2020 Stocks: Will Sleep Country (TSX:ZZZ) Make a Bullish Run?

Description

Sleep Country (TSX:ZZZ) operates in the retail marketplace under three brands, Sleep Country, Dormez-vous and Endy, offering mattresses and bedding products. The company has 275 stores as well as an online shop.

The company's two subsidiaries include Sleep Country Canada Inc. (SCCI) and Endy. The company reports a market capitalization of $730 million with a 52-week high of $22.70 and a 52-week low of $16.01.

Intrinsic price

Based on my calculations using a discounted cash flow (DCF) valuation model, I determined that Sleep Country has an intrinsic value of $24.23 per share.

Assuming less than average industry growth, the intrinsic value would be $22.94 per share and higher than average industry growth would result in an intrinsic value of $25.68 per share.

At the current share price of $19.64 at writing, I believe Sleep Country is slightly undervalued. Investors looking to add a mattress retail company to their TFSA or RRSP should consider buying shares of Sleep Country.

I would recommend investors follow the stock through 2020, as there may be an opportunity to buy shares at a discount.

Sleep Country has an enterprise value of $1.1 billion, representing the theoretical price a buyer would pay for all of Sleep Country' outstanding shares plus its debt. One of the good things about Sleep Country is its low leverage with debt at 18.9% of total capital versus equity at 81.1% of total capital.

Financial highlights

For the nine months ended September 30, 2019, the company reports a mediocre balance sheet with $45 million of negative retained earnings (up from $66 million negative retained earnings in 2018).

This is not ideal for shareholders, however, as it suggests the company has reported more years of cumulative net loss than net income. Despite this, the company has reduced its negative retained earnings by $21 million year over year.

Overall revenues for the period are up from $463 million in 2018 to $526 million in 2019 (+14%) for gross profits of $164 million (gross profit margin of 31%). Pretax income is $57 million (down from $63 million in 2018).

The company reports cash on hand of $48 million (up from $30 million in 2018). Given current lease liabilities of $32 million, the company has enough cash on hand to meet its short-term debt obligations.

The management team is committed to being fiscally responsible, as evidenced by its $19.5 million pay down of long-term debt in 2019 following a $38 million pay down in 2018. This is offset by draws of $26.7 million in 2019 and $35.8 million in 2018.

The company is a dividend paying entity with a current yield of 3.97%. It pays a quarterly dividend of $0.195.

Foolish takeaway

Investors looking to buy shares of a mattress retailer should add Sleep Country to their watch list. Despite the negative retained earnings, overall revenues increased year over year and the company is well positioned to benefit from the online mattress industry with its ownership of Endy.

Sleep Country ended the period with a cash balance of $48 million — plenty of room to cover short-term debt obligations and partially fund business growth.

Further, the company reports a current share price of $19.64, which means that it already trades at less than an intrinsic value of $24.23 per share.

Investors should follow the stock through 2020 as a recession could present an opportunity to buy shares at a cheaper price.

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