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July 8, 2015

Gabelli & Company

Health and Wellness Focus:

The Global Yogurt Industry

China Mengniu Dairy	(2319	–	HKD 36.70	–	HK)
Danone	(BN	–	€57.50	–	FR)
General Mills	(GIS	–	$57.89	–	NYSE)
Lifeway Foods	(LWAY	–	19.12	–	NASDAQ)
Nestlé	(NESN	–	CHF 68.60	–	SW)
Parmalat	(PLT	–	€2.34	–	MI)
Yakult Honsha	(2267	–	¥7350.00	–	TO)
Chobani	(Private)				
Fage	(")				
Müller	(")				

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Health and Wellness Focus: *The Global Yogurt Industry*

AN $83 BILLION GLOBAL MARKET – GROWING 8% PER YEAR

On October 12, 2011, we published a report on the global yogurt industry identifying it as an advantaged product category that was benefitting from several evolving consumer trends including: increasing demand for convenient, affordable and functional foods, a greater consumer focus on healthy ingredients, and the emergence of higher-value category segments, most notably Greek yogurt. In the years since, annual retail sales of yogurt have grown by $18 billion, from $65 billion in 2010 to $83 billion in 2014.

Despite this growth, per capita consumption of yogurt in large, high-potential markets such as the US and China remains meaningfully lower than in the Western European countries that have long-served as yogurt's core markets. In addition, yogurt is well-positioned to benefit from several newer consumer trends including growing demand for high-protein foods, particularly those suited for snacking, and increased shopping on the "fresh perimeter" in retailers. Over the next five years, the global yogurt market is expected to grow at an 8% CAGR, and eclipse $120 billion by 2019. We continue to believe that yogurt is a compelling investment theme, and that publicly traded yogurt manufacturers such as Danone, General Mills, and Yakult stand to benefit from the category's strength.

Table 1 **The Global Yogurt Industry**

(Value: $ in Billions | Volume: Tons in Millions)	**2010A**	**2014A**	**2019E**	*2010-14 CAGR*	*2014-19 CAGR*
Retail Value	$ 65	$ 83	$ 122	*6.3%*	*8.0%*
Volume	30	36		*5.1*	
Avg $/ton	*$ 2,203*	*$ 2,306*		*1.1*	

Source: Euromonitor (from General Mills and Parmalat company filings), Gabelli & Company estimates

YOGURT OVERVIEW

Yogurt is a dairy product that is produced when live bacteria is added to liquid milk and allowed to ferment. The active cultures consume the milk's lactose (sugar) and produce lactic acid, which serves as a thickening agent and as a natural preservative, reducing its perishability. Nuances in the production process and the addition of supplemental ingredients can alter the yogurt's taste, viscosity, and nutritional profile, engendering a wide variety of finished products from a relatively basic set of inputs.

Yogurt is thought to be one of the first processed foods in human history, tracing its origins to the Neolithic era when milk stored in animal skin containers spontaneously reacted to ambient bacteria. Industrial production of yogurt, however, did not become prevalent until the 20th century when a Spanish doctor named Isaac Carasso created a scalable industrial fermentation process and founded the company that would become the modern day global market leader, Danone. Today, yogurt and fermented milks are a sizeable and notably high-value subset of the 225 million ton, $460 billion global dairy market accounting for 16% of the market's volume, and almost 20% of its value.

DRIVERS OF GROWTH - HEALTH AND WELLNESS

Originally marketed as a treatment for digestive ailments, yogurt has long been associated with health and wellness. It contains probiotics (good bacteria), and is also highly nutritious: rich in protein, calcium, and vitamins and minerals. Additionally, yogurt is a fresh product that can be manufactured from a small number of minimally processed natural ingredients. These characteristics position yogurt to capitalize on the recently expanding consumer demand for healthier food, and specifically on the ballooning demand for protein-rich fresh foods that have simple and easy to understand ingredient labels.

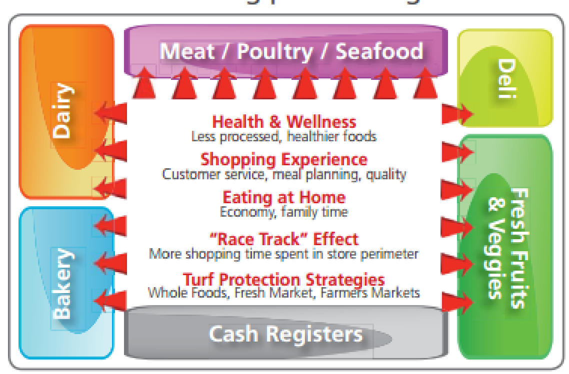
- **Probiotics –** Probiotics have been defined by the Food and Agriculture Organization of the United Nations (FAO) as "live microorganisms which when administered in adequate amounts confer a health benefit on the host." Over the years, a number of health benefits (supported by varying degrees of scientific research) have been associated with probiotics including: better digestive health, a strengthened immune system, increased lactose tolerance, and reduced occurrence of diseases ranging from the common cold to cancer. While active bacteria "starter" cultures such as *Lactobacillus bulgaricus* and *Streptococcus thermophiles* play an important role in the manufacturing of virtually all yogurts, not all finished yogurt products contain meaningful concentrations of live cultures, and health benefits can vary widely by strain.

  Euromonitor estimates that about one-third of manufactured yogurts are marketed as probiotic, and global sales of probiotic yogurts and supplements are estimated to be in excess of $30 billion, which are expected to grow faster than the overall yogurt market and reach $50 billion over the next five years. Such products, such as Yakult's namesake drinkable yogurt, often contain proprietary bacterial strains that can serve as both barriers to entry and points of differentiation. That said, the ability to make probiotic health claims varies widely by market and, in recent years, has been the subject of regulatory scrutiny, particularly in the European Union, where the ability to cite health benefits in product marketing was effectively banned. In other markets, notably Asia and Latin America, probiotic derived health benefits remain a key selling point for many brands.

- **Protein –** FAO data suggests that dairy products account for ~10% of global protein consumption. Protein is an essential nutrient that provides energy, satiety and promotes muscle-growth. Yogurt is a protein-rich food, with most traditional yogurts supplying about one gram of protein per ounce, and strained/Greek yogurts containing two to three grams of protein per ounce. According to the NPD Group the percentage of US adults that consider protein content on nutrition labels increased from 18% in 2004 to 25% in 2013, and according to Kraft, 75% of adults in the US are adding more protein to their diets. Protein content has become one of the core labeling and marketing messages for yogurt, particularly in the United States, and is believed to be a key driver of yogurt category growth.

- **The Fresh Perimeter –** While the center of the store accounts for 73% of grocery dollars spent, for several years, food and beverage manufacturers and retailers have highlighted a shift in consumer focus and spending away from the center of the store towards the perimeter where, according to Acosta and Kraft Foods consumers spend 38% of their shopping time (vs. 18% center store, and 44% in navigation/checkout). Stalwart center-store categories such as ready to eat cereal, canned soup, and frozen entrees have experienced multi-year declines, while fresh categories such as yogurt, produce and animal protein have grown strongly.

