

Saputo Inc. (TSX: SAP)

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Company Analysis

Saputo is a Canadian-based global manufacturer of dairy products

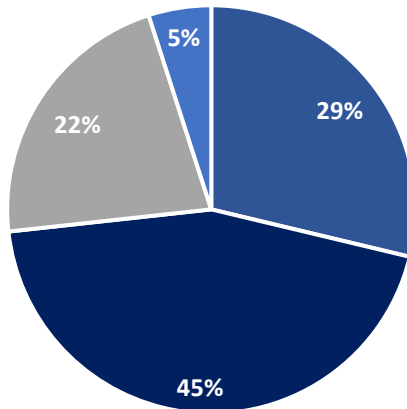
Company Description

- Saputo Inc. is a Montreal-based **Canadian dairy company** founded in 1954
- The company is one of the **top ten dairy processors in the world**, with leading positions in Canada, Australia, Argentina, the U.S., and the U.K.
- Saputo **produces, markets, and distributes a wide array of dairy products**, including cheese, fluid milk, extended shelf-life milk and cream products, cultured products and dairy ingredients
- The company markets and sells its products through a variety of brands:



Revenue Breakdown by Geography

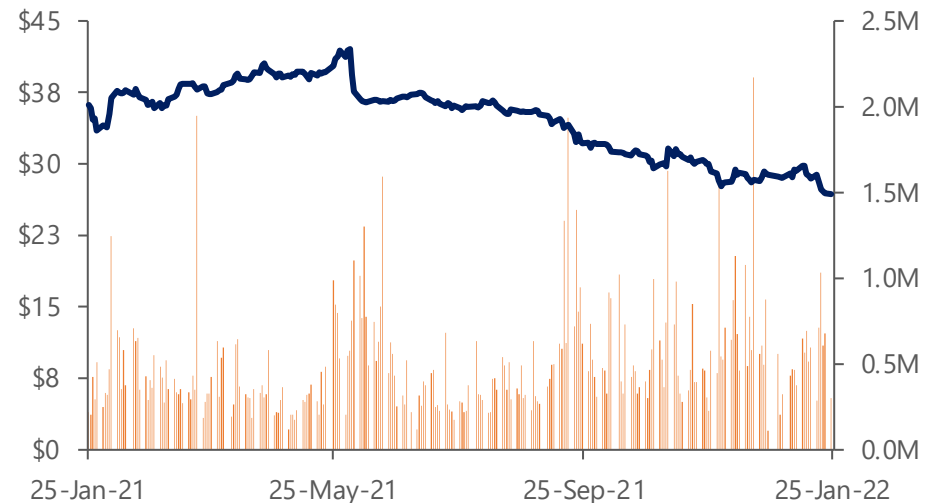
United States Europe
Canada International



Market Information

Ticker	TSX: SAP
Share Price	\$26.79
52 Week Low – High	\$26.21 - 42.42
Total Enterprise Value	\$15.26B
Market Capitalization	\$11.01B
Dividend Yield	2.71%
NTM TEV/EBITDA	10.8x
P/NTM EPS	18.7x

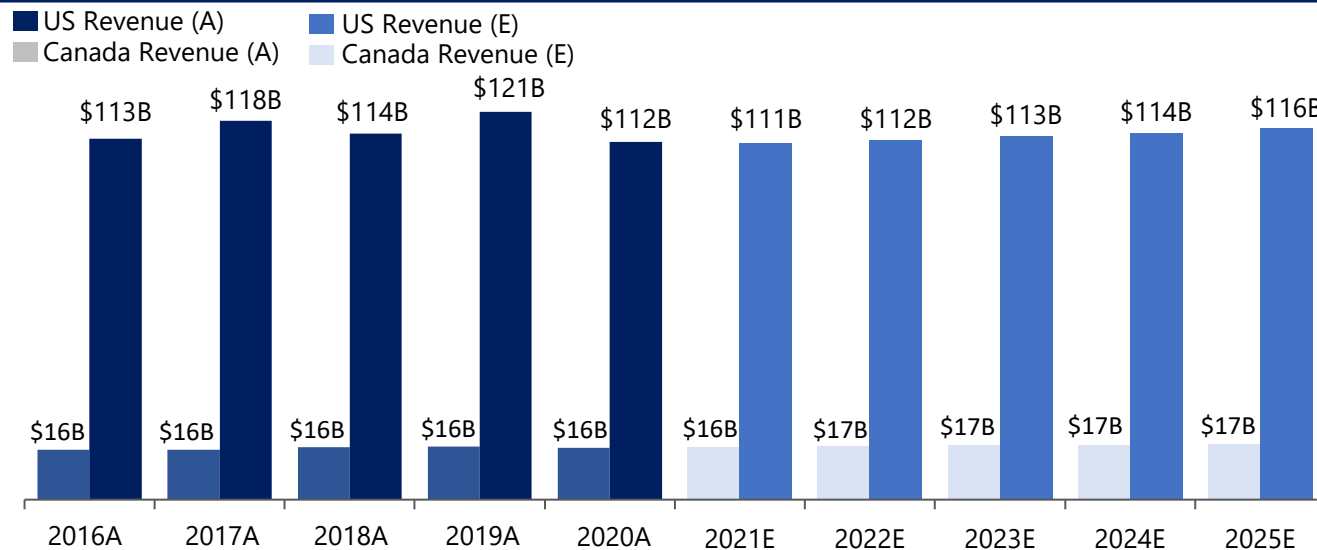
52-Week Performance (as of January 21, 2022)



