Who Won the Danone Boycott? (C)

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The Financial Community Questions Management

Following the positive statements made by Danone management throughout the crisis, market analysts were taken by surprise late in July when preliminary first-half 2001 results showed that Danone's like-for-like growth in France had fallen to 0.8% from 6.3% the previous year. As recently as May, analysts at Morgan Stanley Dean Witter (MSDW) had assured investors that "concerns about significant disruptions in biscuit operations are now receding", but on 25 July the same analysts traced the "marked slowdown" in sales to further "disruptions caused by biscuit restructuring".

Simultaneously, analysts began to express doubts about how Danone had achieved its apparent victory over the protest movement, as in this report from Crédit Suisse First Boston (CSFB) early in August 2001:

> *"[Danone] has negotiated a very tricky six months with a set of results that have met expectations and are consistent with its medium-term revenue and margin growth plans. We do not entirely understand the manner in which it has done so, however; nor are we convinced that Danone's business model [is] functioning in the manner to which we have become accustomed [and] we do not believe that Danone has resolved its [operational difficulties] in French biscuits. Nor do we fully understand the dynamic of Danone's gross and operating cost base over the last six months."*[1]

Danone Acknowledges the Movement's Impact

In an interview with the French newspaper *Le Monde* published on 24 October 2001, the company's HR director Jean-René Buisson acknowledged the substantial impact of the boycott and labor strife for the first time. Buisson confirmed that the boycott had knocked 10% off sales of the firm's fresh products in France for several weeks in the spring – as reported in the press at the time before CEO Franck Riboud denied the "rumors."[2] Buisson further admitted that labor unrest at the Evry plant had "disorganized" production through July, costing the firm "more than 50 million francs", (about 8 million euros). He added that "Consumption of our biscuits has been at its normal level since September," implying that the boycott and labor conflict had depressed sales for most of the year. Lastly, he promised that Danone would close no other plants in France.[3]

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1 James Edwards Jones et. al., "Is it all eau-ver?" Credit Suisse First Boston equity research, 2 August 2001.
2 See Who Won the Danone Boycott? Case A and B.
3 Belot Laure, "Nous ne fermerons pas d'autres usines en France dans les années qui viennent", Le Monde, 24 October 2001.

The overall tone of media reaction to Danone's admissions, and to the wider protest movement, was captured in an article that ran in the daily newspaper *Le Figaro*, one year after the affair began:

> *"In this battle Danone lost its image of a socially responsible enterprise and is working to regain it. On the other hand, the impact of the boycott and the social crisis on the company's results was minimal. Despite a lowering of sales in April [2001], objectives for 2001 were met. Danone would survive[.]"*[4]

Market Analysts React to Management's Admissions

By the fall of 2001 Danone was encountering various managerial challenges in Argentina and China, and further problems with integrating plants acquired from United Biscuits in Scandinavia. In the US, its strategy for expansion in bottled water, one of the firm's most promising markets, met new and heightened competition. Before long, the New Economy stock meltdown, corporate scandals such as Enron, and the September 11th attack on the World Trade Center induced a new pessimism and skepticism in analysts' assessments. In this context the ongoing labor disruption in Danone's French biscuit plants and its negative impact on sales growth took on new significance.

For example, ING Barings analyst François Digard rated Danone stock "buy" on 9 October 2001, arguing that sales slowdowns during the boycott would be overcome once Danone resumed advertising and promotion. Two days later he changed course and lowered his rating to "hold", noting that just-released data showed that, among other issues, "French activities (sales down 4%) have been hit by production glitches linked to restructuring." On 16 November, following the release of further "disappointing" figures from Danone, he recommended that investors sell the stock in favor of its competitor Nestlé, headlining that investment in Danone was now "dead money".[5]

Numerous other analysts cited the labor conflict as a prime contributor to Danone's difficulties and dismissed management assurances that the worst was over, downgrading Danone stock as follows:

- At Deutsche Bank, analysts dropped Danone's rating to "underperform" in November, warning that "We see a high probability that restructuring charges will rise."[6]
- In rating Danone stock "reduce", analysts at UBS Warburg cautioned that "There has to be a risk of further [labor] disruption."[7]

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4 Jean-François Arnaud, "L'affaire Lu, douze mois dans les coulisses d'un plan social", Le Figaro, 7 January 2002, p. 1+.

