Should You Hold On to Saputo Inc.'s Stock Following a Weak Q2?

Description

Saputo Inc. (TSX:SAP), the largest cheese manufacturer in Canada, reported its results for the second quarter of fiscal 2018 on November 2.

Shares dropped almost 3% after Saputo reported a lower profit in Q2, despite a rise in revenue.

Net income dipped 3.4% to $185.2 million in the second quarter compared to $191.8 million in the same quarter last year.

The dairy processor's diluted earnings per share were $0.47 in the quarter compared to $0.48 a year ago, falling short of expectations for $0.52.

Revenue for the quarter rose 1.1% to $2.88 billion. The largest part of Saputo's revenue comes from the U.S. (52%), followed by Canada (36%) and the international sector (12%).

Revenues were negatively impacted by lower sales volume in Canada and an unfavourable product mix. In the U.S., revenues increased with the average price of butter as well as higher sales volumes and higher selling prices for cheese and dairy ingredients.

The fluctuation of the Canadian dollar had a negative impact of about $78 million on the revenues of the most recent quarter.

Acquisitions in Australia and in the U.S.

As Canada's mature dairy market is becoming increasingly competitive, Saputo is targeting emerging markets for growth.

In October, Saputo announced a $1.3 billion agreement to acquire Australia's Murray Goulburn Co-Operative Co., continuing a growth-by-acquisition strategy. The deal would make Saputo Australia's top milk producer and expand its access to China — a market that has a big potential given its large size.

Saputo aims to bring back the co-operative to profitability, by increasing milk collected by the co-operative facilities, which are modern, but running far below capacity.

Murray Goulburn has the potential to generate AU$175-180 million of EBITDA, or core earnings per year approaching the AU$200 million it recorded in 2014. The purchase would bring in $2 billion in revenue and two factories, one of which supplies Coles supermarkets as well as one infant formula factory in China.

The deal, expected to close in the first half of 2018, would add little to the expected profit of $2.07 in 2019. We must look to 2021 to see an annual contribution of $0.15-0.20 per share.

On November 1, Saputo announced that it has signed a deal to buy Betin Inc., the company behind the Montchevre brand of goat cheese in the United States. Betin employs 319 people and has one manufacturing plant in Wisconsin.

Montchevre had revenue of approximately $150 million for the 12 months ended June 30.

The deal is expected to close by the end of the year. The financial details of the agreement weren't disclosed at the time of the announcement.

Saputo is among the top three cheese producers in the U.S. The acquisition of Betin will reinforce the company's position in the U.S.

What should you do with Saputo's stock?

Over the long term, I believe Saputo could be able to achieve strong growth through expansion in emerging markets. For the moment, I don't think Saputo is a buy since its forward PEG of 2.5 suggests the stock is too expensive relative to growth. But if you hold this stock, I think you should keep it if you are patient and have a long-term horizon.

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