

**Danone**

Price EUR64.67

**Sluggish trends in Chinese water and baby food**

Fair Value EUR65 vs. EUR67 (+1%)

**NEUTRAL**

We have lowered our EBIT estimates by 3% on average for the next three years. This is due to the Baby Food and Waters divisions, which are respectively suffering from regulation in China and destocking of Mizone. Our Fair Value has been revised downwards from EUR67 to EUR65. Neutral recommendation maintained.

**ANALYSIS**

- **Cut in estimates. We have trimmed our EBIT estimates by 3% on average for the next three years. This is due to the Baby Food and Waters divisions, which are respectively suffering from regulation in China and destocking of Mizone.** This is partly offset by slightly more optimistic forecasts for Yoghurts and Medical Nutrition. In 2016, we expect 3% group's organic sales growth, with Yoghurts: +2.5%, Waters: +2.7%, Baby Food: +3.5% and Medical Nutrition: +6.9%. This compares to our previous estimate of 3.4% organic sales growth, with Yoghurts: +1.9%, Waters: +3.4%, Baby Food: +5.5% and Medical Nutrition: +6.7%. This is still in line with the group's guidance for 3-5% organic sales growth over the year. Q3 2016 should be very weak. We expect 1.4% organic sales growth after +4.1% in Q2. Danone will only reach its medium-term target of around 5% group's organic sales growth in 2018.
- **Regulation in China impacting Baby Food. We expect the division to post 1% organic sales growth in Q3 and Q4, which implies a strong deterioration vs the first half of the year (+6%). Traders in the cross border C2C channel are currently destocking due to tougher regulation.** The regulation of the Chinese infant formula industry is a risk for Danone, as it is for other players. But the company is in a worse position than its peers due to its overexposure to cross-border C2C. The latter accounts for an estimated 7% of the group's EBIT and is expected to shrink. Danone's Chinese infant business rebounded after the Fonterra alert (2013) as the company was the principal beneficiary of the exceptional growth in cross-border C2C transactions. The volatility could last for some time and it is unlikely the group will manage to transfer all its C2C sales into B2C sales.
- **Challenging trend in Waters. We expect flat organic sales in the next quarter, mainly due to destocking of Mizone (7% of group EBIT). The non-alcoholic beverages market has slowed significantly in China** and is now showing flat to low-single-digit growth. Six months ago, it was running at 5-10%. Q3 sales of the Waters division should also be penalized by flooding in China, and tough comps.

**VALUATION**

- Our Fair Value is revised downwards from EUR67 to EUR65. We have downgraded our recommendation to Neutral in July 11<sup>th</sup> due to uncertainty around Water and Baby food in China and integration of WhiteWave's operations. At yesterday's share price, the stock is trading at a discount of 2% vs its peers in 2016 and in line with them in 2017.

**NEXT CATALYSTS**

- Q3 sales on October 18<sup>th</sup>
- Shareholders's meeting on October 4<sup>th</sup>

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Bloomberg	BN FP
Reuters	DANO.PA
12-month High / Low (EUR)	70.3 / 53.8
Market Cap (EUR)	42,417
EV (BG Estimates) (EUR)	60,730
Avg. 6m daily volume (000)	1 550
3y EPS CAGR	6.5%

	1 M	3 M	6 M	31/12/15
Absolute perf.	-7.3%	6.9%	1.6%	3.8%
Food & Bev.	-2.7%	4.5%	2.7%	-1.2%
DJ Stoxx 600	-1.7%	5.2%	-0.2%	-7.0%

YEnd Dec. (EURm)	2015	2016e	2017e	2018e
Sales	22,412	21,899	25,880	27,252
% change		-2.3%	18.2%	5.3%
EBIT	2,892	2,980	3,493	3,775
% change		3.0%	17.2%	8.1%
Net income	1,791	1,871	1,966	2,180
% change		4.5%	5.1%	10.9%

	2015	2016e	2017e	2018e
Operating margin	12.9	13.6	13.5	13.9
Net margin	8.0	8.5	7.6	8.0
ROE	10.2	14.7	15.3	15.7
ROCE	11.0	12.4	14.0	14.8
Gearing	61.6	141.3	127.2	113.1

(EUR)	2015	2016e	2017e	2018e
EPS	2.93	3.04	3.19	3.54
% change	-	3.6%	5.1%	10.9%
P/E	22.1x	21.3x	20.3x	18.3x
FCF yield (%)	3.9%	4.2%	4.4%	4.6%
Dividends (EUR)	1.60	1.66	1.74	1.93
Div yield (%)	2.5%	2.6%	2.7%	3.0%
EV/Sales	2.2x	2.8x	2.3x	2.2x
EV/EBIT	17.4x	20.4x	17.2x	15.7x



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NEUTRAL ratings 33,1%

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