

Danone

Feedback from investor days - ALERT

Danone held a two-day investor event in New York last week to present its 2020 vision that should drive **strong profitable sustainable EPS growth**. In essence, while capturing the growth opportunities of its categories, a better focus on cost management (procurement, One Danone and industrial restructuring) should lead to a sustainable margin turnaround. We were encouraged by the focus on cost to allow reinvestment in the business, yet we do not see any reasons at this stage to change our mid term assumptions which already factor a recovery in top line and margin from FY15. Meanwhile visibility on a V-shaped recovery in H214E remains low as we expect a weak H1 performance (JPMc 2.4% LFL, margin down 200bps).

- **2020 Strategy.** While noting throughout the two-day event that the company's DNA is about change and capacity to adapt, management's strategic vision to 2020 is to 'bring health through food to as many people as possible' with a corporate model balancing the Economic and the Social purposes. The strategy is articulated around three building blocks: Alimentation by Danone (What you eat and How you eat), Food & Water cycle management (from the cow to the fridge) and a Unique management model (entrepreneurship). While the strategy is short on quantification, its overall aim to deliver 'strong profitable sustainable growth' through strong top line by bringing health, innovation and expanding into new frontier (Africa), by improving profitability through the adaptation of the organization and size leverage and by improving sustainability of performance with the management of resources and volatility (including milk), better compliance and investment in people.
- **A stronger focus on organizational efficiencies.** Management vowed to turn around the margin dynamics that have plagued delivery over the past seven years, leading to only 2% EPS CAGR07-13. While improving mix and leveraging size remain fundamental drivers, there is also a new emphasis on cost management. In Europe Dairy, the recent announcement of three plant closures should lead to an additional €30m savings from 2016. Danone is also setting up a procurement organization, Dan trade (efficient upstream buying but also secure sourcing). The focus on cost will also come at the SG&A level as Danone rolls out 'ONE DANONE' to leverage size and mutualize cost within the Finance, HR and corporate affairs functions.
- **Transforming Dairy, with a focus on rebuilding Europe.** Through the events many presentations were focused on Fresh Dairy and the potential for a turn around by generating Value added growth, Rebuilding margin and Leveraging the size. In Western Europe, the new management is looking at increasing investment again (after A&P to sales dropped in the

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Neutral

DANO.PA, BN FP

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European Food/HPC

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past three years) while improving efficiencies (Dantrade, SKUs simplification, ONE Danone, restructuring). So far 70% of the business has stabilized (including France, Spain). In the US, Danone, while consolidating its 35% leading share in the category, is trying to extend per capita consumption with new innovation in Indulgence, Frozen or Toddlers pouches. Management also presented on the opportunities in China Dairy, with a good start to the Danone Mengnui JV.

- **Early Life Nutrition.** The strategy for the mid term is to enlarge the scope of the business by concentrating on the first 1000 days of life from targeting pregnant women nutrition to toddlers. The extension into mothers' nutrition (Lactamil, Profutura program) also encompasses online servicer and ecommerce (now representing 13% of the division). In China Danone's re-conquest of its foothold is based on the relaunch of Dumex (with a more premium variant international Dumex Precinutri+), the acceleration of the export business Nutricia, the targeting of the premium end of the market, and the improvement of its presence in Hong Kong. So far the company is on track with its FY14 objective to recover 70% of its pre-recall level by end 2014.
- **Waters.** Management continues to see much growth opportunity for the division with low single digit growth in developed markets and 15-20% growth in emerging markets. Aquadrinks, (JPME c30% of the division sales) grew 29% CAGR 2008-13 though management sees further enablers in: the rapid roll out of Mizone and variants in Asia, superior execution, brand activation and innovation.
- **Medical Nutrition.** With €1.3bn sales, Danone is a global leader in medical nutrition having built strong presence outside Western Europe in the past years namely in China and Turkey. Despite the recent challenges in WE, the market dynamics remain highly attractive, which Nutricia can address through a broad brand portfolio and leading science. While Western Europe growth slowed to c2%, Nutrition enjoyed strong growth in Asia/Eastern Europe of c23% and c6% in the Americas. The division margin erosion has been halted thanks to a focus on cost (moving from 4 to 3 regions), strong position in China, Turkey and Russia on developing self paying OTC products.

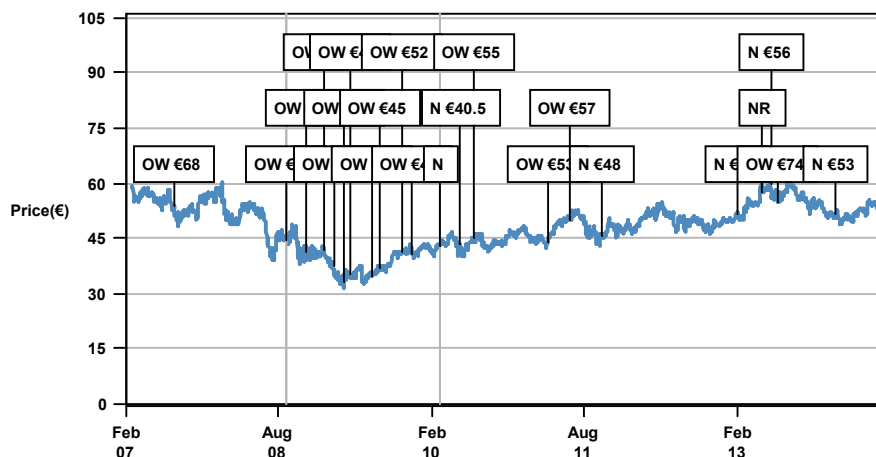
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Danone (DANO.PA, BN FP) Price Chart



Source: Bloomberg and J.P. Morgan; price data adjusted for stock splits and dividends.
Break in coverage Mar 01, 2010 - May 13, 2010.

Date	Rating	Share Price (€)	Price Target (€)
23-Jul-07	OW	53.64	68.00
28-Aug-08	OW	44.55	68.00
06-Nov-08	OW	41.43	53.00
09-Jan-09	OW	41.93	54.00
11-Feb-09	OW	37.37	49.00
23-Mar-09	OW	33.03	44.00
16-Apr-09	OW	35.39	45.00
03-Jul-09	OW	34.98	41.00
27-Jul-09	OW	36.74	45.00
13-Oct-09	OW	41.09	52.00
19-Nov-09	OW	40.66	48.00
01-Mar-10	N	42.95	--
13-May-10	N	43.24	40.50
29-Jun-10	OW	45.30	55.00
22-Mar-11	OW	44.20	53.00
10-Jun-11	OW	49.86	57.00
04-Oct-11	N	45.81	48.00
28-Jan-13	N	51.82	56.00
26-Apr-13	NR	57.62	--
29-May-13	N	59.56	56.00
20-Jun-13	OW	55.12	74.00
15-Jan-14	N	51.72	53.00

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