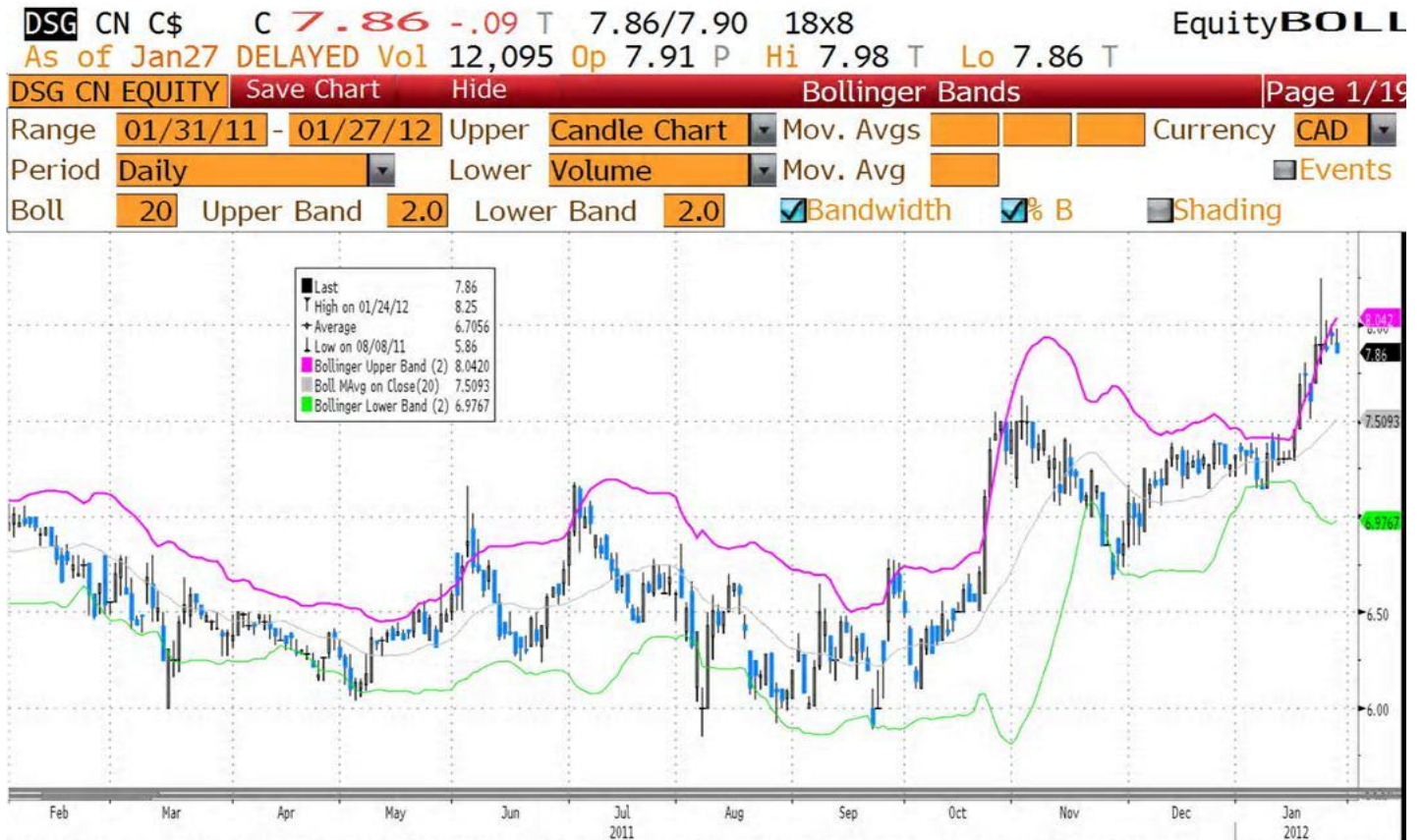


The signal line crossed the MACD indicator, which is often interpreted as a common buy signal, just over a week ago. We would like to take a position once this indicator comes back down, and once again gains momentum and crosses over from underneath. Combined with the MACD, other indicators also suggest an upcoming correction, after which we predict another rally for Descartes Systems Group.

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## Bollinger Bands



Bollinger Bands show the channel which the security is currently trading in. As seen on the chart, the current price just breached the upper Bollinger band, which if looking at the equity historically over the past year, suggest a slight correction, lasting anywhere between two to four weeks. With that being said, these corrections seem to be followed by a very strong growth in stock price in the two months following. We look for the stock price to correct, and then approximately in late February to Early March take a position in the equity, and follow it up on its move. This would coincide with the MACD diverging, followed by a convergence which, depending on macroeconomic circumstances at the time, could be a very strong buy signal.

