



Hydra Investments

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LTS Challenge 2022

Danone Investment Thesis

May 31st, 2022



Investment Thesis



A BUY call based on new management gathered by Danone to put value creation in the right place a centenary company with huge cash generation potential and which has been underperforming due to past execution.

Danone's stock has walked sideways during the past years

Danone stock performance



Overweighted investment Thesis on DANONE

Three pillars thesis sustain our investment decision

New Management

New highly-experienced management has put Danone's turnaround back on track, providing value creation in the long run.

Huge Asymmetry

A positive asymmetry for Danone's Share Price. Growth and Cash Generation do not match with current Danone's Market Capitalization.

Macro Resilience

Robust business to tackle with resilience a possible U.S. Recession. Furthermore, it's feasible to believe that this macro landscape could also act as a trigger for Danone's shares.

▶ TIR = 33.4%

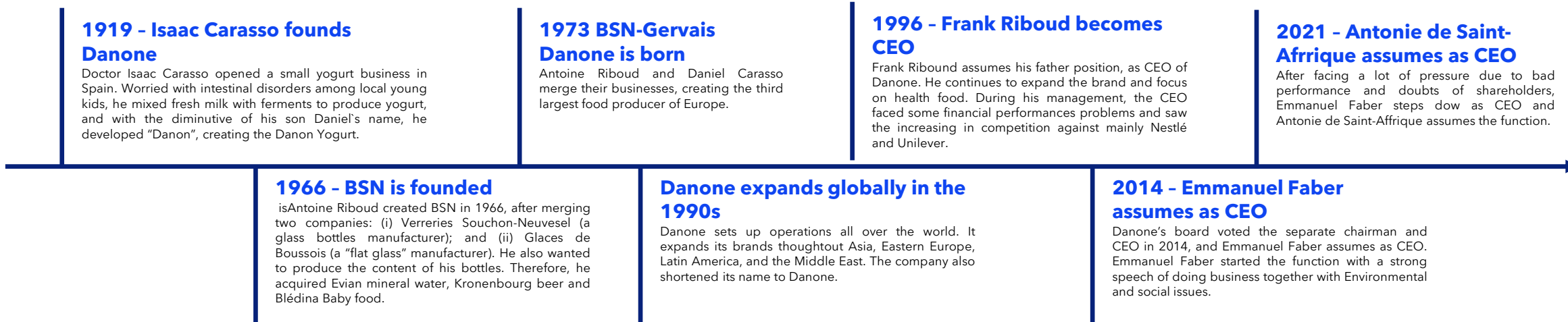
▶ Implied P/E = 20.6x

Danone At a Glance

A great company with ESG since its beginning and its roots; Dairy and SN the top value-creating businesses.

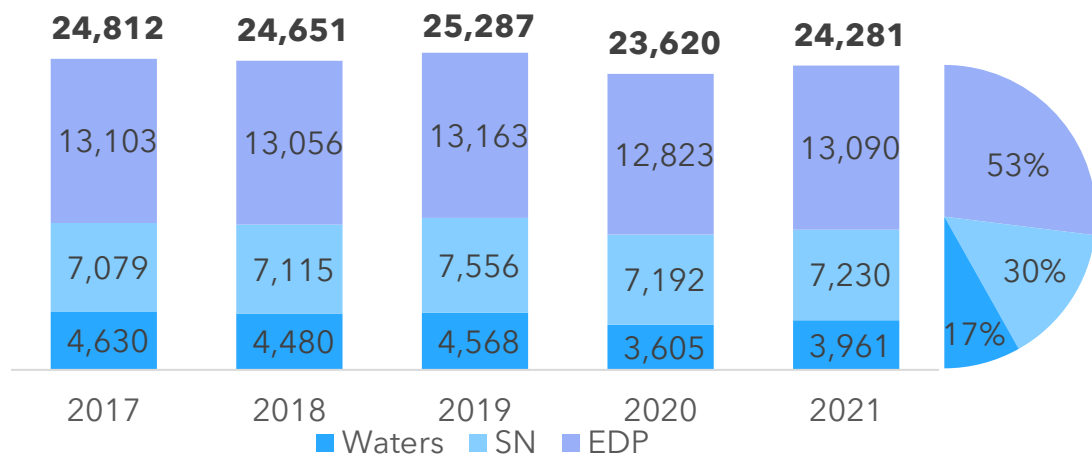
A centenary french company with brand spreaded all over the world

Danone's History



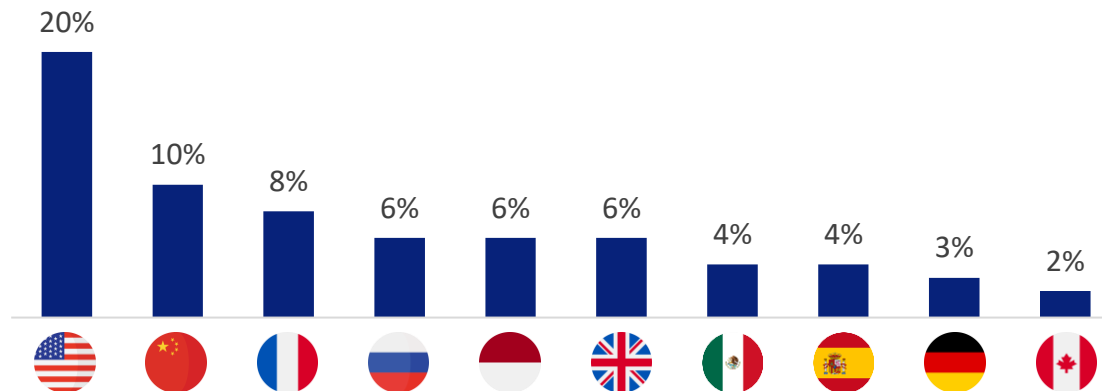
The company has three main divisions: EDP, SN, and Waters

Revenue Breakdown (in EUR mn) vs Avg % of total



Although being a French company, US accounts for 1/5 of Danone's sales

Top 10 countries contribution in sales



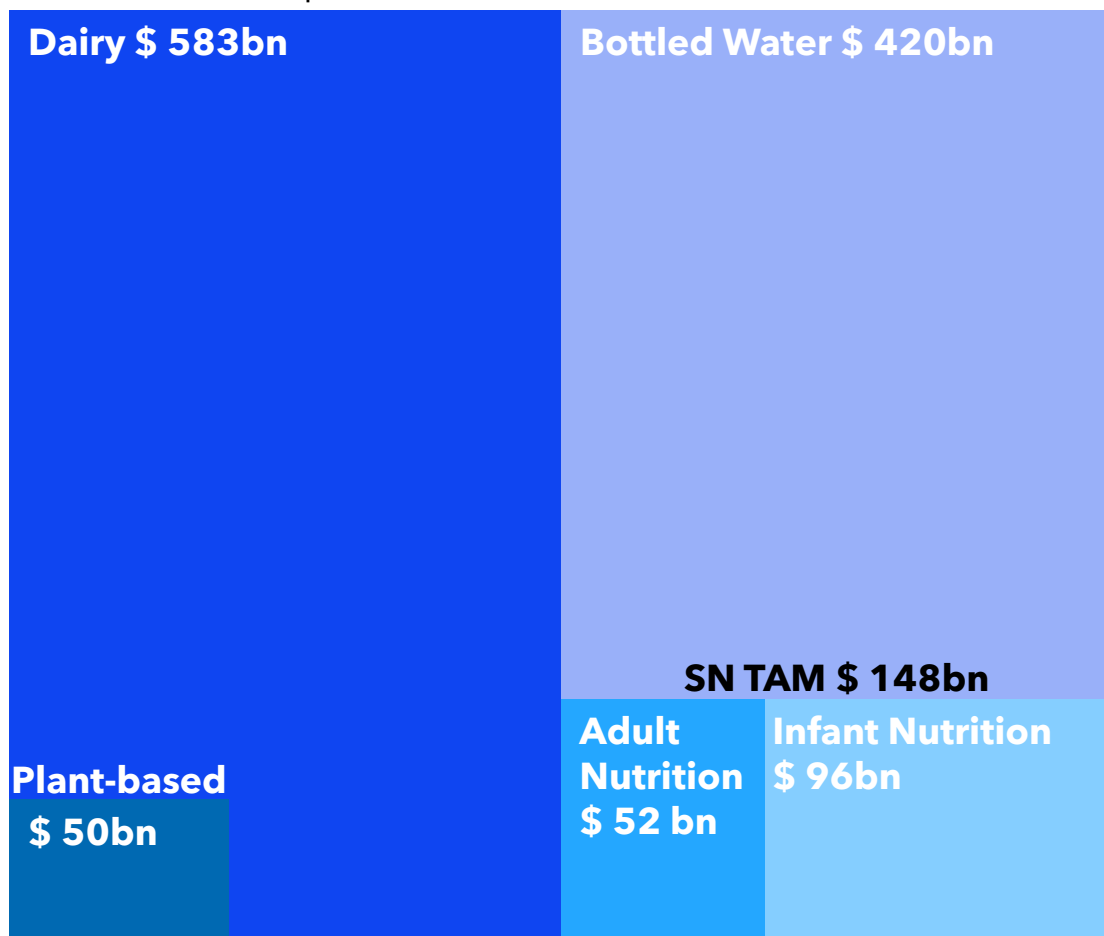
Industry Overview: Danone's Battlefield

EDP and bottled water represent the biggest piece of Danone's TAM. Although Danone is in a one digit growth market, the size of the whole pie is way too big.

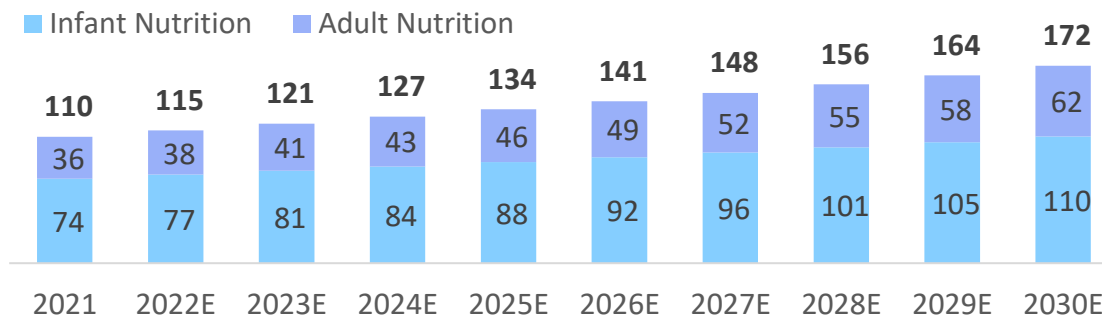
Although Danone's Industry growth is decelerating, company's TAM is a huge opportunity

Danone's TAM to reach \$1.2 tn by 2027

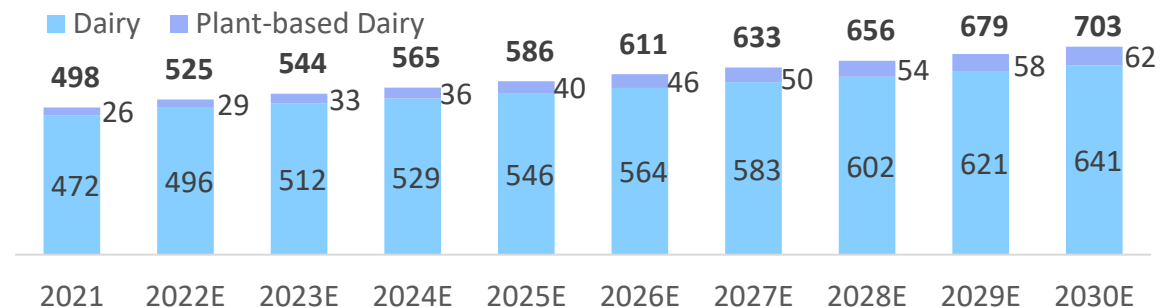
EDP TAM \$ 633bn



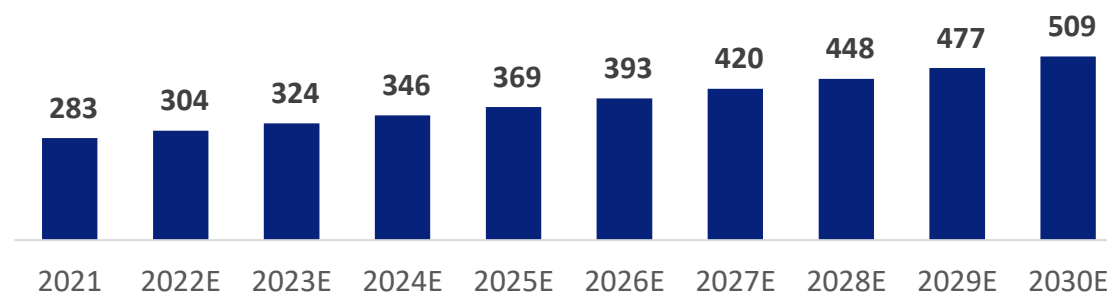
Specialized Nutrition Industry (in USD bn)



Dairy Industry (in USD bn)



Bottled Water Industry (in USD bn)

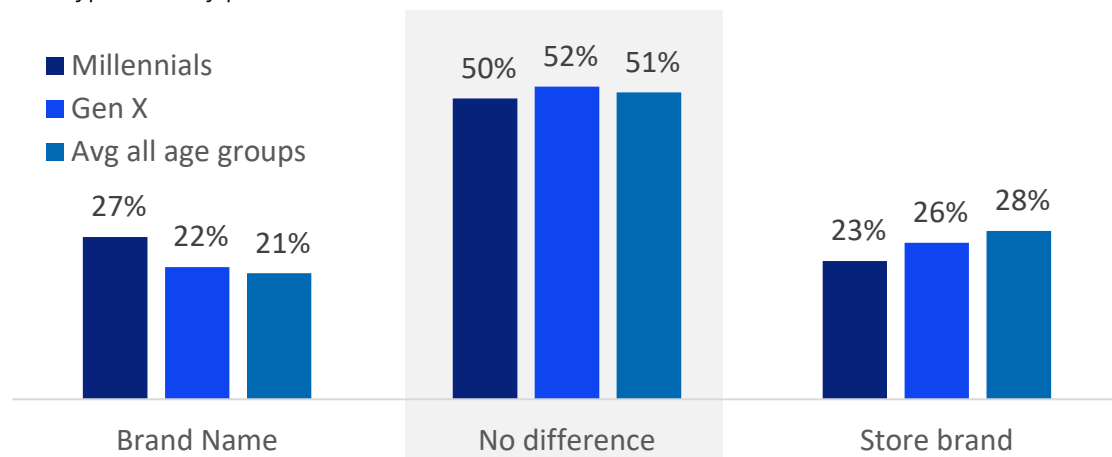


(1/2) What will Danone face in the coming years?

