Has Saputo Inc. Stock Become Too Cheesy?

Description

Saputo Inc. (TSX:SAP) produces, markets, and distributes a wide range of dairy products, including cheese, fluid milk, extended shelf-life milk and cream products, cultured products, and dairy ingredients.

Saputo is one of the top 10 dairy processors in the world as well as the largest cheese manufacturer and the leading fluid milk and cream processor in Canada. Its products are sold in several countries under well-known brand names, such as Saputo, Cracker Barrel, Milk2Go/Lait's Go, Neilson, and Nutrilait.

While Saputo cheese is fresh and delicious, its stock may not be such a great investment.

A disappointing fourth quarter, but a good year overall

On June 1, 2017, Saputo reported its results for the quarter ended March 31, 2017. The dairy processor earned $165.2 million, or $0.42 per share, compared with a profit of $141.2 million, or $0.36 per share, a year ago. Fourth-quarter revenue totaled nearly $2.72 billion compared with just over $2.73 billion in the same quarter a year earlier.

Saputo missed analysts' expectations, who, on average, expected the company to earn $0.48 per share on revenue of $2.92 billion, according to **Thomson Reuters**. A drop in the volume of cheese sales in the United States largely contributed to this earnings miss.

Saputo also reported on June 1 its financial results for the fiscal year which ended on March 31, 2017. The company earned revenues of $11.16 billion — up 1.6% from last year. Net income was $731.1 million — up 21.6% from last year.

In fiscal 2017, Saputo increased its dividend and repurchased some shares. It also expanded its activities in new and existing markets and invested in capital projects.

A strong appetite for acquisitions

In fiscal 2018, the company intends to continue growing by making targeted acquisitions and strategic capital investments. Its solid balance sheet and capital structure, as well as its high levels of cash and low debt, gives it the financial flexibility needed to go on with those projects.

To improve the effectiveness of its operations, Saputo plans to continue expanding and modernizing its plants by investing in equipment and processes.

Saputo has expanded its global presence by completing about 25 deals since 1997. The company has made major acquisitions in the United States and Australia in recent years, and it is currently in negotiation for four to five potential deals. While Saputo has proven to be a prudent acquirer historically, this hunger for acquisitions adds a layer of risk to its business.

Challenging dairy industry

Saputo’s pricing/cost structure is sensitive to dairy prices which are highly volatile. So, despite the efforts it is making to reduce costs and reinvest in operations, it will be hard for the firm to improve its competitive edge and margin profile.

Even though Saputo offers dairy products under several brands, there are many other brands offered on the market, so the competition is intense. With all the choices available to them, consumers tend to favour price over brand when shopping in the dairy aisle. The preference of consumers for price over brand constrains Saputo’s ability to increase prices in the face of rising costs.

We can note that Saputo has a solid balance sheet and is looking for more growth through acquisitions. The firm is also making efforts to modernize its operations and improve its effectiveness. However, given the challenging context in which Saputo operates and its several acquisitions, there are risks associated with this investment that you shouldn’t ignore.

I don’t expect Saputo’s share price to go up a lot in the future, but it may have its place in a diversified portfolio.

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