Maple Leaf Foods Inc.: It's Time to Sell Despite Momentum

Description

You can't argue with success.

A $10,000 investment made in **Maple Leaf Foods Inc.** (TSX:MFI) five years ago is worth $28,044 today–$14,471 more than the S&P/TSX Composite Index over the same period.

It literally is, as Fool.ca contributor Ryan Vanzo recently called it, the best stock you've never heard of.

The company has totally overhauled its business, moving from an inefficient, cash-burning enterprise to one with reasonably strong margins and free cash flow to boot. Operating in the highly competitive, low-margin, processed-foods industry, Maple Leaf Foods invested $400 million in 2014 on a new 402,000-square-foot hot dog plant in the Hamilton area that consolidated five manufacturing facilities into one—the largest investment in the history of the Canadian food industry.

In 2013 Maple Leaf Foods generated -$101 million in free cash flow on $4.4 billion in revenue. At the end of June 2016 it had trailing 12-month free cash flow of $105 million on $3.3 billion in revenue. In the span of 30 months, it's completely reversed its cash flow situation—to the positive.

So, it's not hard to understand why its stock's been on a tear in recent years—it's up 23% in 2016, 10 percentage points clear of the index—but at some point investors have to take stock of the fact that its ability to deliver future revenue growth beyond the 4% it's currently generating will require acquisitions and the ratcheting up of debt, something it's not been keen to do since selling Canada Bread in 2014.

The company's Q2 2016 earnings release said the following about its future: "Our team is focused on pursuing profitable growth, market expansion, and further cost efficiencies." Essentially, its move to be a company focused solely on the protein business hasn't changed. Only a truly special opportunity within the protein segment would get Maple Leaf Foods to open up their wallet.

Therefore, while MFI has been one of the top-performing large-cap stocks in Canada, investors might want to think twice about owning its stock.

While it's done an admirable job turning its cash flow around, it's market cap is still 37 times free cash flow. You can buy **Hormel Foods Corp.** (NYSE:HRL) for 27 times free cash flow, a company whose brands—not to mention margins—are far superior. If you want a leader in processed foods, Hormel is the way to go.

Also, what happens when Maple Leaf Foods can no longer find any cost reductions to be had? Its current annual dividend of $0.36 yields just 1.2%. That’s hardly the kind of income I’d want to receive while waiting for management to figure out its next move. Getting more efficient was a no-brainer for the company. What it does next isn’t nearly as obvious.

While Maple Leaf Foods has got a lot of momentum and it’s a great stock, I wouldn’t buy until it retreats back to the low 20s where it was at the beginning of the year.

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2. TSX:MFI (Maple Leaf Foods Inc.)

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