



DANONE
ONE PLANET . ONE HEALTH



Órion Partners | LTS Challenge

Miguel Figueiras ♦ Rubens Ortega ♦ Victor Bertoldi

Danone's X-Ray

The company is a giant in the alimentary sector but has had a very bad performance in the last 5 years



A **century-old company** that operates in three segments with a huge global market...

A quick overview of **Danone's History**

Danone's **global expansion**

Renew Danone is introduced



Isaac Carasso began to sell "Danone" yogurt.

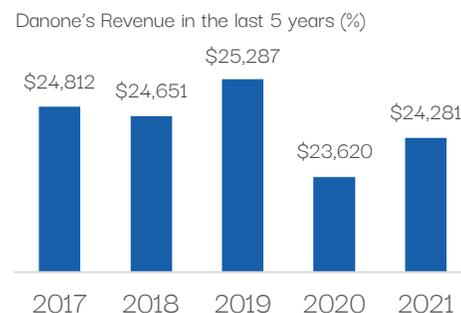
Emmanuel Faber steps up as Danone's CEO and Chairman

Revenue breakdown

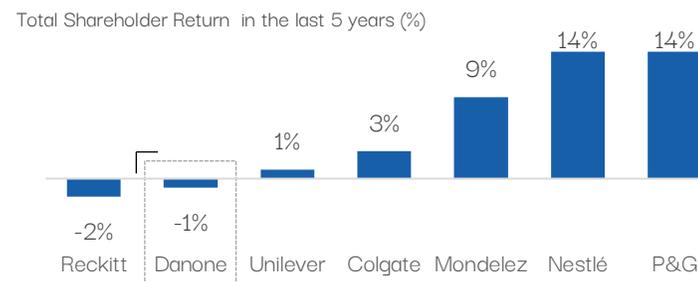


... however, it has **not been performing well** for the past five years.

The revenue **has not had a satisfactory performance** over the last 5 years.



Performance over the past few years has made the **stock's return perform poorly compared to its peers**.

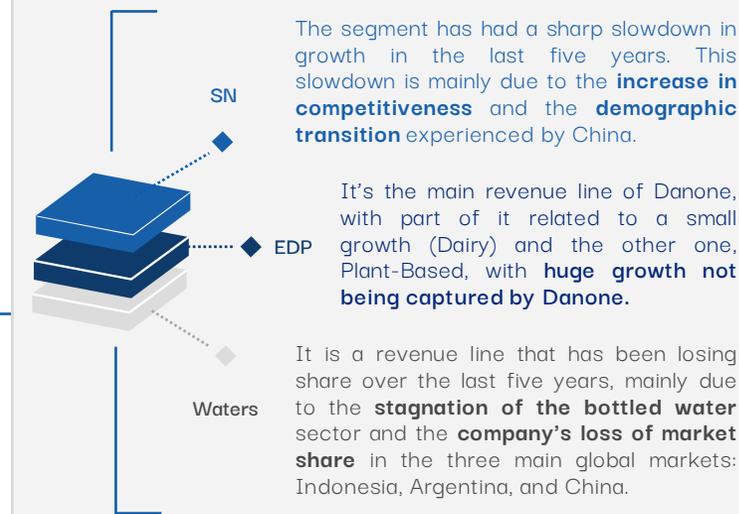


Emmanuel Faber
Ex-CEO

Under heavy pressure from **activist funds** Artisan Partners and Bluebell Capital, Faber stepped down as CEO and Chairman after an intense behind-the-scenes **political dispute**.

But why is this happening?

The first point that explains Danone's poor result is the **weak performance of the sectors** in which it is involved



In addition to structural factors, **poor management performance** also had **a strong impact** on Danone's poor results

ESG + Margin ----- **- Share - Growth**

The company's major focus since Emmanuel Faber joined has been on margin growth and ESG policy. These targets were supported by the remuneration policy adopted at Danone. In fact, the company had a growth in margins and became a world reference in ESG.