Low customer capitivity, low-exposure industry trends and fierce competitive scenario in EDP put limits on company's growth in the long run in Dairy industry.

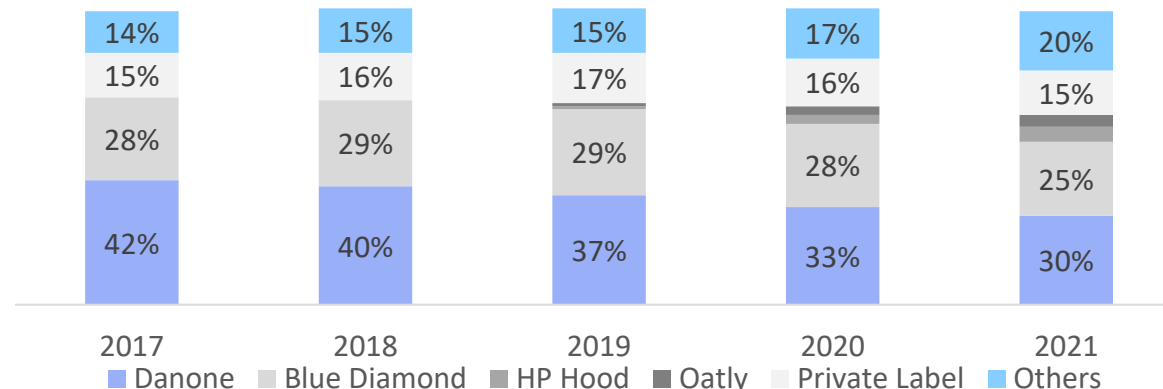
Unconcern about brand name results in lack of customer capitivity

Which type of dairy product offers better value?



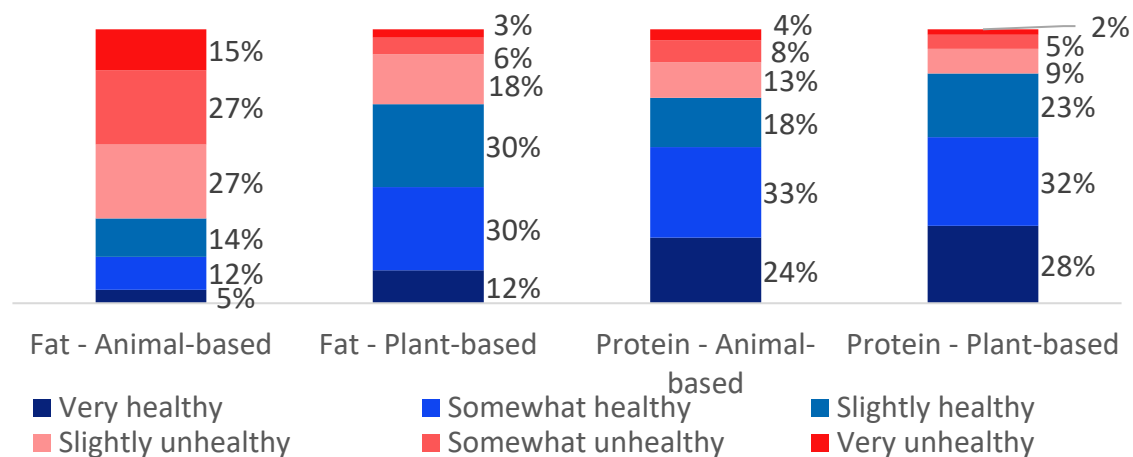
Lower barriers to enter will increase competition in Plant-based industry

US Plant based milk alternatives market share evolution



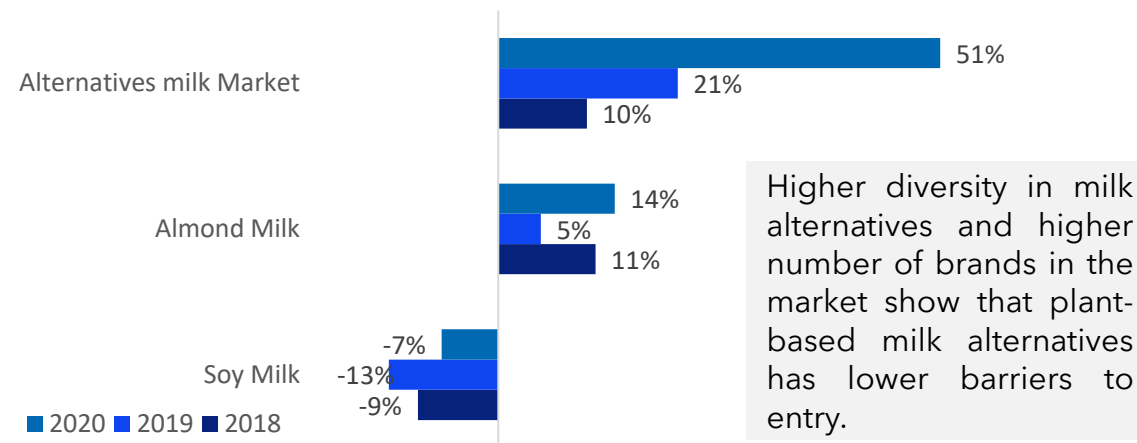
Healthier trends might drive milk alternatives industry growth

Health perceptions



There are more than 17 types of milk alternatives

Milk Alternatives growth in the US



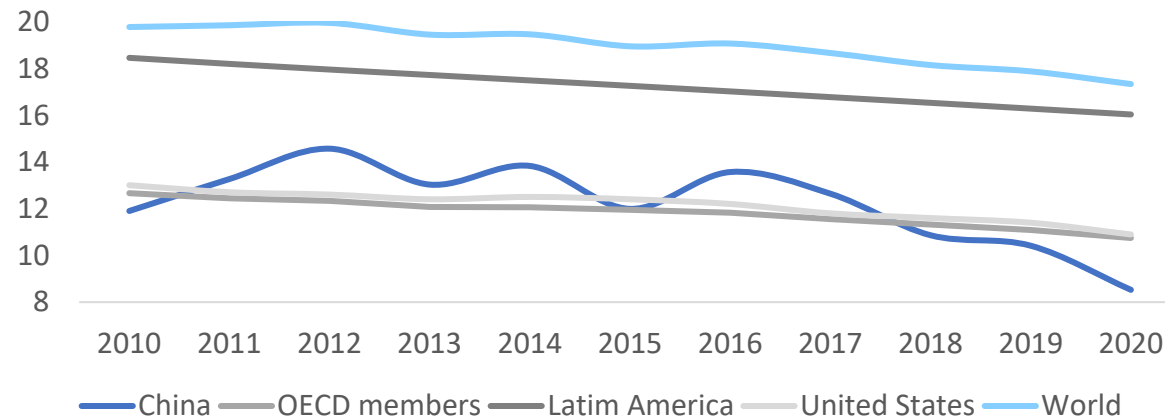
Higher diversity in milk alternatives and higher number of brands in the market show that plant-based milk alternatives has lower barriers to entry.

(2/2) What will Danone face in the coming years?

In the SN, lower birth levels, especially in China, also slows Danone's growth and sustainable trends put doubt to the future of bottled water business.

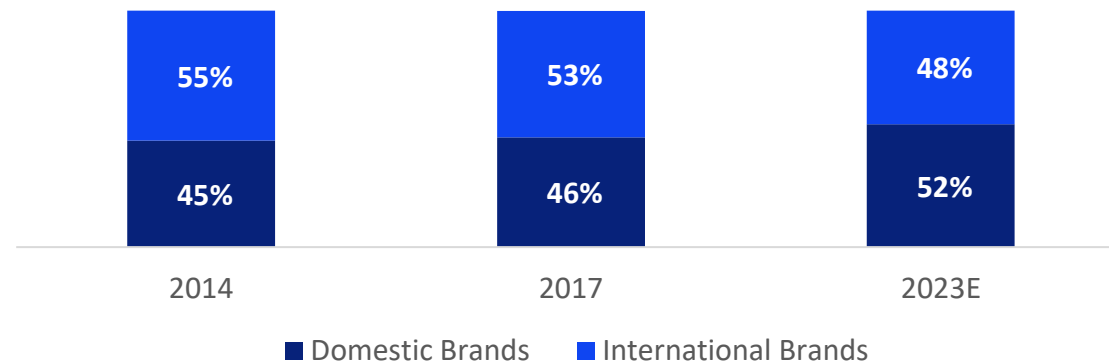
China lower birth rate is a concern to one of Danone's main SN markets

Birth rate, crude (per 1,000 people)



Also, Domestic Brands seem to intensify China's SN market

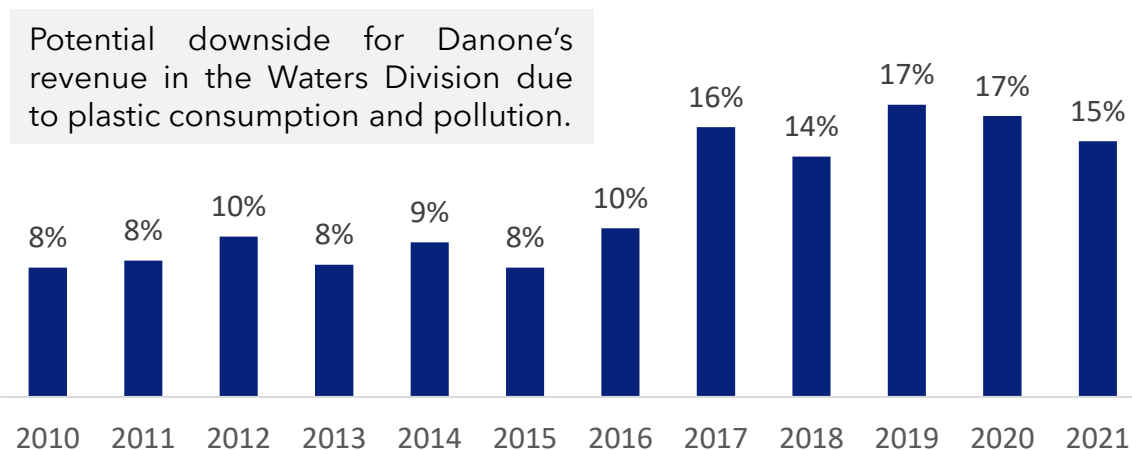
Retail sales of IMF market share evolution



Google trends evidence global concern regarding plastic pollution

Interest on plastic particle water pollution issue

Potential downside for Danone's revenue in the Waters Division due to plastic consumption and pollution.



