Buy This Retail Stock for Long-Term Value Creation

Description

Sleep Country Canada Holdings's (TSX:ZZZ) stock price has seen many highs and lows in the last two years, peaking at over $40 in the summer of 2017 and sinking more than 50% to lows of just over $20 last month.

With the recent purchase of Canadian mattress-in-a-box online retailer, Endy, Sleep Country continues to solidify its leading market share position.

Here are five reasons to add Sleep Country stock to your portfolio.

Balance sheet

Let's start with a look at Sleep Country's balance sheet — a balance sheet that was strong before the acquisition and that enabled Sleep Country to finance the $88.7 million Endy acquisition with debt.

The balance sheet remains strong even after the acquisition, with a net debt to EBITDA ratio of 1.5 times.

Opportunistic acquisition

Let's go back to the acquisition of Endy.

This fast-growing online mattress and bedding retailer has been rapidly growing, as it has benefited from the rapid rise of online sales in general, serving consumers through the medium they are demanding.

The 2017 sales at Endy doubled and are expected to more than double in 2018.

Being an online retailer with no physical locations, Endy does not have any of the expenses that come with them, meaning that we can expect it to generate higher margins than Sleep Country's business over the long term.

As such, this acquisition can be expected to increase Sleep Country's margins and be accretive to earnings.

Competitive advantage

Market share gains continue to drive Sleep Country's leading position in its niche market — a market that is underserved in many parts of Canada as a result of Sears Canada's demise, and a market that remains highly fragmented.

Key to the thesis is this simple fact: with Sears's demise, what was once Sleep Country's biggest competitor is now gone, and Sleep Country has scale and positioning to capture a big portion of these sales that are up for grabs.

Sleep Country is the biggest competitor in this market, with a more than 25% market share, so there is a real opportunity for continued consolidation and market share increases.

Strong free cash flows

In 2017, Sleep Country generated free cash flow of $65 million, 76% higher from 2016 levels, and in the first nine months of 2018, free cash flow was $37 million, placing the company in a good position to end the year with free cash flows of well above last year's.

Valuation

Sleep Country trades at a mere 12 times this year's expected earnings, with a dividend yield of 3.34%, and a steadily growing earnings profile, strong returns, and strong free cash flow generation, making it a very attractive buy for long-term investors.

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