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Stock Pick of the Week: Fresh Del Monte Produce (FDP)

Sometimes, a reaction to a company's earnings creates an opportunity too good to resist. This week's stock pick of the week produces goods that are in generally constant demand. Despite some one-time issues with the company's procurement costs last quarter, this company has delivered excellent profit growth and consistent free cash flow for its shareholders over the past several years, and we expect this trend to continue. This week's stock pick of the week is Fresh Del Monte (FDP).

What is Fresh Del Monte Produce?

Fresh Del Monte produces, markets, and distributes fresh fruit and vegetables worldwide. The company's main product is bananas, but it also sells pineapples, melons, tomatoes, and grapes. The company also produces prepared foods such as juices and snacks from the above fruits. Fresh Del Monte offers its products under the Del Monte brand, as well as Rosy, Fruit Express, and other regional brands. The company sells its products mainly to retail stores, wholesalers, and foodservice operators.

Why Invest Now?

Despite an "earnings miss" in 1Q15, Del Monte is operating at some of the highest levels in the company's history. Global demand for its products, especially bananas, tomatoes, and avocados, led Del Monte to an excellent 2014. With the quarterly earnings report disappointing the market's expectations, the stock has fallen 10% in the past week. This creates a great entry point for this profitable and successful company.

How Fundamentally Strong is Fresh Del Monte?

In 2014, Del Monte saw strong growth in both revenues and after tax profits (NOPAT). Revenues grew nearly 7% over 2013 and NOPAT margin increased to 5%, up from under 4% in 2013. Del Monte increased its return on invested capital (ROIC) to 7% in 2014, up from 5% the prior year. Del Monte also generated over $156 million in free cash flow in 2014.

Del Monte's NOPAT in 2014 followed the company's revenue growth, and increased 49% year over year due in large part to a lackluster 2013. The picture is also good over the long term: Since 2010, Del Monte has grown NOPAT by 8% compounded annually.

The aforementioned disappointment in the 1Q15 earnings was also overblown. Revenues were up nearly 2% year over year on the back of strong banana and tomato sales. However, procurement costs of bananas increased and tomato quality issues arose, causing Del Monte's bottom line to suffer. Despite these unexpected problems, the company has exhibited a strong history of growing profits over the long term, and the post-earnings sell-off is a reaction to short term concerns.

We Made These Adjustments to Fresh Del Monte's Operating Profitability and Valuation

We make several key adjustments to the earnings and balance sheets of companies to uncover the recurring cash flows of each company's core business and the value left for shareholders. We made the following major adjustments to Del Monte's earnings in 2014:

- Removed $880 million in reported non-operating expenses
- Removed $13 million in implied interest for operating leases

When considering Del Monte's valuation, we also added $212 million in off-balance sheet debt (80% of Del Monte's total long-term debt) from operating leases to Del Monte's total debt.

Buying Opportunity

As mentioned above, Del Monte's stock price has unjustly run down over the past week, and we believe current share prices present a great buying opportunity. At its current price of $36/share, Del Monte has a price to economic book value (PEBV) ratio of only 0.8. This ratio implies that the market expects Del Monte's NOPAT to

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permanently decline by 20% from current levels. Given that Del Monte grew NOPAT by over 40% in 2014 alone, we believe the market's expectations are too pessimistic.

If Del Monte can grow NOPAT by just 4% compounded annually for the next eight years, the stock is worth $50/share today — a 39% upside.

Disclosure: David Trainer and Kyle Guske II receive no compensation to write about any specific stock, style, or theme.

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2. Standard for all companies.
3. A more accurate representation of the true underlying cash flows of the business.

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