Industry Analysis

The US and Canadian dairy markets exhibit similar trends, but vary primarily in size

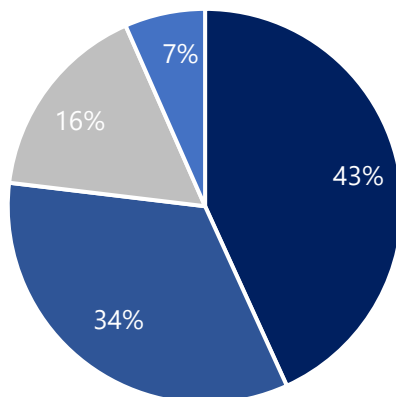
US-Canada Dairy Industry Revenue Comparison (Billions USD)



- In Canada, the industry has been growing at a **CAGR of 0.7%** over the last five years
- Canadian dairy is expected to grow at a **CAGR of 1.26%** from 2021 to 2025, due to a high restriction in price control
- Historically, the US market grew at a **CAGR of -0.2%** from 2015-2020.
- The US dairy market is anticipated to rise at **CAGR of 1%** from 2021 to 2025.
- In the US, the federal government keeps the milk prices stable, resulting in the low revenue growth rate among dairy companies

Product Segmentations

■ Cheese ■ Butter
■ Milk Based Product ■ Condensed Milk Product



Industry Conditions

■ Changing Consumer Preferences:

- The industry has seen a shift in taste preferences from fluid milk to alternative dairy products over several years
- In 2019, the Canada Food Guide reduced its emphasis on dairy products, decreasing consumer demand for dairy as a source of nutrition
- Vegan populations in Canada and the US have grown substantially to reach 1.7 million (84% increase since 2018) and 9.7 million (500% increase since 2014), respectively – permanently reducing demand for all dairy products

Retailer Demand:

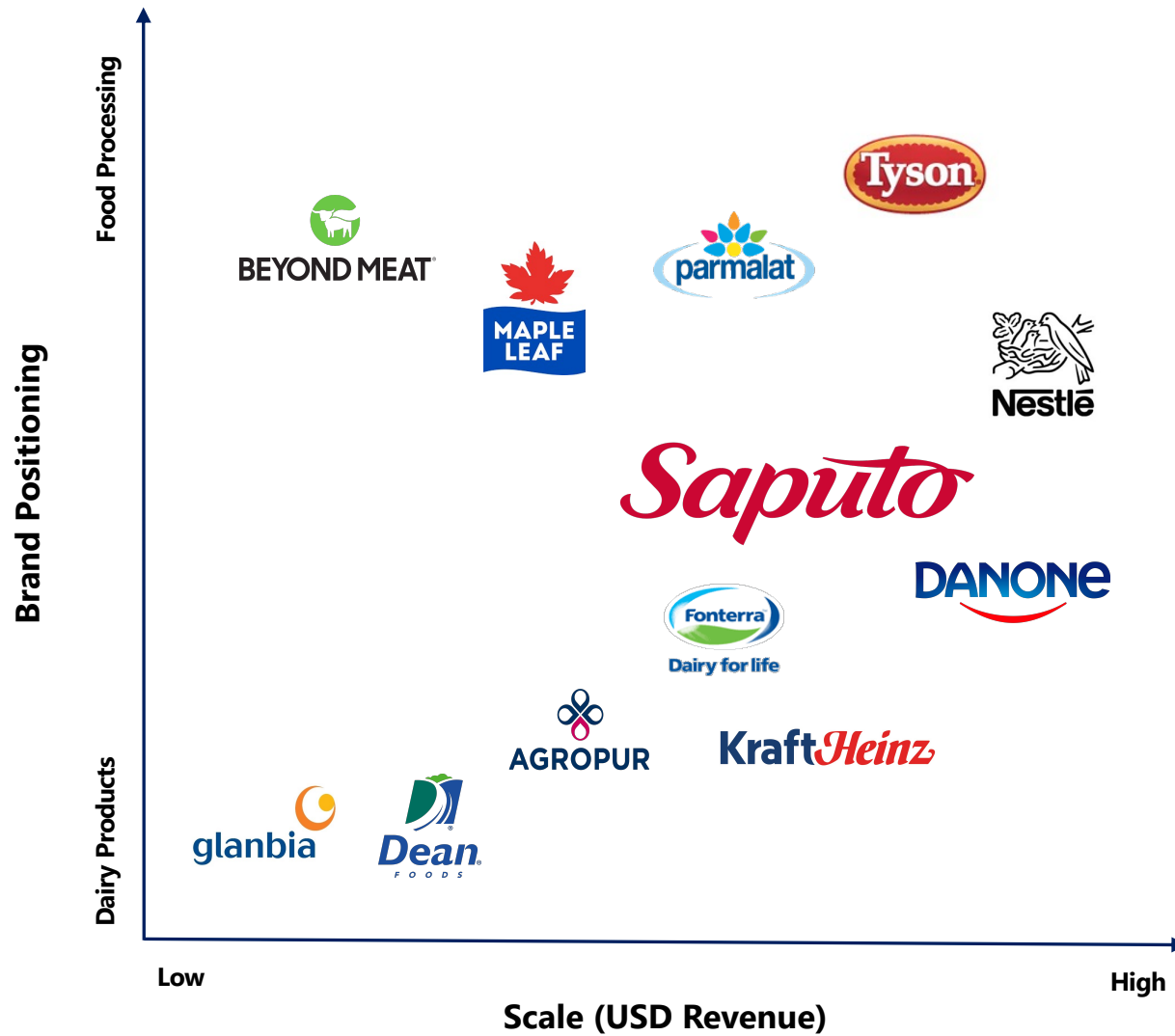
- As demand from retailers decreases, supermarkets and grocery stores purchase fewer dairy products, leading to declining revenue