And according to Euromonitor, Danone has already been losing share

Market share growth by revenue line evolution

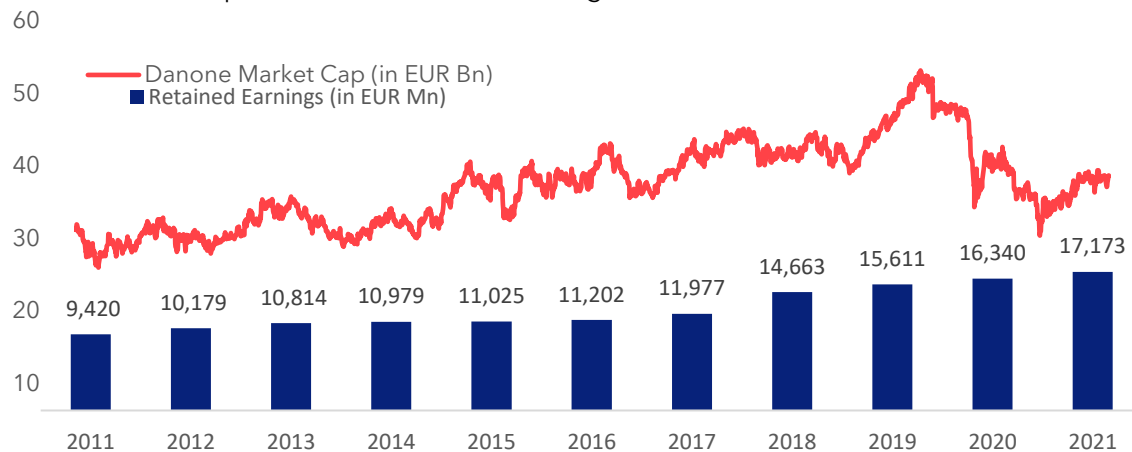


Bad execution has discounted Danone's shares

The former management with bad decisions and wrong capital allocation drove Danone's stocks downhill.

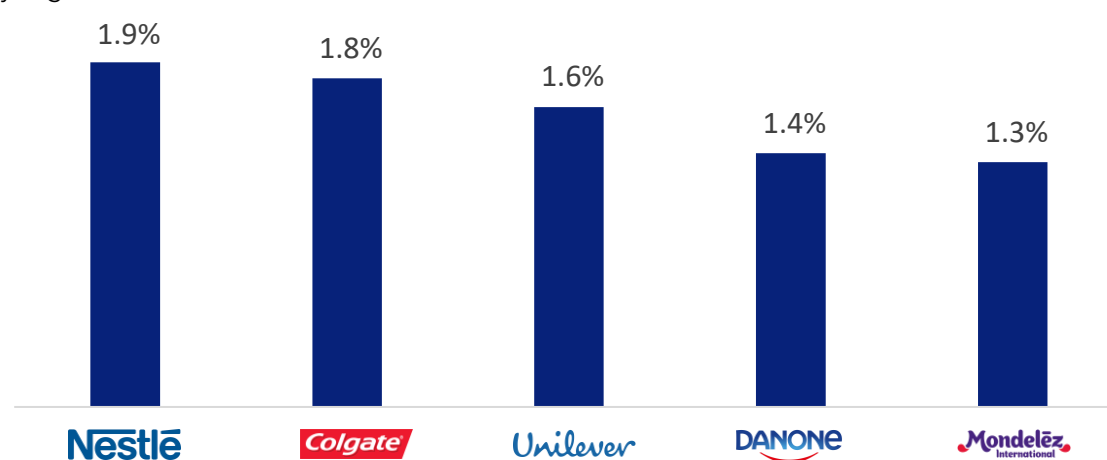
Buffet's One Dollar test shows BN has not created value in the past 10y

Danone's Market Capitalization vs Retained Earnings



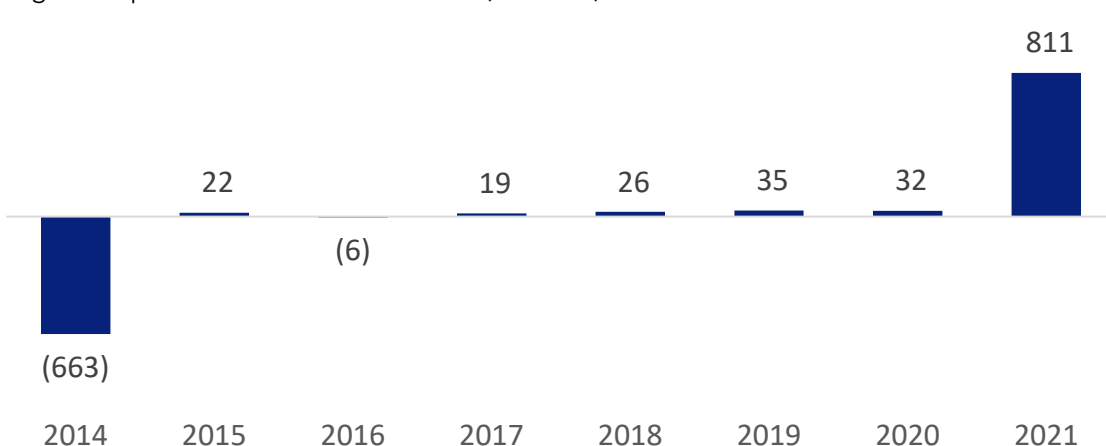
Danone has invested in R&D below its peers in the past 5y

5y avg R&D as a % of sales



Mengniu investment has generated a negative NPV of USD -45,000

Mengniu acquisition and divestment NPV (USD mn)



Other examples of bad management execution

- 1. High turnover** of senior management, which compromised long term strategy.
- 2. Governance centralization** by merging CEO and Chairman role.
- 3. Acquisition of WhiteWave**, which in the former CEO words wasn't necessary, even though he spent EUR 11.3 bn.
- 4. Payroll Costs** have inflated in the period former management was ahead of Danone, while productivity has decreased.

New management, new horizons

Although Danone puts a new team in charge, the stock has not gone back to where it belongs. We believe market is still skeptical with Danone’s governance, but in our opinion, Danone sets right with the new management, which will face a difficult turnaround ahead, but a feasible one.

A new team gathered by Danone to put the company in the right rails

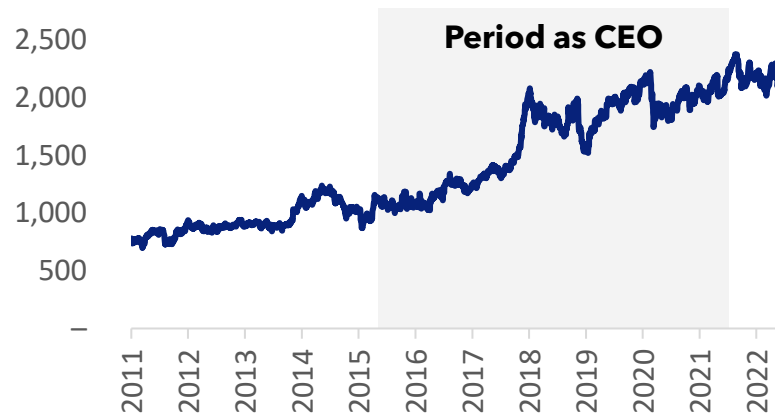
New governance and execution trajectory



Great background and success case of the team Danone has been gathering

Mr. Saint-Affrique as CEO of Barry Callebaut

Stock Performance (CHF mn)



Mr. Schnepf as CEO of Legrand SA

Stock performance (EUR mn)



Ms. Chapoulaud-Floquet as CEO of Rémy Cointreau

Stock Performance (EUR mn)

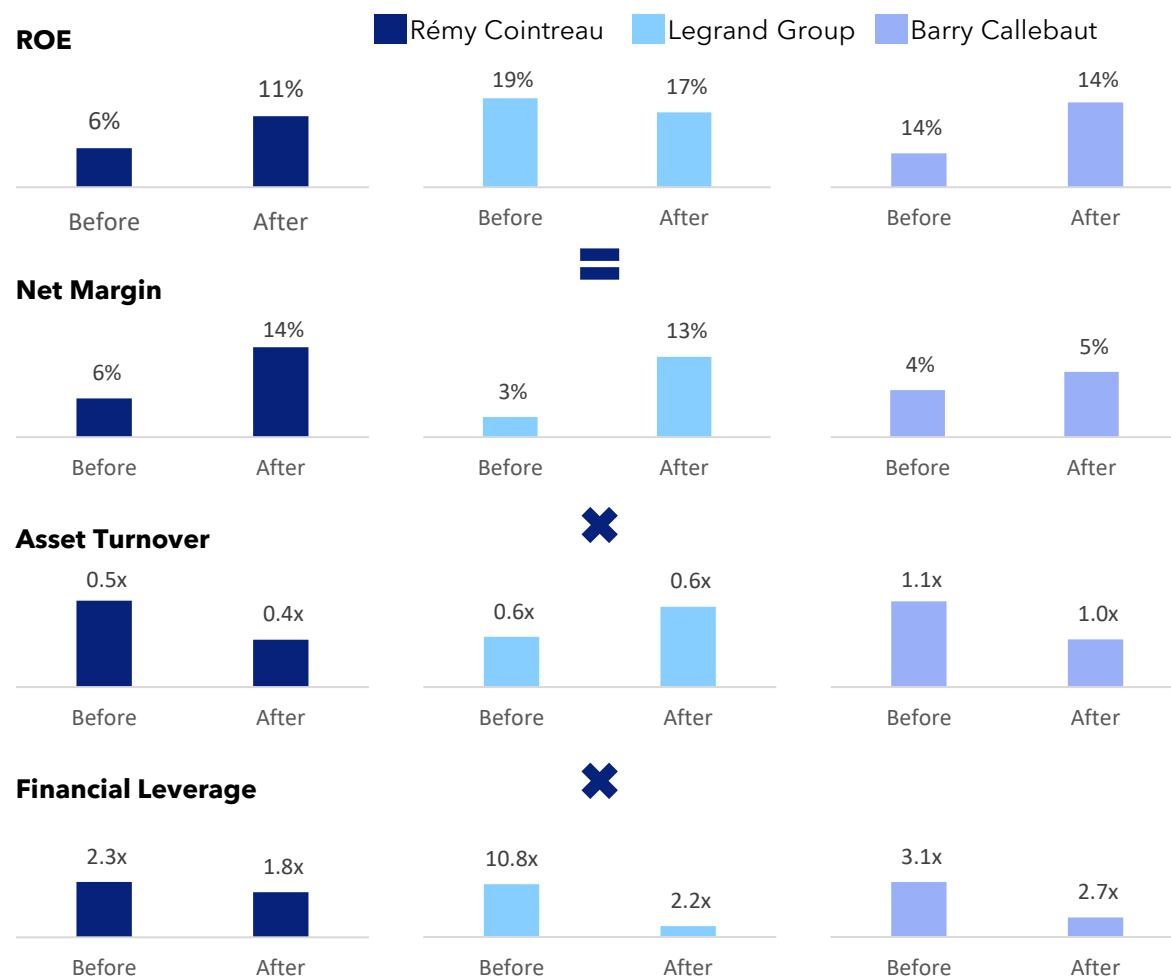


A deep dive in former management roles

Our thesis relies mainly on the strong belief that Danone's executives can achieve a turnaround. This belief is supported to management background.

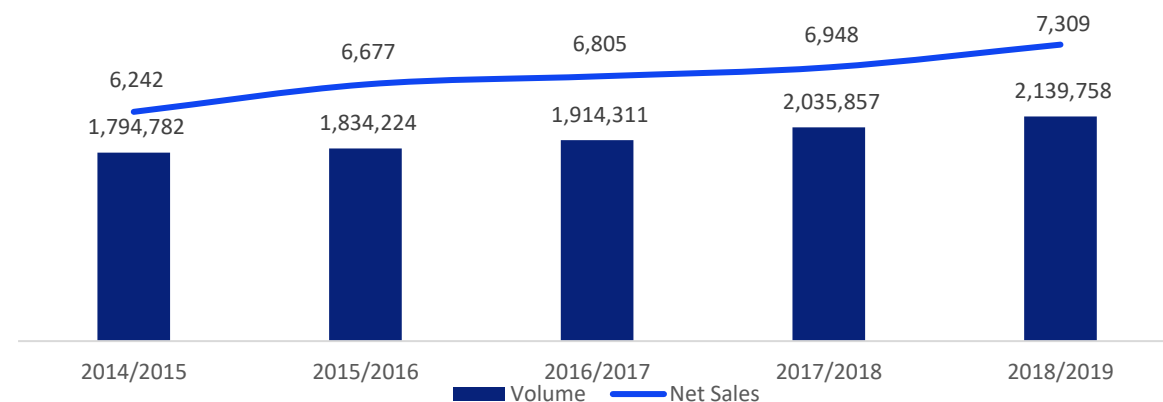
As CEOs in their former role, CEO, Chairman and Lead Independent Director delivered a more profitable companies

Dupont Analysis



Antoine de Saint-Affrique delivered the guidance it promised during its period at Barry Callebaut

Volume (ton) vs Sales (CHN mn)



A complete team with expertise in many industries

Antoine de Saint-Affrique, CEO

Has began its carrer in 1989 at Unilever, where he was responsible for marketing functions. In 1997, he joined Danone as Marketing Vice-President. Back in 2003, he returned to Unilever as Chairman and CEO of Unilever Hungary, Croatia, and Slovenia. In 2015 to 2021, he assumed the function of CEO at Barry Callebaut. And, in september, 2021, he went back to Danone as CEO.

