



Is Warrnambool Cheese & Butter Worth Saputo's Investment?

Description

Saputo ([TSX:SAP](#)) has given its newest acquisition target, Australia-based **Warrnambool Cheese & Butter**, until Jan. 22 to accept the company's "last and final offer" of nearly half a billion dollars.

In the meantime, The Canada Press [reported yesterday](#) that Saputo had increased its existing ownership stake in Warrnambool by 2.8 million shares. It was already the largest shareholder; its total stake now stands at 26.4%.

This acquisition fight has been one of the "hottest bid battles in Australia of recent times," wrote *The Wall Street Journal*. Which begs the question: Is Saputo right to be chasing Warrnambool?

Growth by acquisition

In an industry that requires volume for profitability, growth-through-acquisition is a quick way to obtain the scale required. And Saputo is no stranger to acquisition.

In January of last year, it purchased Morningstar Farms for \$1.45 billion, giving it greater access to the U.S. markets. Revenue in its 2014 fiscal year first quarter increased 28% from the prior-year period, based largely on the Morningstar acquisition (although a higher price for cheese helped as well). In the six-month period that ended Sept. 30, revenue was up 28%, to the tune of \$ \$960.2 million.

We can already begin to see the effects of the Morningstar acquisition on revenue, which perhaps has helped investors stomach its large purchase price. Saputo has since turned its eyes to Australian dairy producer Warrnambool, and has found itself in the middle of a very publicized bidding war.

The most recent bid by Saputo has valued Warrnambool at up to \$9.60 per share. With 55.97 million shares outstanding, this cash deal could potentially cost Saputo up to \$537 million.

Though [Warrnambool has much to offer](#) — notably, access to Asia — Saputo was clever in structuring a tiered offer that only outbid the competition if 90% shareholder approval was met.

In August, Warrnambool [reported](#) a net operating profit after tax of only \$7.5 million for the year ended June 30. According to the 2013 annual report, that was a 50.7% decrease from the previous year. In

fact, when you look back over the last few years, the results are somewhat disappointing.

Net Profit After Tax	
2012	\$15.2M
2011	\$18.5M
2010	\$8.8M

Amounts in Australian dollars. Source: Company Reports.

Is the access to Australasia so valuable that Saputo would pay a premium for a company that will not generate the kind of sales that Morningstar Farms has delivered?

Saputo said in the outlook portion of its first-quarter 2014 report that it expects dairy to be challenging. Throw in currency exchange on top of a commodity-based business and you have one added layer of risk — although these are challenges that are no stranger to this company.

Warrnambool does have existing distribution networks that Saputo would potentially acquire, but they are already factored into the net profits. Any capitalization would need to come from Saputo's ability to expand market share in these regions.

It's less than 10 days now until Saputo's bid expires. We'll find out soon whether the company will capture its target.

CATEGORY

- Investing

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- TSX:SAP (Saputo Inc.)

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