However, this accomplishment came at the expense of revenue growth and necessary reinvestments in the operation, leading to a loss in the company's market share in its main markets of operation. Hence, explaining the company's poor performance against its peers



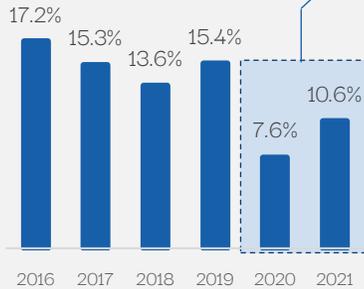
Waters: a revenue line that hasn't added much for the company

Difficulty in increasing value-added and underpenetration in the most promising markets...



The water sector **lost relevance** in the company's revenue, having a **sharp drop by the pandemic**

Water business operating profit before tax (%)



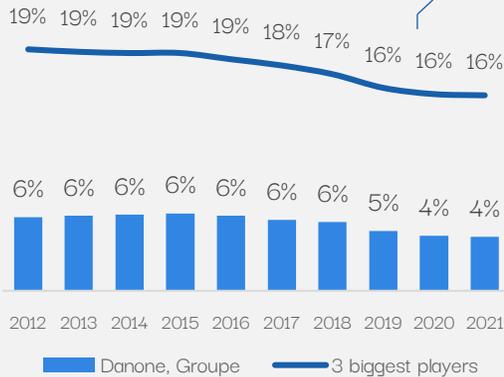
A huge pandemic impact

In the first half of 2020, **all geographic regions posted sales declines**, which ranged between 20% and 40%. COVID-19 expanded into new regions in the second quarter, which **reflected the full effect of out-of-home closings in Europe and other countries**.

Said Cécile Cabanis, chief financial officer, in a July 30 earnings call.

... the **lack of competitive advantages** is one of the causes, given the decreasing market share of the 3 biggest players

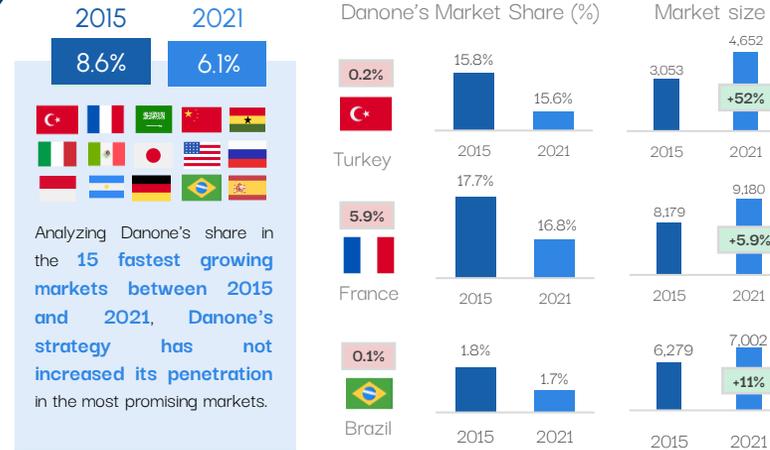
Market share (%)



Struggling market

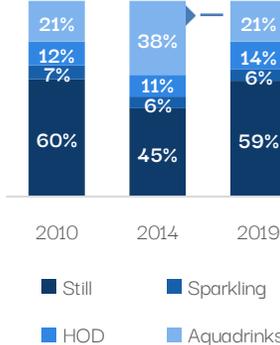
In the last 10 years, the 3 biggest players **not only did not captured market share** from another players, but also **lost market share for small players**. The lack of barriers to entry is even more evident in still water, product that represents **59% of water sales**.