■ Effective Exchange Rate Index: CEER

- The index is on an overall rising over the past five years, which may be detrimental to Canadian export but beneficial for Canadian import.

Competitive Landscape

The Food Processing and Global Dairy industry is highly competitive



Competitive Conditions

- Major players are highly fragmented, with the top 10 players occupying 17.5% of the global dairy industry
 - Top players are a mix of farmer cooperatives and multi-national corporations
- Non-dairy products, such as oats and almonds, create synergies and optimize a firm's product portfolio
 - Competitors like Kraft-Heinz and Nestle utilize this strategy
- As dairy is fairly homogenous, products are differentiated by quality, price, product innovation, marketing, and distribution capabilities
- Larger competitors pursue M&A to capture market share and enter new markets

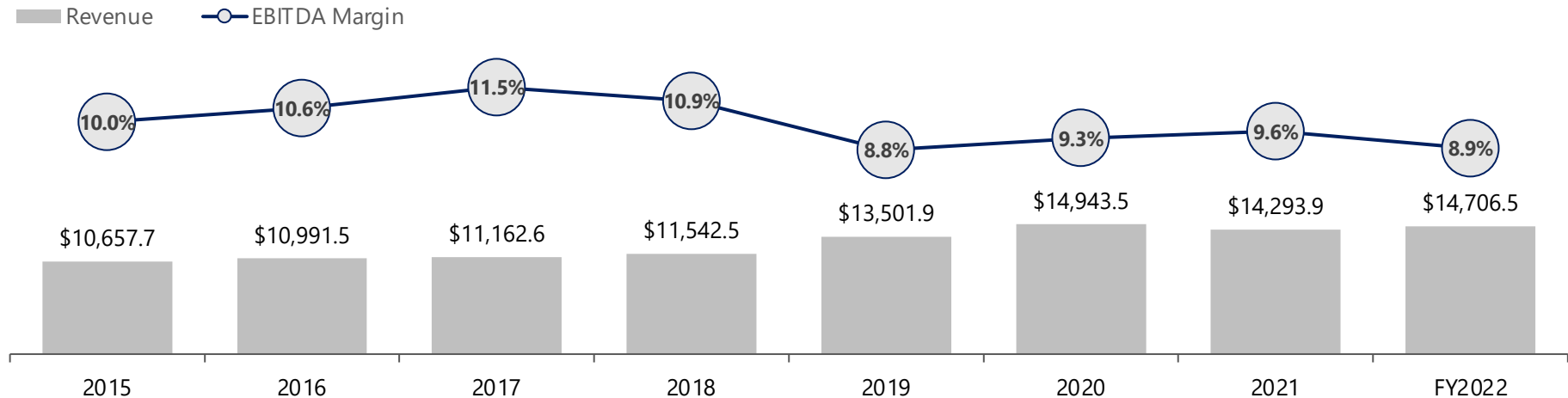
Saputo's Competitive Scorecard

Canada	Top Player
Argentina	Top 3
US	Top 3
Australia	Top 4

Thesis I: Market is Bearish on Dairy Industry

Consistent growth from strong underlying business despite poor operating environment

Revenue and EBITDA Margin Growth



Transitory Headwinds from COVID

- Saputo was hit by external economic factors, outside of their control
 - Global public health-driven restrictions decreased demand in the food service market segment, especially in the US
 - Lower international dairy ingredient market prices
 - Labour shortages and supply chain turmoil affected bottom line
 - Fluctuation of foreign currencies vs CAD decreased revenues
- Saputo lowered administrative expenses and closed two Canadian facilities, cutting nearly 300 jobs to trim costs in response to rising energy prices
- This has pushed average net profit margin in industry is between -3.1% to 13.2% during the pandemic
 - Saputo's 9.3% EBITDA margin demonstrates that the company is managing costs more effectively than competitors

