



## UPDATE 3-Dairy recovery lifts Danone out of downturn

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- \* Q3 dairy volumes rise 7 percent
- \* Q3 group sales 3.78 bln euros, vs Reuters poll 3.82 bln
- \* Confirms/details full-year targets
- \* Negative Q3 exchange rate impact 4.5 percent
- \* Shares rise 3.7 percent

By James Regan

PARIS, Oct 23 (Reuters) - French food group Danone (DANO.PA) said price cuts and a step-up in advertising helped accelerate the recovery in fresh dairy sales volumes in the third quarter and added that it was confident about next year.

Quarterly sales at the group, whose top brands include Activia and Actimel yoghurts, fell 1.7 percent to 3.78 billion euros (\$5.66 billion), pulled down by currency movements. At constant rates like-for-like revenue rose 4.1 percent.

Dairy volumes rose 7 percent, compared with 2.7 percent in the second quarter and five quarters of declines before that, Danone said on Friday.

*"The sharpening of pricing in fresh dairy has delivered excellent volume growth," independent analyst James Amoroso said. "We are now starting to see Danone returning to its former glory."*

Danone was expected on average to post third-quarter sales of 3.82 billion euros, according to analysts polled by Reuters, on dairy volume growth of 4.59 percent.

Shares in Danone rose as much as 3.7 percent and were up 1.5 percent at 42.21 euros by 1015 GMT, compared with a 0.9 percent rise on the French benchmark CAC 40 index .FCHI.

Danone makes about 57 percent of sales in dairy and has cut prices, after raising them 10 percent last year, to buoy demand as the economic crisis has dented consumer budgets. It has also enjoyed growth at its baby food and medical nutrition units.

The company, which says its dairy products help the digestive and immune systems, trades at around 16 times forecast 2010 earnings, compared with multiples of nearly 15 for rivals Nestle (NESN.VX) and Unilever (ULVR.L).

"We believe that the momentum Danone is currently experiencing is likely to set up for much better organic growth in 2010 ... and in 2011," Bernstein Research analyst Andrew Wood said in an email.

Danone said second-half like-for-like sales growth would be close to 4 percent, with an improvement in full-year operating margin of 60-70 basis points. It repeated its forecast for 2009 fully diluted earnings per share to rise 10 percent.

ING Financial Markets analyst Marco Gulpers said the forecasts were in line with market expectations and signalled that full-year sales would grow 3 percent like-for-like.

Danone finance head Pierre-Andre Terisse told analysts milk prices would likely increase in coming quarters, but said any rises would not be dramatic and could be offset by productivity improvements and "competitive" increases in its own prices.

"I have no concern on the growth for the dairy division in the coming quarters," Terisse said.

Overall, third-quarter dairy revenue fell 2.5 percent to 2.15 billion euros for a like-for-like rise of 2.3 percent.

Group sales were dragged down 4.5 percent by exchange rate changes "mainly driven by the Polish zloty, the Mexican peso, the Russian rouble and the British pound", Danone said.

Baby food sales rose 4.8 percent in the third quarter, while medical nutrition revenue was 8.6 percent higher, Danone added.

The group's water business, which has been struggling in some developed markets, saw quarterly sales fall 8.7 percent overall but rise 4.6 percent like-for-like, boosted by emerging markets and a rebound in France, the UK and Germany.

Nestle, the world's biggest food group, said on Thursday that nine-month sales fell 2.2 percent to 79.5 billion Swiss francs (\$78.8 billion), below analysts' average forecast of 80.3 billion, hit by currency effects.

The Swiss company reiterated its full-year forecasts.

Danone raised 3.05 billion euros earlier this year in its first capital increase in 22 years to cut debt and buy smaller rivals hurt by the financial crisis.

Terisse reiterated on Friday that the company was looking at and working on small and medium-sized acquisitions up to 1 billion euros.

(\$1=.6679 euros) (\$1=1.009 Swiss Franc)

(Reporting by James Regan, editing by Will Waterman and Mike Nesbit)

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