Is This Cheap Stock Too Cheap to Ignore?

Description

Saputo (TSX:SAP) might be the largest dairy producer in the country, but its performance in the market over the past year leaves a lot to be desired. Since early 2021, the company has shed about a fifth of its market value. Losses approach 38% if you pull the chart back to 2017.

A steady decline like this usually indicates some weakness in the fundamentals. In Saputo's case, capped prices and rising operational costs are the key drivers of this lacklustre performance. However, the stock has already priced in some of these factors and has probably overcorrected.

Here's why Saputo's valuation makes it look like a cheap stock.

Milk price debacle

Saputo's underperformance stems from the fact that the provincial government sets the prices of its main commodity. The Canadian Dairy Commission (CDC) regulates the process of milk every year and is in line with inflation. Conversely, its top line will always be limited to forces beyond its control.

In addition, rising inflation, which has surged to historic highs, continues to negatively impact the milk business. The costs associated have shot up significantly, all but affecting Saputo's margin. While costs have shot up, the milk prices have failed to offset the rising costs.

The 20% stock price plunge registered last year could be a result of the company feeling the full brunt of labour shortages amid the pandemic. Additionally, Saputo's operations were hard hit by supply-chain issues that continued to pressure margins.

These factors could abate in 2022, which could unlock some value for shareholders.

Saputo's 2022 outlook

Things could change in 2022, as the CDC recommends an 8.4% boost in wholesale milk prices. A

12.4% increase in butter prices would be a big boost to Saputo's bottom line and help protect margins.

Saputo's business is also far less exposed to the rest of the economy. If interest rates rise and economic growth slows down, it doesn't impact milk consumption much. Milk is, after all, an essential consumer staple. Families are probably willing to absorb some of the price hikes in milk products, which makes Saputo a relatively safe bet for investors.

Meanwhile, Saputo stock has already priced in the worst-case scenario. The stock trades at a price-to-earnings multiple of 16. That implies an earnings yield of 6.25% — far higher than the market average. That's what makes Saputo a "cheap stock" that should be on your watch list.

The dividend yield is another reason to keep an eye on this stock. At the time of writing, Saputo offers a dividend yield of 2.4%, which is about average for Canadian dividend stocks. But the payout ratio is just 63%, which means the company has room to expand this dividend in the years ahead.

Bottom line

Saputo has been losing market value for years — for good reason. Weak fundamentals and a lack of growth during a bull market have undoubtedly suppressed the stock price. But now the valuation may be a bit too pessimistic. Saputo's earnings could expand slightly in 2022, while the valuation is still too low.

If you're looking for a safe, low-volatility bet in 2022, this cheap stock should certainly be on your radar.

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