Danone

September 9, 2009
12:45 PM ET

Suzanne Seibel: Ladies and gentlemen, welcome to the after-lunch session. I'm Suzanne Seibel. I have joined Barclays Capital this month and I will be the European Food and HPC analyst. It's great to be back at a time when European food actually is on everyone's agenda. It's also great to see so many familiar faces. Thank you for all the good wishes and, in particular, thank you for the warm welcome that Andrew and his team have provided to both my colleague Alex and to myself.

More importantly, I'm here to introduce Emmanuel Faber from Danone this afternoon. Emmanuel joined Danone in 1997. He is presenting here as the Co-COO. He used to be the CFO and also the VP of Asia-Pacific and he certainly has witnessed, along with us, the transformation that started about a decade ago of Danone into one of the most dynamic and most innovative companies in the food and beverage sector, not to the detriment of the shareholders. I must say the portfolio transformation is very impressive and I hope we can hear an update today about the strategy and also about what is on the agenda for the coming financial year.

Over to you. Bienvenue, Emmanuel, and bonne chance.

Emmanuel Faber: Good afternoon, everybody. It's good to be here with you, a few familiar faces. We will try in the next 30 minutes or so to give you a flavor of another way of looking at food and beverage, which is the Danone way of doing so.

Danone's mission is to bring health, through food, to as many people as possible. We have been walking the talk for ten years now, building a group which is entirely focused, 100 percent focused, on healthy food categories, which have been shown on this chart. We have done that with a sense that this was the best thing we could give to our shareholders, to our employees, that this company would lead the pack in terms of growth for the very, very long term.

When we are talking about food for all, health for all, we are really talking for all. It means that we are scratching the surface of social economic classes, pyramids in a number of countries. We are reengineering our products, our processes, to be able to address the health issues of the future through nutrition solutions, engineering those solutions through our various businesses and we are also working increasingly across ages and across health conditions.

Across ages and health conditions is, I think, very well exemplified by the Numico acquisition two years ago, which has been fantastically well integrated by and with the Danone team today, delivering beyond our expectations, both on volume synergies and on cost synergies and which today allows us to address consumer needs from the infancy to elderly people, well, in good condition, or also suffering from diseases, all with the same simple view, how can nutrition address your health needs.

When we say this, we're conscious that it means growth. It means growth because health is going to drive nutrition needs for the future with the support of international, national health authorities and food administrations. We are conscious that more and more consumers, whether in emerging markets or in developed markets, are concerned with the link between nutrition, lifestyle and health, and we are addressing those through our categories and we don't think that it is the fruit of random that those categories are actually the fastest growing of all food and beverage categories.

The left part of this chart shows you by Euromonitor the projection of growth, volume growth, for the four categories in which we are active in 2008 projected for the next five years, as well as in 2009, projected for the next five years, and you can see that medical nutrition, baby nutrition, still bottled water and yogurt and fresh dairy are the fastest-growing categories. How we grow in those categories is shown on the right-hand part of this chart with our portfolio being about-- more than half of our product is fresh dairy products, 20 percent water, a bit less than 20 percent baby nutrition and the remaining is our nicely growing little jewel of medical nutrition business, which we acquired through the Numico acquisition.

Those businesses as you can see in 2008 have produced sales, like for like growth, anywhere between 2 percent for water, 7.7 percent for fresh dairy, and beyond 15 or in the range of 15 percent for the ex-Numico categories. So you can really see that we are positioned on categories that grow well above the average of food and beverage.

The second aspect of why we grow faster and why we believe this mission is going to lead us to grow faster, continue to grow faster than the rest of the pack, is the diversification of our country mix today. Today, 40 percent of our sales are generated from emerging markets.

We are in emerging markets skewed toward large countries. A list of those you've got on the right here -- China, Indonesia, Brazil, Argentina, Mexico, Russia -- that historically have been producing over the last ten years significantly faster growth, not only from a GDP standpoint, but even more from a consumption standpoint than the rest of the world. Obviously, some of them are going today through a transformation, but long term, we have no doubt that these countries are the right countries for us to make sure that we continue to grow faster than the rest of our competitors.

The result is that today -- I'm really talking today -- we are delivering this superior growth. You know that we have been obsessed about like-for-like growth and organic growth in the past, for the last ten years, gradually accelerating the pace of the growth.