... Looking deeper, Danone **failed to grow** in the **most promising markets...**



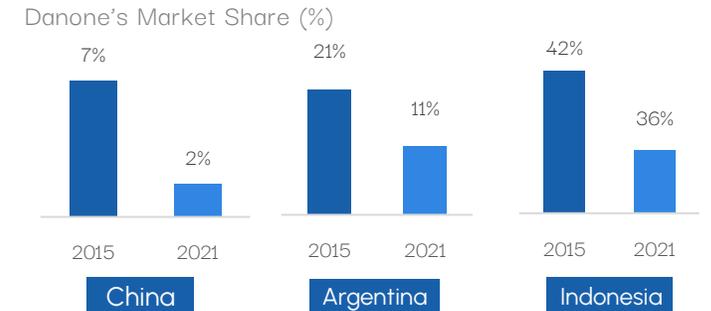
Aquadrinks, an important way to be explored...

Danone Waters sales split (%)



From 2010 to 2014 Danone managed to increase the relevance of aquadrinks in its revenue, but from 2014 onwards it did not maintain the development of this sub-sector, which has a negative impact given that it has greater added value than still water and more significant competitive advantages.

... furthermore, it has **not been performing well** for the past five years in its three biggest markets



In EMs, Danone's leading innovation and strong brands was not enough to mitigate the threat of local competition...



Danone's brands have been **losing market share to local brands** in China, Argentina and Indonesia and this has been causing the company's performance in the segment to drop.



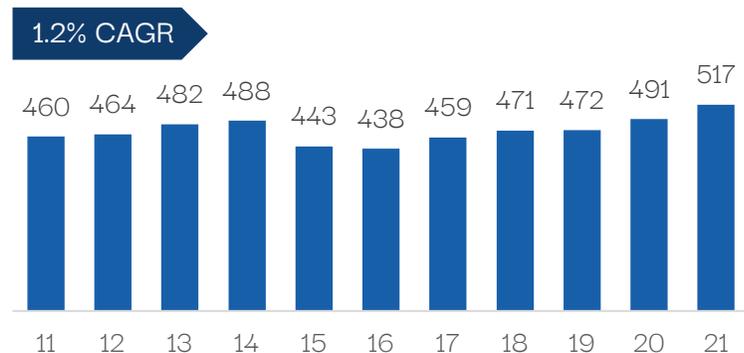
EDP: Essential Dairy and Plant-Based Products

On one hand, stagnation. On the other, promising growth not being captured



The Dairy market showed a **small growth** during the past years.

Essential Dairy Market Size (USD bn)



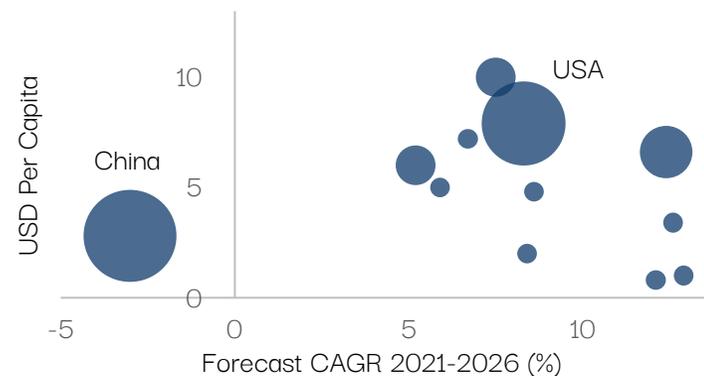
While the industry is showing a **slow consolidation**, Danone is not maintaining its share anymore.

HHI (#) and Danone's Market Share (%)



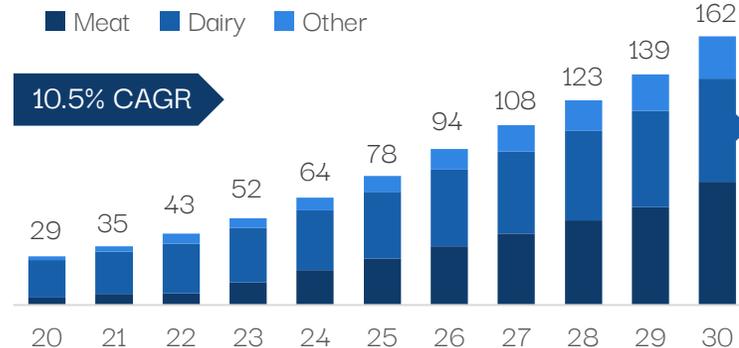
The EDP game changer should be the Plant-Based Products, that are strong mainly in USA...