Gilles Schnepf, Chairman

Mr. Schenepp was Vice-President of Merrill Lynch France. And after that, he joined the Legrand Group in 1989 as CFO of the company. Then in 2006 to 2018, he was appointed as CEO of the French group. Gilles Schnepf was appointed to chairman position at Danone in March, 2021.

Vlérie Chapoulaud-Floquet, Lead Independent Director

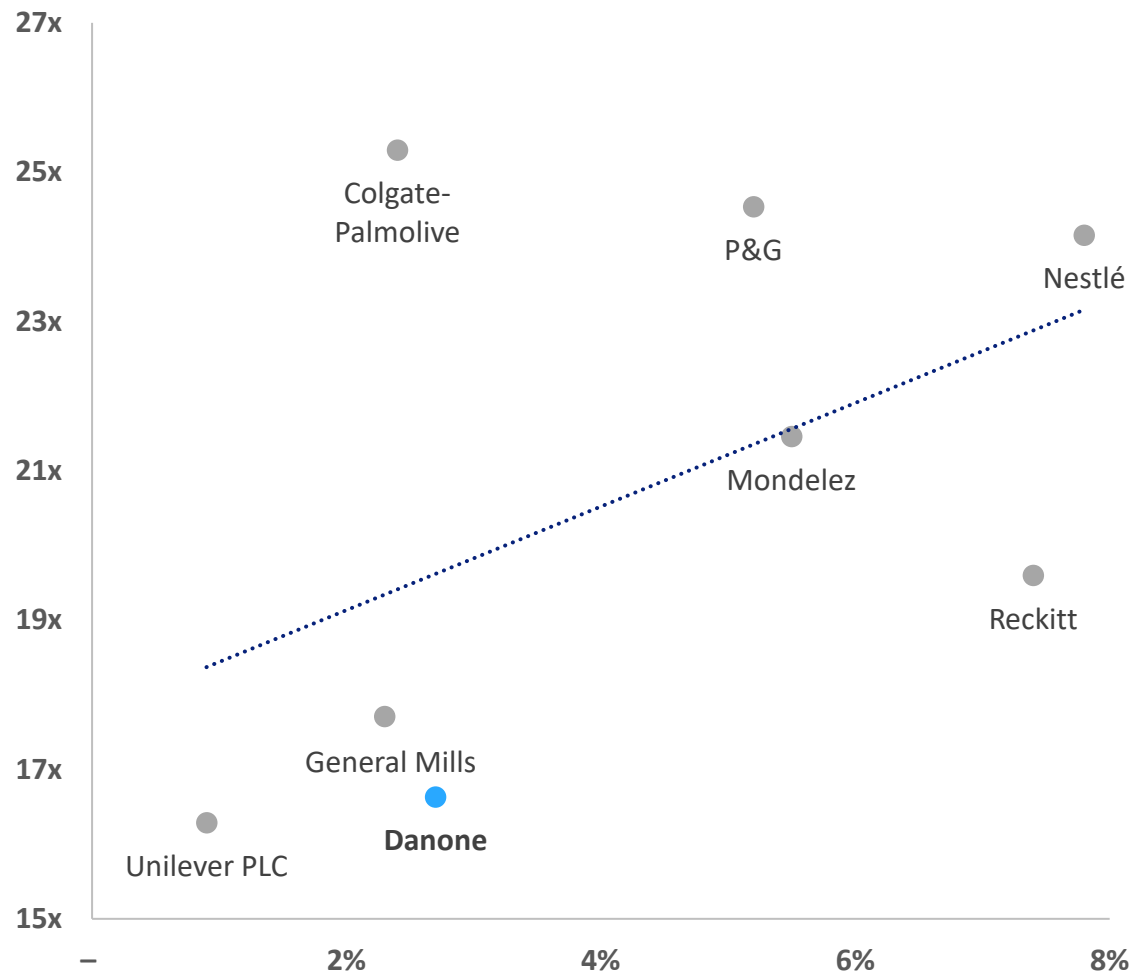
Ms. Chapoulaud-Floquet has passed through many companies incluid L'Oréal, LVMH Group and assumed different senior positions such as CEO, Vice-president, and Chairman. She joined Danone in March, 2022.

Market has not adjusted Danone's price yet

Danone's stock has been falling since the past year, but we assess that this penalization drove the shares to a bigger asymmetry opportunity in the market.

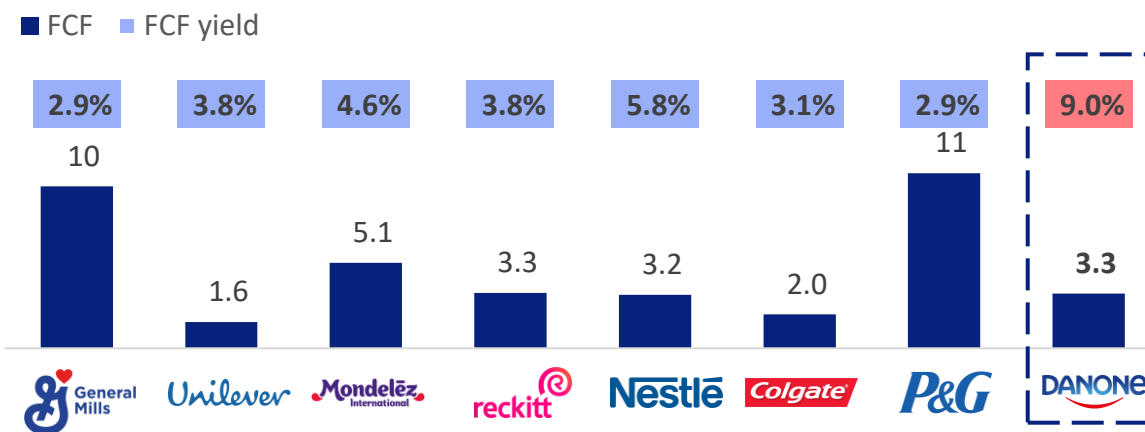
Danone's P/E does not reflect its growth outlook compared to its peers

Consensus P/E NTM vs Estimated 2y EPS growth



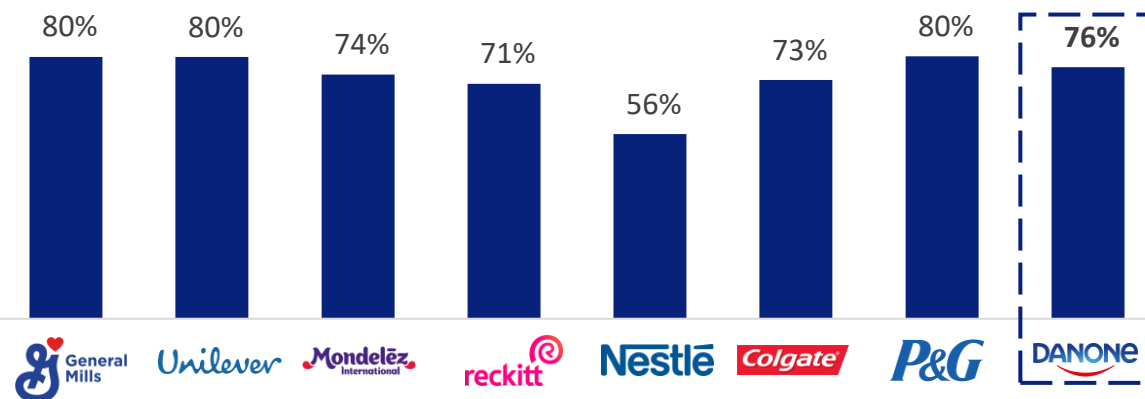
The biggest cash generator compared to its market cap among its peers

FCF (USD bn) vs FCF yield



And not behind when it comes to CFO generation

CFO to EBITDA



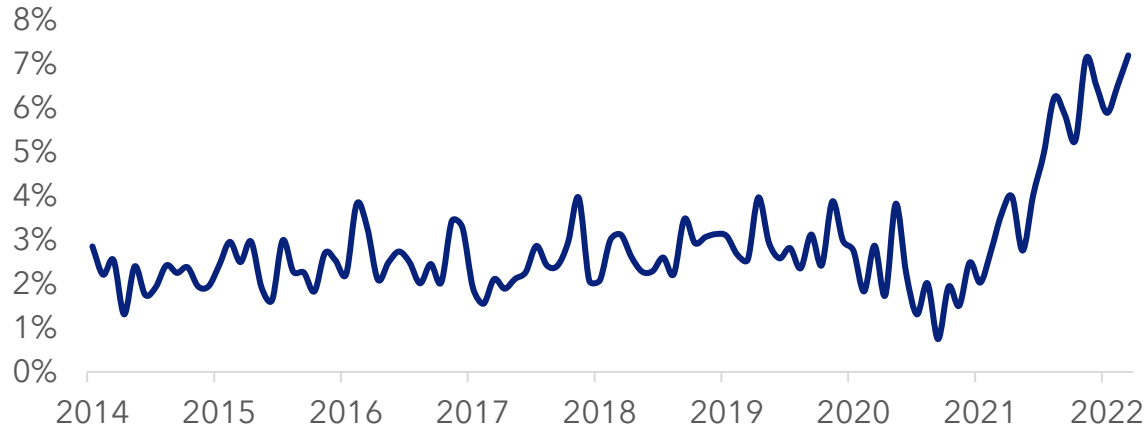
An uncertain macro outlook, but a robust business



Global inflation and a potential recession forward concern the short and middle term future for some industries and companies, but in our assessment Danone has a resilient business which can tackle these uncertainties easier.

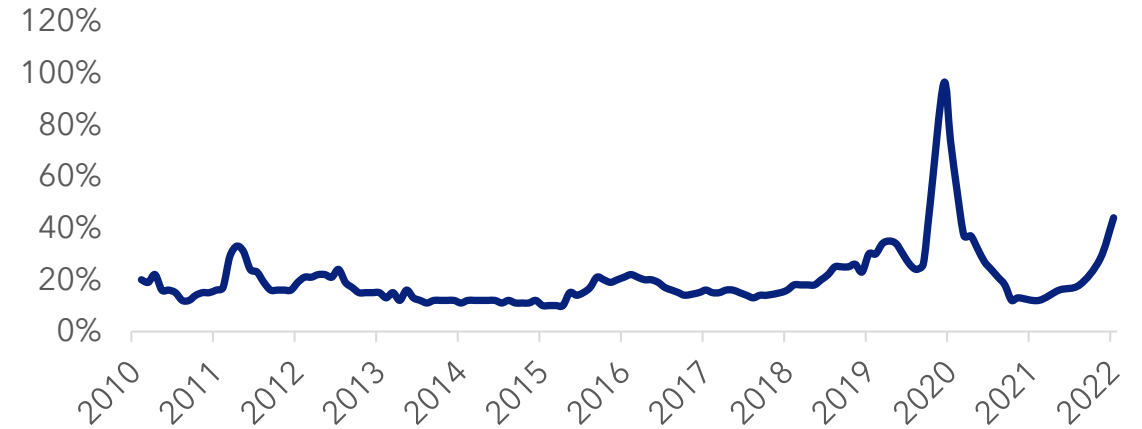
Higher inflation rate will force FED to elevate interest rates

Median Consumer Price Index



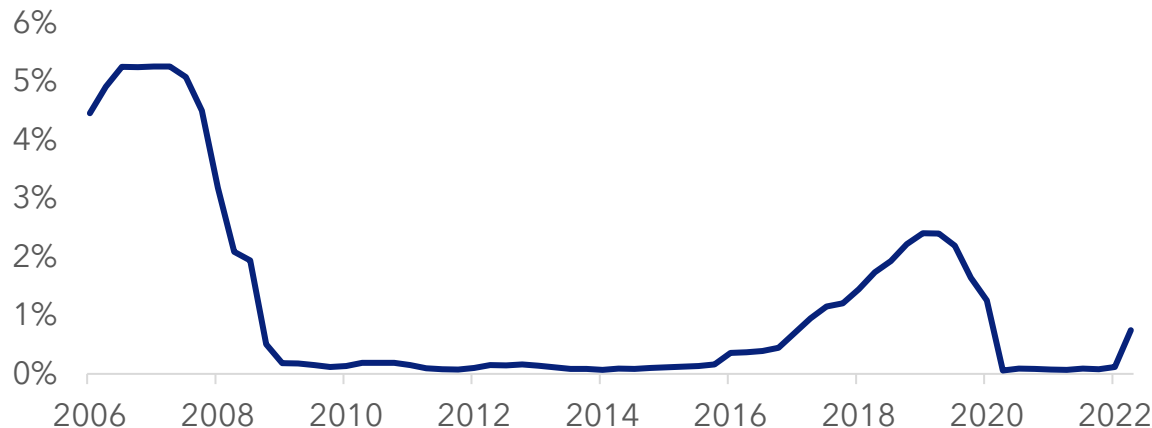
Economists see a 44% chance of recession in US in coming years

Recession Probability



Higher interest rates will slow down US economy

Federal Funds Effective Rate



And how we see this macro scenario for Danone?