Factors driving perimeter growth



Source: Acosta

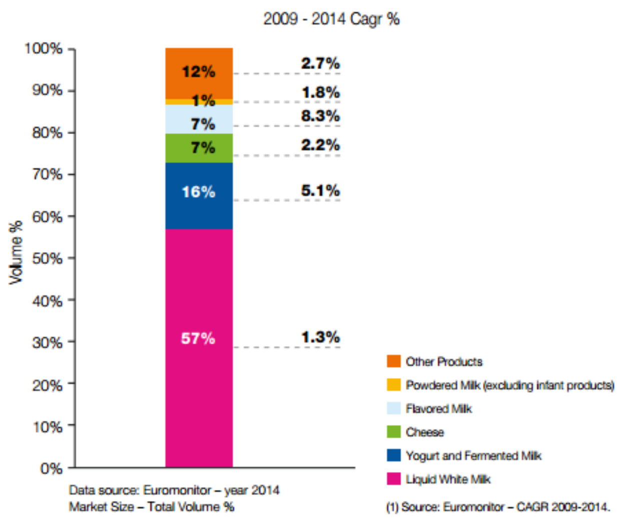
- **Clean-Label Snacking –** Over the past several years consumers have been increasingly forgoing traditional "three-meals a day" eating in favor of more frequent smaller meals and snacks. According to the Snack Food Association, fewer than 40% of Americans were regularly eating three meals per day in 2015, compared to 66% in 2010, and more than one-half of Americans were eating three or more snacks per day versus only 21% in 2010. As a pre-portioned, nutrient rich food that requires no preparation or cooking, yogurt aligns well with this trend.

  At the same time, consumers are increasingly demanding simpler food with fewer, easier to understand ingredients. Major food producers such as Nestlé, Kraft, and General Mills have announced sweeping initiatives to remove artificial colors and flavors from their products, and specialized ingredient companies are seeing strong rapid growth in their natural businesses. While some yogurts do have artificial ingredients, particularly more indulgent flavored varieties, most have relatively simple labels consisting of milk, active bacteria, and fruit, making them good options for consumers seeking clean labels.

INDUSTRY OVERVIEW

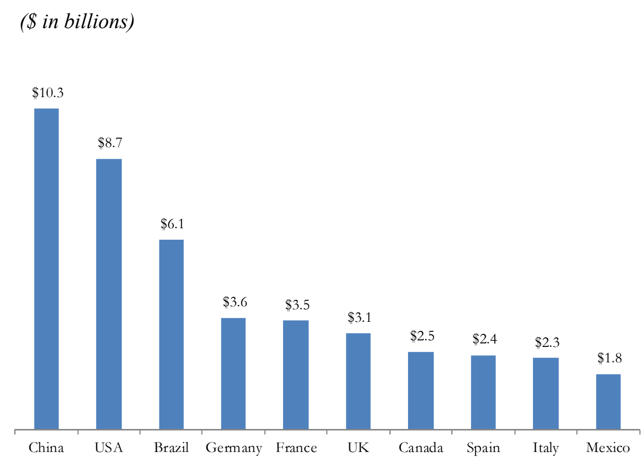
According to Euromonitor, global consumers purchased 220 million tons of processed dairy products in 2014 valued at about $460 billion. Liquid white milk accounted for the majority (57%) of the category's volume, but yogurt and fermented milk represented the next largest subset (16%). Retail sales of yogurt are estimated to be approximately $83 billion, or about 20% of the overall dairy market. The top-ten yogurt markets account for over one-half of worldwide retail sales, and the top-three markets China, the US, and Brazil account for ~30%.

Exhibit 1 Global Dairy Categories by Volume



Source: Euromonitor (from Parmalat)

Exhibit 2 Top 10-Yogurt Markets by Retail Sales

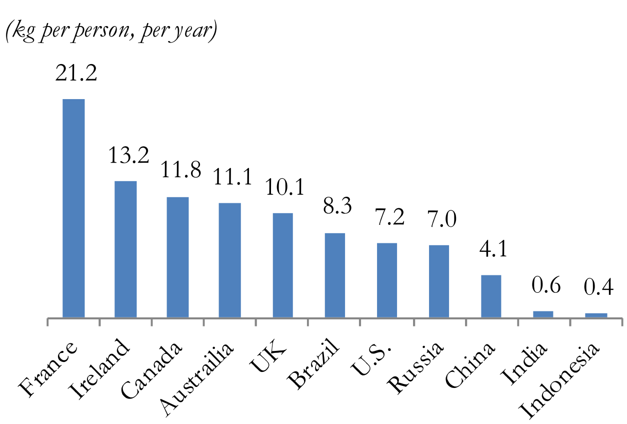


Source: Euromonitor (from AAFC)

PER CAPITA CONSUMPTION

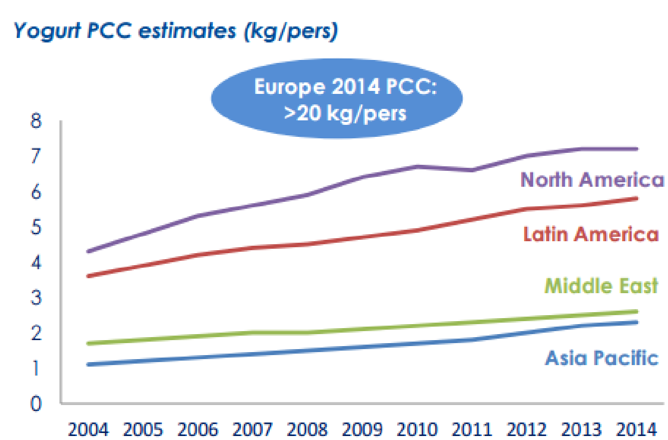
While FAO data suggests that overall dairy consumption is becoming increasingly ubiquitous on a global basis, per capita yogurt consumption continues to vary widely across markets. In the highly developed yogurt markets of Western Europe, such as Germany and France, consumers eat in excess of 20kg of yogurt per year, and nearly 60% of consumers report eating yogurt every day. In contrast, in some of the largest Yogurt markets such as the US ($8.7 billion yogurt market) and China ($10 billion yogurt market) per capita consumption is significantly lower – 7kg in the case of the US, and only 4kg in China – with only 20% of US consumers and fewer than 7% of Chinese consumers eating yogurt every day.