Top 12 Markets by Retail Value Sales (2021)

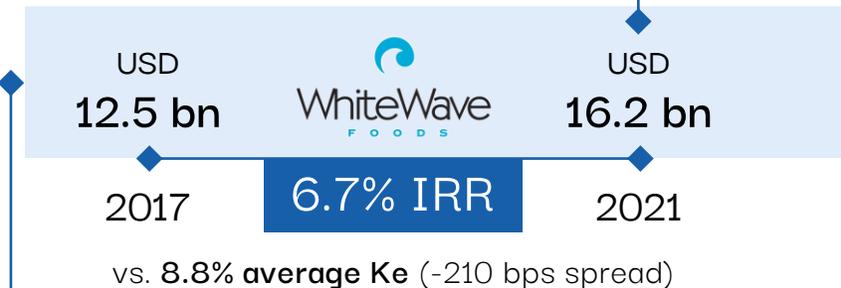


... and has expectations to **grow at a fast pace** in the next decade...

Plant-Based Products Market Size (USD bn)

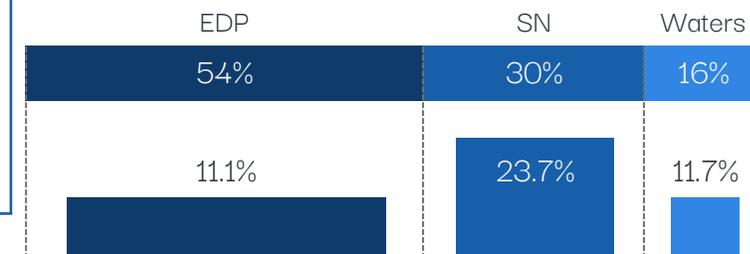


To reinforce its position, Danone bought WhiteWave, and **we valued it in 2021**, reaching...



WhiteWave has also caused a **drop in Danone's margins** in the segment, that was naturally lower than the other revenue lines

Danone's Sales Breakdown by Segment



Danone's Operating Margins by Segment (2017)

WhiteWave's operating margin was **10.4%** at the time, in a segment that should have higher margins than Dairy.

Specialized Nutrition segment

Drop in performance mainly due to increased competitiveness and the Chinese demographic transition

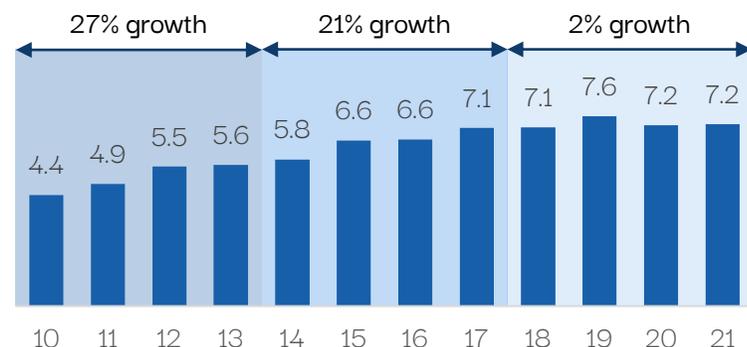


A **quick overview** of the Specialized Nutrition segment...

