

## Sector View

## Food industry

	1 M	3 M	6 M	31/12/15
Food & Bev.	-5.5%	-4.7%	-1.9%	-4.7%
DJ Stoxx 600	-0.5%	0.4%	-2.3%	-6.8%

\*Stoxx Sector Indices

## Companies covered

<b>DANONE</b>	<b>NEUTRAL</b>	<b>EUR71</b>
Last Price	EUR63,5	Market Cap. EUR41,649m
<b>NESTLE</b>	<b>BUY</b>	<b>CHF86</b>
Last Price	CHF73,2	Market Cap. CHF227,810m
<b>UNILEVER</b>	<b>NEUTRAL</b>	<b>EUR44</b>
Last Price	EUR38,325	Market Cap. EUR99,430m

## Decelerating sales trend

On average, our groups posted 2.8% organic sales growth in Q3 vs +4% in the first half of the year. The slowdown reflected a weakness in volumes mainly due to China where the food market has now stabilised. Q4 2016 should show a slight acceleration but the prospects for 2017 appear gloomy. Nevertheless, we have revised our Fair Value for Nestlé and Unilever upwards due to the roll-over and for Danone in view of more favourable conditions for the WhiteWave acquisition.

## ANALYSIS

- A decelerating trend. On average, our groups posted 2.8% organic sales growth in Q3 vs +4% in the first half of the year.** This came as a surprise at Nestlé as the group had guided for an acceleration in H2 supposedly driven by 1/ a favourable comparison base as H2 2015 was affected by a rebate adjustment on skin health products in the US and the Maggi noodles recall, and 2/ a recovery in the pricing effect due to price increases made to offset currency depreciation. **The slowdown in the sector reflected a weakness in volumes. Unilever's volumes decreased 0.4%, which was below expectations (+0.6%) and the H1 trend (+2.2%).** This performance was the worst since Q4 2014. **Danone's volumes were also disappointing.** They dropped 0.7% over the quarter (+0.9% in H1) while the consensus was expecting them to be broadly flat. **Nestlé's volumes compare favourably.** Their growth decelerated from 2.8% in H1 to 1.9% in Q3 but remains better than for peers.
- Slowdown in the Chinese market. The Chinese infant nutrition market has been disrupted by new regulations, leading to tough price competition, mainly in the mainstream and premium segments.** This is why Nestlé reported only 1.4% organic sales growth in its Nutrition division in Q3. Danone's sales of Early Life Nutrition grew 1.7% over the last quarter, which was a strong deterioration vs H1 (+6%). The group's indirect sales (2/3 of Chinese activities LY) decreased 25% in Q3 because of the destocking of traders operating in cross border e-commerce. **More generally speaking, the Chinese food market has now stabilised as a result of 1/ the deteriorated macro background with some reverse migration of workers going back to rural areas and 2/ a shift between channels with the rapid growth of e-commerce.** Excluding Nutrition, Nestlé's sales in China have been in negative territory since the beginning of 2016 and the trend is worsening. Danone continued to suffer from the deceleration in the non-alcoholic beverages market, which is now flat whereas it was running at 5-10% nine months ago. The group's water brand Mizone is being destocked. Finally, China was partly responsible for the poor volume trend registered by Unilever in Q3 in Asia/AMET/RUB, with volumes up 0.6% after 4% in H1.
- The outlook for 2016 is broadly unchanged but prospects for 2017 appear gloomy. Only Nestlé has revised its organic sales growth guidance for 2016 downwards from +4.2% to +3.5%. The impact on our estimates is very limited as we were forecasting 3.7% annual organic sales growth.** The new guidance implies an acceleration in Q4, which should be driven by Brazil and Nestlé Nutrition. Brazil should recover next quarter as most of the volume impact has now been felt. The group mentioned that it started to return to volume growth at the end of Q3 in the country. Q3 sales in the Nestlé Nutrition division were impacted by negative pricing and inventory adjustments ahead of the change in regulations in China. In Q4 this should be partly offset by the launch of a new SKU on the Illuma brand. The end of supply chain constraints related to the packaging transition in the US should also help. **Danone reiterated its full year guidance for organic sales to increase 3-5% but said that it should reach the low-end of this range.** Q4 should show an improvement driven by Yoghurts and Waters. **The Anglo-Dutch company indicated that the underlying trend remains around 4%, in the middle of its sales target (3-5%),** which implies a globally unchanged trend in Q4 vs Q3.

## VALUATION

- Over the past three months, the food & beverage sector has underperformed the DJ Stoxx by 5.6%.
- We have revised upwards our Fair Value for Nestlé and Unilever to respectively CHF86 and EUR44 (3,990p for PLC) as we have rolled over our estimates by one year.
- We have also adjusted our Fair Value for Danone upwards to EUR71 to take into account more

favourable financing conditions for the WhiteWave acquisition

#### NEXT CATALYST

- 2016 results: Danone on 15th February, Nestlé on 16th February and Unilever on 26th January.

#### Comparative data

	Danone	Nestlé	Unilever
<b>2016e</b>			
Organic sales growth	3.1%	3.5%	4.0%
Reported EBIT margin increase	73	25	30
<b>2017e</b>			
Organic sales growth	4.1%	4.4%	4.4%
Reported EBIT margin increase	-17	47	40
EPS growth 2015-2018e	9.0%	7.0%	6.0%

#### Fair Values and recommendations

	Danone	Nestlé	Unilever NV	Unilever PLC
<b>Fair Value</b>				
Before	70	83	43	3590
After	71	86	44	3990
<b>Recommendation</b>	Neutral	Buy	Neutral	Neutral

Source of all charts: Bryan, Garnier & Co

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