Exhibit 3 Per Capita Consumption Select Markets



Source: Euromonitor (from General Mills)

Exhibit 4 Per Capita Consumption Growth by Region



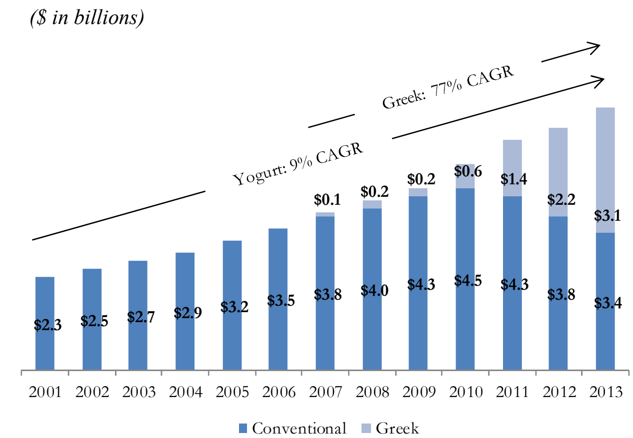
Source: Euromonitor (from Danone)

Over the past several years, these markets have outpaced the overall yogurt market with the US growing at a 9% CAGR and China growing double digits, growth rates that are expected to continue. Further, in markets such as India, Southeast Asia and Africa, where the comprehensive refrigerated distribution is still developing and cooler proliferation at the point of sale is limited, per capita yogurt consumption barely registers, despite large populations and growing dairy consumption, suggesting a healthy long-term opportunity for yogurt.

MARKET FOCUS – THE UNITED STATES

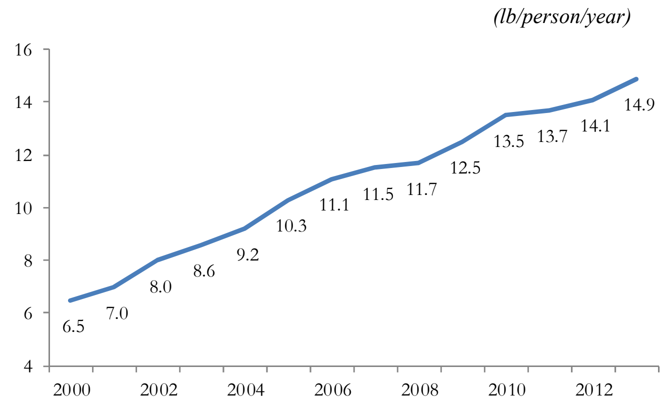
Between 2001 and 2013, the sales of yogurt in US measured channels more than tripled from $2.3 billion to $7.5 billion. Over the same period, US per capita consumption of yogurt has increased from about 7lb per person per year to nearly 15lbs. In recent years, this growth can be attributed to the massive expansion of Greek yogurt, which grew from a virtually non-existent niche sub-category to nearly 50% of the overall market between 2007 and 2013.

Exhibit 5 US Yogurt Market Growth Measured Channels 2001-2013



Source: Chobani

Exhibit 6 US Yogurt Consumption Per Capita



Source: USDA

Greek yogurt's fermentation process is similar to traditional yogurt, but it is manufactured from larger quantities of milk (~3x) and then strained so as to separate and exclude the (mostly water) liquid whey. This process results in a more filling, significantly thicker yogurt with higher protein content per ounce. Owing to greater raw material costs, Greek yogurts typically sell at higher price points than traditional varieties ($1.00-2.00 a cup vs. $0.50-1.00).

Greek-style yogurts have been sold commercially sold in United States for many years – Greek dairy company Fage began importing yogurt into the United States in 1998 – but it was not until the 2007-8 introduction of Chobani that that the products gained significant traction with consumers. Chobani grew rapidly, from start-up to ~$1 billion of sales in less than seven years, taking substantial share from the long-established US yogurt market leaders, Danone and General Mills.

Table 2 Current US Yogurt Market Share

	Total Yogurt	Greek
Danone	33%	33%
General Mills	25	11
Chobani	16	33
Fage	5	11
Other/Private Label	21	12

Source: Danone, General Mills, Fage, Gabelli & Company estimates.

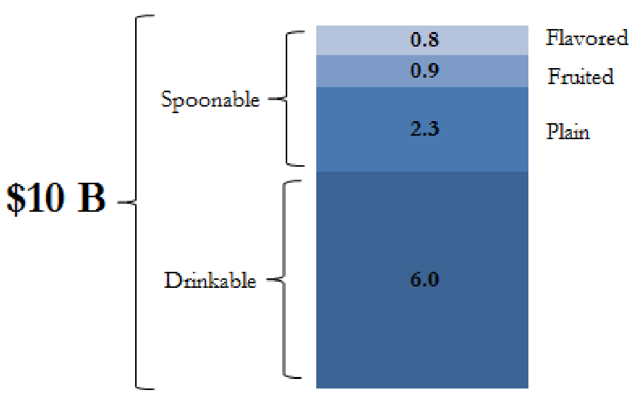
Today Chobani holds ~15% share of the overall US yogurt market, but has seen its dominant share (once as high as 50%) in Greek erode as established players built capacity and competing brands such as Danone's Oikos, which is now roughly the same size as Chobani, and General Mills' Yoplait Greek, which is growing substantially ahead of the overall category. The market's expansion has also prompted new entrants from both branded competitors, such as PepsiCo (in a JV with Müller) and private label. With increased competition, category pricing has been more competitive, and overall market growth has slowed to mid-single digits as a result. That said, producers remain optimistic about the opportunity for continued US per capita consumption growth, and are marketing new innovations to target untapped demographics and segments including: male consumers (protein, satiety), children (health and wellness) and non-breakfast occasions (snacking, indulgence).

MARKET FOCUS – CHINA

With more middle class consumers spending on higher-quality foods and beverages, China's dairy industry is expected to more than double to $70 billion by 2017, according to Euromonitor. Yogurt is one of the fastest growing segments of the market, and with $10 billion of yogurt sales, China is already the world's largest market by value. Yet with per capita yogurt consumption less than 20% that of top Western European markets, the potential for further development is vast, drawing manufacturers to invest to meet rapidly expanding demand. Further, yogurt prices relative to fresh milk in China are substantially below most established yogurt markets, suggesting a significant opportunity to grow the market's value through premiumization.

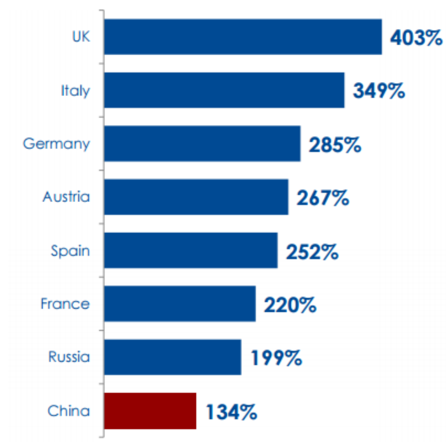
Exhibit 7 China Yogurt Market

($ in billions)



Source: Euromonitor (General Mills)

