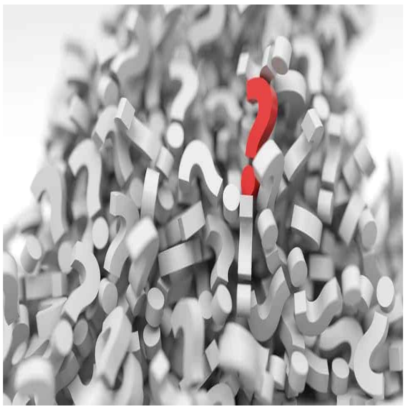

Saputo Inc. Signals Against TPP: Should You Buy Low or Steer Clear?

Description

Saputo Inc. (TSX:SAP) stock fell 0.71% on February 6. Shares have declined 10.7% in 2018 and 11.5% year over year. The Montreal-based marketer and distributor of dairy products released its fiscal 2018 third-quarter results on February 1.

Saputo reported adjusted net earnings of $183.2 million, which represented a 7% decrease year over year. It also reported revenues of $3.02 billion — up 1.9% from Q3 in the prior year. Saputo recorded an income tax benefit of $178.9 million to adjust for future tax balances due to the Tax Cuts and Jobs Act, which was signed into law by the Trump administration on December 22, 2017.

Revenues were mostly flat in the Canadian sector for Saputo, with operation efficiencies improving adjusted EBITDA. Higher butter market prices and higher sales volumes increased revenues in its U.S. sector. A higher Canadian dollar was a negative development for revenues and adjusted EBITDA in the third quarter. Saputo also announced a dividend of $0.16 per share, representing a 1.6% dividend yield.

The big story during its third-quarter conference call was the criticism from Saputo leadership of the latest version of the Trans Pacific Partnership (TPP) accepted by the Canadian government. This is not the first time that Saputo has chimed in on trade policy. In 2016, Saputo CEO Lino Saputo Jr. said that the company could actually benefit from an end to supply management. The U.S. delegation demanded an end to supply management in late 2017, but Canadian officials have vowed that the policy will not be changed under any circumstances.

In this instance, Saputo criticized Canadian officials for accepting import quotas that existed before the U.S. withdrawal from the deal in 2017. The trade deal allocates 3.25% of the Canadian supply-managed dairy sector to foreign competition. Saputo argues that this was expected to be filled primarily by U.S. producers in its original design.

Saputo contended that larger volumes of dairy imports could damage producers, while conceding that it may be good for consumers. Lino Saputo warned Canadian negotiators not to make the "same mistake" that they did with the Comprehensive Economic and Trade Agreement (CETA) with the

European Union. The company also expects NAFTA negotiations to drag on with a general election in Mexico and U.S. midterms in November.

The company and other producers will likely not see dairy price inflation reach high levels in 2018. Dalhousie University and the University of Guelph released its Canada Food Price Report for 2018 late last year, in which it projected overall food price increases between 1% and 3%. The price of dairy products is expected to increase between 0% and 2% in 2018.

Saputo is an early beneficiary of U.S. tax reform, and this should boost earnings going forward. Early estimates have projected that tax reform could boost corporate revenues by over $6 trillion over the next decade. It is hard not to like Saputo's price as of close on February 6, and with a solid dividend backing it up, I like the stock going forward in 2018.

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