

Sector View

Food industry

	1 M	3 M	6 M	31/12/15
Food & Bev.	-1.3%	1.3%	5.6%	-0.2%
DJ Stoxx 600	0.3%	-1.9%	4.7%	-6.5%

*Stoxx Sector Indices

Companies covered

Company	Rating	Market Cap.
DANONE	NEUTRAL	EUR67
Last Price	EUR68.22	Market Cap. EUR44,745m
NESTLE	BUY	CHF84
Last Price	CHF77.8	Market Cap. CHF242,126m
UNILEVER	NEUTRAL	EUR43
Last Price	EUR40.855	Market Cap. EUR117,119m
UNILEVER Plc	NEUTRAL	3590p
Last Price	3526.5p	Market Cap. GBP45,261m

Q2 earnings season review

The earnings season was positive for our coverage. Organic sales growth remained modest (4% on average in Q2) due to the weak pricing environment and macro uncertainties in emerging countries, especially China. But profitability improved. Nestlé should post an acceleration in organic sales growth in H2 vs H1 and stronger improvement in profitability, while Danone and Unilever are expected to face a deterioration. We still favour the Swiss group (Buy; Fair Value: CHF84). We think that 1/ going forward it will better use its size to optimise its cost base and working capital and 2/ the arrival of the new CEO in 2017 should trigger a more efficient policy for the group's cash.

ANALYSIS

- Q2 sales figures showed: continued pressure on prices...with Nestlé suffering the most.** The group's pricing effect continued to slow, rising just 0.4% in Q2 after +0.9% in Q1, reflecting the deflationary environment in a number of developed markets, the lack of rebound in commodity prices and the tough comparison base (price increases in Latam and Eastern Europe last year). **Unilever reiterated that there is unlikely to be any improvement in pricing in 2016 vs 2015.** The company expects growth of around 2%. This is despite a good performance in Q2. The price effect picked up to 2.8% after +2% in Q1. **Danone said that excluding in Brazil it did not take any price increases in Q2...and deterioration in China. The food & beverage market has significantly slowed and is now flat.** Danone (the country accounts for 7% of its group's sales) said that the destocking at Mizone was not over at the end of H1 and the non-alcoholic beverages segment is now flat to up low single digit. When it released its 2015 results, it had indicated growth between 5% and 10%. Nestlé (which generates 8% of its sales in China) reported that the trend at Yinlu remains negative and is not expected to improve before 2017. These two groups are facing a **deterioration in the Chinese infant nutrition market** affected by a combination of low milk prices, a tough competitive environment and regulatory changes. According to Danone, this market is now growing between 3% and 5%, compared with double digit growth in the past.
- But profitability improved. All our groups beat consensus expectations for EBIT margin:** Nestlé +30bp vs consensus +20bp, Danone +125bp vs consensus +80bp, and Unilever +50bp vs consensus +30bp. **This was mainly the result of the low input cost environment although they also benefited from margin-accretive innovations.** On this topic, it is interesting to mention that Unilever increased margin in its Home Care division by 250bp to 9.8% and is now very close to reaching its medium term target of 10%. **Efforts to optimise cost bases also helped.**
- What about the H2 outlook? Nestlé's organic sales growth should accelerate** (organic sales expected to rise 4.6% after +3.5% in H1) thanks to: 1/ a pricing recovery driven by price increases in Brazil, Russia, Turkey, Ukraine and the UK..., 2/ easy comps as H2 2015 was impacted by a rebate adjustment on skin health products in the US and the Maggi noodles recall in India and 3/ the deconsolidation of the poorly performing ice cream business in Europe with the closing of the Froneri transaction at the end of the summer. **In contrast, we expect a slowdown at Unilever and Danone.** The Anglo-Dutch group said that organic sales growth momentum in the second part of the year (our estimate: +3.4% after +4.7% in H1) should be penalised by tough comps (+5.3% in H2 2015 after +2.9% in H1) and a deterioration in the business environment due to political uncertainty (Brexit referendum, presidential impeachment in Brazil, coup attempt in Turkey) and the economic slowdown in LATAM and Europe. In H2 we anticipate Danone's sales to increase 2.9% organically, decelerating vs H1 (+3.8%) due to tougher comps for yoghurts, poor performance of Mizone and regulatory issues in China. **The EBIT margin improvement in H2 should be above H1 for Nestlé** (easy comps for the AOA and Other Businesses divisions) **and below H1 for Unilever** (increase in marketing expenses and restructuring charges) **and Danone** (less favourable comparison base for input costs and no positive one-offs).

VALUATION/ NEXT CATALYSTS

- At yesterday's share price, Nestlé's stock is trading at 22.0x P/E 2016e vs 22.0x for Unilever and 22.4x for Danone / Q3 2016 sales in October: Unilever on 13th, Danone on 18th and Nestlé on 20th



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