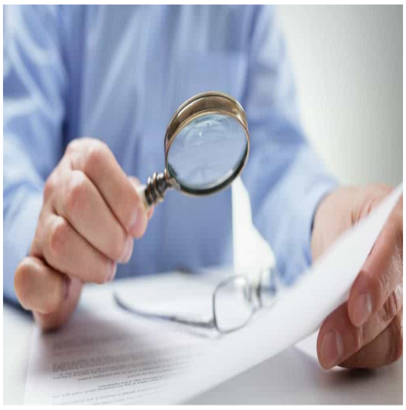

Why Saputo (TSX:SAP) Stock Was Down 20% in 2021

Description

Montreal-based dairy company **Saputo** (TSX:SAP) should have had a boring year in 2021. Instead, the stock lost a fifth of its value last year. In fact, the family-owned company has been gradually losing market value since 2017.

Here's a closer look at why this company seems to be underperforming the rest of the market.

Price-taker

There are two types of industries: price takers and price makers. The makers get to set their own prices and are usually only limited by their marketing efforts. A luxury retailer is a good example of this. However, price takers work with regulated commodities that are considered essentially and tightly controlled by the government. Milk production falls into this category.

The price of milk is set by Canada's provincial governments. The Canadian Dairy Commission (CDC), a regulating body, recommends price increases every year in line with inflation, but, overall, the price is stabilized for the benefit of consumers. That means Saputo's top line is limited by market forces and government intervention.

The company can only control its operational costs. Improving efficiency could magnify margins and help the bottom line. Unfortunately, that's not happening.

Rising costs

Inflation, of course, is currently at historic highs. That seems to be impacting the milk production business. All the costs associated with farming — from fuel to livestock — have shot up in the past year. That means Saputo's costs have swelled, while the retail price of milk hasn't offset these rising costs enough.

Things could change in 2022. The CDC is recommending an 8.4% boost in the price of wholesale milk and 12.4% for butter. As a result, analysts expect Saputo's EBITDA to jump 4% this year. The underlying stock doesn't seem to have priced this in yet.

Saputo stock valuation

Saputo stock has lost 20% of its value over the past year and 41% since hitting an all-time high in 2017. The stock's valuation is compressed. It's currently trading at a price-to-earnings ratio of 25.4. It also offers a 2.5% dividend yield.

We already know that the price of wholesale milk is rising in 2022. So, Saputo's top line should expand. What we don't know is what happens to operational costs. If the cost of milk production keeps rising in 2022, Saputo's current valuation may not be as attractive as it seems.

Investors looking for stable cash flows and robust dividends have plenty of better options. Canada's banking sector or energy sector could be a better bet, in my view. Even the utility sector has more positive catalysts on the horizon than milk production. However, Saputo could be an ideal bet for investors who understand this industry deeply and can spot catalysts that I may have overlooked.

Bottom line

Family-owned milk producer Saputo has been gradually losing value for years. Last year, it lost a fifth of its market capitalization. This year, things could be better as wholesale milk prices rise substantially. However, I believe there are better alternatives for value-oriented dividend investors.

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