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Target Price: \$55.00

Market Data

Price (23-Oct)	\$43.12
52-Wk Range	\$37.28-\$46.36
Mkt Cap (\$mm)	\$8492.6
Dividend per Share	\$0.84
Dividend Yield	1.92%

Estimates

Year	2012A	2013E	2014E
EBITDA	830.9	856.03	904.57
EPS	1.86	2.56	2.77

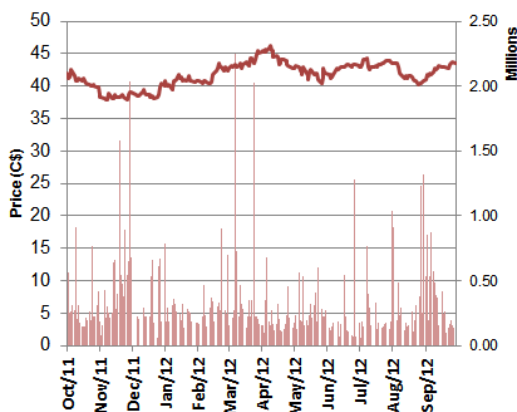
EPS Quarterly Estimates

Year	2012A	2013E	2014E
Q1	0.61	0.6A	0.72
Q2	0.61	0.67	0.77
Q3	0.64	0.73	0.77
Q4	0.61	0.65	0.75

Valuations

Year	2012A	2013E	2014E
EV/EBITDA	10.7x	10.4x	12.0x
P/E	17.1x	15.5x	19.0x

Stock Performance
Saputo Inc.



Food & Drug Retailing

Saputo Inc.

(SAP-TSX)

Stock Rating: Market Outperform

Valuation

We believe that 1) Saputo's current share price neglects to consider the rising demand for dairy products in the long-term 2) Saputo's current stock price does not adequately reflect Saputo's acquisition potential and 3) the stock price should trade at a premium to large international dairy processors such as Groupe Danone and Nestlé that the market views as comparable international competitors.

Saputo's ability to take on additional debt between C\$2.5-C\$3.5 billion and management's comments that indicate that they are actively seeking acquisition targets means that significant acquisition activity is likely in the near future.

Our valuation of \$55 is derived from the average of 1) a 19.5x multiple applied to our FY14 EPS estimate and 2) a 12x multiple on our FY14 EBITDA estimate.

