Saputo's Emerging Market Play

Description

If you follow **Saputo** (TSX: SAP), Canada's largest dairy company and one of the largest dairy processors in the world, you probably know that it has operations in an important South American market, Argentina. But Saputo's most significant territory worldwide, one that it treats as an emerging market for all practical purposes, is actually the United States. Saputo invests in the States in the same manner that other companies plow resources into countries such as China and India.

Morningstar recap and the effect on earnings
On January 3, Saputo completed the acquisition of Morningstar Foods, a subsidiary of U.S. foods giant **Dean Foods**. In its last fiscal year before the acquisition (2012), Saputo booked $6.93 billion of revenue. With the acquisition, Saputo's annual revenues are expected to increase to more than $8.6 billion. So far, folding in Morningstar has fueled impressive comparisons to the same quarter last year: revenue is up 28%, and net earnings have climbed more than 12%.

Proximity and sour cream
Before the Morningstar acquisition, Saputo already owned appreciable operations in the U.S., having bought a number of dairies and cheese companies over the past seven years, the most notable of which was the purchase of the cooperative Land O' Lakes' West Coast industrial cheese business in 2007. Saputo likes to acquire operations even closer to home. The relative proximity of major U.S. dairy states Wisconsin, Michigan, and Minnesota enables the company to exchange best practices with its acquired dairies, such as DCI Cheese and Alto Dairy, which are both located in Wisconsin.

The Morningstar deal opens up new avenues for revenue due to Morningstar's expertise in "Extended Shelf Life," or ELS products. These non-dairy items include ice-cream mixes, creamers, and half-and-half. The purchase also gives Saputo the all-natural, cultured products "Friendship" dairy, which is well known for its sour cream, and boasts the No. 1 cottage cheese brand in New York State. Saputo's management undoubtedly liked this deal for the numerous ways it supplements its cheese business, a traditional strength of the company.

A shot in the arm at just the right time
Just how important has the U.S. market become to Saputo? In the current fiscal 2014 fiscal year, it will

most likely overtake Canada in providing more than 50% of company revenues. The growing contribution of U.S. revenues can be seen in the following chart.

Saputo Incorporated: Revenues by Sector, Q1 Fiscal 2013 through Q1 Fiscal 2014 | Infographics

Over the last five business quarters, the “U.S.A. Sector” has grown from $581.5 million in Q1 2013, to $1.05 billion in Q1 2013, an increase of more than 81%. The same is true of earnings before taxes, depreciation, and amortization, or EBITDA, which has grown from $70.8 million to $112.6 million over the same period (an increase of 59%):

Infographics

One observation can be drawn from both charts: without U.S. revenues and the aggressive development of business via acquisition, results would surely have disappointed, as the Canada and International sectors basically exhibited flat revenue and earnings over these five quarters.

Looking ahead

In its earnings release earlier this week, Saputo expressed some caution about earnings for the rest of the fiscal year. Analysts did not like this uncertainty, and had even higher expectations for earnings post-merger, thus, the stock sold off a bit. Foolish investors may want to take a step back and take into account the fact that Saputo has been able to grow its top and bottom lines despite a difficult domestic market. The long-term outlook is still quite positive.

Next stop: Latin America?

Numerous opportunities for expansion exist in the U.S. In its 2013 annual report, the company stated that it still has an “appetite for growth” through more acquisitions. In addition, during Saputo’s earnings conference call earlier this week, CEO Lino Saputo stated that U.S. dairy and cheese concerns in the pattern of Morningstar still make sense. That’s not to say the company won’t consider purchases within the more traditional definition of emerging markets. When pressed by an analyst, Saputo cited Brazil as an example of a country that holds promise for future mergers.

Looking for more stock ideas?

Does Saputo’s success snapping up companies south of us have you wondering about U.S. stocks? The S&P 500 index has returned 18.5% year to date, versus flat performance of the TSX Composite Index. For guidance on diversifying into some of the best stocks our neighbor has to offer, check out this free report by clicking here!

Asit Sharma does not own shares of any companies mentioned.

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1. TSX:SAP (Saputo Inc.)

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