4 Top Beneficiaries of the Weak Canadian Dollar

Description

The Canadian dollar is in a bear market and has now declined by 18% since reaching a level of C$0.94 against the U.S. dollar three years ago. Against a basket of currencies of Canada's main trading counterparts, including the U.S. dollar, euro, and yen, the decline has been somewhat less pronounced at 13% over the past three years.

Many analysts expect the currency to continue on its weaker path, with declining oil and commodity prices and ongoing low interest rates the key determinants of the future direction. Most expectations range between C$1.12 to C$1.18 for 2015.

For ease of reference, most companies reporting for the period until the end of September would have seen a Canadian dollar/U.S. dollar on average weaker by around 7% in 2014 compared to 2013.

Advantages of a weaker currency

The primary beneficiaries of a weaker domestic currency are manufacturing companies that have a large export component denominated in U.S. dollars. These companies will benefit on condition that domestic inflation does not erode the improved export revenue and that the U.S. dollar prices of their exports remain stable or increase.

Among these Canadian manufacturers is **Saputo Inc.** (TSX: SAP), one of the largest dairy producers in the world. Saputo receives 49% of its revenues from the U.S., and according to the company, its EBITDA should increase by 0.5% for every 1% depreciation in the Canadian dollar relative to the U.S. dollar.

Canfor Corporation (TSX: CFP) is another company that benefits from a weaker Canadian currency. More than 50% of its lumber sales volumes came from the U.S. in 2013, 22% from China, and 18% from Canada. Pretax profit is rather sensitive to movements in the Canadian dollar and the company estimates that a 1% decrease in the Canadian dollar versus the U.S. dollar will result in a 6% increase in pretax profits. Of course, the company's profit is also highly sensitive to the movement in lumber prices.

Other beneficiaries from a weak Canadian dollar are companies that have substantial foreign operations denominated in U.S. dollars where the gain will be translated directly into the financial results of the Canadian entity.

Toronto-Dominion Bank (TSX: TD)(NYSE: TD) receives about 26% of total income from its U.S. banking operation. The bank indicates that a 1% decrease in the Canadian dollar will add about $23 million, or 0.4%, to TD Bank's annual net income.

Canadian National Railway Company (TSX: CNR)(NYSE: CNI) has a considerable portion of revenues and expenses denominated in U.S. dollars. The company says that a 1% decrease in the value of the Canadian dollar will increase annual profit by $10 million-$15million, or around 0.5%.

A welcome tailwind

A weak domestic currency is not the only factor that could impact the profitability and share price performance of a company. However, it can provide a welcome tailwind for exporters on condition that domestic inflation does erode the export revenue benefits and that U.S. dollar export prices remain stable or improve.

For companies with considerable non-domestic operations, the gain is relatively straightforward: As long as the foreign operation performs well, the weaker currency will translate foreign profits as a gain for the domestic holding company.

CATEGORY

1. Investing

TICKERS GLOBAL

1. NYSE:CNI (Canadian National Railway Company)
2. NYSE:TD (The Toronto-Dominion Bank)
3. TSX:CFP (Canfor Corporation)
4. TSX:CNR (Canadian National Railway Company)
5. TSX:SAP (Saputo Inc.)
6. TSX:TD (The Toronto-Dominion Bank)

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Date
2025/07/19
Date Created
2014/10/02
Author
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