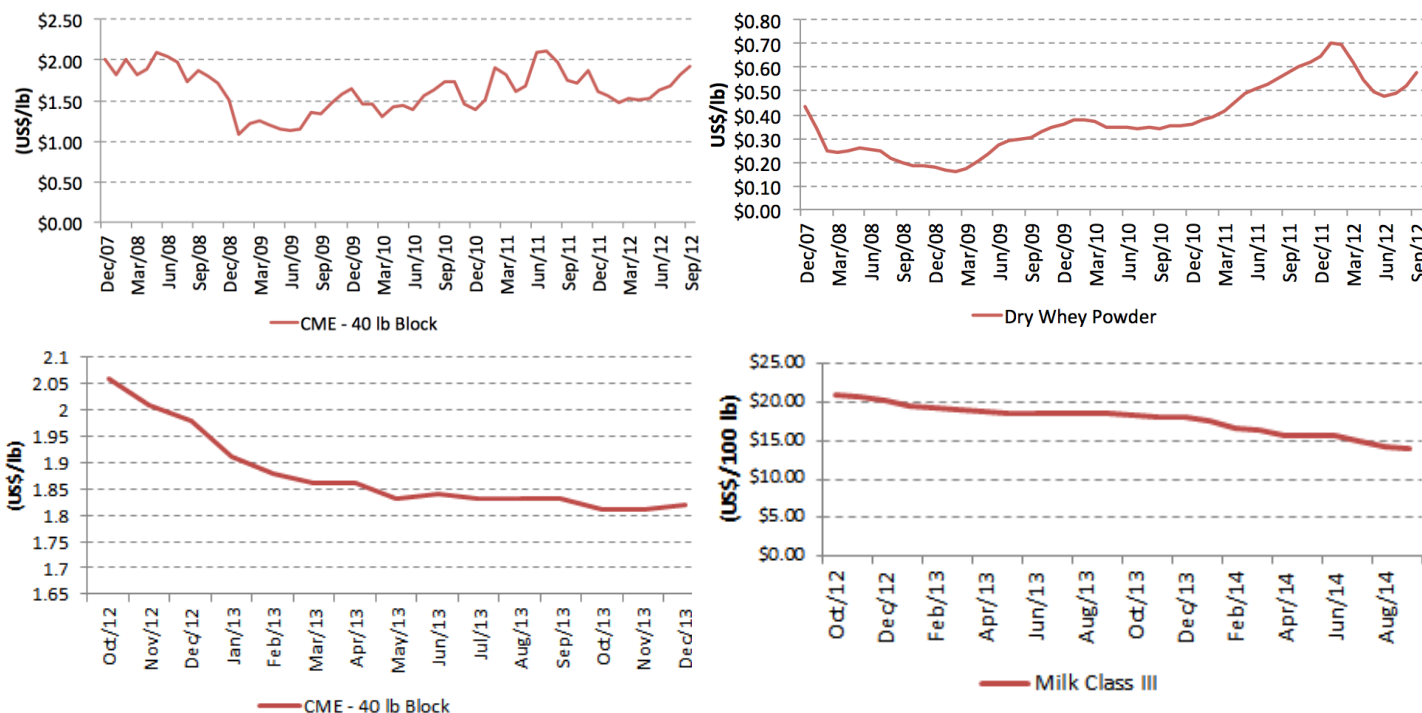
Recommendation

Upgrade Saputo to a Market Outperform rating. The short-term pressures that caused Saputo to report unimpressive Q1/FY13 results have been mitigated and it has become increasingly likely that it will engage in one, or several, acquisitions that will increase shareholder value.

Positive Short-Term Outlook

The main factor that impacts Saputo’s profits is the Cheese-Milk Spread. In the past, Saputo’s production efficiency and yield have exceeded the industry average by approximately 20%. This amplifies the effect of the Cheese-Milk spread by 20%. As a result, Saputo’s gross margins are better than those of its peers. This superior operational efficiency will continue.

Exhibit 1. Commodity Dairy Prices & Futures



*Futures Prices Settlement Date Oct 23, 2012

Based on futures prices, it appears the price of cheese will begin to increase. In Q1, the smaller spread resulted in lower EBITDA despite steady revenues. However, the spread between milk and cheese is becoming larger. In fact, the futures market expects Cheese prices to rise from to \$1.89 while milk prices are expected to decrease significantly from current prices (Exhibit 1).

Additionally, Saputo hedges against a rise in milk prices by producing whey, a cheese by-product. The price of whey has increased to \$0.51/lb in the current quarter and it is anticipated that it will continue to rise further (Exhibit 1)

These price increases will more than offset the small negative effect that has resulted from changes to the California milk pricing formula which cost the company C\$0.6m in Q1 and will cost the company C\$0.6m-C\$0.9m per quarter.

The Canadian Dollar should also weaken slightly over the next year. Small changes in foreign currency exchange rates should decrease the company’s expenses. This will improve the company's competitive position.

Canadian Competitive Environment: Not a significant impediment

The Canadian dairy industry features 3 large players vying for market share. This competitive environment will require Saputo to continue to invest in high cost advertising to defend and expand its share in a market with no growth.

In the past, Saputo has succeeded in growing by taking significant market share from competitors in the fluid milk and cheese categories. While this trend is expected to continue, Saputo's now large market share means that such growth will slow down. The lack of significant organic growth opportunities in Canada is not an impediment to significant increases in profitability due to Saputo's significant expansion into international markets.

Regulatory Change: Not a significant threat

Talks of reform in the dairy industry may result in a more equitable distribution of dairy margins between dairy producers and dairy processors. This would be undesirable from Saputo's perspective as processors have better margins than producers. These fears are speculative at best as it is unlikely that such reforms would be implemented.

Canada's invitation to participate in the Trans Pacific Partnership trade agreement (TPP) trade talks in June 2012 may result in lower dairy prices as acceptance of TPP may result in a change in the reduction of Canada's dairy tariffs which would result in lower dairy product prices. However, the Government of Canada is not likely to approve an agreement that does not give it veto rights on the TPP's resolutions.

With regards to the U.S Farm Bill, management has stated that the proposals as they relate to dairy will not have a material impact on their business.

Rising Demand and Lagging Supply

Saputo's current share price neglects to consider the rapidly rising demand for dairy products globally. Global cheese consumption is expected to rise to over 21 million metric tons by 2015 and supply is expected to lag relative to the increase in demand. Saputo is in a good position to capitalize on the inevitable increase in dairy prices that will occur over the next 10 years.

Acquisition Potential

Saputo saw a small increase in its current ratio to 1.55 (Exhibit 2) while the company's debt ratio remained unchanged at a low 0.15. The Q1 FY13 balance sheet also contained C\$173m in cash. A secondary offering would not be necessary to fund an acquisition as Saputo's strong balance sheet can withstand an additional C\$3.0b in debt while allowing Saputo to maintain a net debt/ TTM EBITDA ratio below 3.5x. Despite the capacity to take on a significant amount of debt, future acquisitions are likely to be similar in size to the acquisition of Fairmount Cheese Holdings Inc. in that they would cost less than C\$500m as there are few attractive acquisition targets that would cost more than that value.