Strong underlying business burdened by poor economic conditions

Growth Strategy

- During the pandemic, Saputo has managed to grow its revenue base and mitigate losses with only a 4.3% decline in revenues from 2020 to 2021

Strengthening Core Business

- Maximizing brand penetration and expanding new locations
- Successfully launched two direct-to-consumer websites in Canada and UK

Accelerate Product Innovation

- Becoming a leader in dairy alternative cheese and beverages
- Introducing new products, flavours, and innovative packaging

Optimizing and Enhancing Operations

- High quality, low-cost processor compared to industry
- Leveraging automation to optimize distribution and supply chain

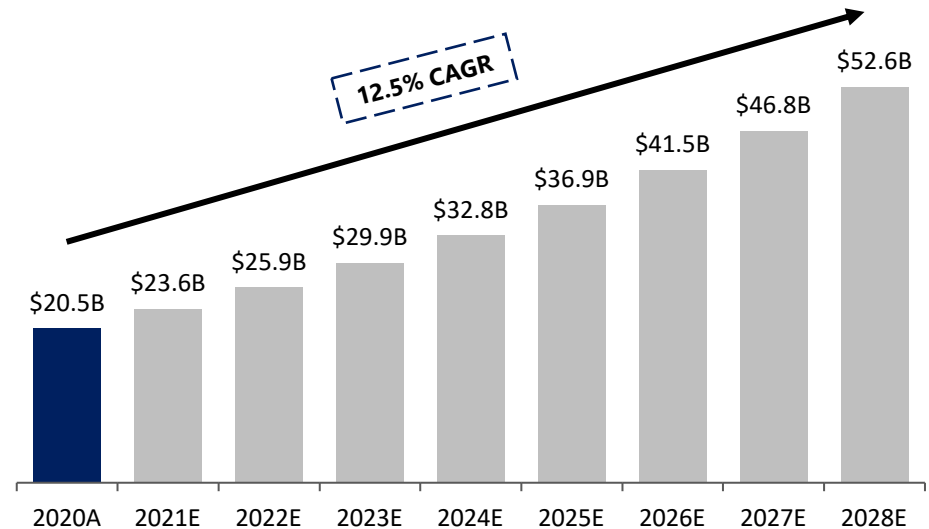
Strong track record of management team to implement strategy

Thesis II: Opportunity in Dairy Alternatives Market

Saputo is well-positioned to take advantage of a rapidly-growing market

Market Trends in the Dairy Alternatives Industry

- The global dairy alternatives market was valued at US\$20.50 billion in 2020 and is expected to **expand at CAGR of 12.5%** from 2021 to 2028
- The market is gaining momentum and witnessing **growth in demand** from **shifts in consumer eating patterns** and change in diet trends
 - The increasing occurrences of milk allergies and lactose intolerance cases are expected to further drive the demand for dairy alternatives over the forecast period
- Numerous food and beverage companies are thus making use of dairy alternatives to appeal to the growing consumer base that is opting for plant-based non-dairy alternatives
- This niche market presents **economic opportunity** due to its comparatively higher inelastic demand and barriers to entry for competitors
- The higher selling price of dairy alternatives provides stronger margins compared with the conventional dairy segment while differing formulations avoid the commoditization of the traditional dairy market



Recent Developments by Saputo

- Saputo plans on leveraging these trends by accelerating product innovation in the alternative dairy space
 - The company has already begun production on almond and oat milk for private label and foodservice brands
 - Saputo is **internally developing a plant-based cheese** brand (Sheese)
- The recent Bute Island and Dairy Crest acquisitions add intellectual property and production capability in plant-based cheese
 - The Dairy Crest acquisition also gave the company rights to the Vitalite brand (another dairy-free cheese), further expanding their position in the alternative dairy space
 - Saputo has secured listings for its dairy-alternative pizza cheese with major U.S. foodservice distributors and some regional pizza chains and is working to secure North American listings with multinational pizza chains
- Expansion into the less saturated dairy alternatives products market allows Saputo to avoid the marketing and branding challenges involved with competing in the non-dairy milks market

The company has expressed **continued interest in future acquisitions** to expand their alternative dairy portfolio. Strategic acquisitions that fit with Saputo's brand and operational capabilities should assist Saputo in becoming a trailblazer in the \$1 billion dairy-alternative cheese market.