Clearly, we understand and our belief is that consumers are going through a major change in their shopper, in their feeding, in their overall consumption pattern around the world, around the globe, not only here in the U.S., but I can tell you everywhere. We believe this is going to be long-lasting and we don't want to wait until that transformation has gone to restore the growth of our company.

So exactly one year ago we have decided significant reset programs -- and I will describe those -- to ensure that we restore the growth potential of our business immediately, not for the medium term. The result of this is that in the fourth quarter of this year, among the five biggest food and beverage companies around the world, we have been the only one that had positive volume growth, 1 percent. In the second quarter of this year, as you can see, we have been the fastest growing, with 3.6 percent volume growth.

So we are talking about delivering superior growth immediately. When I say "immediately," the third quarter will show an improvement even on these numbers and the fourth quarter will show an improvement on the third quarter. So it really means that, one way or the other, we will end this year in the middle of the consumption transformation worldwide that I described with a growth rate of our volume somewhere in the mid single digits. We believe that this creates a unique platform to continue to grow, despite the consumption issues, despite the jobless situations, despite the GDP, because we are growing right now significantly faster than the economies.

Let me say, also, that this is not only growth for today, but also growth for tomorrow and after tomorrow. If you look at this chart, it tells you basically what our geographical key positions are, region by region. In each of the categories where we operate we are either number one, a few times number two, but most of the times number one.

For many reasons, we believe that being the leader in a food company or food and beverage company clearly gives you an advantage in terms of further development in the long term. This is why that rather than being the biggest company in the world we've tried to do only a few things, build leading worldwide positions in a limited number of categories, focus on them, do only that, day by day, day after day and delivering superior growth in those categories.

Obviously, the biggest growth engine that we have, given its size, is our dairy products business and I would like to spend some time with you to explain how the dairy products category of Danone has been acting as an engine for growth in the transformation of the economies and the markets that we are currently going through.

Basically four key drivers for growth. First of all, among all the players in the yogurt and fresh dairy category we focus on health, coupled with superior quality. This is very basic but we are-- Yakult and ourselves are basically the only companies in that space that have this health focus and positioning in the fresh dairy category. So it means that we have a unique position and I will come back to this.

The second driver is the reset program that I described, which you have to understand is not just an adaptation or a quick fix just to make sure that we continue to grow despite the current lukewarm environment. This is about making sure that we adapt the business model, the price positioning, the processes of the business, to a situation which we believe could last for long. And, therefore, we are building for the future and not only just for immediately with this program of resets.

Thirdly, increase the penetration and the per capita consumption of our products. This is a major driver. It's been the case for many years and we'll come back to that.

And finally, obviously, open up new geographies. There are still plenty to come beyond the 25 geographies that we've opened over the last ten years.

Just a quick reminder. You've seen this chart before. Yogurt is a very fastly growing category worldwide. It's growing 4 percent on average, has been growing about 5 percent on average on the long term over the last ten years. It's forecast to grow anywhere between 3.5, 4.5 percent in the future.

One of the reasons why we grow faster than the category is the first driver of our growth, as I said. We offer a completely unparalleled health benefits program for our consumers through our products, which is coupled with a very strong request for superior product quality.

There is no product within Danone, which is launched -- no new product -- if it doesn't match a very simple acid test, a 60/40 consumer preference. Any new product at Danone needs to be preferred by consumer 60 percent versus the next competitor, 40 percent. Below that, we don't launch, for a simple reason. We are not going to be able to bring health through nutrition and, therefore, the nutrition to our consumer, wherever they are, in Bangladesh or in the U.S., if they don't like our product better than the others. The only way for us to bring that health benefit is that they like the product, they taste it, and they repeat that taste and the consumption.

So we are a food company. We are not a pharmaceutical company. It is very important for us, because it is also the way we define the scope of our business and what will happen in the future in terms of our next move.

At the same time, we are the only company that really acts as a pharmaceutical company. We are the only company in the space of fresh dairy that runs clinical studies to support the claims that we are using to our consumers. This is true here in the U.S., but this is true in the 50 markets in which we operate.

And last year we've been running more than 50 clinical studies to support the claims of the health benefits of our product. It's a huge barrier to entry to anybody. I can tell you this is probably ten times more than anybody else in this industry, other than our friends of Yakult, which we have a quite strong cooperation and research and development cooperation with, on top of the 20 percent stake that we own in their equity. It's a Japanese company, for those of you who don't know that company.