As Danone's Portfolio is composed by essential goods, with a more inelastic demand, we see a more resilient business in a possible recession in the U.S. as people would still purchase Danone's products. Furthermore, this resilience could act as a trigger for Danone's stock as market starts to position itself against this pessimistic macro environment.

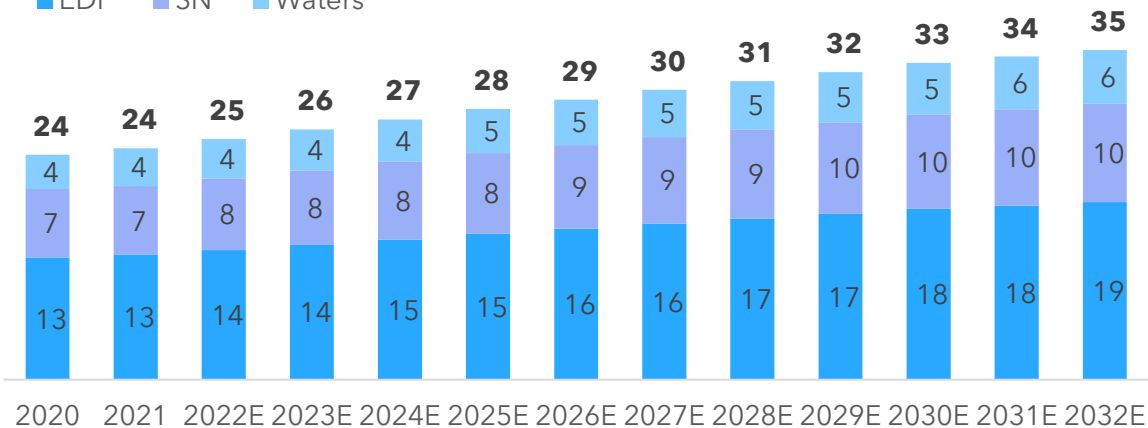
Into some operational numbers

We modeled revenue in line with management guidance, and with its new strategy, margins should be pressured in the short term, but an expansion in the long run.

Revenue to reach EUR 37bn with a CAGR₂₀₂₂₋₃₂ of 3.8%

Revenue & breakdown (EUR bn)

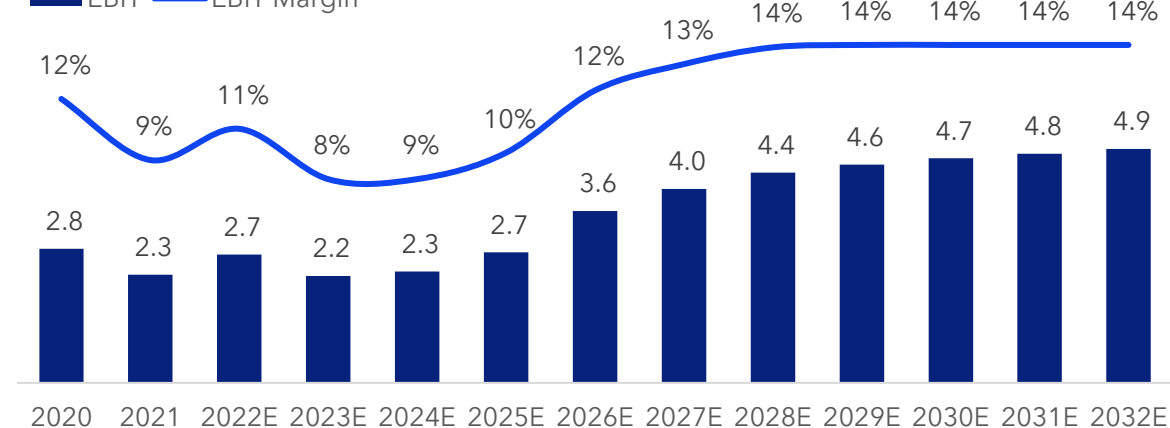
■ EDP ■ SN ■ Waters



EBIT to reach EUR 5.2bn & Margin of 14% with a CAGR₂₀₂₂₋₃₂ of 5.3%

EBIT (EUR bn) & EBIT Margin

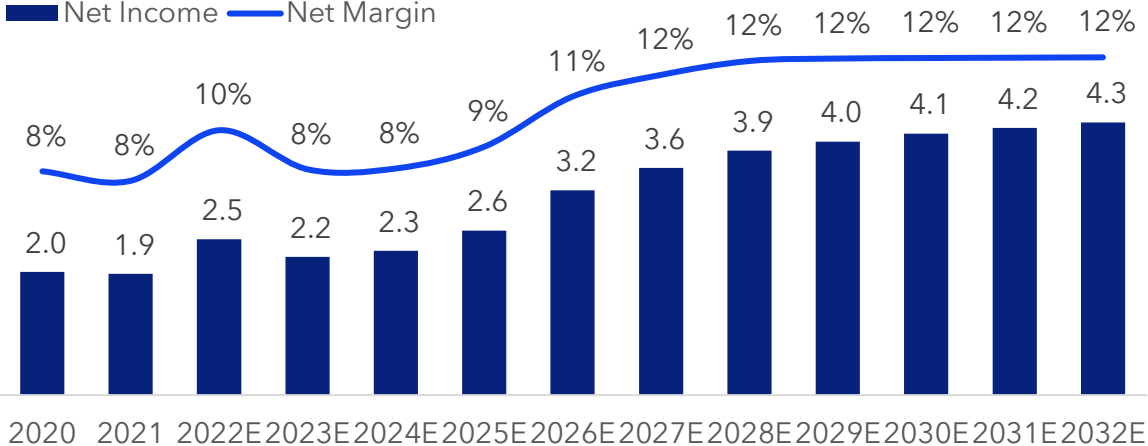
■ EBIT — EBIT Margin



Net margin to reach 13% with a CAGR₂₀₂₂₋₃₂ of 7.5%

Net Income (EUR bn) & Net Margin

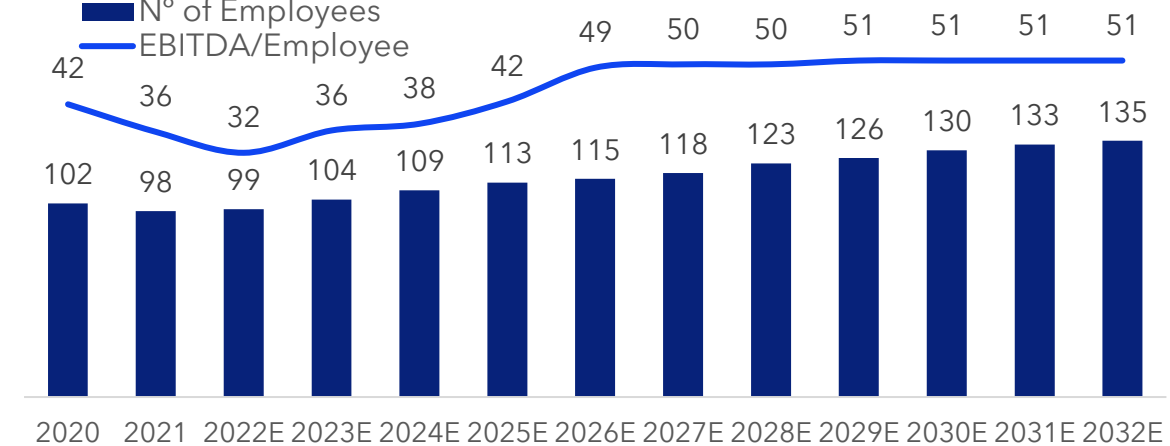
■ Net Income — Net Margin



Productivity per employee also to increase

Employees vs EBITDA

■ N° of Employees — EBITDA/Employee

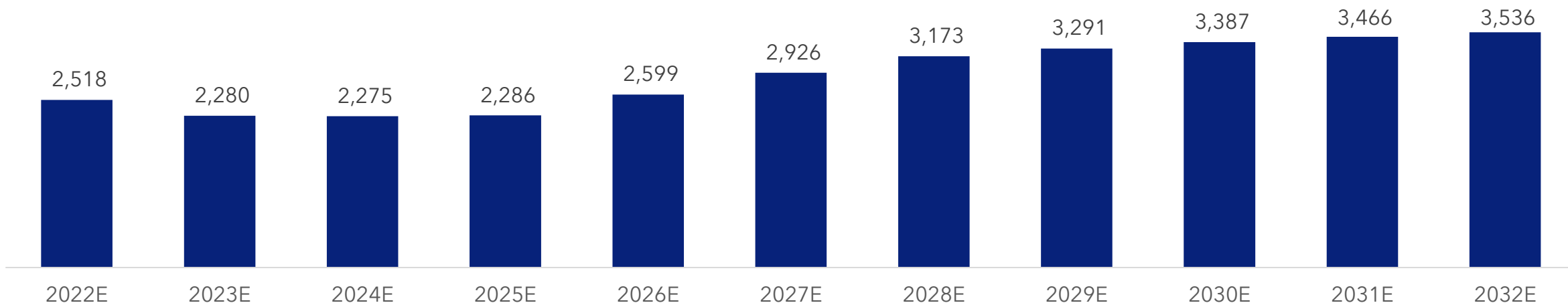


An asymmetry ahead among french companies

With a 6.6% discount rate, we assess a **27.0% upside** potential in our DCF valuation. Considering other methods, we reach a 37.3% upside with a P/E exit multiple analysis with the exit year in 2026.

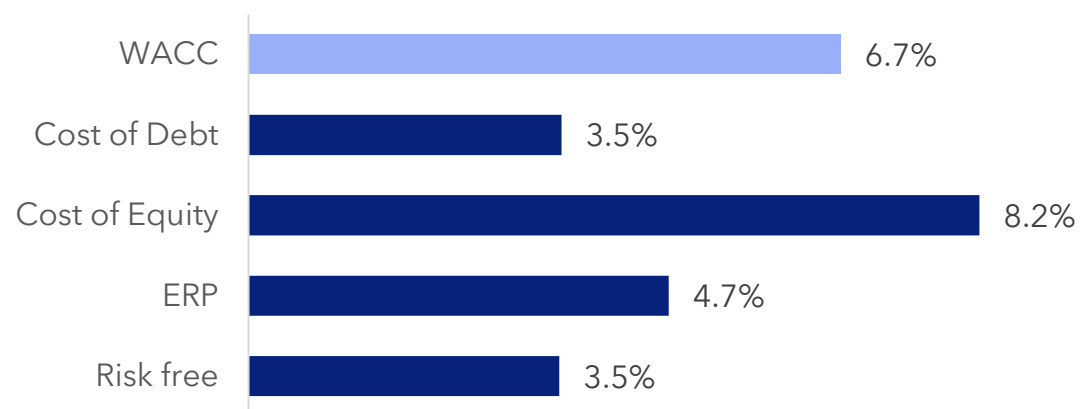
Free Cash Flow to Firm to reach EUR 3.6bn with a CAGR₂₀₂₂₋₃₂ of 11.5%

FCFF (EUR mn)



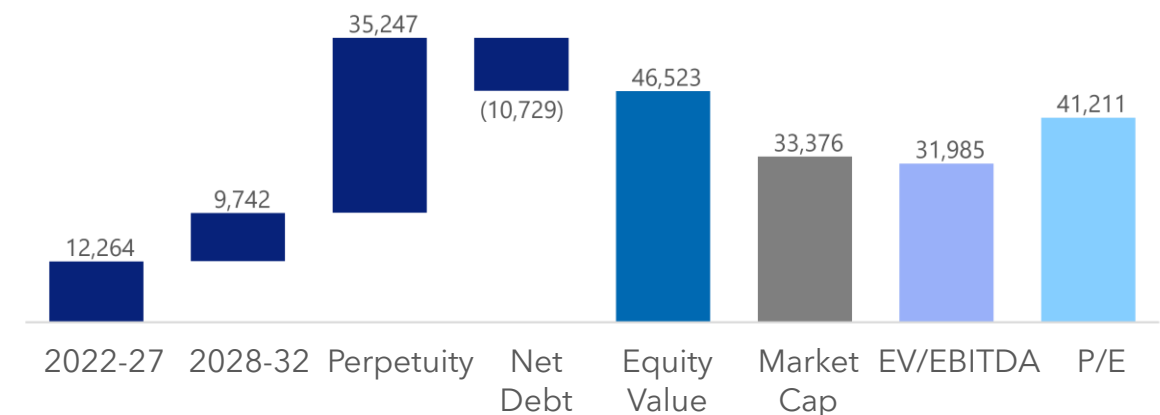
We used in our model a discount rate of 6.6%

Wacc Breakdown



Multiple assessment also confirms upside potential

Waterfall Equity Value composition



Bull, Base, Bear

We assessed different scenarios which showed a limited downside and huge upside in the most optimistic scenario.

