

Danone

Price EUR60.40

Dairy in trouble - cut in top line guidance

Fair Value EUR70 vs. EUR71 (+16%)

NEUTRAL

The weak performance by the dairy division has forced Danone to revise its 2016 guidance. The group now anticipates full year like-for-like sales growth to be slightly below previous guidance for 3-5%. EBIT margin should be above target vs prior guidance of +50-60bps. Our Fair Value is adjusted downwards to EUR70. We maintain our Neutral recommendation. We think that Danone has lost its organic growth engines (i.e. mainly Chinese water and baby food) over the past couple of months, and the integration of the WhiteWave acquisition will prevent the company from focusing on their recovery.

ANALYSIS

- **Dairy organic sales are only set to rise 0.5% in Q4 vs the previous forecast for +3%. The weak performance of the dairy division (49% of total sales) has forced Danone to revise its 2016 guidance. The group now anticipates full year like-for-like sales growth to be slightly below prior guidance of 3-5%. The EBIT margin should be above target vs prior guidance of +50-60bps.** The relaunch of Activia (an estimated 30% of the European dairy sales) in mid-September, which includes a change in marketing/packaging/recipes has been disappointing for many reasons (marketing campaign excessively global, packaging problems with differentiating flavours, consumers' false belief that prices have been increased) and the brand's Q4 sales are below expectations. In addition, **Spain** (5% of total sales) has deteriorated, with the yoghurts category down low single digit and private labels gaining shares. The group's CFO said that the yoghurts division is expected to grow around 2% over the year, implying +0.5% in Q4 2016. This is a significant slowdown vs the first nine months of the year when dairy sales rose 2.5% organically. This is also well below our previous forecast of +3% which factored in an improvement in dairy trends in Q4 thanks to the Activia relaunch.
- **Organic sales growth slightly revised downwards from +3.1% to +2.9%. Today's adjustment is minor. At the Q3 sales release on 19th October, Danone indicated it would hit the low end of the guidance.** We now expect 2.9% organic sales growth vs +3.1% previously. **According to the CFO, the EBIT margin increase in LFL in 2016 should be 5-10bps higher than the prior guidance range. Our current estimate now calls for +70bps vs +60bps before.** All the savings that are extracted are not reinvested as there is no need to push for short-term growth in the current environment.
- **No change in trend in the other divisions to be expected. Ms Cabanis indicated that the trends in the other divisions remain unchanged vs what was said previously.** We forecast Waters (22% of total sales) to increase 8% organically in the last quarter of the year. The destocking of the brand Mizone continues as the growth of the non-alcoholic beverages market in China is basically zero (it was high single digit ten months ago) but the comparison base is highly favourable. On an organic basis, Early Life nutrition (22% of total sales) should drop 1% as a result of the shrinking of the grey market and destocking of traders operating in this channel. **The regulation of the infant milk industry in China is proving highly disruptive. The Australian baby food company Bellamy's has been granted a trading halt** in order to finalise an updated announcement of the impact of trading conditions on its financial results. **The Chinese company Mengniu has said it expects to record substantial loss**, citing impairment provision after unit Yashili's losses.
- **WhiteWave to be integrated in Q1 2017.** Last Friday, the group was granted clearance of the European activities for the WhiteWave acquisition. The transaction is still under review by the DOJ. **Yesterday Danone has confirmed that the closing and integration of the US company should occur in Q1 2017 (vs Q4 2016 when the transaction was announced).**

VALUATION / NEXT CATALYST

- **Our Fair Value is adjusted downwards to EUR70. We maintain our Neutral recommendation. We think Danone has lost its organic growth engines (ie mainly Chinese water and baby food) over the past couple of months and the integration of the WhiteWave acquisition will prevent the company from focusing on their recovery. We see 2018 as the turning point** as organic sales growth will be supported by the WhiteWave acquisition and the infant milk industry in China will start to normalise. The group will release its 2016 results on 15th February.

	BN FP
Bloomberg	DANO.PA
Reuters	70.3 / 58.0
12-month High / Low (EUR)	39,616
Market Cap (EUR)	57,903
Ev (BG Estimates) (EUR)	1 735
Avg. 6m daily volume (000)	8.8%
3y EPS CAGR	

	1 M	3 M	6 M	31/12/15
Absolute perf.	2.7%	-6.6%	0.8%	-3.0%
Food & Bev.	4.2%	-4.8%	0.2%	-5.7%
DJ Stoxx 600	6.0%	5.4%	10.4%	-1.7%

YEnd Dec. (EURm)	2015	2016e	2017e	2018e
Sales	22,412	21,886	26,044	27,347
% change		-2.3%	19.0%	5.0%
EBIT	2,892	3,018	3,545	3,823
% change		4.4%	17.5%	7.8%
Net income	1,791	1,897	2,116	2,326
% change		5.9%	11.6%	9.9%

	2015	2016e	2017e	2018e
Operating margin	12.9	13.8	13.6	14.0
Net margin	8.0	8.7	8.1	8.5
ROE	10.2	14.9	16.4	16.6
ROCE	11.0	12.6	14.3	15.2
Gearing	61.6	140.8	125.7	110.8

(EUR)	2015	2016e	2017e	2018e
EPS	2.93	3.08	3.44	3.77
% change	-	5.1%	11.6%	9.9%
P/E	20.6x	19.6x	17.6x	16.0x
FCF yield (%)	4.1%	4.6%	5.0%	5.4%
Dividends (EUR)	1.60	1.68	1.88	2.06
Div yield (%)	2.6%	2.8%	3.1%	3.4%
EV/Sales	2.1x	2.6x	2.2x	2.1x
EV/EBIT	16.4x	19.2x	16.1x	14.7x



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