

Danone

Price EUR63.69

Difficulties of Chinese Water and Baby Food to continue

Fair Value EUR70 vs. EUR65 (+10%)

NEUTRAL

Danone has currently lost its organic growth engines. In China, the non-alcoholic beverages market has slowed significantly while the infant nutrition industry is being regulated. Visibility on the group's outlook in 2017 is very weak. Nevertheless, our Fair Value is revised upwards to EUR70 as we have rolled over our estimates by one year. We maintain our Neutral recommendation.

ANALYSIS

- **Weak Q3 sales.** Organic sales were up 2.1% in Q3, deteriorating strongly vs H1 (+3.8%). Volumes proved to be very weak, dropping 0.7% over the quarter while the consensus was expecting them to be broadly flat. This reflected 1/ the tough macro environment for dairy in CIS and Brazil and 2/ the Chinese destocking for water and baby food. Danone indicated that organic sales growth would have been >4% without destocking in China. The performance in this country was penalised by the slowdown in the non-alcoholic beverages market and the regulation of the infant nutrition industry.
- **Yoghurts.** The group continues to target a stabilisation of its European sales by the end of the year. Activia was relaunched in mid-September in this region with a new packaging and marketing campaign, change in recipes etc. It is too soon to see the first results. Actimel and Danonino were relaunched in Q2 2016. The US was impacted by a very tough pricing environment during the summer. But the situation should normalise. Going forward, 5% organic sales growth in the country seems achievable.
- **Waters.** Chinese brand Mizone was in decline in Q3, impacted by 1/ flooding during the summer and 2/ destocking caused by the slowdown in the non-alcoholic beverages market. Danone's priority is to protect its 5% market share. The transition of Mizone should continue for a few quarters but should not impact Q4 to the same extent as Q3. The group's CFO indicated that the Waters division should post high single digit organic sales growth in Q4 thanks to easy comps.
- **Baby food.** Indirect sales (2/3 of Chinese activities) decreased 25% in Q3 while direct sales were up double digit. The division should continue to be impacted by the destocking of traders operating in cross border e-commerce and for this reason, management expects it to be in slight decline in Q4. The group has confirmed that business related to traders will disappear. It also said it is confident that the transition from indirect to direct will not impact its margin.
- **Outlook.** The group confirmed its full year guidance for: 1/ organic sales to increase 3-5% and 2/ EBIT margin to improve 50-60bps in organic. But it said that it should reach the low-end of its top line target and the high-end of its bottom line target. Our estimate calls for 3.1% organic sales growth over the year. This implies an improving trend in Q4, which should be driven by Yoghurts and Waters. We now expect EBIT margin to rise 60bps in organic (+50bps previously).

VALUATION

- Our DCF now points to a Fair Value of EUR70 as we have rolled over our estimates by one year. At yesterday's share price, the stock is trading at 20.8x P/E 2016e and 19.4x P/E 2017e, 1% and 1% below the peer average.

NEXT CATALYST

- Nestlé will release its Q3 sales on 20th October.

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Bloomberg	BN FP
Reuters	DANO.PA
12-month High / Low (EUR)	70.3 / 58.1
Market Cap (EUR)	41,774
Ev (BG Estimates) (EUR)	60,073
Avg. 6m daily volume (000)	1 568
3y EPS CAGR	7.6%

	1 M	3 M	6 M	31/12/15
Absolute perf.	-0.4%	-2.4%	2.2%	2.3%
Food & Bev.	-0.3%	-2.5%	0.2%	-1.9%
DJ Stoxx 600	1.4%	1.1%	-0.5%	-6.4%

YEnd Dec. (EURm)	2015	2016e	2017e	2018e
Sales	22,412	21,940	26,152	27,532
% change		-2.1%	19.2%	5.3%
EBIT	2,892	3,005	3,537	3,822
% change		3.9%	17.7%	8.1%
Net income	1,791	1,888	2,025	2,251
% change		5.4%	7.3%	11.2%

	2015	2016e	2017e	2018e
Operating margin	12.9	13.7	13.5	13.9
Net margin	8.0	8.6	7.7	8.2
ROE	10.2	14.8	15.8	16.2
ROCE	11.0	12.5	14.2	15.0
Gearing	61.6	141.1	126.7	112.3

(EUR)	2015	2016e	2017e	2018e
EPS	2.93	3.06	3.29	3.65
% change	-	4.6%	7.3%	11.2%
P/E	21.7x	20.8x	19.4x	17.4x
FCF yield (%)	3.9%	4.3%	4.5%	4.9%
Dividends (EUR)	1.60	1.67	1.80	2.00
Div yield (%)	2.5%	2.6%	2.8%	3.1%
EV/Sales	2.2x	2.7x	2.3x	2.1x
EV/EBIT	17.1x	20.0x	16.8x	15.3x

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