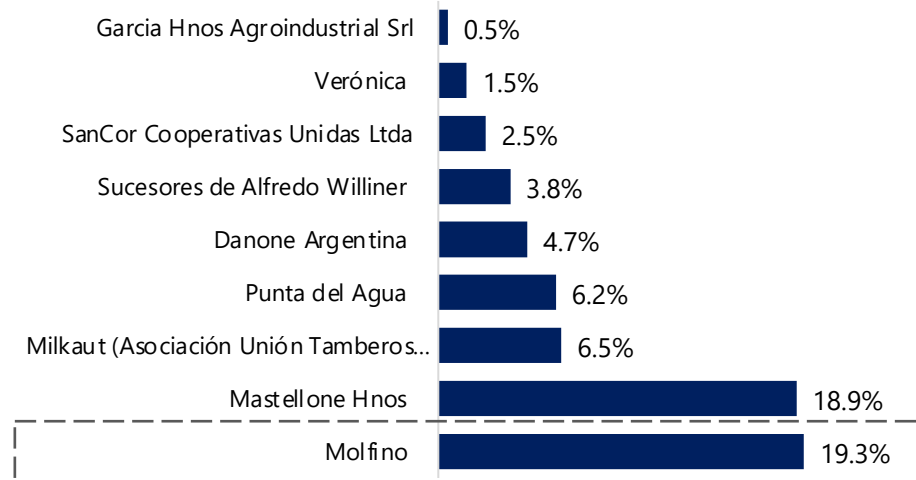
Thesis III: Underestimated Demand in Argentina's Cheese Market

Opportunistic Outlook in the Argentina Market

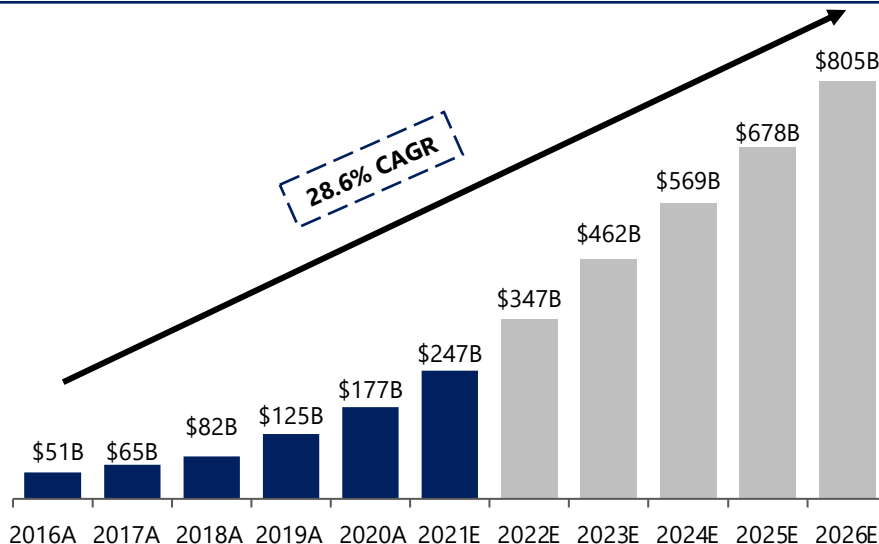
Saputo's Market Position

- Saputo entered the Argentina market in 2003 with the **acquisition of Molfino**
- Molfino generated **USD\$318.64 million** in revenue in FY2021
 - 10%** of Saputo's international sales (excluding Europe and US)
- The company produces soft, semi-soft, hard and grated cheeses as well as butter, cream, milk powder, UHT milk and dulce de leche (caramelized milk)
 - Brands include: La Paulina, Ricrem, and Taluhet
 - Molfino utilizes a third-party distribution network of more than 200 distributors
- In 2021, Molfino is set to retain its leading position in cheese, ahead of Mastellone Hnos, with both leading players expected to grow their respective value shares.
 - This is a result of **more secure production and supply lines**.

Competitive Landscape - Cheese Segment



Argentina Cheese Market Sales Performance (in Millions Peso)



Argentina Market Consumer Trends

- Soft cheese makes up 66% of segment revenue; whereas hard cheese makes up only 20% of total revenue
 - This is related to traditional Argentinian consumption habits that favour soft to hard cheese
 - The demand for soft cheese has risen due to this consumer trend
- Argentina cheese market has a projected CAGR of 28.58% until 2026
- Danone Argentina, Saputo's next largest competitor, has lost 6% market share from 2017 to 2020, largely as a result of its higher-than-average prices.
 - Danone's loss of market share has given Molfino the opportunity to grow their market share by 11%

Strong industry growth prospects combined with the loss of market share from competitors positions Molfino and Saputo to strengthen their position in Argentina and yield topline growth

Risks and Mitigations

International Expansion both fuel & hinder Saputo's growth prospects

Risks

The US-Canada Trade Dispute

The US is suing Canada over its controversial dairy practices, accusing the country of breaching the US-Mexico-Canada agreement. The trade dispute may bring uncertainties in price volatility of dairy products.