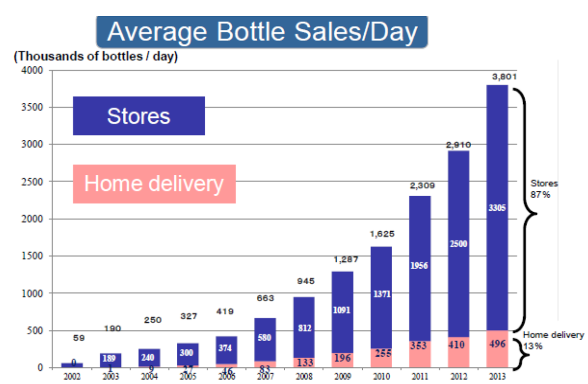
Exhibit 8 China Yogurt/Milk Price Index



Source: Danone

Both foreign and domestic, companies have been successful selling Chinese consumers on yogurt's general health and wellness proposition as well as the benefits of probiotics. China Mengniu Dairy, the #1 Chinese yogurt manufacturer with $1.2 billion of yogurt sales and over 20% market share, has grown its yogurt business nearly 65% over the past two years. Yakult, the global leader in drinkable, probiotic yogurt has been selling product in the Chinese market for over ten years with volumes expanding at a 35% CAGR. The company now sells over 4 million bottles of its namesake product per day in China, which accounts for 15% of its international volumes, despite only reaching about one-third of the population. Yakult expects its growth to continue, and recently invested in two new manufacturing plants providing the capacity to more than double its business.

Exhibit 9 Yakult China Volume Growth



Source: Yakult

While over 60% of the Chinese market yogurt market is sold in drinkable form today, future growth is also expected from more traditional spoonable products where global market leaders such as Danone and General Mills (Yoplait) have core competency. Both companies have made investments in China over the past few years to capitalize on the emerging market opportunity.

In 2013, Danone entered into a joint venture with China Mengniu Dairy, investing over €800 million for a 20% stake in the JV and a 9.9% indirect stake in Mengniu itself, establishing Danone as its second-largest shareholder behind the Chinese government. The JV, which currently has sales in excess of €500 million, will leverage Danone's brands, manufacturing know-how, and leadership in concert with Mengniu's significant distribution and raw material sourcing capabilities. General Mills has similarly built a new yogurt manufacturing plant in China, partnered with a local dairy supplier, and recently launched its first three new products Shanghai. The company plans to expand its portfolio city-by-city over the next several years.

MARKET FOCUS – WESTERN EUROPE

With approximately $20-25 billion of yogurt sales at retail, and average per capita consumption over 20kg per person per year, Western Europe remains one of the world's most important regions for yogurt manufactures. That said, while market performance varies by country, in aggregate, the Western European yogurt market has experienced little growth in recent years. Overall, the region's the top-five countries (France, Germany, Italy, Spain, and the UK), which account for over 60% of the market, declined ~$300 million (-0.5% CAGR) between 2010-2014, and are expected to be relatively flat over the next few years.

Table 3 **Top 5 Western Europe Yogurt Markets 2010-2018E**

($ in billions)	2010	2014	2018E	*2010-14 CAGR*	*2014-18 CAGR*
France	$ 3.4	$ 3.5	$ 3.5	*0.2%*	*0.5%*
Germany	3.7	3.6	3.7	*-0.9*	*0.6*
Italy	2.5	2.3	2.2	*-1.8*	*-1.0*
Spain	2.7	2.4	2.5	*-3.0*	*0.8*
UK	2.8	3.1	3.0	*2.5*	*-0.7*
Top 5 Total	**$ 15.1**	**$ 14.8**	**$ 14.9**	***-0.5%***	***0.1%***

Source: Euromonitor (from AAFC), Gabelli & Company estimates.

This lackluster growth stemmed from a number of factors including: poor economic growth, increased private label penetration and price competition, and more stringent regulation of health-claims, which led to declines in many premium-priced products that used health claims as a point of differentiation. Additionally, with both retailers and consumers resistant to price increases, unprecedented raw material cost inflation over the past few years forced producers to cut advertising and promotional spending to maintain profitability, further weakening the market.

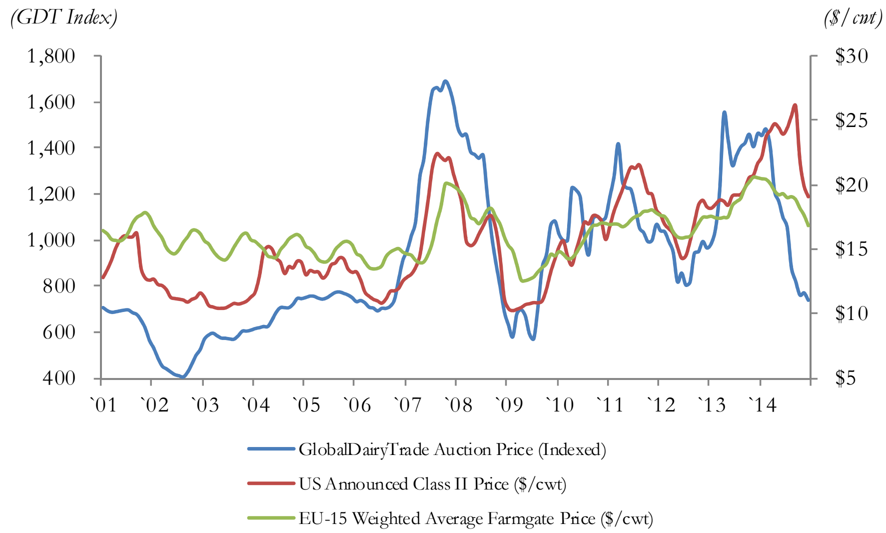
While we are not expecting any dramatic shifts in the European market conditions, we would note that the situation does appear to be improving. Many European economies have strengthened over the past few years, and with five years elapsed since the European Food Safety Authority (EFSA) tightened rules regarding health claim marketing, producers have adjusted their product marketing to the "new normal" and are continuing to present more credible scientific research to support their product's benefits. Danone, the largest producer of yogurt in Western Europe, has restaged its multi-billion euro Activia brand, abandoning its probiotic, health-food roots, and now markets it as more traditional lifestyle brand with celebrity endorsement. Working within EFSA constraints, Danone also began marketing its drinkable Actimel probiotic yogurt as an immune system booster, and has seen sales stabilize.

More significantly, over the past year, global dairy costs have begun to meaningfully decline as worldwide production has increased to meet increasing dairy demand. As these lower costs begin to reach producer P&Ls, they will be able to reinvest in the category and their brands, potentially spurring growth.

GLOBAL DAIRY COSTS DYNAMICS

Raw milk represents the most significant input cost for yogurt producers, often accounting for 20-30% of their total cost spending. While most milk is consumed geographically close to where it is produced, local prices can be heavily influenced by global events and markets tend to be highly interconnected and correlated. Beginning in the early 2000s, dairy prices entered a period of significant volatility punctuated by rapid price swings. These movements occurred in tandem in both global and local markets. Over the past year, prices have fallen precipitously, and many producers are beginning to see margin benefits. While these benefits are unlikely to be permanent, in the near-term they will likely provide margin tailwinds for producers, allowing them to invest to drive growth.