Exhibit 2. Saputo Short Term Liquidity

	12 months Mar-31-2008	12 months Mar-31-2009	12 months Mar-31-2010	12 months Mar-31-2011	12 months Mar-31-2012	LTM 12 months Jun-30-2012
Current Ratio	1.5x	1.2x	1.5x	1.4x	1.6x	1.7x
Quick Ratio	0.8x	0.5x	0.6x	0.6x	0.7x	0.8x

Acquisition Opportunities

Both Australia and Brazil are of particular interest to Saputo. While Australia's milk supply pricing, which is based on international dairy prices, makes it an ideal candidate for export, we believe that Brazil is more likely to be the immediate target. This is because Brazil is a net importer of dairy products and continues to see increasing demand for dairy products. Furthermore, operations in Brazil would be easily managed from neighbouring Argentina. We believe that an additional acquisition in Australia will occur in the medium term. It is expected that the amount of capital deployed over the next two years will be between C\$0.8b and C\$1.2b.

Acquisition Benefits

Since its IPO in 1997, Saputo has developed a history of successful acquisitions that have created shareholder value (Exhibit 3). This occurred through the utilization of Saputo's superior operational knowledge to improve the targets' operations. This has resulted in a significant increase in the company's EBITDA and has resulted in significant value creation for shareholders.

Based on historical efficiency gains, it is expected that Saputo will succeed in increasing the EBITDA margin of any potential acquisition by 125%. Assuming that synergy gains can also be achieved, EPS accretion to shareholders will be significant. It is estimated that it will be upwards of \$0.80 per share assuming two acquisitions valued at C\$1.0b over two years.

Exhibit 3. Recent Acquisition History

Announced Date	Closed Date	Acquisition	Price Paid (\$mm)	Sales (\$mm)	EBITDA (\$mm)	Multiple
February 17, 2011	March 25, 2011	Fairmount Food Group, LLC	US\$270.5	US\$460	US\$34	8.0x
June 23, 2009	July 20, 2009	F & A Dairy of California, Inc.	US\$44.5	US\$140		
October 22, 2008	December 1, 2008	William Neilson, Ltd.	\$467.50	\$600	\$50	9.4x
January 29, 2008	April 1, 2008	Alto Dairy Cooperative	US\$160	US\$378	US\$19.6	8.2x
February 21, 2007	April 2, 2007	Land O'Lakes West Coast	US\$216	US\$415	US\$20	10.8x

Premium to large international dairy processors

We believe that the practice of pricing Saputo's shares at a slight discount to Groupe Danone and Nestle is unjustified.

Saputo is focused on product segments that are significantly different from these companies. For example, Saputo generates only 2% of its revenue through snack foods relative to Nestlé's significant focus on this segment. The vastly different scope of operations between them makes reasonable valuation comparisons inappropriate. Furthermore, Saputo's focus on Cheese is a significant strength as the market for cheese is one that is poised for significant growth while the additional segments of the market that these international companies are involved do not possess sufficiently high gross margins to justify similar valuations. Thus, Saputo should be priced at a premium relative to these companies.

Exhibit 4. Competitor Comparison

	Price 23-Oct-12	Market Cap (\$mm)	Total Debt/ EBITD A	EV/EBITDA			EPS		P/E		
				2012	2013	2014	2012	2013	2012	2013	2014
Saputo	43.12	8492.6	0.6x	10.7x	10.4x	10.0x	1.86A	2.56E	17.1x	15.5x	14.3x
Dairy Competitors											
Nestle SA	59.95	185652	1.5x	11.55x	10.72x	9.95x	3.29E	3.51E	17.51x	16.51x	15.18x
Groupe Danone	45.97	27925	2.8x	9.65x	9.07x	8.47x	2.98E	3.23E	15.23x	14.07x	12.86x
Average			2.15x	10.6x	9.9x	9.2x			16.37x	15.29x	14.02x

Conclusion

As Saputo continues to gain market share in North America at the expense of other cheese manufacturers and as it continues to expand internationally, the risks associated with its earnings continue to diminish. As well, Saputo's history of adding value through successful acquisitions and the ability and willingness of management to make two or three medium sized acquisitions in both Brazil and Australia in the near to medium term lead us to believe that there is significant value associated with Saputo's shares.

Based on the factors noted above we rate Saputo Market Outperform and value it at \$55 per share. This valuation is based on 1) a 19.5x multiple applied to our FY14 EPS estimate and 2) a 12x multiple on our FY14 EBIDTA estimate.