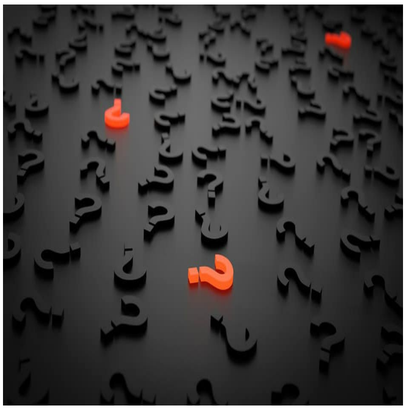

# Saputo Inc. Spills the Milk in its Latest Quarter: Time to Sell?

## Description

**Saputo Inc.** (TSX:SAP) shares are down ~6% over the past year following a lower than expected profit in an underwhelming second-quarter earnings report. With net income dropping 3.4% on a year-over-year basis, and diluted EPS missing the Street consensus and dropping by a penny year over year, does it still make sense to pay a boring defensive business with a hefty 23.1 price-to-earnings multiple?



The markets have been hot of late, but it's never too early to start bolstering the defensive portion of your portfolio, especially since some believe 2018 could be a rockier road. There are few high-quality blue-chip defensive plays on the TSX, so it's understandable that Saputo shares may have a premium valuation.

With a ~$17 billion market cap, Saputo is one of the world's largest dairy companies, and, as you'd imagine, it can be quite difficult to remain competitive in a commoditized industry. Sure, Saputo has its own brands, including Armstrong, Cracker Barrel, Dairyland, Milk2Go, just to name a few, but let's be frank.

When the average consumer goes grocery shopping, they're probably not going to go out of their way for a specific brand, especially if there are cheaper brands that are on sale. Branding is important, but for a commoditized item like milk or cheese, there's less power in the brand, and that means lower pricing power compared to other types of food brands.

**Where will the growth come?**

How do you grow in the dairy business? Saputo has been making a considerable number of acquisitions over the years, and going forward, more of the same is likely in the cards. To spark even more growth, Saputo has ventured into foreign markets such as Australia with its recent purchase of Murray Goulburn Co-Operative Co. Limited for $1.29 billion.

The deal makes a tonne of sense because it puts the company close to Asia — a promising market that may spark further growth.

**Bottom line**

There’s a great deal of competition in the dairy market, so there’s little room for anything short of operational excellence. The international growth prospects may sound promising, but I’m not convinced that shares are attractively valued today at 1.5 price-to-sales and 22.8 price-to-cash flow multiples, both higher than the company’s five-year historical average multiples of 1.3 and 18.1, respectively.

Shares are too expensive for my liking, but investors should keep the stock on their radar should a further pullback be in the cards. Saputo is a great defensive holding, but at these prices, there are far better value plays elsewhere on the TSX.

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