5 François Digard, "Danone", ING Barings, 9 and 11 October and 16 November 2001.

6 John Parker, "Danone", Deutsche Bank, 24 January, 31 May, 7 July and 21 November 2001.

- In October 2001, MSDW analysts Massot and Quiroga dropped their rating two steps to "neutral" and pointedly added, "The company [now] admits that it suffered from supply chain disruptions."[8]
- Analysts at Société Générale referred to "bad surprises" in the biscuit division, lowering their rating from "buy" in April – when they had argued "We do not believe that the consumer boycott will be significant," – to "hold" in October.[9]
- At Wargny, a Paris brokerage house, analyst Pierre Tegner's November report on Danone was scathingly ironic:

  "The return [to growth] that the company let us understand [was coming] in July didn't happen in the third quarter. Moreover, the negative impact of the restructuring on sales is incontestable. These counter-performances are surprising, coming after the reassuring discourse of the company[.]"[10]

As the winter progressed, analysts repeatedly complained that management was not fully informing them. In a report headlined "A Plea for Clarity" on 18 February 2002, Crédit Suisse First Boston analysts warned that "An improvement in visibility is likely to be a precondition of a re-rating for Danone's stock." In February 2002, MSDW's analysts referred to the "limited visibility" of Danone's operations three times in explaining why they maintained a neutral rating on the stock.[11] As late as October 2002 they continued to question the "execution of restructuring and acquisitions at Danone".[12] Some of Danone's supporters during the crisis were now among its most severe critics.

The chart below shows movements in Danone's stock price from 1 January 2001, before the crisis began, through the end of 2002, in comparison to Nestlé, its leading rival in the sector (with prices for each firm shown as a percentage of their share prices in January 2001). The chart indicates that by September 2002 Danone's market capitalization had declined by over 20%. Nestlé's stock, while following a similar curve, performed slightly better through the end of 2002.

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7 Alan Erskine et. Al., "Danone", UBS Warburg, 19 October 2001.

8 Sylvain Massot and Eva Quiroga, "Danone: Valuation leaves little room for disappointment", Morgan Stanley Dean Witter, 11 October 2001.

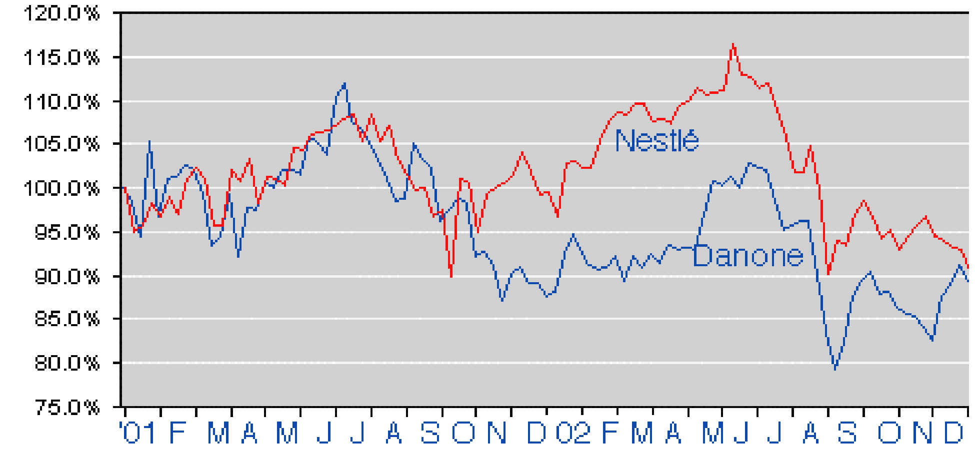
9 Joseline Gaudino and Sandrine Le Guennec, "A Good Q1", April 2001, and "Une machine légèrement enrayée à court terme", 11 October 2001, Société Générale.

