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The Fastest Growers in Software

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Why are investors willing to pay only 10 times earnings for some stocks, but 20, 50, even 100 times earnings for others?

The short answer: Growth. Companies that can grow their earnings meaningfully could make lofty current P/E ratios look cheap in hindsight.

Of course, any company can promise a rosy, growth-rich future. Figuring out which companies can actually deliver is far trickier. In this series, I take the first step by identifying companies that have put up the best growth track records in their respective sectors.

Below, I've listed the top 10 sales growers in Application Software (I do Systems Software separately) over the last five years. Here's how to interpret each data column.

- **5-Year Sales Growth:** I rank each company's sales growth, to capture its pure trailing expansion without regard to the vagaries of earnings.
- **5-Year EPS Growth:** Since sales growth means nothing if it doesn't ultimately fall to the bottom line, I've also included each company's five-year trailing EPS growth rate.
- **5-Year Analyst Estimates:** This column shows us how much EPS growth analysts expect over the next five years. Just keep in mind that analysts tend to [grossly overestimate](#) a company's prospects.
- **5-Year ROIC Range:** [Return on invested capital](#) (ROIC) basically shows you how efficiently a company is converting its debt and equity into profits. We want companies that can do a lot with a little. By looking at the five-year range, we can start to gauge both the power and the consistency of a company's profit engine.

Company Name	5-Year Sales Growth	5-Year EPS Growth	5-Year Analyst Estimates	5-Year ROIC Range
Ebix (Nasdaq: EBIX)	43.7%	56.2%	20.0%	13.4% / 18.5%
AsiaInfo-Linkage	37.7%	NM	10.7%	2.3% / 8%
salesforce.com (NYSE: CRM)	36.3%	-21.9%	25.7%	-1% / 8.7%
Concur Technologies	29.2%	NM	23.8%	1.1% / 4.6%
Solera Holdings	28.6%	NM	17.2%	2.5% / 9%
Nuance Communications (Nasdaq: NUAN)	27.7%	NM	13.9%	1.7% / 1.9%
Pegasystems (Nasdaq: PEGA)	27.5%	54.5%	24.8%	0.9% / 12.6%

Taleo	26.6%	NM	21.2%	-2.3% / 1%
Synchronoss Technologies (Nasdaq: SNCR)	26.4%	-21.9%	28.0%	5.9% / 17.7%
Ansys	24.3%	55.7%	16.9%	7.3% / 10%

Source: Capital IQ, a division of Standard & Poor's. NM = not meaningful; EPS growth that is NM results from losses during the period. N/A = not applicable; analyst estimates that are N/A result from lack of analyst coverage.

Use the table above as a first step to help you generate ideas for your own further research. Once you identify stocks worth a closer look, the following three steps will help you can further assess their growth prospects:

- Carefully study the table for discrepancies and outliers among the columns -- high sales growth but low EPS growth, analyst growth expectations significantly trailing past growth, weak ROIC figures, etc. Then follow the trail.
- Find out how the company achieved its prior growth: organically, or via acquisition? Can it sustain that previous growth?
- Pay attention to how management plans to implement its growth plans. Does its strategy seem prudent and plausible to you?

Remember: The more profitable, efficient, and predictable growth a company can achieve, the more we investors should be willing to pay.

When I scan the list above, I notice a few things:

- Three of the companies exhibit both big sales growth and big earnings per share growth: Ebix, Pegasystems, and Ansys. Meanwhile, the best ROIC ranges belong to Ebix, Solera, Pegasystems, Synchronoss, and Ansys.
- Four of the companies are recommendations of Motley Fool newsletters: Ebix, Salesforce.com, Nuance, and Pegasystems.
- Notice that Salesforce and Nuance are recommendations despite not having the best numbers of the group. It's a reminder that, especially in areas like tech, the numbers only tell part of the story. Even for numbers-focused investors, knowing the business is key.

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