And lastly, we have more than 1,000 researchers in research and development, based in a number of centers that we have, but a lot of them are locally based in our markets to ensure that we have the right mix of global science engine, but very local food carrier and ensure the relevance of our products to the local needs.

The-- to put it in a nutshell, this unparalleled health benefits portfolio has allowed us to grow significantly faster than the category. On average, we have taken about 0.85 percent or close to 1 percent market share every year on the global scale business for the last ten years.

And this has accelerated as we have accelerated the rollout of our big blockbusters. You can see Activia, which is nearly a EUR 3 billion sales brand, one of the biggest brands in the food and beverage space anywhere. Actimel, a fantastic success in now close to 40 countries. Danacol, which is flying. It's our anti-cholesterol product, which is one of the first products that the EFSA, the FDA in Europe, has actually already accepted as part of its new program for certification. Danonino about the growth of bones and calcium to support the growth of kids, particularly in the emerging markets, and NutriDay, which is a very powerful mix that we've developed for base of the pyramid consumers and rolled them out in a number of emerging markets in C and D class consumer spaces.

So, essentially, this is the first driver. It's at the core of the Danone engine.

The second driver is the rest program. Just to give you a perspective of what happened to us, not only as everybody else we were caught in the middle of the consumption shift that I mentioned before, about a year ago, that we were in the middle of another issue that we had to deal with and a transformation, which is a huge spike in the price of milk that occurred in 2007 that hit us incredibly strongly. We're talking about EUR 700 million increase of additional cost to us on the two-year basis between 2007 and 2008, linked to the unprecedented spike in milk cost, which we decided, because this is the way this industry works, to transfer to consumers.

So you can see on the right part of this chart, the effect of the input price that you have on the left part, which is that we transferred, gradually, price increases to our consumers up to the tune when, in the middle of last year, the price effect on the total sales of our dairy business worldwide was 10 percent. So, on average, we were charging 10 percent more to our consumers than the year before, on a business, which is an EUR 8 billion business.

So a huge increase and charge for our consumers. This is outrageous. So you can imagine that in certain countries we are talking about 20 percent. So very, very significant.

We were in the process of doing this and in the middle of that process, the consumer confidence falls dramatically. We forecast that we need to address, if we just don't want to just wait until the price is lower, we believe that consumer shift is going to happen for a long time and, therefore, we decide to reposition our products, positioning both in terms of the shopper attitude, how we promote the product, how we market the product, the size of the product, some formulation changes, as well, and, obviously, the price and the price relative to our competition.

So the price reset program is not just the idea that we should take our prices down by 5 or 7 or 8 or 10 or 15 percent. It's a complete reshuffle of the portfolio of our products to ensure that we project the way our consumers are going to trade off their arbitration between health, taste, food, beverage, telephone, insurance, travel, cars, et cetera, in the future, wherever in the world, they are not lost with the Danone product. Make sure that we don't lose contact with our consumers while they are reviewing their way of trading off their consumption pattern.

And, as I just said before, it means entirely revisiting the portfolio. It's been a company-wide project at the dairy division of Danone for the last 12 months.

A few examples is, for example, in the United States where we significantly changed our approach to promotion and couponing versus sampling, where we changed the advertising support. When we also created a six-pack, which is clearly based on our experience in a number of other markets -- and we know it's new here -- but has been a great success to give access to a lower price per kg for consumers.

And you can see the results, which is that our business was traveling in the negative. If you see volume growth in blue here, was traveling negative 12.5 percent in January, 4 percent in March, 8 percent in June and has been even better ever since. So we have resumed the growth, simply by making sure that we didn't lose sight of our consumers, where they were going in their minds and what they were prepared to pay for the health and the taste of a Danone product.

Another example, I think even more striking, is France. A big country for us, obviously, as well as the U.S. for dairy. You can see here on this chart basically you have four competitors. The black line is 100 index on the bottom. This is private label pricing. Obviously, this pricing has evolved over the last three years. You have '07, '08, '09. It has grown because of the peak in the milk prices, so even the private labels have increased their price, but we've used that as 100 basis.

The smaller competitor, in red, is around 120. You have a competitor, which is even higher than us, 170, basically, index and Danone was 140, last year 146 and in 2009 the whole Danone portfolio in France will be 129. So it means that in a matter of exactly one year, 12 months, we have taken the whole portfolio of Danone fresh dairy in France down 15 percent relative to the private label index.