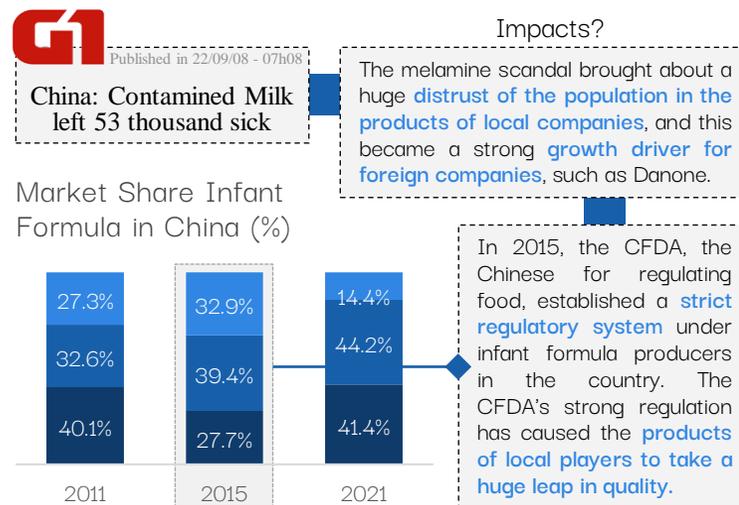


The segment's growth was **considerably lower** than at the beginning of the decade. **But why's that?**

Specialized Nutrition Revenue (USD mn)

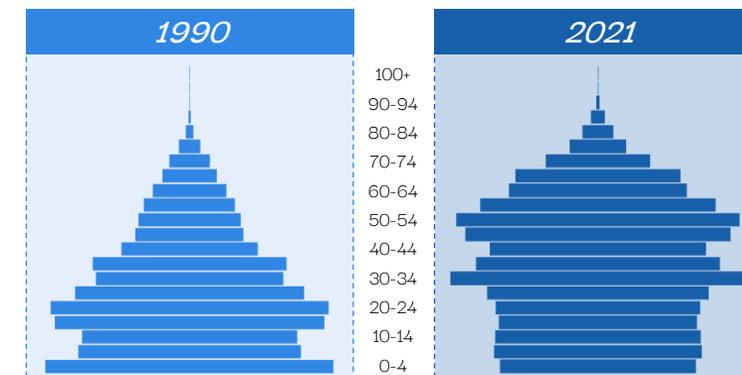


After a decade of the melamine scandal, **local players** are once again **sharpening competition** in the industry



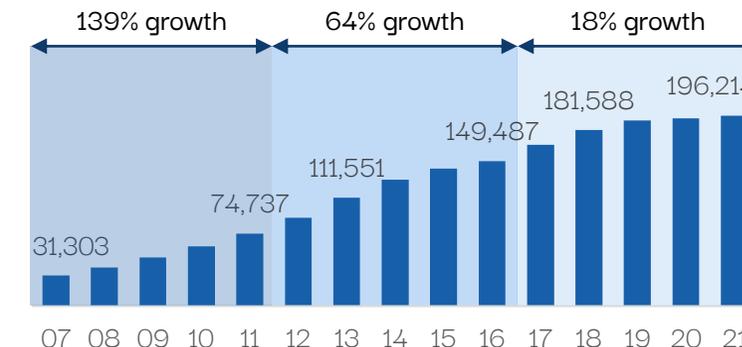
In addition to increasing competition, China has also been going through **a demographic transition...**

China's demographic distribution 1990



And this transition is slowing the growth of the sector, thus **hurting Danone's growth**

Baby food Market Size in China (CNY mi)



Market Share in China 2021 (%)



Main conclusion

With the **increase in quality**, there has been a regaining of the **population's confidence** in infant milk from local producers. This was a **strong driver for local players** to have a good result with substantial gain of share, thus **slowing the good performance** of foreign companies such as **Danone.**

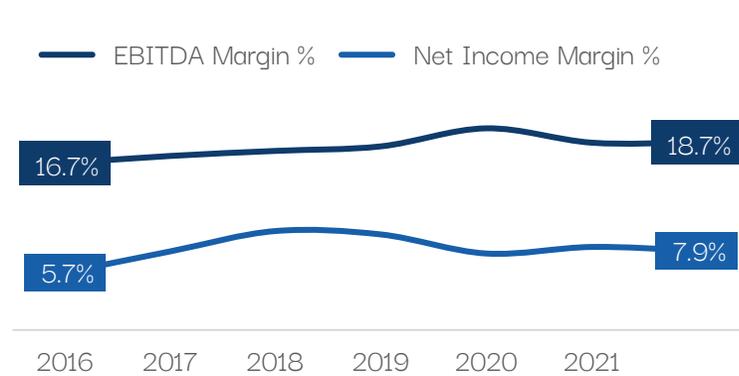
In the wrong hands

Prioritization of margins and ESG over growth and market share resulted in poor performance