Exhibit 10 **Select Global Milk Prices 2001-2014**



Source: GlobalDairyTrade, USDA, AHDB Dairy

The overall global dairy market has grown at a rate of 1-3% per year since 1991, and is expected to continue to grow at that rate over the next several decades, driven by rising incomes in developing countries and global population growth. Over long periods, supply and consumption have grown at modest rates and relatively in tandem.

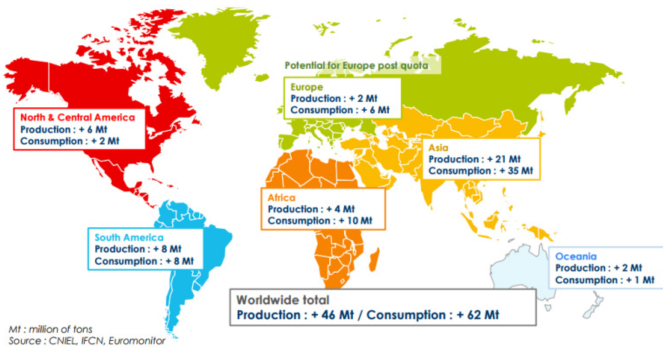
Exhibit 11 **Dairy Product Average Annual Growth Production & Consumption 1991-2050P**

	Production (%)			Consumption (%)		
Region	1991–2007	2005/07–2030	2005/07–2050	1991–2007	2005/07–2030	2005/07–2050
Developing countries	***4.2***	***2.1***	***1.8***	***3.9***	***2.1***	***1.7***
East Asia	9.5	2.2	1.5	7.9	2.2	1.5
Latin America and Caribbean	3.3	1.7	1.3	2.6	1.5	1.1
Near East and North Africa	3.1	1.9	1.7	2.8	1.9	1.6
South Asia	4.1	2.3	2.0	4.1	2.3	2.0
Sub-Saharan Africa	3.5	2.4	2.3	3.5	2.5	2.3
Developed countries	***0.0***	***0.5***	***0.3***	***-0.1***	***0.5***	***0.3***
World	***1.6***	***1.3***	***1.1***	***1.6***	***1.3***	***1.1***

Source: FAO, 2012.

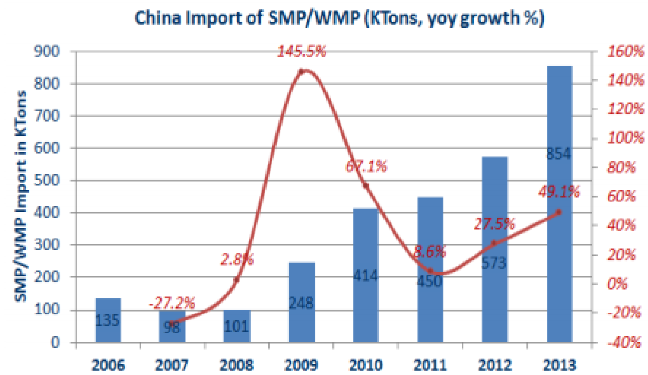
That said, adding incremental dairy supply takes time, and if demand increases rapidly over short periods, global supply and demand can become unbalanced, as happened between 2008-2012. During that period, exploding growth in Africa and Asia, particularly China, resulted in increased demand for dairy inputs that drove rapid price spikes in the global dairy markets.

Exhibit 12 Global Milk Supply/Demand 2008-2012



Source: Danone

Exhibit 13 China Milk Imports 2006-2013



Source: Danone

Yet while China is expected to continue to be the primary driver of global dairy demand for many years, its international purchases have tapered off over the past year, and dairy farmers, bolstered by record low feed costs, have added significant supply. This, combined with Russia's ban on imports, has resulted in a glut of supply and overall lower prices in the market.

COMPANIES

With global retail sales of $83 billion, we estimate aggregate yogurt manufacturer revenue was approximately $60 billion in 2014. Much of the industry is fragmented, with more than one-half of world's yogurt revenues generated by companies that are either private, or do not specifically disclose their yogurt revenues. That said, approximately $28 billion of revenue is attributable to the companies listed below, and the brands owned by the three largest yogurt manufacturers: Danone, General Mills, and Yakult Honsha account for over one-third of the global market.

Table 4 Select Yogurt Manufacturers

Company Name	Est. Yogurt Revenues ($ in Billions) (a)	Key Brands
Danone	$ 14.8	Activia, Actimel, Dannon, Oikos
General Mills/Yoplait (b)	4.0	Yoplait
Yakult Honsha	2.8	Yakult
Lactalis/Nestlé (c) /Parmalat (d)	2.5	Nestlé, La Laitière, Yoco, Ski, Parmalat
China Mengniu Dairy	1.2	Just Yoghurt, Yoyi C, Bio
Chobani	1.0	Chobani
Müller	0.7	Müller
Fage	0.5	Fage
Lifeway Foods	0.1	Lifeway
Total	**$27.6**	

(a) Converted to USD at 2014 avg. exchange rate
(b) $3 billion of revenue from General Mills owned markets
(c) Total estimated sales from Nestlé/Lactalis JV, which is 40% owned by Nestlé
(d) Parmalat is 83% owned by Lactalis

Source: Company filings and websites, Gabelli & Company estimates

Danone

With 6.5 million tons of annual production, Danone is the largest global manufacturer of fresh dairy products, generating more than 50% of its €21 billion of revenue from yogurt (€11 billion). In aggregate, the company holds over 25% share in the markets where it competes, which include virtually all significant global yogurt markets, and owns leading brands including: Activia, Actimel, Danonino, Light & Fit, Oikos, and Stonyfield, among others. Danone also has a number of strategic investments in other yogurt manufacturers including: Yakult Honsha (20%), China Mengniu Dairy (9.9%) and Lifeway Foods (21%). While Danone has recently faced a number of challenges in its yogurt business including: rising raw material costs, increasing private label competition, the ban on health-claim related marketing in Europe, and the rise of Greek yogurt in the United States, we believe that these issues are temporary. Over time, we expect Danone to be one of the primary beneficiaries of the yogurt industry's positive fundamentals.

General Mills

General Mills is a diversified manufacturer of packaged foods with nearly $18 billion of revenue, $3 billion of which comes from yogurt. The company owns a 51% stake in Yoplait (with French dairy cooperative Sodiaal), the second-largest global yogurt brand which has over $4 billion of cumulative sales in over 50 markets. The brand is licensed to over 25 franchisees globally, with General Mills directly controlling the operations in the US, France, Canada, the UK, and most recently, China. While General Mills holds over 25% share in its core US market, it lost a significant amount of business over the last several years as its Greek strategy struggled to find its footing. That said, in recent quarters Yoplait has been the fastest growing US yogurt brand, accounting for most of the growth of the US yogurt market, and the company is rapidly regaining lost sales.