Bull Scenario Bear Scenario

64.7% Upside

36.6% Downside

Implied P/E
22.6x

Implied P/E
18.3x

Revenue growing above guidance (CAGR₂₀₂₂₋₃₂ 4.1%)

Revenue growing below guidance (CAGR₂₀₂₂₋₃₂ 1.0%)

Margin growing above expectations, with investments in line with guidance

Margin under expectations, with investments below guidance

SG&A pressuring less in the short term due to restructuring

SG&A in line due to lower investment in R&D and marketing

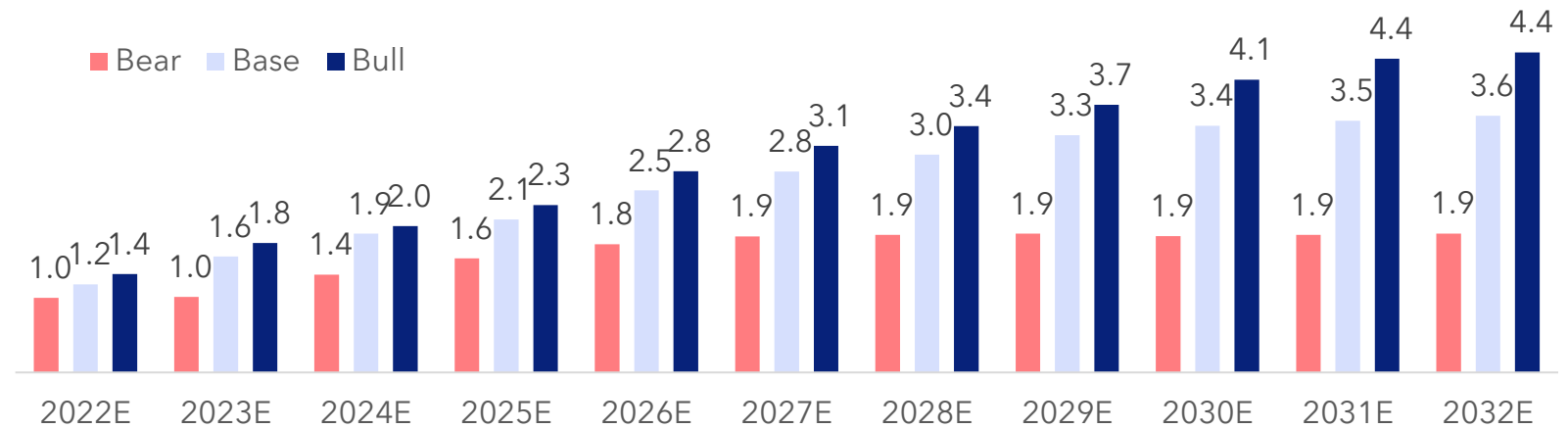
Lower need of WK with increasing bargaining power

Company without bargaining power with suppliers

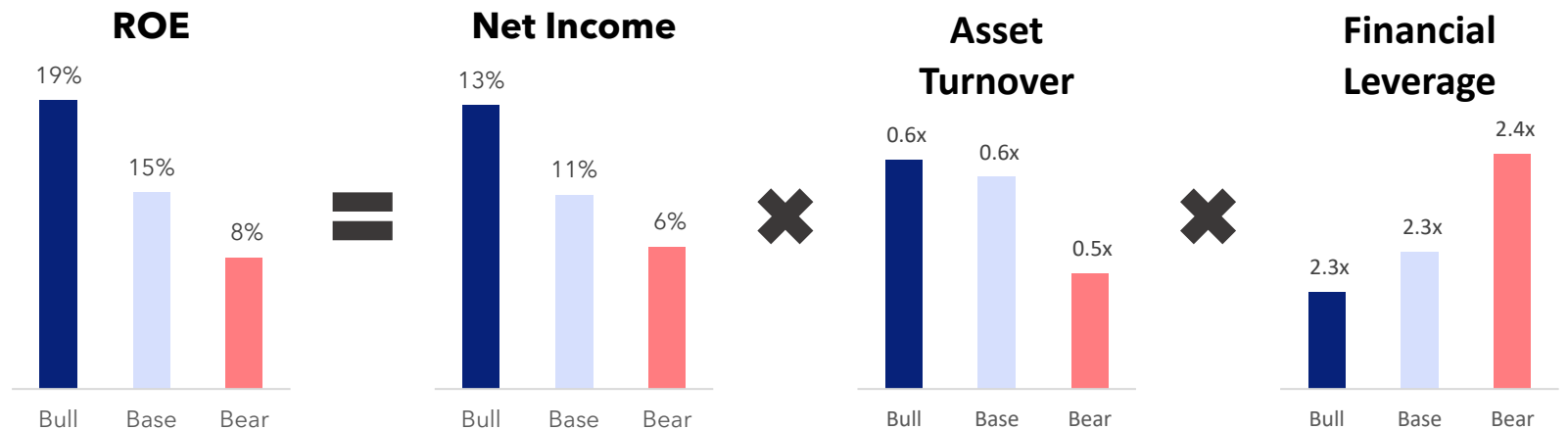
Higher profitability due to better asset turnover and margin

Lower profitability with lower margins and asset turnover

FCFF in three scenarios (EUR bn)



ROE & Dupont Analysis



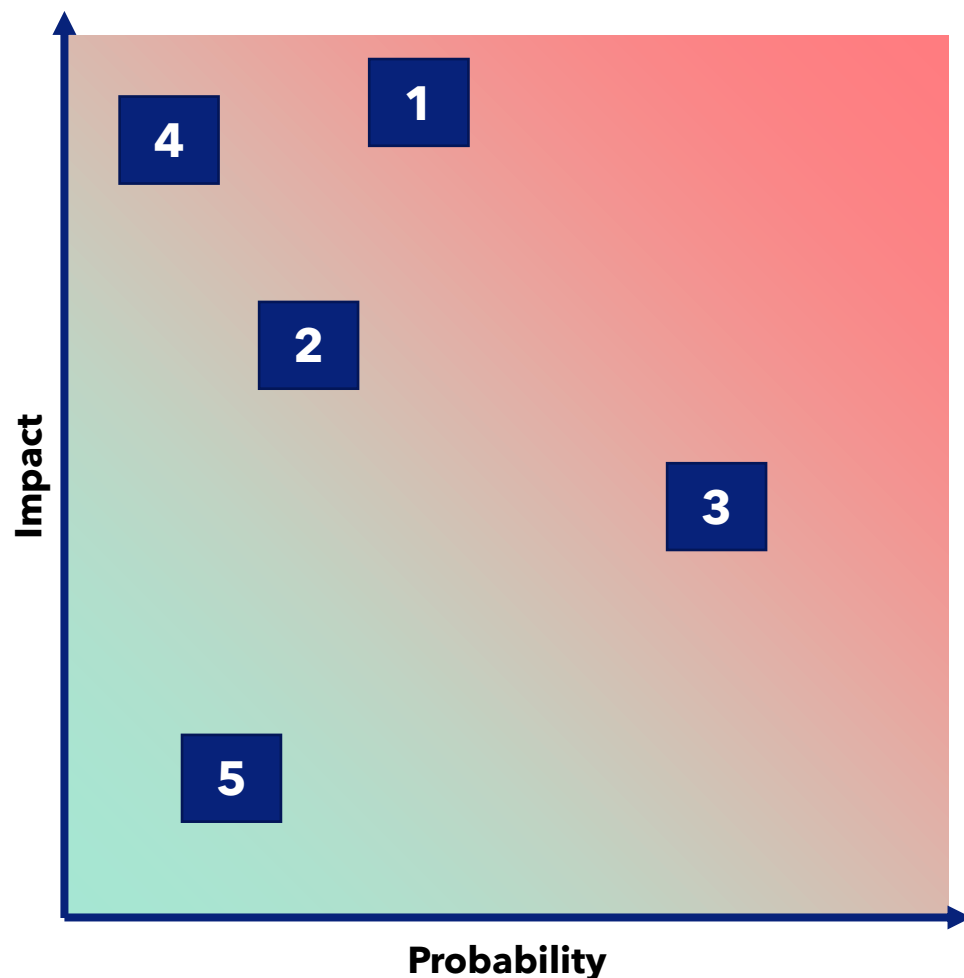
What could go wrong and how it impacts the company



We see some risks in our thesis; the most concernable is the the faillure in executing a turnaround, but we see that risk as moderate due to our strong belief in management expertise.

Main risks regarding our thesis

Risk Matrix



Main risks description

1. Management does not achieve a turnaround, with guidance mismatch and wrong strategy.
2. Global inflation to persist and company with difficulty to cost inflation in their products, putting pressure on margins.
3. Competition more intense than expected, limiting Danone's growth.
4. Lower birth rate in China than expected, limiting SN growth.
5. Sustainable issues regarding bottled water business limiting long term growth.

Only in 1/3 percent of the scenarios, we find downside

Sensitivity Analysis

		Growth				
	27%	0.5%	1.0%	1.5%	2.0%	2.5%
WACC	4.6%	87%	110%	140%	182%	244%
	5.6%	40%	53%	70%	91%	118%
	6.6%	9%	17%	27%	39%	54%
	7.6%	-13%	-8%	-2%	6%	15%
	8.6%	-30%	-26%	-22%	-17%	-11%

OKRs: "The simple Idea that drives 10x Growth"

We recommend a simple management approach to help in Company's turnaround. Also we believe that selling part of bottled water business would let Danone to focus on its core brands. Furthermore, investing in emerging markets could make Danone continues to grow in the long run.

A simple management approach to help Danone to unlock maximum value creation

Who

OKRs were famous known when John Doer putted the method in practice to help google achieve its goals. Also used by Bill Gates in its fundation and by Bono, vocalist of U2.

What

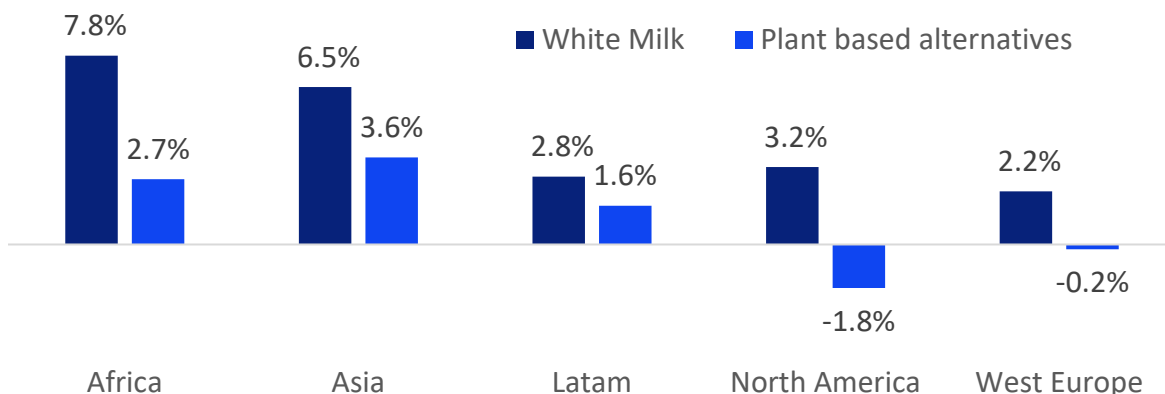
An approach that combines goals with metrics, simple to implement and can be used towards the whole company's employees. From CEO to interns, all Danoners can pursue the same objective with diferente roles.

Why

OKRS can also enhance company's culture by creating a sense of purpose as all employees have its own objectives to achieve. With OKRs, Danone can line up sustaiable growth with profitability in a practice approach.

