BARRON'S
THE DOW JONES BUSINESS AND FINANCIAL WEEKLY www.barrons.com JUNE 1, 2009

Stocks End Best Three Months Since '98

By Vito J. Racancelli

The market demonstrates it has a lot of fight left.

The eternal joys of the classic peanut butter-and-jelly sandwich appear to be beyond the market's ken. Like many defensive stocks, J.M. Smucker (SJM) hasn't fully participated in the rally since March 9. At Friday's close around 40, shares are up by less than half the rise in the S&P 500, of which it is a member, and down from 2007 highs of 58. The stock is little changed from late-2003 levels, though profits have grown 9% to 11%, and dividends 5%, annually since then.

In addition to investor disdain for defensive issues, Smucker's woes stem from two other problems, one fading and the other likely to do so soon. A recall in January of salmonella-tainted peanut products hurt sales of all related products, even those not recalled, like Smucker's Jif brand. But sales are recovering. The Nielsen Company says unit volumes of jarred peanut butter rose 5% in the four weeks ended April 18 from the previous month; in January they fell 8% from December's level.

Second, Smucker guided earnings lower earlier this year for the fiscal year ended April, to a range of $3.15 to $3.30 a share, below the previous range of $3.45 to $3.50. It cited higher-than-expected amortization costs from the purchase in 2008 of Folgers coffee from Procter & Gamble (PG). In fiscal '08, Smucker posted net of $3 a share.

That amortization issue was unexpected, but Folgers will nearly double Smucker's annual sales, giving it lots of operating leverage, says Alexander Roepers, president of Atlantic Investment Management, among Smucker's biggest shareholders. Atlantic bought most of its shares in February, at around 35.

This fiscal year, several factors will support the stock, says Roepers, including $20 million in acquisition-related synergies; a $10 million improvement in the peanut-butter business, and a $35 million reduction in acquisition costs. That totals about 50 cents a share, before taxes.

Smucker isn't just PB&J sandwiches. The company's brands include well recognized names like Hungry Jack pancake mixes and Crisco oils.

Given its predictable cash flow and those brands, Smucker deserves a "pretty high" multiple, Roepers says. Yet on several measures of value it trades near the bottom of its own long-term trading range. For example, its P/E has ranged from 10 to 30 over the years. Today it is 12 times fiscal 2010 consensus estimates of $3.36. And the stock sports a 3.5% yield.

If the S&P 500's gains are sustained, the company's shares eventually will participate in the rally. If they fade, peanut butter will become as highly valued to investors as it is to kids. Either way, Smucker shares seem undervalued.