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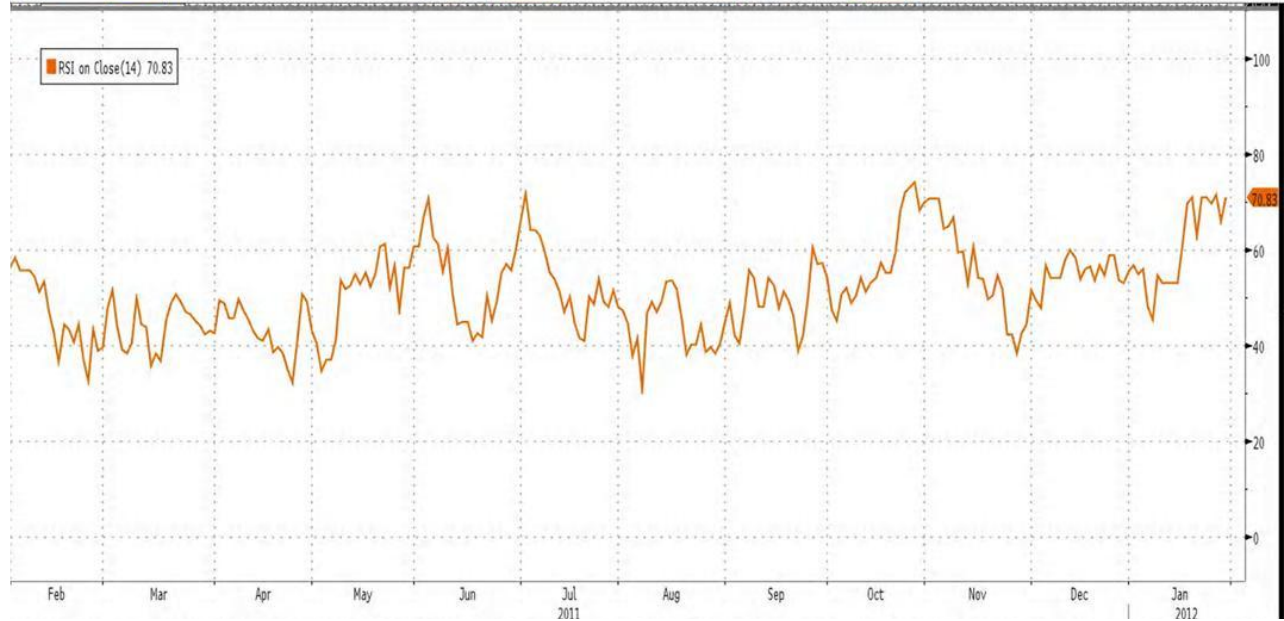


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## Relative Strength Index

**DSG** CN C\$ C **8.04** **+.18** X 7.86/8.10 26x12 Equity **RSI**  
 As of Jan30 DELAYED Vol 139,583 Op 7.86 T Hi 8.10 T Lo 7.86 T  
**DSG CN EQUITY** Save Chart Hide Relative Strength Index Page 1/19  
 Range 01/31/11 - 01/30/12 Upper Bar Chart Mov. Avgs Currency CAD  
 Period Daily Lower None Mov. Avg Events  
 RSI 14 OverB OverS



The Relative Strength Index (RSI) is technical indicator, which measures the momentum and velocity of directional price movements. The RSI is typically used in a fourteen day time frame, however, it can also be used in longer intervals to show support longer outlooks. High and low levels are marked 70 and 30 respectively. Once the index goes above 70, the equity is deemed overbought and is due for a correction in the near-term. Conversely, if the index goes below 30, the equity is said to be oversold, and is generally due for an upward swing. The index is currently at 70.83 indicating that the Descartes is overbought, and will likely experience a short-term downturn, after which, given the strong fundamentals of Descartes, we believe the equity will go right back up.

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## Fibonacci Retracements



Fibonacci Retracements show the major and minor support and resistance points. As seen on the chart above, Descartes' stock just bounced off the very top resistance level, and is now heading down toward the 23.6% and the 38.2% support levels. These support levels are not set in stone since technical indicators are not an exact science. Given the upward momentum of the equity, we speculate the security will have a minor correction, possibly breaking through the 23.6% support, which will be followed by an upward swing where Descartes will test the highest resistance point, and may have the opportunity to break through. If Descartes breaks through the top resistance level, it will have the potential for a lot of upside. Combined with the previous technical indicators, we believe that the optimal entry point is around the 23.6 support level, somewhere between \$7.55 and \$7.70. The exit point should be set around \$6.95.

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## SELECTION METHODOLOGY

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The first step in the selection process was identifying relatively young companies in a growing sector that provide fundamentally strong services, the industry would have high barriers to entry, are making strategic expansions, and ideally have some type of competitive advantage in their industry. Descartes Systems Group fit the bill from the start. As part of its supply chain network solutions, Descartes offers immediate hard dollar savings, as well as increased efficiency and flexibility. All are vital aspects of a healthy supply chain, yet many of Descartes competitors fail to provide such products or services. Descartes Systems Group has also been expanding aggressively through very strategic acquisitions, meant to not only improve, but also broaden the scope of their products and services. Some of Descartes' acquisitions in the past two years include the acquisition of 96.17% interest in Zemlaz NV who provides global trade management solutions, Imanet, Routing International NV, Telargo Inc., InterCommIT, and most recently, in January 2012, GeoMicro, Inc. In addition, over the past six months, DSG has had relatively predictable movements and has been on an uptrend since October 2011, which for our purposes is very favourable. Finally, analyst expectations and statements are very encouraging, with many recommendations to build an overweight position in Descartes. Taking all factors into account, Descartes Systems Group appears to be a sound investment with significant upside potential.

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