
# Dollarama's (TSX:DOL) Stock Has Plunged by 31%: Should You Buy Before Earnings?

## Description

It was one of Canada's most successful initial public offerings (IPOs) of the past decade. There was a point when **Dollarama** (TSX:DOL) could no wrong. That all changed this year. Dollarama shareholders have suffered through a 31% drop in share price in 2018. Unless the company makes a miraculous comeback, it will be this first year that the company has posted negative returns since its IPO.



With the holiday season approaching, is now the time to consider a position in this discount retailer?

**Slowing growth**

There were two factors working against Dollarama this year. An expensive valuation and warnings signs of slowing growth. The company's growth rate was key to justifying Dollarma's valuation. It's not uncommon for high-growth stocks to command a premium.

The problem is, when growth begins to slow, that premium is longer justified. Over the past few years, Dollarama's P/E ratio hovered in the high-20s to high-30s. Unfortunately, the company's results in 2018 didn't justify this valuation. Through the first six month of the year sales grew by only 7% over the comparable period of 2017. Single-digit growth is not enough to justify a P/E above 30.

Its poor performance has led to downward revisions on earnings and revenue.

**Current valuation**

Trading near 52-week lows, it's now time to reanalyze the company's valuation. As of writing, Dollarama is trading at a price to earnings of 22.5. Although this is well below historical averages, it's not directly comparable due to the slowing growth.

Speaking of which, analysts are expecting full year earnings per share growth of 13.1% in 2018 and a further 12.2% growth in 2019. Although not as high as historical averages, these are fairly decent growth rates. On a forward basis, the company is trading at 18.67 times earnings.

The company's P/E to growth (PEG) ratio of 1.50 indicates that Dollarama's share price may still be somewhat overvalued. Famed value investor Peter Lynch preferred a PEG ratio below 1. However, there are plenty of investors who choose a PEG ratio below 1.50 as a benchmark, especially when looking at growth stocks. A growth stock is typically defined as having an average annual growth rate above 10%.

**Is the stock oversold?**

Investors must be careful not to fall into the oversold trap. Just because the company is trading near 52-week lows, does not mean it is oversold. In fact, the recent downturn was more than justified, as I explained earlier.

The term "oversold" is a technical term use by traders to determine whether a company's stock price is trading below its value. It's a short-term indicator that flags investors when there has been a change in the stock's pricing trend. The most commonly used indicator is the 14-day **Relative Strength Index** (RSI). In general, a RSI below 30 is usually indicative of a stock in oversold territory. At this point, the stock may be due for a correction in the near future.

What is Dollarama's RSI? As of writing it's comfortably sitting at 47, which means it's neither overbought or oversold. There was a period early this month when the company flirted with being oversold, but it quickly corrected.



**Foolish takeaway**

Dollarama is scheduled to report earnings on December 6. The company has missed big in Q1 and Q2, seeing double-digit losses immediately post earnings. If it beats estimates this week, the company could see an upwards spike. On the flip side, another miss can send its price crashing once again. If you like the company at these levels, the safest approach would be to take half a position today, and half post earnings.

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