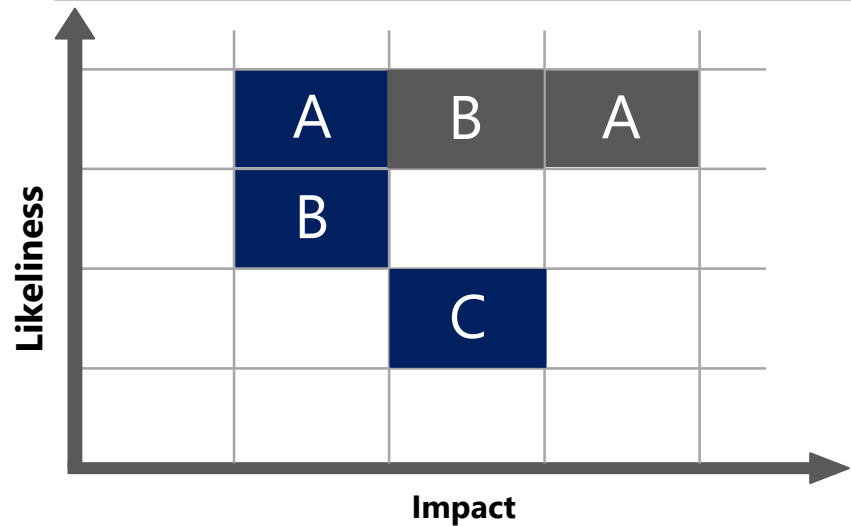
The Ongoing Impact of COVID-19

The spikes in the Delta variant may lead to slower economic recovery, resulting in continuous disruptions to companies' supply chain as well as labour shortages.

Acquisitions Leading to Synergy/Market Risks

Saputo's acquisition strategy targets companies around the globe. Therefore, Saputo may be exposed to exchange rate risks, market uncertainties, and synergy issues (different culture).

Risks & Catalyst Matrix



Catalysts

Recent Acquisitions in South Carolina

In August 2021, Saputo acquired Carolina Aseptic and Carolina Dairy. These acquisitions should help enhance Saputo's capacity to manufacture and distribute products in both beverage and food categories, and nutritional snacks space.

E-Commerce Launch

As part of their e-commerce strategy, Saputo's Canadian Dairy Division launched *Nibbl*, an innovative B2C platform, in September. The expansion to the e-commerce domain gives Saputo the opportunity to capitalize on the industry tailwinds and drive significant revenue.

Risks

- A The US-Canada Trade Dispute
- B The Ongoing Impact of COVID-19
- C Acquisitions Leading to Synergy/Market Risks

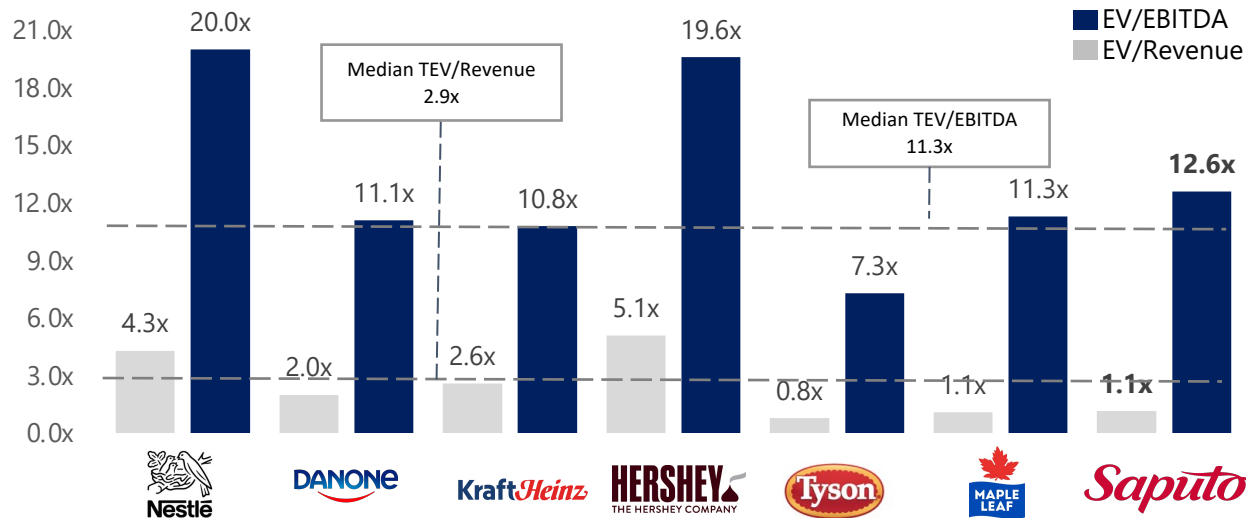
Catalysts

- A Recent Acquisitions in South Carolina
- B E-Commerce Launch

Valuation Overview

With a 7.04% WACC and 1.5% perpetual growth rate, SAP is valued at \$42.53, a 58.8% premium

