SunOpta: Capitalizing on the Organic/Natural Food Trend

Description

The organic food market has brought excitement back to the food industry.   We have seen evidence of this in the grocery stores, as more and more shelves are dedicated to organic foods. Ten years ago, organic food retail sales were $7 billion per year with a growth rate of 15-20% per year. Currently, organic food retail sales growth rates are still going strong. It's estimated that growth in organic foods will be 13% per year for the next 5 years. This is a secular trend that is not going away. It is not a fad that will change with the seasons.

This has not gone unrecognized in the stock market and we have seen exceptional returns on organic food companies in the last few years. Given my belief that this trend is just beginning, I went on a search to find an organic food company whose potential is not yet fully reflected in its stock price.

Enter **Sunopta** (TSX: SOY), a vertically integrated organic food company that sources raw materials such as soy, corn, vegetables and fruit, transforms them into value-added ingredients for food manufacturers, and produces consumer packaged products. The risk in their business model is relatively low. They are a vertically integrated company, they do not own farms, and they do not have consumer brands. They sell their products to a large number of retailers, such as **Wal-Mart**, **Costco**, **Whole Foods**, and consumer goods companies, such as **Kraft**, **Cargill**, and **Gerber**.

Catalysts that should lead to outperformance

– Strategy to Increase Margins

SunOpta's focus going forward will be on the consumer packaged goods business, which has much higher operating margins (8%-12% margins) than the raw materials segment (2%-4% margins). Consumer packaged goods currently account for 40% of sales, and management will focus on increasing it to 60%.

The potential for increasing margins, coupled with the expected continued strong growth rates in the organic food industry, should lead to very healthy returns for SunOpta.

– Growth Strategy

SunOpta has plans to divest of its non-core assets in order to become a pure play natural and organic foods company. Proceeds from selling these businesses will enable them to look at acquisitions to further grow the business. They also have a strong balance sheet which they can tap in order to help with their growth strategy.

– Valuation

SunOpta is trading at about 19 times 2013 expected earnings. As we'll see in the peer group analysis below, this is attractive relative to its US peers. Given the industry fundamentals and the company's strategy to increase margins, earnings are expected to increase 17% in 2013 and 21.5% in 2014.

Peer Group Analysis

There are no direct comparisons for SunOpta in the Canadian market, but we can look to the US for peers that are involved in the organic/natural food business. As we can see from the following chart, the price earnings multiples on these stocks are higher with lower growth rates, which means that SunOpta stands out as very attractive.

Company Name	P/E	EPS Growth – 2013e	EPS
The Hain Celestial Group (NASDAQ:HAIN)	25.9	34%	
United Natural Foods (NASDAQ:UNFI)	24.2	12%	
Whole Foods (NASDAQ:WFM)	37.5	15%	
SunOpta	19.8	17%	

The Hain Celestial Group

The P/E multiple on Hain is high and the company's consumer brands face strong competition. Their strategy is a more high risk one, as they are not involved in the different levels of getting the organic products to the market.

United Natural Foods

Although United Natural Foods is in the right industry, they are a distributor, and that business is a low margin business with little value add. The expected earnings growth rate for 2013 is 12% and 14% for 2014. SunOpta has a stronger earnings growth rate profile and is more attractive on a P/E basis.

Whole Foods

With a P/E of 37.5 times, Whole Foods is clearly a very expensive stock, almost priced for perfection. This makes me nervous. While I believe it is an excellent company, I would not be willing to pay this hefty price. Should a minor hiccup occur or should the stock be taken down in a weak market, I would definitely take another look, as I believe in the fundamentals of this industry and the strength of the Whole Foods business model.

The Bottom Line

Although SunOpta is up 45% year to date, the stock is still a very attractive investment opportunity. The company has many of the factors that we as investors should look for. It has a competitive advantage (vertically integrated), it has catalysts to keep the stock moving higher (concrete plan to increase margins, and plan for acquisitions to grow the business), it is attractively valued relative to its peers, it has a strong balance sheet, and it is in a booming industry.

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This post was created by Fool contributor Karen Thomas.

Fool contributor Karen Thomas owns shares of SunOpta. David Gardner owns shares of Whole Foods. Tom Gardner owns shares of Whole Foods. The Motley Fool owns shares of Hain Celestial and Whole Foods.

CATEGORY

1. Investing

TICKERS GLOBAL

1. TSX:SOY (SunOpta Inc.)

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Date
2025/07/01
Date Created
2013/06/26
Author

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