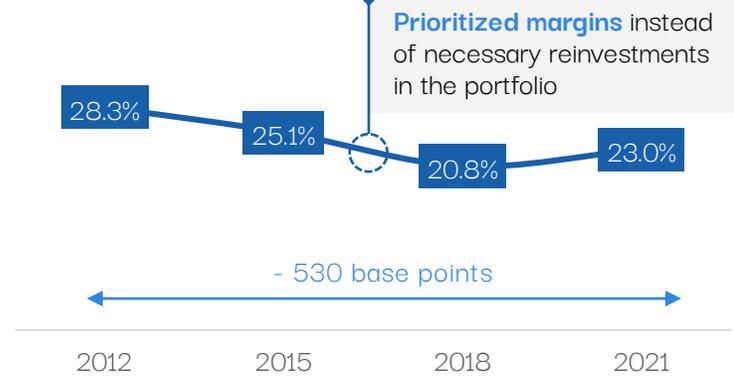


The management prioritized margins and ESG and, with the lack of investments, obtained a poor performance.

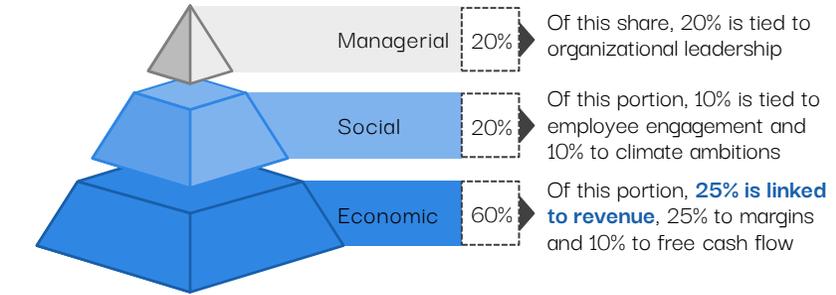
Margins evolution (%)



Capex/EBITDA (%)



This was mainly due to the inadequate compensation structure of the management

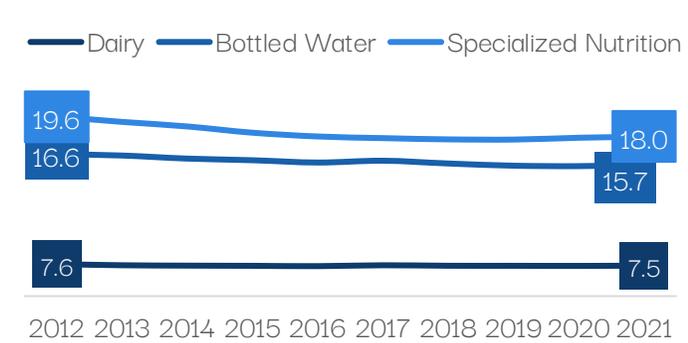


DANONE Last 5 years
Margin ESG
 The achievement of the margin and ESG targets came at the expense of the necessary investment in CAPEX, thus causing poor performance in the last 5 years with loss of market share in the main segments.



ESG Focus
 Danone has made the ESG issue a priority since Faber joined. It has been able to achieve several international certifications and in 2020 adopted the "Société à Mission" status created by the French "Pacte" law in 2019.

Danone's Global Market Share per segment (%)



Performance

Since Faber's entry, the growth target has never been fully achieved. On the other hand, the social and management results have exceeded the target in every year. In addition, in only one year (2021) were the margin targets not met.

Impacts

In addition to structural problems in each segment and execution errors, inadequate management incentives were also responsible for Danone's poor performance relative to its peers over the last 5 years.



“ The company suffered from a lack of product innovation, underinvestment in brand marketing and poor capital allocation. ”

David Samra, Portfolio Manager of Artisan

Artisan Quarterly commentary, 31/03/2021