



ANALYSIS – Danone to get slimmer premium in tougher world

Fri Oct 23, 2009 8:38am EDT

- * Danone share price premium likely to be slimmer
- * Strong Q3 sales growth driven by price cuts
- * Nestle and Unilever also see growth accelerating

By David Jones and James Regan

LONDON/PARIS, Oct 23 (Reuters) - Danone (DANO.PA) shares are unlikely to regain their wide price premium over arch food rivals Nestle (NESN.VX) and Unilever (ULVR.L) despite the recovery at its yoghurt business that is boosting its stock.

The French group beat forecasts with a 4.1 percent rise in third-quarter underlying sales on Friday, pushing its shares higher, but its valuation gap is unlikely to return to historic levels as competitors are also seeing accelerating sales growth.

"We believe that Danone will hold its recent gains and will continue to trade at a premium," said industry analyst Jeff Stent at brokers Citi, but he added that its top-line sales growth will only be modestly above rivals.

Given the close correlation between Danone's top-line sales growth and its valuation, many analysts say its stock is moving in the right direction after a weak year-to-date performance.

Danone shares rose 1.3 percent to 42.13 euros by 1100 GMT to trade on 15.8 times forecast 2010 earnings compared to both Nestle and Unilever trading on around 14.7 times, with historic levels often some two to three percentage points ahead.

"My view is that Nestle and Unilever are also making good progress operationally and, in this sense, are catching up in the perception of the market relative to Danone," said independent analyst James Amoroso.

"I think the Danone premium versus these two companies will be less than historically for this reason," he added.

Danone's sales growth has traditionally outpaced its rivals driven by its perceived healthy range of yoghurts, bottled water and baby foods pushing its share to a premium, but the downturn hit sales hard forcing the French group to cut prices.

The cuts made earlier this year were largely at its Activia and Actimel yoghurt business, which make up nearly 60 percent of group sales. These helped revive group sales growth from a meagre 1 percent in the first quarter, while a first-quarter 1.2 percent fall in dairy sales was turned into a 2.3 percent gain.

"Danone has cut prices more sharply than we anticipated but got the volume uplift to make it work," said analyst James Edwardes Jones at brokers Execution Research.

Volume sales at Danone's dairy business rose a sharp 7 percent in the third quarter, but it needed average price cuts of 4.7 percent to drive that surge. [nLN141968]

Bigger rivals Nestle and Unilever (UNc.AS) have relied more on increased marketing and innovation than price cuts, and the Nescafe coffee and Kit Kat chocolate bar group saw its third quarter sales growth accelerate to 3.8 percent on Thursday from a lacklustre 3.5 percent rise in its first half. [nLM416716]

Maker of Knorr soups and Hellmann's mayonnaise Unilever is also seeing sales growing strongly to drive up its share rating with new Chief Executive Paul Polman seeing 4.1 percent second quarter underlying sales growth and hopes for further progress at its third-quarter results on Nov 5.

Other analysts said Danone was using the fall in milk prices to fund increased marketing and extend the price cuts into new markets but were uncertain how long this could last.

"We still have some slight concerns on the price cuts sustainability and the consequent possible long-term impact on Danone's brand equity," said analyst Warren Ackerman at Evolution Securities.

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