Yakult

Yakult Honsha is a diversified Japanese holding company primarily operating in the food and beverage and pharmaceutical industries. Its namesake Yakult brand is the third-largest yogurt brand in the world, with over $2.5 billion of sales. A scientific leader in probiotic research and development, the company's primary product is the Yakult probiotic beverage that was created by Dr. Minoru Shirota in 1935; one of the first manufactured drinkable yogurts in the world. While Japan continues to be the product's primary market, it has gained significant traction in international markets, with over 30 million bottles of Yakult sold per day globally. The company is also well known for its "Yakult Lady" system, whereby Yakult is sold direct-to-consumers by a dedicated salesforce of over 70,000 women who espouse Yakult's health benefits and try to drive bottle-a-day habits. Danone owns a 20% stake in Yakult.

Lactalis/Nestlé (c)/Parmalat (d)

With €16 billion of annual revenue, Lactalis is the largest privately held dairy company in the world, and generates 12% of its revenue from chilled dairy products, including yogurt. Much of that revenue is derived from its 60% owned Lactalis Nestlé Produits Frais joint venture with Nestlé, the world's largest dairy company. The joint venture had over €1.5 billion of revenue at the time of its formation in 2007, and is the second-largest yogurt manufacturer in Western Europe. Nestlé manufactures yogurt in some of its smaller, emerging markets, outside of the JV, but has primarily partnered, licensed or sold its brands in international markets. For instance, in Australia and New Zealand, Fonterra (a New Zealand dairy co-op) owns and markets the Nestlé brands. Lactalis also owns 83% of the Italian dairy company Parmalat, which generates 5-10% of its €5.6 billion revenue from Yogurt, primarily in North America, South Africa, Australia and Italy.

Chobani

Privately held Chobani entered the US yogurt market in 2007 after retrofitting an abandoned Kraft Foods factory to manufacturer Greek style strained yogurt. In the time since, the company totally reshaped the US yogurt market and is now the third-largest yogurt producer in the United States with over $1 billion of sales and 16% market share. Yet despite the company's massive success, it has struggled to maintain its market share and growth in the face of increasing Greek yogurt competition, and until recently, was reportedly losing money. In 2014, Chobani secured a $750 million loan from TPG Capital, which has taken on partial management responsibilities in an attempt to reduce costs and rekindle growth.

China Mengniu Dairy

With over $8 billion in revenue, China Mengniu Dairy is the leading liquid milk company in China. In addition, Mengniu generated over $1.2 billion of revenue from yogurt in 2014 (growing 30%+) and holds over 20% share of the rapidly growing Chinese market. Through its 80% owned joint venture with Danone, the company's yogurt business has over 3000 employees as well as national manufacturing and distribution, producing and selling over 650k tons of yogurt annually. Over the next several years, Mengniu plans to leverage Danone's brands and manufacturing know-how to both continue its growth, but also drive margin improvement through the elimination of inefficient manufacturing processes.

Müller/Quaker (PepsiCo)

Müller is a private dairy company based in Germany with over $5 billion in total revenues, and is one of the largest private yogurt manufacturers in the world, with over $1 billion in estimated retail yogurt sales. Müller is the market leader in the UK with over 25% share, and has a strong presence in Italy with over 15% share. Müller entered the United States market in 2012 in a joint venture with PepsiCo's Quaker Dairy selling imported product and in 2013, demonstrated a long-term commitment to the market by opening a $200 million manufacturing facility in New York. Today, the Müller/PepsiCo venture is estimated to have $100 million of sales.

Fage

Fage (pronounced “fa-yeh”) is a dairy company headquartered in Athens, Greece, with about $670 million of revenues, about $500 million of which is from sale of yogurt in the US, Western Europe, and Greece. The company holds ~5% market share of the overall US yogurt market and about 11% of the US Greek segment, which it pioneered. Recently the company has focused its growth strategy around the “plain” segment of the market, which is growing at a mid-teens rate, and where it is the market leading brand.

Lifeway Foods

Lifeway Foods is the largest US manufacturer of Kefir, a fermented, drinkable yogurt with Eastern European roots. With about $120 million of revenue, Lifeway has in excess of 50% market share of the niche, but rapidly growing Kefir category in the United States, which has strong health and wellness credentials. The company recently expanded into frozen and protein enriched products, and acquired a new manufacturing facility to meet future demand. Lifeway is closely held by the founding Smolyansky family (50.1% stake) and Danone (21% stake).

Table 5 **Publicly Traded Yogurt Companies**

(in millions, except per share data)		China Mengniu (a) 2319 - Hong Kong		Danone BN - Paris		General Mills, Inc. GIS - NYSE		Lifeway Foods LWAY - Nasdaq		Yakult 2267 - Yokyo	
12-Month High/Low		HKD 51.00	HKD 27.00	€ 67.74	€ 49.84	$ 57.80	$ 48.32	$ 22.38	$ 12.34	¥ 9,030	¥ 7,220
Capitalization		FYE 5/31		FYE 12/31		FYE 5/31		FYE 12/31		FYE 3/31	
Balance Sheet as of:		12/31/14		12/31/14		5/31/15		12/31/14		12/31/14	
Shares Outstanding		1,958		600		596		16		165	
Options/Converts		-		1		15		-		-	
Fully Diluted Shares Outstanding		1,958		601		611		16		165	
Price as of 7/7/2015		HKD 36.70		€ 57.50		$ 57.89		$ 19.12		¥ 7,350	
Equity Market Capitalization		**HKD 71,870**		**€ 34,544**		**$ 35,365**		**$ 313**		**1,215,129**	
Total Debt and Preferred Stock		12,379		8,403		9,224		9		119,691	
Minority Interest		3,784		35		1,175		-		37,199	
Cash and Equivalents		(10,506)		(3,197)		(334)		(6)		(251,907)	
Hidden Assets		-		(431)		(981)		-			
Total Enterprise Value (TEV)		**HKD 77,527**		**€ 39,353**		**$ 44,449**		**$ 315**		**¥ 1,120,112**	
Consolidated:											
Net Revenues	2015P	CNY 61,476	*10.9%*	€ 23,524	*5.5%*	$ 17,488	*-0.8%*	$ 166	*18.0%*	¥ 407,898	*3.5%*
(growth)	2015E	55,414	*10.7%*	22,298	*5.5%*	17,630	*-1.6%*	140	*18.0%*	394,096	*7.1%*
	2014A	50,049	*15.4%*	21,144	*-0.7%*	17,910	*0.8%*	119	*22.0%*	367,980	*5.0%*
5-Yr CAGR	*08-13A 12-17P*			*6%*		*2%*		*18%*		*8%*	
EBITDA	2015P	CNY 5,414	*8.8%*	€ 4,188	*17.8%*	$ 3,521	*20.1%*	$ 19	*11.2%*	¥ 70,623	*17.3%*
(margin)	2015E	4,678	*8.4%*	3,955	*17.7%*	3,396	*19.3%*	16	*11.3%*	66,022	*16.8%*
	2014A	4,284	*8.6%*	3,618	*17.1%*	3,495	*19.5%*	8	*6.5%*	57,691	*15.7%*
5-Yr CAGR	*08-13A 12-17P*			*7%*		*4%*		*32%*		*13%*	
EPS	2015P	CNY 1.68	*17.5%*	€ 3.30	*10.0%*	$ 3.02	*5.6%*	$ 0.59	*21.5%*	¥ 189	*9.2%*
(growth)	2015E	1.43	*19.2%*	3.00	*14.5%*	2.86	*1.2%*	0.49	*179.4%*	173	*13.8%*
	2014A	1.20	*5.0%*	2.62	*-5.8%*	2.82	*5.0%*	0.17	*-43.1%*	152	*113.4%*
5-Yr CAGR	*08-13A 12-17P*			*11%*		*7%*		*43%*		*16%*	
TEV/EBITDA	2015P	11.4		9.4 x		12.6		17.0 x		15.9 x	
	2015E	13.2		10.0		13.1		19.9		17.0	
	2014A	14.4		10.9		12.7		41.1		19.4	
P/E	2015P	17.3		17.4		19.2		32.4		38.9	
	2015E	20.4		19.2		20.2		39.4		42.5	
	2014A	24.3		22.0		20.5		110.0		48.4	
Total Debt/EBITDA		2.9 x		2.4 x		2.8 x		1.2 x		nm x	
EBITDA/Interest		12.6 x		24.3		10.7 x		83.2		nm	
Net Debt/TEV		20.2 %		13.1 %		20.2 %		1.0 %		nm %	
Additional Information:		*Hong Kong*		*Paris, France*		*Minneapolis, MN*		*Morton Grove, IL*		*Tokyo, Japan*	
Dividend		HKD 0.34	*0.9%*	€ 1.50	*2.6%*	$ 1.76	*3.0%*	$ 0.08	*0.4%*	¥ 25	*0.3%*