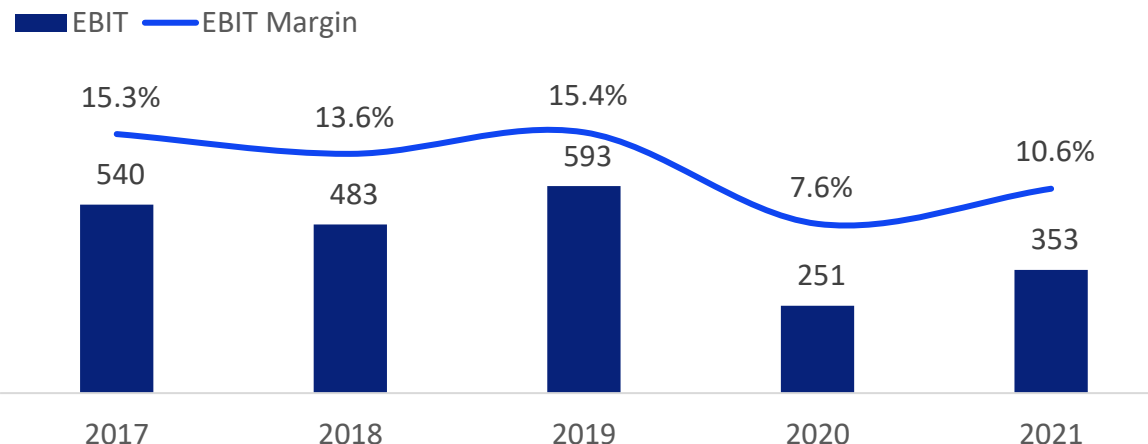
Emerging markets are also as an opportunity to pursue long term growth

Dairy products CAGR₂₀₁₆₋₂₁ consumption



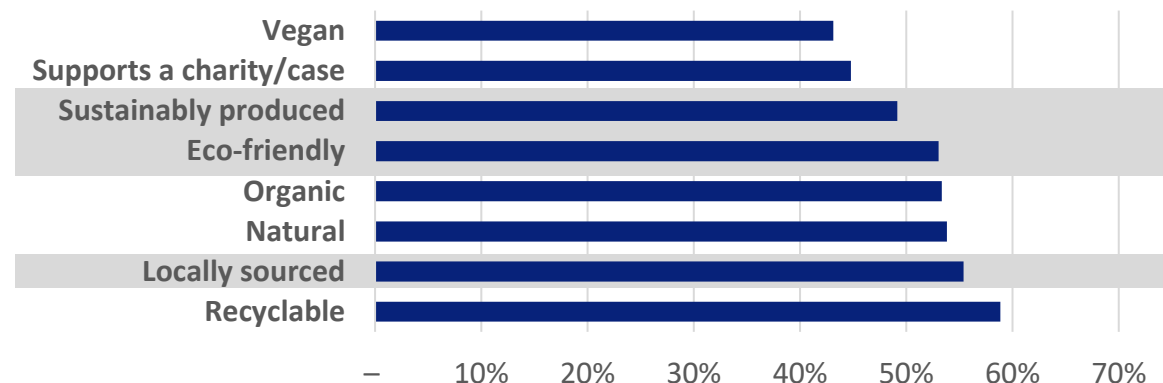
Selling total or part of bottled water business to focus in core portfolio

Water business EBIT & Margin (EUR mn)



M&A with local could enhance Danone's portfolio, and sustainability to enhance brand awareness

Do you consider the following product labels to be trustworthy?





DANONE
ONE PLANET. ONE HEALTH

Thank You!

Appendix



DANONE
ONE PLANET. ONE HEALTH

1. Income Statement
2. Balance Sheet
3. ROIC & Invested Capital
4. Management Guidance
5. Debt Schedule
6. Net Debt
7. Payout & Dividends
8. Peers - Payout Ratio
9. TIR

1. Income Statement

EUR mn

Appendix

Income Statement	2021	2022E	2023E	2024E	2025E	2026E	2027E	2028E	2029E	2030E	2031E	2032E
(+) Total Sales	24,281	25,252	26,262	27,313	28,405	29,400	30,429	31,341	32,282	33,250	33,915	34,593
(-) COGS	(12,835)	(13,636)	(14,182)	(14,612)	(15,055)	(14,994)	(15,214)	(15,514)	(15,979)	(16,459)	(16,788)	(17,124)
(=) Gross Profit	11,446	11,616	12,081	12,700	13,351	14,406	15,214	15,827	16,302	16,791	17,127	17,470
<i>Gross Margin</i>	47%	46%	46%	47%	47%	49%	50%	51%	51%	51%	51%	51%
(-) SG&A	(9,189)	(8,939)	(9,848)	(10,379)	(10,624)	(10,819)	(11,167)	(11,440)	(11,751)	(12,103)	(12,345)	(12,592)
(=) EBIT	2,257	2,677	2,232	2,322	2,727	3,587	4,047	4,388	4,552	4,688	4,782	4,878
<i>EBIT Margin</i>	9%	11%	8%	9%	10%	12%	13%	14%	14%	14%	14%	14%
(=) EBITDA	3,522	3,816	3,417	3,554	4,008	4,913	5,419	5,801	6,008	6,188	6,312	6,438
<i>EBITDA Margin</i>	15%	15%	13%	13%	14%	17%	18%	19%	19%	19%	19%	19%
(+/-) Financial Result	(262)	(307)	(307)	(307)	(307)	(307)	(307)	(307)	(307)	(307)	(307)	(307)
(=) EBT	3,260	3,509	3,110	3,247	3,702	4,606	5,113	5,495	5,701	5,881	6,005	6,131
(-) Tax	(589)	(1,036)	(918)	(959)	(1,093)	(1,360)	(1,510)	(1,622)	(1,683)	(1,736)	(1,773)	(1,810)
(=) Net Income	2,671	2,473	2,192	2,288	2,609	3,246	3,603	3,873	4,018	4,145	4,232	4,321
<i>Net Margin</i>	11%	10%	8%	8%	9%	11%	12%	12%	12%	12%	12%	12%

2. Balance Sheet

EUR mn

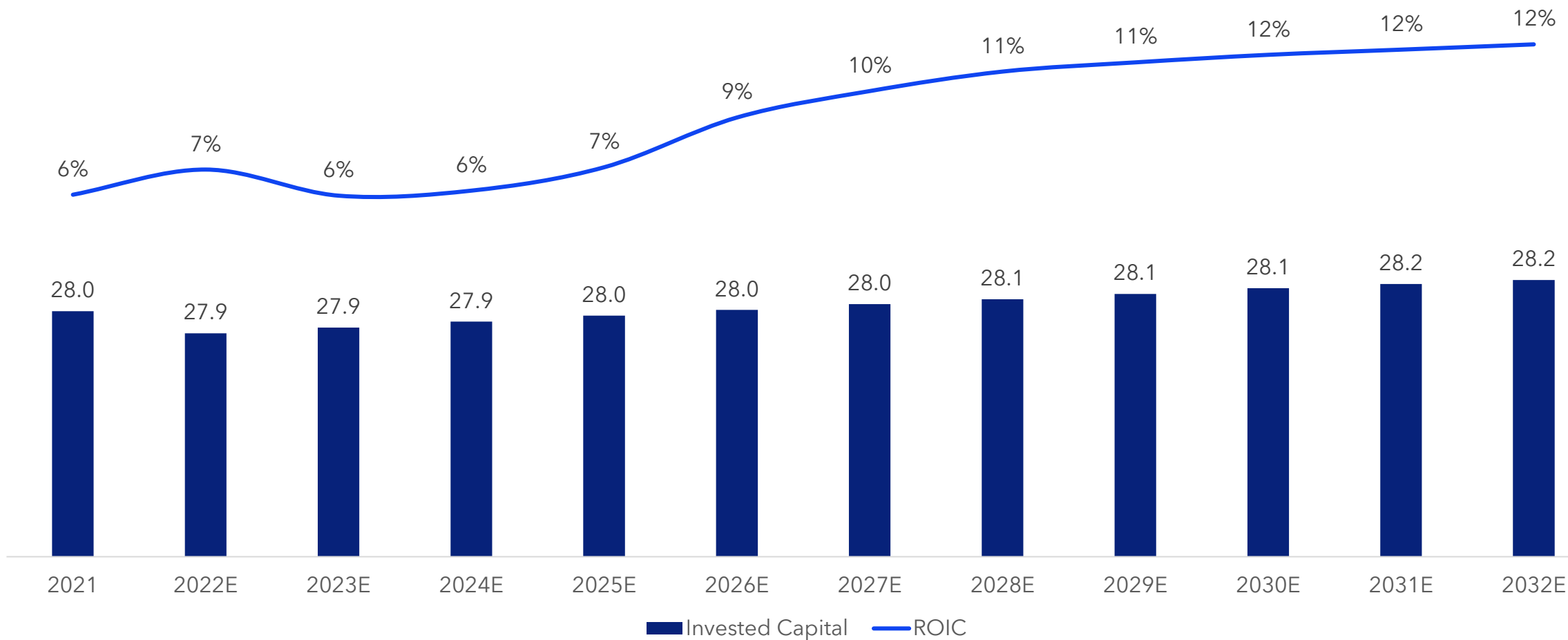
Appendix

Balance Sheet	2021	2022E	2023E	2024E	2025E	2026E	2027E	2028E	2029E	2030E	2031E	2032E
Total assets	42,735	43,795	44,712	45,670	46,724	47,849	48,979	50,087	51,034	51,804	52,329	52,433
Current assets	11,231	12,294	13,214	14,174	15,231	16,360	17,493	18,604	19,555	20,324	20,849	20,953
Cash and cash equivalents	659	1,439	2,168	2,929	3,778	4,719	5,657	6,594	7,367	7,953	8,351	8,326
Inventories	1,827	1,964	2,043	2,124	2,209	2,287	2,367	2,438	2,511	2,586	2,638	2,691
Trade receivables	2,681	2,827	2,940	3,058	3,180	3,291	3,406	3,508	3,614	3,722	3,797	3,873
Other accounts receivables and prepaid expenses	800	800	800	800	800	800	800	800	800	800	800	800
Others	5,264	5,264	5,264	5,264	5,264	5,264	5,264	5,264	5,264	5,264	5,264	5,264
Non-current assets	31,504	31,501	31,498	31,496	31,493	31,490	31,486	31,483	31,480	31,480	31,480	31,480
Investments accounted for under the equity method	642	642	642	642	642	642	642	642	642	642	642	642
Investments in non-consolidated companies	225	225	225	225	225	225	225	225	225	225	225	225
Long-term loans	344	344	344	344	344	344	344	344	344	344	344	344
Financial instruments - assets	120	120	120	120	120	120	120	120	120	120	120	120
Deferred tax assets	785	785	785	785	785	785	785	785	785	785	785	785
PPE	6,350	6,347	6,345	6,342	6,339	6,336	6,333	6,329	6,326	6,326	6,326	6,326
Goodwill	17,016	17,016	17,016	17,016	17,016	17,016	17,016	17,016	17,016	17,016	17,016	17,016
Brands	5,669	5,669	5,669	5,669	5,669	5,669	5,669	5,669	5,669	5,669	5,669	5,669
Other intangible assets	351	351	351	351	351	351	351	351	351	351	351	351
Total Liabilities and shareholders equity	42,735	43,795	44,712	45,670	46,724	47,849	48,979	50,087	51,034	51,804	52,329	52,433
Total liabilities	26,361	26,560	26,715	26,875	27,042	27,194	27,351	27,491	27,634	27,782	27,884	27,988
Current liabilities	10,421	10,620	10,774	10,935	11,102	11,254	11,411	11,550	11,694	11,842	11,943	12,047
Trade payables	3,659	3,858	4,012	4,173	4,340	4,492	4,649	4,788	4,932	5,080	5,181	5,285
Accrued expenses and other current liabilities	2,714	2,714	2,714	2,714	2,714	2,714	2,714	2,714	2,714	2,714	2,714	2,714
Financial liabilities	3,826	3,826	3,826	3,826	3,826	3,826	3,826	3,826	3,826	3,826	3,826	3,826
Lease Debt	222	222	222	222	222	222	222	222	222	222	222	222
Non-current liabilities	15,941	15,941	15,941	15,941	15,941	15,941	15,941	15,941	15,941	15,941	15,941	15,941
Financial liabilities	11,793	11,793	11,793	11,793	11,793	11,793	11,793	11,793	11,793	11,793	11,793	11,793
Lease Debt	744	744	744	744	744	744	744	744	744	744	744	744
Pensions and post-retirement healthcare liabilities	1,000	1,000	1,000	1,000	1,000	1,000	1,000	1,000	1,000	1,000	1,000	1,000
Deferred tax liabilities	1,300	1,300	1,300	1,300	1,300	1,300	1,300	1,300	1,300	1,300	1,300	1,300
Other non-current liabilities	1,104	1,104	1,104	1,104	1,104	1,104	1,104	1,104	1,104	1,104	1,104	1,104
Total equity	16,373	17,234	17,998	18,794	19,681	20,655	21,628	22,596	23,400	24,022	24,445	24,445
Share capital	6,107	6,107	6,107	6,107	6,107	6,107	6,107	6,107	6,107	6,107	6,107	6,107
Retained profit	17,822	18,683	19,447	20,243	21,130	22,104	23,077	24,045	24,849	25,471	25,894	25,894
Others	-7,556	-7,556	-7,556	-7,556	-7,556	-7,556	-7,556	-7,556	-7,556	-7,556	-7,556	-7,556

3. ROIC & Invested Capital

EUR mn; %

Appendix



New targets for the 2022-2024 period

All references to like-for-like sales growth, recurring operating income, recurring operating margin, ROIC and net debt/EBITDA ratio correspond to financial indicators not defined in IFRS. Their definitions are listed in section 3.5 Financial indicators not defined in IFRS.

