Could Metro Inc.'s Q3 Earnings Beat Support a Rally to New All-Time Highs?

Description

Metro Inc. (TSX:MRU), one of the largest owners and operators of grocery stores, convenience stores, and pharmacies in Canada, announced better-than-expected third-quarter earnings results before the market opened on August 12, and its stock reacted by making a slight move to the upside in the trading session that followed. The company's stock now sits just 1.5% below its all-time high of $37.10 reached back in April, so let's take a closer look at the results to determine if they could support a rally to new highs.

Breaking down the better-than-expected quarterly performance

Here's a summary of Metro's third-quarter earnings results compared with what analysts had anticipated and its results in the same period a year ago.

Metric	Reported	Expected	Year-Ago
Fully Diluted Earnings Per Share	$0.64	$0.62	$0.54
Revenue	$3.84 billion	$3.83 billion	$3.62 billion

Source: Financial Times

Metro's earnings per share increased 18.5% and its revenue increased 6.1% compared with the third quarter of fiscal 2014. The company's double-digit percentage increase in earnings per share can be attributed to its net income increasing 13.1% to $163.5 million, and this growth was amplified by its weighted average number of diluted shares outstanding decreasing 4% to 250.1 million.

Its very strong revenue growth can be attributed to its same-store sales increasing 4.3%, and it credited this performance to its ability to stay on top of consumers' needs, as well as its continued investments to improve its retail network.

Here’s a quick breakdown of six other notable statistics from the report compared with the year-ago period:

1. Operating income before depreciation, amortization, and associate’s earnings increased 9.6% to $277.6 million
2. Operating margin expanded 20 basis points to 7.2%
3. Earnings before income taxes increased 13.1% to $163.5 million
4. Cash flow from operating activities increased 8.5% to $201.9 million
5. Total operating expenses increased 5.8% to $3.56 billion
6. Opened six new stores and carried out “major expansions and renovations” of 17 stores

Metro also announced that it will be maintaining its quarterly dividend of $0.117 per share, and the next payment will come on September 21.

Should you buy or avoid Metro’s stock today?

Metro posted a very strong performance in the second quarter, so I think its stock responded correctly by moving higher. I also think this could be the start of a sustained rally to new all-time highs because the stock still trades at inexpensive forward valuations and because it is one of the top dividend-growth plays in the market, which will continue to make it popular with income investors.

First, Metro’s stock trades at just 18.5 times fiscal 2015’s estimated earnings per share of $1.98 and only 16.7 times fiscal 2016’s estimated earnings per share of $2.19, both of which are inexpensive given its long-term growth rate. I think Metro’s stock could consistently command a fair multiple of at least 20, which would place its shares upwards of $39.50 by the conclusion of fiscal 2015 and upwards of $43.75 by the conclusion of fiscal 2016, representing upside of more than 8% and 19%, respectively, from today’s levels.

Second, Metro pays an annual dividend of $0.468 per share, which gives its stock a 1.3% yield at current levels. A 1.3% yield may not seem impressive at first, but it is very important to note that the company has increased its annual dividend payment for 21 consecutive years, and its increased amount of free cash flow and low payout ratio could allow this streak to continue for the foreseeable future.

With all of the information above in mind, I think Metro represents one of the best investment opportunities in the retail industry. Foolish investors should strongly consider beginning to scale in to long-term positions today.

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1. Editor's Choice

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