Should You Buy Sierra Wireless, Inc. on the Dip?

Description

When a stock drops in value, it could present an opportunity to buy low with the hopes that the stock will recover in price. However, it can be a risky strategy buying on a dip, because a stock that is on the decline may be dropping for a valid reason.

Sierra Wireless, Inc. (TSX:SW)(NASDAQ:SWIR) has been on a bit of a steep decline of late, and it could be a good time to get in on shares that, up until now, had been performing very well. By the end of July Sierra Wireless saw its stock appreciate by almost 75% since the start of the year. However, since August the stock price has dropped by over 20%.

Why did the stock drop so much in value?

Sierra Wireless released its second-quarter results in early August, which is when the stock price went over a cliff. However, the results showed the company continues to post strong growth with sales increasing 11% year over year.

Investors may have been unimpressed with the company's guidance for the third quarter, which only called for sales of $167-175 million. This guidance would likely mean lower sales than Q2, but it would still be an improvement from the prior year.

The company also announced an acquisition of another Internet of Things provider, Numerex. If investors believed the company was not a good fit or the price was too much, that too may have resulted in a sell-off in the stock price.

Drops in stock price are sometimes overblown, which could be the case here.

This technical indicator suggests the stock is oversold

The Relative Strength Index (RSI) is used to measure average gains and average losses. When the RSI drops below a level of 30, indicating the losses are heavily outweighing the gains, it suggests a stock has been oversold, and there might be a trend reversal coming. As of the close of Wednesday, the 14-day RSI level for Sierra Wireless was at 29, indicating an oversold condition.

Current valuation

At earnings per share of $0.64 for the trailing 12 months, the company is currently trading at over 44 times its earnings. However, **Constellation Software Inc.** (TSX:CSU) is a comparable tech stock, and it trades at a multiple of over 50, so Sierra Wireless's stock price may not be that high. The company's price-to-book value of around two also suggests Sierra Wireless may not be that expensive.

It comes down to whether or not Sierra Wireless was overpriced to begin with and this was an overdue correction, or if the drop in price was due to an overreaction to an earnings report that was not viewed favourably. Where you fall on that spectrum will likely determine where you think the stock is headed.

Bottom line

This is not a stock I would invest in for the long term. But in the short term, I would bet on it being oversold, and that the stock should at least see a modest recovery. It's not uncommon for the markets to have an overreaction and then subsequently see a correction afterward.

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