19th April 2016

Food & Beverages

Danone

Price EUR62.32

Investment case still valid but more risks in the short to medium term

Fair Value EUR70 (+12%) **BUY**

Bloomberg	BN FP
Reuters	DANO.PA
12-month High / Low (EUR)	67.5 / 53.1
Market Cap (EURm)	40,817
Ev (BG Estimates) (EURm)	48,032
Avg. 6m daily volume (000)	1 685
3y EPS CAGR	7.4%

	1 M	3 M	6 M	31/12/15
Absolute perf.	-0.9%	6.2%	7.0%	0.1%
Food & Bev.	1.4%	4.7%	1.9%	-2.1%
DJ Stoxx 600	0.7%	4.7%	-5.2%	-5.9%

YEnd Dec. (EURm)	2015	2016e	2017e	2018e
Sales	22,412	21,865	23,053	24,508
% change		*-2.4%*	*5.4%*	*6.3%*
EBIT	2,892	2,960	3,216	3,487
% change		*2.4%*	*8.6%*	*8.4%*
Net income	1,791	1,833	2,011	2,213
% change		*2.3%*	*9.7%*	*10.0%*

	2015	2016e	2017e	2018e
Operating margin	12.9	13.5	13.9	14.2
Net margin	8.0	8.4	8.7	9.0
ROE	10.2	15.3	15.5	15.8
ROCE	10.7	10.7	11.5	12.3
Gearing	61.6	55.7	47.1	39.2

(EUR)	2015	2016e	2017e	2018e
EPS	2.93	3.00	3.30	3.63
% change	-	*2.5%*	*9.7%*	*10.0%*
P/E	21.3x	20.8x	18.9x	17.2x
FCF yield (%)	4.0%	4.1%	4.3%	4.7%
Dividends (EUR)	1.60	1.64	1.80	1.98
Div yield (%)	2.6%	2.6%	2.9%	3.2%
EV/Sales	2.2x	2.2x	2.1x	1.9x
EV/EBIT	16.8x	16.2x	14.7x	13.4x

Our Buy recommendation on Danone is based on a recovery in the yoghurts division and a gradual improvement in the group's trading operating margin. So far the company has met our expectations. Although it is only at the beginning of its five-year road plan, it is clearly moving in the right direction. Growth in yoghurts was strong for the second quarter in a row (+2.3% in Q1 after +2.6% in Q4) and the group's EBIT margin should widen 30bp in organic terms in 2016, after +17bp in 2015. However we think the group's risk profile has increased. Danone said that the impact of tax changes on cross border C2C should not be significant, and we agree on this point. However, it also confirmed what Nestlé said at its Q1 sales release, namely that the Chinese authorities have further measures in the pipeline. Danone is overexposed to cross border C2C (an estimated 7% of the group's EBIT). A toughening in regulations is a significant threat to these flows. This needs to be monitored closely.

ANALYSIS

- **Our investment case remains intact. Our Buy recommendation on Danone is based on a recovery in the yoghurts division and the gradual improvement of the group's trading operating margin. So far the company has met our expectations**. It is only at the beginning of its five-year road plan but is clearly moving in the right direction. **Growth in yoghurts was strong for the second quarter in a row (+2.3% in Q1 after +2.6% in Q4 2015).** Although the group was clearly helped by a technical effect in Europe related to the streamlining of its portfolio, the region is reportedly making progress. Actimel and Danonino have already been relaunched and Activia will follow in H2. The group reiterated its target to stabilise Europe by the end of the year. The United States returned to positive territory in Q4 and confirmed the healthy Q1 performance with mid single digit growth. The US is an emerging country for yoghurts and, as such, offers strong potential. We maintain our estimate for 2% organic sales growth for the yoghurts division in 2016. This is close to the group's 2020 guidance (+3-5%). **Danone's EBIT margin should rise in 2016 for the second consecutive year.** Guidance is for "solid" improvement, with "solid" meaning higher than in 2015 (+17bps in LFL). Our forecast is for a margin of 13.54%, up 63bps in reported and 30bps in organic. Management said that the increase in H1 should be significantly higher than in H2 as H1 2015 was impacted by: 1/ a fire in a factory and 2/ the Dumex adaptation plan.
- **However, we think the group's risk profile has increased.** During the call, the group discussed tax changes in cross border e-commerce, following tax increases from 10% to 15% on C2C and from 10% to 12% in the free trade zones. A number of exemptions were also eliminated in these free trade zones. **Danone said that the impact of these tax changes should not be significant, a point on which we agree. But it has also confirmed what Nestlé said at its Q1 sales release: more measures are in the pipeline from Chinese authorities.** Danone said it is working on the sales conversion from C2C to B2C but did not give a lot of details. **The group is overexposed to cross border C2C (an estimated 7% of the group's EBIT). We think that a toughening in regulations is a significant threat to these flows. This needs to be monitored closely.** Note that management stated that **organic sales growth in Early Life Nutrition should improve in Q2 (our estimate: +6%) after Q1 (+4.8%).**

VALUATION

- Our EPS estimates remain globally unchanged over the next three years. At yesterday's share price, the stock is trading on 2016e P/E of at 20.8x vs 21.2x for Nestlé and 22.2x for Unilever.

NEXT CATALYSTS

- Mead Johnson: Q1 2016 sales on 28th April
- Danone: Shareholders' Meeting on 28th April

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