10 "Danone: Une croissance sous tension", Société de Bourse Wargny, October 2001.

11 Sylvain Massot and Eva Quiroga, "Danone: No Surprises in 2001, But It Is 2002 That Really Counts", Morgan Stanley Dean Witter, 19 February 2002.

12 Sylvain Massot, "Danone: Organic Growth to reach 5.6%", Morgan Stanley Equity Research, 11 October 2002.

Danone and Nestlé: share price movements, Jan. 2001 - Dec. 2002



EUR Millions Source: Datastream

Epilogue

In its annual report for 2003, Danone declared that the restructuring that had engendered the conflict of 2001 was “well on its way to completion”. The firm had reduced the number of employees worldwide in the biscuit division by 20%, from over 30,000 in 2001 to just under 24,000 in 2003. In France 36% of the employees affected by the biscuit restructuring had accepted other jobs proposed by the firm, 20% had accepted early retirement, and 37% had found new jobs outside the group; thus nearly all had benefited from the firm’s social measures. Danone also carried through some redevelopment plans, such as building a call center that provided some 500 jobs at the site of its closed biscuit plant in Calais.[13] In Hungary, government pressure forced Danone to cancel its plans to close the factory in Gyorki. Instead, the company invested €3 million in modernizing the plant and created 120 jobs while cutting 320.[14]

However, group biscuit sales declined – from €3.4 billion in 2001 to €3.2 billion in 2002, and again to just under €3.1 billion in 2003.[15] The chief reason, said management, was that sales fell “across the board” of biscuit products in France, which accounted for nearly 40% of all Danone’s biscuit sales. Nonetheless, said

13 Annual Report 2003, p. 45

14 Florence La Bruyère, “Les petits Lus hongrois font plier Danone”, Libération, 30 October 2001.

15 Annual Report 2003, p. 42.

management, Lu remained France's most popular biscuit brand with a national market share of 34%.[16]

In 2003 Danone's stock remained depressed compared to its pre-crisis levels (occupying a range of 80% to 90% of its price at the beginning of January 2001), in large part because of continuing difficulties in the US water market. To some observers Danone now appeared under-valued. Until the summer of 2005, when the French government announced that it would strongly oppose any hostile attempt to acquire Danone, the firm was repeatedly rumored to be a target for predators.

[16] Annual Report 2003, p. 45.

Appendix 1:

GROUPE DANONE, FINANCIAL HIGHLIGHTS 2000-2001

(Source : Groupe Danone Annual Report, 2001)

(%)	2000	2001	Change
Net sales (€ Million)	14,287	14,470	+5.1%
Operating income	1,550	1,609	+9.8%
Operating margin	10.8%	11.1%	+27 bp
Net income (excl. one-time provisions)	720	780	+8.3%
Exceptional items (after tax)	1	(648)	
Net income(excluding minorities)	721	132	
Cash flow from operations	1,558	1,611	
Capital expenditure	798	737	
Investment in subsidiaries and affiliates	2,849	1,071	
Net earnings per share (€, diluted) (excluding exceptional one-time provisions)	5.09	5.51	+ 8.3 %
Net dividend per share (€)	1.90	2.06	+ 8.4 %
Return on capital invested	9.0%	9.3%	

SALES AND OPERATING MARGIN OVER FIVE YEARS

	1997	1998	1999	2000	2001
Sales (In € Million)	13,488	12,935	13,293	14,287	14,470
Change:					
• published	+5.4%	(4.1%)	+2.8%	+7.5%	+1.3%
• like for like	+2.3%	+4.6%	+5.7%	+7.0%	+5.1%
Operating margin	9.1%	10.0%	10.5%	10.8%	11.1%

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