(a) RMB results converted to HKD for comparability

Source: Thomson Reuters, Company filings, Gabelli & Company estimates.

Companies Mentioned

China Mengniu Dairy	(2319	– HK)
Danone	(BN	– FR)
General Mills	(GIS	– NYSE)
Kraft Foods Group	(KRFT	– NASDAQ)
Lifeway Foods	(LWAY	– ")
Nestlé	(NESN	– SW)
Parmalat	(PLT	– MI)
PepsiCo	(PEP	– NYSE)
Yakult Honsha	(2267	– TO)

I, ***Joseph A. Gabelli,*** the Research Analyst who prepared this report, hereby certify that the views expressed in this report accurately reflect the analyst's personal views about the subject companies and their securities. The Research Analyst has not been, is not and will not be receiving direct or indirect compensation for expressing the specific recommendation or view in this report.

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Ratings

Analysts' ratings are largely (but not always) determined by our "private market value," or PMV methodology. Our basic goal is to understand in absolute terms what a rational, strategic buyer would pay for an asset in an open, arms-length transaction. At the same time, analysts also look for underlying catalysts that could encourage those private market values to surface.

A **Buy** rated stock is one that in our view is trading at a meaningful discount to our estimated PMV. We could expect a more modest private market value to increase at an accelerated pace, the discount of the public stock price to PMV to narrow through the emergence of a catalyst, or some combination of the two to occur.

A **Hold** is a stock that may be trading at or near our estimated private market value. We may not anticipate a large increase in the PMV, or see some other factors at work.

A **Sell** is a stock that may be trading at or above our estimated PMV. There may be little upside to the value, or limited opportunity to realize the value. Economic or sector risk could also be increasing.

We prepared this report as a matter of general information. We do not intend for this report to be a complete description of any security or company and it is not an offer or solicitation to buy or sell any security. All facts and statistics are from sources we believe to be reliable, but we do not guarantee their accuracy. We do not undertake to advise you of changes in our opinion or information. Unless otherwise noted, all stock prices reflect the closing price on the business day immediately prior to the date of this report. We do not use "price targets" predicting future stock performance. We do refer to "private market value" or PMV, which is the price that we believe an informed buyer would pay to acquire 100% of a company. There is no assurance that there are any willing buyers of a company at this price and we do not intend to suggest that any acquisition is likely. Additional information is available on request.

As of May 31, 2015, our affiliates beneficially own on behalf of their investment advisory clients or otherwise approximately 4.70% of Lifeway Foods and less than 1% of China Mengniu Dairy, Danone, General Mills, Kraft Foods Group, Nestlé, Parmalat, PepsiCo and Yakult Honsha. One of our affiliates serves as an investment adviser to Nestlé or an affiliated entity and has received compensation within the past 12 months for these non-investment banking securities-related services. Because the portfolio managers at our affiliates make individual investment decisions with respect to the client accounts they manage, these accounts may have transactions inconsistent with the recommendations in this report. These portfolio managers may know the substance of our research reports prior to their publication as a result of joint participation in research meetings or otherwise. No part of my compensation was, is, or will be, directly or indirectly, related to the specific recommendations or views expressed in this research report. In addition, the undersigned lead analyst(s) has not and will not receive any compensation for providing a specific recommendation or view in this report. The analyst, who wrote this report, or members of his household, owns no shares of the above mentioned companies.

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Danone (BN - €57.50 - Euronext Paris) Global Yogurt Leader - Buy

Year	EPS	P/E	PMV	
2017P	€3.65	15.8 x	€80	Dividend: €1.50 Current Return: 2.6%
2016P	3.30	17.4	73	Shares O/S: 600 million
2015E	3.00	19.2	67	52-Week Range: €67.74 - €49.84
2014A	2.62	22.0	---	

COMPANY OVERVIEW

Paris, France based Danone is a manufacturer of fresh dairy (yogurt), early life nutrition, beverage, and medical nutrition products. The company's stated mission is to "bring health through food to as many people as possible" and its geographically diverse product portfolio is aligned towards health and nutrition. We expect Danone to generate revenue, EBITDA and earnings of €22.3 billion, €3.95 billion and €3.00 per share, respectively, for the year ending December 31, 2015. Our 2016P PMV is $73 per share.

We continue to recommend that investors Buy Danone shares:

- Danone enjoys strong market position in four global consumer products categories that are poised to benefit from changing consumer preferences and demographics, including:
  - #1 share of the $83 billion global yogurt market, where increasing consumer focus on healthy snacking and growing dairy consumption in emerging markets are driving growth.
  - #2 share of the $155 billion bottled water market, which is benefitting from both a global shift away from sugary drinks and from population and income growth in countries with underdeveloped water infrastructure.
  - #2 share of the $62 billion baby-food market (formula, $45 billion) which is driven by increasing female labor participation and rising incomes in the countries where most of the world's babies are being born.
  - #3 share of the $30 billion medical nutrition market which will expand as the global population ages.
- A number of recent headwinds, most notably global dairy cost inflation, and disruptions in the Chinese baby nutrition business are abating. Dairy represents 25% of Danone's total €15 billion spend base, and global dairy prices have declined over 40% in the past year. We believe that Danone will reinvest much of these savings back into its business, allowing it to rebuild brand equity lost over the past few years. In China, Danone's restaged baby business continues to recover share lost following its 2013 product recall, with the added benefit that its now more-premium imported portfolio is well-exposed to the e-commerce channel, which is driving the market.
- Management has increased its focus on profitability, responding to softening demand in its European dairy by shedding low-margin volume, closing factories, and trimming jobs, generating €200 million of annual savings. At the same time, it continues to invest capital in infrastructure that will improve efficiency and stabilize long-term costs, as well as in assets and ventures that will drive growth, such as its investments in Africa and China.
- Danone shares currently trade at 9.4x and 17.4x our 2016E EBTIDA and EPS estimates of €4.2 billion and €3.30 per share, respectively. We calculate Danone's Private Market Value to be €73 per share, growing to €94 by 2019P. Shares currently trade at a 21% discount to PMV, and offer a 2.6% current return. We believe that at current levels investors have a sizeable margin of safety and recommend purchase.

