Why Sleep Country Canada Holdings Inc. Is Down Over 12%

Description

Sleep Country Canada Holdings Inc. (TSX:ZZZ), Canada's leading mattress retailer, announced its third-quarter earnings results after the market closed yesterday, and its stock has responded by plummeting over 12% in early trading today. Let's break down the quarterly results and the fundamentals of its stock to determine if this sell-off represents a long-term buying opportunity or a warning sign.

Strong mattress sales lead to great results

Here's a quick breakdown of 10 of the most notable financial statistics from Sleep Country's three-month period ended September 30, 2017, compared with the same period in 2016:

Metric	Q3 2017	Q3 2016	Change
Mattress revenue	$140.7 million	$126.2 million	11.5%
Accessory revenue	$36.4 million	$34.6 million	5.2%
Total revenues	$177.12 million	$160.85 million	10.1%
Same-store sales growth	7.3%	7.7%	N/A
Operating EBITDA	$35.81 million	$33.62 million	6.5%
Operating EBITDA margin	20.2%	20.9%	(70 basis points)
Adjusted net income from operations	$23.54 million	$21.87 million	7.6%
Adjusted earnings per share (EPS)	$0.63	$0.58	8.6%
Stores opened	2	1	100%
Total stores in operation	244	234	4.3%

What should you do now?

It was another great quarter for Sleep Country, which has been an ongoing theme for the company in 2017 as its revenue is up 11.9% to $434.46 million, its operating EBITDA is up 12.5% to $74.17 million, and its adjusted EPS is up 17.1% to $1.23 in the first nine months of the year compared with the same period in 2016. The company also proudly noted that this quarter marked the 17th consecutive quarter in which it has achieved positive same-store sales growth, which is a great sign for investors.

With all of this being said, I do not think the sell-off is warranted, and I think it actually represents a very attractive entry point for long-term investors for four primary reasons.

First, it's one of the retail industry's best growth stories. Sleep Country grew its adjusted EPS by 17.1% to $1.23 in the first nine months of 2017, which puts it on pace to achieve the consensus analyst estimate of 17.6% growth to $1.60 in the full year of 2017, and analysts expect it to grow its EPS by another 15% to $1.84 in fiscal 2018, which I think is very achievable as well.

Second, it's stock is undervalued based on its aforementioned growth. Sleep Country's stock now trades at just 20.9 times fiscal 2017 estimated EPS of $1.60 and only 18.2 times fiscal 2018's estimated adjusted EPS of $1.84, both of which are very inexpensive given its current earnings-growth rate and its long-term earnings-growth potential.

Third, its expansion potential is massive. Sleep Country has opened nine new stores so far in 2017, which brings its store count to 244, and I think it could easily add 10-20 new stores annually through 2025 without every running into issues related to market densification; I think this expansion paired with continued same-store sales growth at its existing stores will lead to record revenue and earnings for the company in the years ahead, and I think this will drive its share price significantly higher.

Fourth, it has a great dividend. Sleep Country currently pays a quarterly dividend of $0.165 per share, equal to $0.66 per share annually, which gives it a respectable 2% yield. Investors must note that the mattress retailer is on track for 2017 to mark the second consecutive year in which it has raised its annual dividend payment, and its 10% hike in May has it positioned for 2018 to mark the third consecutive year with an increase. I think its strong financial performance will allow this streak to continue in 2019 and beyond.

Sleep Country's stock has soared more than 90% since I first recommended it in December 2015, and I am as bullish as ever on the company's long-term potential, so I think all Foolish investors should strongly consider making it a core holding.

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