Comparable Company Analysis | EV/Revenue and EV/EBITDA



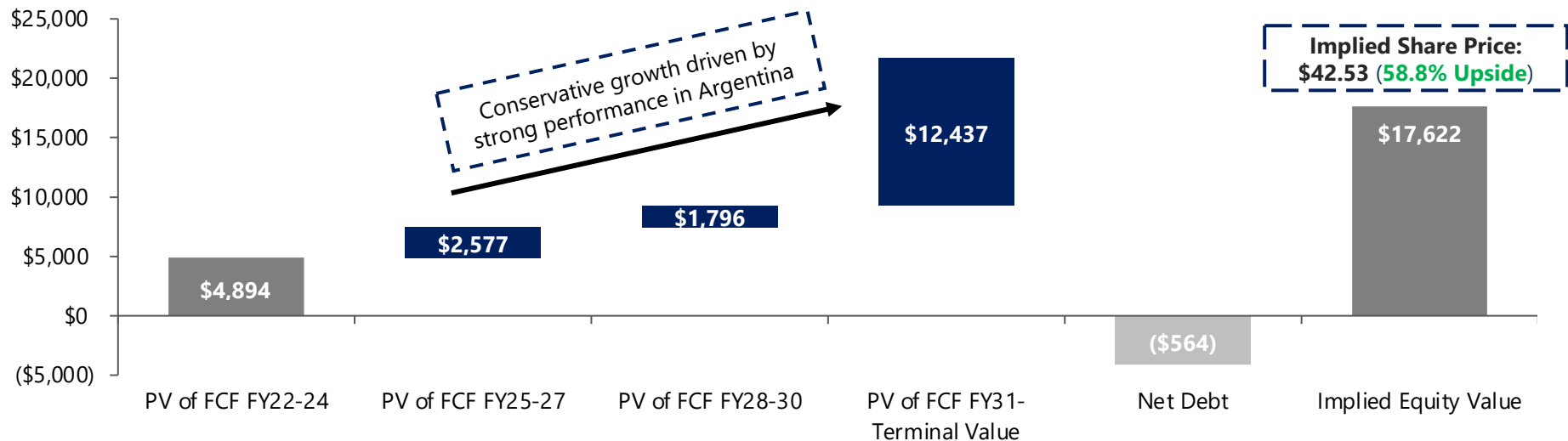
Forward Multiple Range:

- TEV/ Total Revenue: 0.8x – 5.2x (med. 2.9x)
- TEV/EBITDA: 7.3x – 20.0x (med 11.3x)

Share Price Valuation

- EV/Revenue: \$22.36 – \$232.14 (med \$124.27)
- EV/EBITDA: \$12.43 – \$63.61 (med. \$28.54)
- Comparable Companies were chosen on basis of business model, geography, size, and industry

Discounted Cash Flows Analysis | Implied Enterprise Value Bridge



Appendix

Industry Analysis

The high level of regulatory constraints in the dairy industry incited conflict between the US and Canada

US-Canada Tariff Allotments

- Under Canada's supply management system, the import of foreign dairy carries heavy tariffs
- The United States has been fighting Canada for the past 30 years to increase tariff-free imports



*Approx. \$70 million additional revenue for US dairy

Regulations in the US

- The Dairy Product Production industry is heavily regulated at both the state and federal level through regulations targeting milk pricing, food safety, the environment, product standards, labeling and employee safety
- There are four major national programs that regulate the milk market to support milk prices and provide a market for milk production
 - The Dairy Product Price Support Program
 - The Dairy Export Incentive Program
 - The Milk Income Loss Contract
 - The Federal Milk Marketing Order System
- There are also several federal food regulations from the Food and Drug Administration (FDA):
 - The Federal Food
 - Drug and Cosmetic Act
 - Public Health Service Act

Regulations in Canada

- | | |
|---------------------------|---|
| Production Control | <ul style="list-style-type: none">▪ Canadian farmers are given an annual production quota – a license to produce a set amount of milk▪ Quotas are set based on estimated domestic demand |
| Price Control | <ul style="list-style-type: none">▪ The federal government sets a minimum price for milk▪ Farmers are compensated relative their cost each year if production costs exceed revenues |
| Import Control | <ul style="list-style-type: none">▪ To protect domestic producers, 10% of dairy market is allotted to imports with either low to no tariffs▪ The remainder is subject to high tariffs |