Table 6 **Danone Earnings Model 2011A – 2019P**

(€ in millions, except per share data)

FYE 12/30	2011	2012	2013	2014	2015E	2016P	2017P	2018P	2019P	2014-19P CAGR
Revenues	€ 19,318	€ 20,869	€ 21,298	€ 21,144	€ 22,298	€ 23,524	€ 24,822	€ 26,199	€ 27,660	*6.9%*
% Growth	*13.6%*	*8.0%*	*2.1%*	*-0.7%*	*5.5%*	*5.5%*	*5.5%*	*5.5%*	*5.6%*	
EBITDA	€ 3,480	€ 3,628	€ 3,519	€ 3,618	€ 3,955	€ 4,188	€ 4,441	€ 4,712	€ 5,005	*8.5%*
% Margin	*18.0%*	*17.4%*	*16.5%*	*17.1%*	*17.7%*	*17.8%*	*17.9%*	*18.0%*	*18.1%*	
% Growth	*9.1%*	*4.3%*	*-3.0%*	*2.8%*	*9.3%*	*5.9%*	*6.0%*	*6.1%*	*6.2%*	
EPS	€ 2.90	€ 3.01	€ 2.78	€ 2.62	€ 3.00	€ 3.30	€ 3.65	€ 3.95	€ 4.35	*13.5%*
% Growth	*6.5%*	*4.1%*	*-7.8%*	*-5.8%*	*14.5%*	*10.0%*	*10.6%*	*8.2%*	*10.1%*	
TEV/EBITDA				10.8x	9.9x	9.4x	8.8x	8.3x	7.8x	
P/E				22.0x	19.2x	17.4x	15.8x	14.6x	13.2x	
CAPEX	€ 885	€ 976	€ 1,039	€ 984	€ 1,115	€ 1,176	€ 1,241	€ 1,310	€ 1,383	

Source: Company filings, Gabelli & Company estimates.

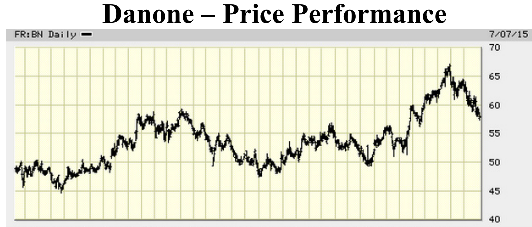
Table 7 **Danone Private Market Value**

(€ in millions, except per share data)

FYE 12/31	2013A	2014	2015E	2016P	2017P	2018P	2019P
Fresh Dairy Products							
EBITDA	€ 1,556	€ 1,370	€ 1,523	€ 1,605	€ 1,693	€ 1,785	€ 1,883
Valuation Multiple	12.0x	12.0x	12.0x	12.0x	12.0x	12.0x	12.0x
Segment Value	18,672	16,440	18,274	19,266	20,314	21,422	22,593
Waters							
EBITDA	€ 660	€ 690	€ 743	€ 783	€ 827	€ 872	€ 921
Valuation Multiple	9.0x	9.0x	9.0x	9.0x	9.0x	9.0x	9.0x
Segment Value	5,940	6,210	6,688	7,051	7,439	7,852	8,293
Early Life Nutrition							
EBITDA	€ 931	€ 922	€ 1,023	€ 1,103	€ 1,189	€ 1,283	€ 1,385
Valuation Multiple	14.0x	14.0x	14.0x	14.0x	14.0x	14.0x	14.0x
Segment Value	13,034	12,908	14,322	15,437	16,646	17,959	19,383
Medical Nutrition							
EBITDA	€ 287	€ 305	€ 330	€ 352	€ 375	€ 400	€ 428
Valuation Multiple	14.0x	14.0x	14.0x	14.0x	14.0x	14.0x	14.0x
Segment Value	4,018	4,270	4,622	4,926	5,254	5,607	5,986
Total Private Market Value	€ 41,664	€ 39,828	€ 43,905	€ 46,680	€ 49,653	€ 52,840	€ 56,256
Less: Net Debt	(4,722)	(5,206)	(4,275)	(3,291)	(2,254)	(1,158)	14
Less: Put Options	(2,558)	(2,558)	(2,558)	(2,558)	(2,558)	(2,558)	(2,558)
Less: Options Payments	(43)	(25)	(54)	(75)	(98)	(122)	(148)
Less: Minority Interest	(35)	(35)	(35)	(35)	(35)	(35)	(35)
Plus: Equity investments	3,098	3,098	3,098	3,098	3,098	3,098	3,098
Equity Private Market Value	€ 37,404	€ 35,102	€ 40,081	€ 43,818	€ 47,806	€ 52,065	€ 56,627
Shares outstanding	587	600	600	600	600	600	600
PMV per share	**€ 64**	**€ 59**	**€ 67**	**€ 73**	**€ 80**	**€ 87**	**€ 94**
Current discount to PMV	*9.9%*	*1.8%*	*14.1%*	*21.4%*	*28.0%*	*33.8%*	*39.1%*

Source: Company filings, Gabelli & Company estimates.

Danone – Price Performance



Source: Public data. As of July 8, 2012 BN.FR was rated BUY.

I, ***Joseph A. Gabelli,*** the Research Analyst who prepared this report, hereby certify that the views expressed in this report accurately reflect the analyst's personal views about the subject companies and their securities. The Research Analyst has not been, is not and will not be receiving direct or indirect compensation for expressing the specific recommendation or view in this report.

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As of May 31, 2015, our affiliates beneficially own on behalf of their investment advisory clients or otherwise less than 1% of Danone. Because the portfolio managers at our affiliates make individual investment decisions with respect to the client accounts they manage, these accounts may have transactions inconsistent with the recommendations in this report. These portfolio managers may know the substance of our research reports prior to their publication as a result of joint participation in research meetings or otherwise. No part of my compensation was, is, or will be, directly or indirectly, related to the specific recommendations or views expressed in this research report. In addition, the undersigned lead analyst(s) has not and will not receive any compensation for providing a specific recommendation or view in this report. The analyst, who wrote this report, or members of his household, owns no shares of the above mentioned companies.