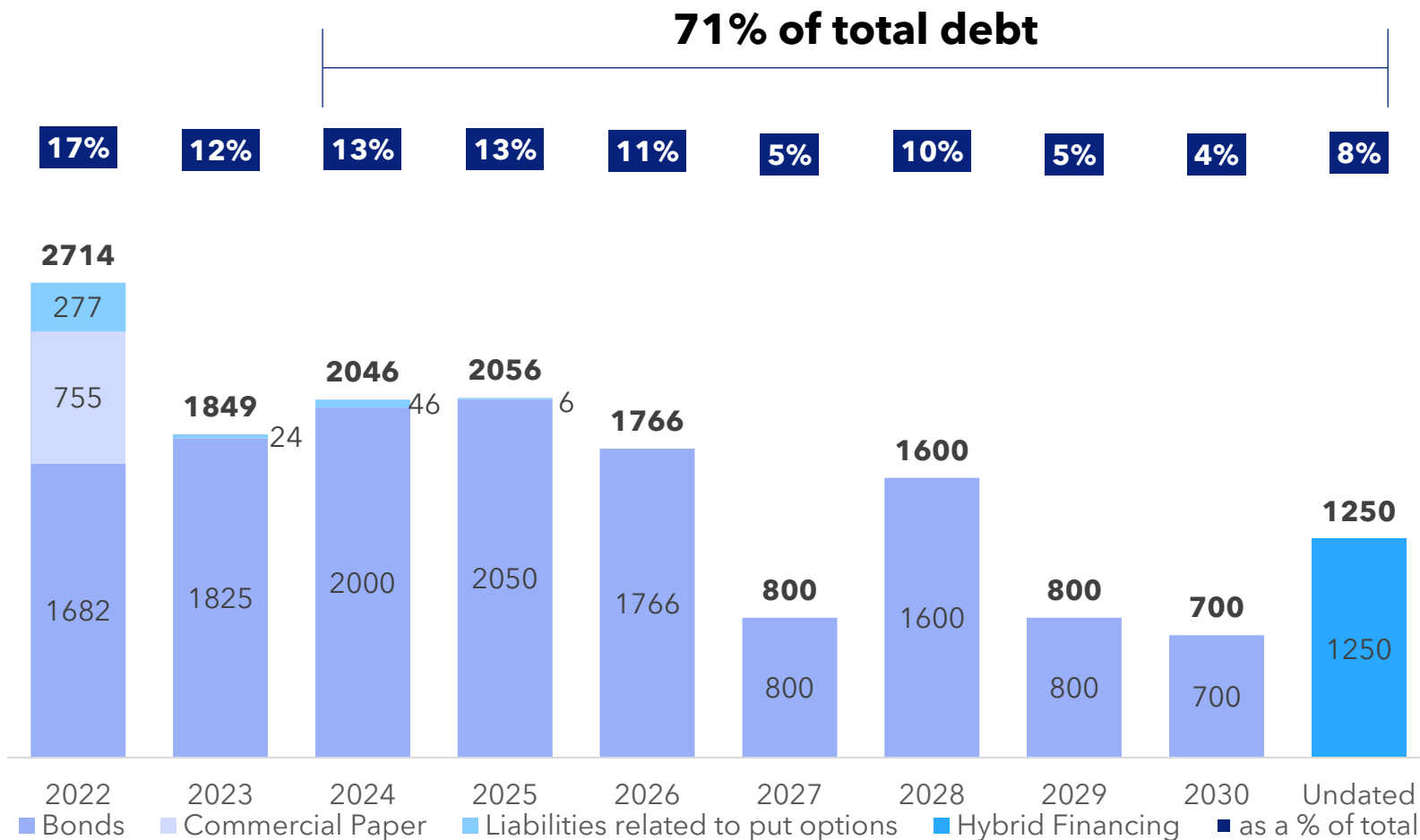
Based on the elements described above, Danone announced a new set of targets for the 2022-2024 period:

- 2022 will be a foundational year with price-led like-for-like sales growth between +3 and +5% and a recurring operating margin above 12%, assuming the reinvestment of 100% of Local First savings, a productivity higher than last year and a low to mid-teens level of input cost inflation (based on current macro-economic assumptions);
- 2023-2024 ambition, profitable growth: like-for-like sales growth between +3 and +5% with recurring operating income growing faster than like-for-like net sales;
- sustainable value creation and shareholder returns: sequential ROIC improvement over the period supported by capital allocation discipline, portfolio rotation reaching around 10% of net sales, an annual capital expenditure envelope equivalent to a maximum of 4.5% of net sales, and further improvement in working capital;
- disciplined financial policy: healthy balance sheet with targeted net debt to EBITDA ratio below 3x, and stable or growing yearly dividend.

5. Debt Schedule

EUR mn/ %

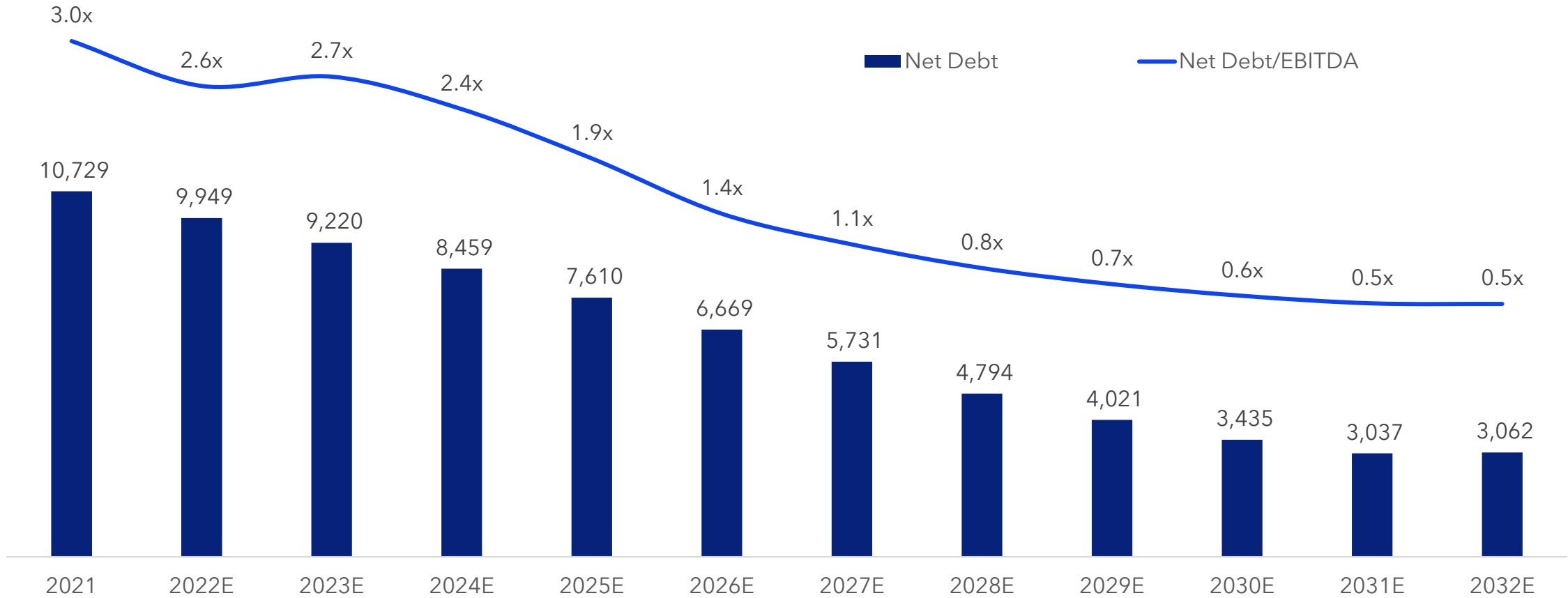
Appendix



6. Net Debt

EUR mn

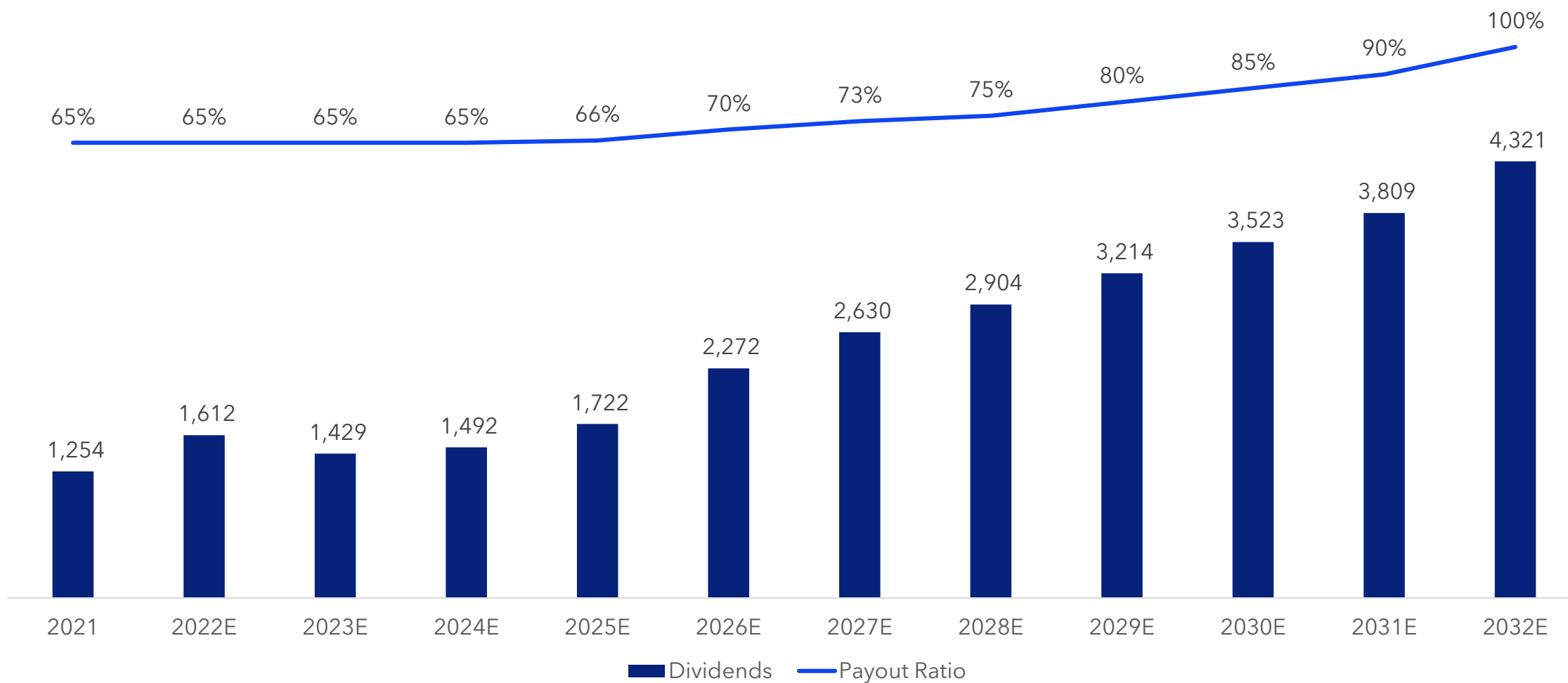
Appendix



7. Payout & Dividends

EUR mn & %

Appendix



8. Peers - Payout Ratio

Company Name	Ticker	LTM Total Dividends Paid	LTM Net Income	Payout Ratio
Danone S.A.	ENXTPA:BN	1,354	2,001	68%
Unilever PLC	LSE:ULVR	4,663	6,292	74%
Barry Callebaut AG	SWX:BARN	159	419	38%
Mondelez International, Inc.	NasdaqGS:MDLZ	1,864	4,194	44%
Colgate-Palmolive Company	NYSE:CL	1,681	2,044	82%
General Mills, Inc.	NYSE:GIS	1,245	2,707	46%
The Procter & Gamble Company	NYSE:PG	8,705	14,596	60%
Nestlé S.A.	SWX:NESN	7,979	17,560	45%

9. TIR

EUR mn; %

Appendix

TIR		UNIT	buy in	2022	2023	2024	2025	2026	2027	2028	2029	2030	2031	2032
Exit				42,925	38,046	39,717	45,278	56,344	62,542	67,214	69,738	71,942	73,456	75,000
Dividends Paid				1,612	1,429	1,492	1,722	2,272	2,630	2,904	3,214	3,523	3,809	4,321
	33.4%	2022	(33,376)	44,537										
	11.2%	2023	(33,376)	1,612	39,474									
	10.3%	2024	(33,376)	1,612	1,429	41,209								
	12.1%	2025	(33,376)	1,612	1,429	1,492	47,000							
	15.2%	2026	(33,376)	1,612	1,429	1,492	1,722	58,617						
	15.2%	2027	(33,376)	1,612	1,429	1,492	1,722	2,272	65,172					
	14.8%	2028	(33,376)	1,612	1,429	1,492	1,722	2,272	2,630	70,118				
	14.1%	2029	(33,376)	1,612	1,429	1,492	1,722	2,272	2,630	2,904	72,952			
	13.6%	2030	(33,376)	1,612	1,429	1,492	1,722	2,272	2,630	2,904	3,214	75,466		
	13.1%	2031	(33,376)	1,612	1,429	1,492	1,722	2,272	2,630	2,904	3,214	3,523	77,265	
	12.7%	2032	(33,376)	1,612	1,429	1,492	1,722	2,272	2,630	2,904	3,214	3,523	3,809	79,321