Comparable Company Analysis

Appendix

Peers	Price	Market Cap	Enterprise Value	EV / EBITDA		EV / Revenue		Revenue Growth		EBITDA Margin		Net Debt / LTM EBITDA
	21-Jan-22			2021E	2022E	2021E	2022E	2021E	2022E	2021E	2022E	
Dairy Producers												
Nestle S.A.	\$132.27	\$363,802	\$406,692	20.0x	19.0x	4.3x	4.1x	2.3%	4.7%	21.4%	21.5%	2.2x
Danone S.A	\$65.44	\$42,590	\$55,561	11.1x	10.8x	2.0x	2.0x	1.1%	5.0%	18.4%	18.1%	2.5x
Oatly Group	\$6.53	\$3,864	\$3,284	NA	NA	5.2x	3.2x	NA	60.2%	-19.4%	-8.2%	NM
Kraft-Heinz	\$37.00	\$45,290	\$67,241	10.8x	11.4x	2.6x	2.7x	-0.6%	-5.0%	24.0%	23.9%	2.7x
Average				14.0x	13.7x	3.5x	3.0x	0.9%	16.2%	11.1%	13.8%	2.5x
Median				11.1x	11.4x	3.4x	3.0x	1.1%	4.8%	19.9%	19.8%	2.5x
Broadcasters												
The Hershey Company	\$200.35	\$41,273	\$45,307	19.6x	18.5x	5.1x	4.9x	10.1%	4.7%	26.0%	26.2%	1.7x
Tyson Foods	\$89.93	\$32,652	\$40,038	7.3x	7.8x	0.8x	0.8x	12.6%	3.5%	11.2%	10.1%	1.1x
MapleLeaf Foods	\$22.92	\$2,859	\$3,876	11.3x	9.1x	1.1x	1.0x	7.3%	4.9%	9.5%	11.2%	2.9x
Beyond Meat	\$61.60	\$3,901	\$4,170	-53.5x	-65.0x	8.9x	6.8x	13.9%	31.5%	-16.7%	-10.5%	NM
General Mills	\$69.03	\$41,639	\$54,133	14.5x	14.6x	2.9x	2.9x	1.3%	1.3%	20.2%	19.9%	2.8x
Average				-0.2x	-3.0x	3.8x	3.3x	9.0%	9.2%	10.0%	11.4%	2.1x
Median				11.3x	9.1x	2.9x	2.9x	10.1%	4.7%	11.2%	11.2%	2.3x
Global Average				5.1x	3.3x	3.7x	3.2x	6.0%	12.3%	10.5%	12.5%	2.3x
Global Median				11.2x	11.1x	2.9x	2.9x	4.8%	4.7%	18.4%	18.1%	2.5x
Saputo Inc.	\$21.24	\$8,819	\$12,039	12.6x	9.6x	1.1x	1.0x	-1.6%	6.8%	8.4%	10.3%	3.2x

Discounted Cash Flow Analysis

Base Case Scenario

- Discounted cash flow analysis with an assumed WACC of 7.09%
- Terminal value based on perpetuity growth methodology with an assumed growth rate of 1.5%

Cash Flow Summary	FY 2021A	FY 2022E	FY 2023E	FY 2024E	FY 2025E	FY 2026E	FY 2027E	Terminal Value & Implied Share Price	
Revenue	\$14,294	\$14,633	\$15,383	\$16,114	\$16,844	\$17,675	\$18,588	Terminal UFCF	\$828
Revenue Growth %	-4.3%	2.4%	5.1%	4.8%	4.5%	4.9%	5.2%	Terminal Growth Rate	1.5%
EBITDA	\$1,478	\$1,202	\$1,347	\$1,491	\$1,643	\$1,812	\$1,925	Terminal Value	\$22,597
EBITDA Margin %	10.3%	8.2%	8.8%	9.3%	9.8%	10.3%	10.4%	Discount Factor	0.52
EBIT	963	656	773	888	1,019	1,154	1,232	PV of Terminal Value	\$11,788
Less: Taxes	(\$255)	(\$174)	(\$205)	(\$235)	(\$270)	(\$306)	(\$326)	PV of UFCF	9,916
Net Operating Profit After Tax	708	482	568	653	749	848	906	Implied TEV	\$21,704
Add: Amortization	515	546	574	603	624	659	692	(-) Debt	(4,304)
Less: Capital Expenditures	(380)	(381)	(445)	(438)	(461)	(492)	(510)	(+) Cash	222
Less: Change in Net Working Capital	(101)	(4,766)	1,932	1,790	257	113	119	Implied Equity Value	\$17,622
Unlevered Free Cash Flow	\$743	(\$4,119)	\$2,630	\$2,608	\$1,169	\$1,128	\$1,207	FD Shares Outstanding	414.4
Discount Period		0.50	1.50	2.50	3.50	4.50	5.50	Implied Equity Value Per Share	\$42.53
Discount Factor		0.97	0.90	0.84	0.79	0.73	0.69		
PV of Unlevered FCF		\$319	\$2,373	\$2,197	\$920	\$829	\$828		

IMPLIED SHARE PRICE SENSITIVITY

		WACC				
		4.6%	5.6%	6.6%	7.6%	8.6%
Perpetual Growth Rate	0.5%	\$63.87	\$50.33	\$41.18	\$34.59	\$29.61
	1.0%	\$70.65	\$54.28	\$43.69	\$36.29	\$30.81
	1.5%	\$79.58	\$59.18	\$46.69	\$38.26	\$32.17
	2.0%	\$91.90	\$65.43	\$50.34	\$40.58	\$33.73
	2.5%	\$109.98	\$73.67	\$54.87	\$43.35	\$35.56

IMPLIED TERMINAL MULTIPLE SENSITIVITY

		WACC				
		4.6%	5.6%	6.6%	7.6%	8.6%
Perpetual Growth Rate	0.5%	12.5x	10.1x	8.5x	7.4x	6.5x
	1.0%	14.3x	11.3x	9.3x	8.0x	6.9x
	1.5%	16.7x	12.7x	10.3x	8.6x	7.5x
	2.0%	19.9x	14.5x	11.4x	9.5x	8.1x
	2.5%	24.7x	16.9x	12.9x	10.4x	8.8x

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