It is a huge change. It means that we have divided or we have cut by one third our premium versus private label. Some of our products will continue to be, probably, 200 like Actimel. Some of them will be 110, but the overall repositioning is this one. So we are really talking about not tactical but full reengineering to ensure that we can continue to grow our mission, bringing health to these consumers through food by having the right price positioning versus our competition.

An example of how successful that was is on Danette, which is our dessert chocolate premier dessert where basically, if you just look at the numbers on the bottom of the page, you can see that we were traveling minus 7 percent in April, minus 7 percent in May in terms of sales, 2 percent in June and faster ever since. And volume-wise, we are talking about a growth of more than 4 percent.

This is not stellar growth. We don't need stellar growth from Danette. We just want to continue to grow that product as it grew in the past and we believe it has now the right overall mix, including price, for our consumer to continue to eat this product.

Another example is Mexico. Mexico it's an incredible example. Our drinkable yogurt was called NutriPLUS with a small Danone reference on the product, as you can see, but the color code is yellow, very focused on NutriPLUS, positioned with a 16 percent premium to competition and we have changed, overnight, to a Danone-branded, much bigger brand of Danone, the blue color code of Danone, simply because this is what, in this crisis, consumers want to eat. They want the quality of Danone, making sure that they understand it's really Danone and not something else.

We have cut the price by 15 percent to competitors, so relative to competition it's a 30 percent change and it has produced a 10 percent growth in terms of sales in a matter of a couple of months, and a 25 percent growth in terms of volumes and it's even increasing from those numbers nowadays.

So you can see that when we are talking about reset, we are really talking about reset. I could use another example, Poland. In Poland we have been decreasing the total portfolio in terms of pricing of our Polish business by 14 percent. The result has been a 25 percent increase in volume and a 15 percent increase in sales, overall, through the mix.

And so we are resetting every geography -- Russia, Brazil, Mexico, France, Spain, the U.S. We've taken all the big geographies to make sure that as quickly as possible we would be well positioned to continue the superior growth of our business.

The next driver, third driver, is increase the penetration and per capita consumption of our products. I just have one chart for this one. It's hard to read from a distance. But basically, this is the per capita consumption in kilos, kgs, per annum of each of the countries where we operate.

So it goes from 0 to about 40 kilos. In the-- sorry, the left part of the chart, you have countries like France, Spain, Turkey, Saudi Arabia, countries in which the consumption per capita is already very significant. On the middle somewhere you have a number of countries. The U.S. is about five, so it's about one cup per week, so a lot of potential. The U.K. is about 11, so still very far from the 30 of France. Brazil is about seven, but India is close to zero, China is close to zero, Russia is about three or four.

So the geographies in which we have invested heavily over the last couple of-- or, let's say, five or seven years are really geographies in which the per capita consumption is still extremely low. And if I-- I will just use an example, Activia, near EUR 3 billion.

Activia penetration, overall, in the countries where we operate, the average penetration is 14 percent. So you can imagine that just driving Activia from 14 percent to 24 percent, which is the average of the countries where Activia is for more than ten years, just by doing this we will add EUR 2 billion or EUR 3 billion of sales to our fresh dairy operations worldwide.

So this third driver of increasing the penetration and the per capita consumption of our products in the emerging yogurt countries is absolutely critical and has been, also, one of the ways why overall yogurt has been growing faster than the rest-- than food and beverage and why we have been growing faster than yogurt overall over the last several years.

To expand our consumer base, let me recap. We call it "affordvaluity." It means one brand across different price points. It's very important for us and I'll come back to an example that we have in Argentina. The second is expand our fresh dairy products penetration through lower price points and the reset is obviously a reaction to the consumer change, but we also drive this whatever consumer attitude is about this. We also develop new forms of products and their existing brands. It's a very important driver for consumption. And we open new geographies.

I think Argentina is a very good example. Yogurisimo -- this is one of our brands in Argentina under the global brand name of La Serenisima. Let me just tell you that in Argentina we have 80 percent market share. Ten years ago in 2001 when the crisis occurred in South America, our market share was about 55 percent.

We have done all the price resets that we've gone through and that I described before, we've done that in 2001. When a number of competitors were actually leaving the country, we've been staying there. We've lowered our price points. We've developed lower and affordable ranges. We went into traditional trade because nobody could afford to go at the Carrefours any more for some time. We ran through the cash economy and at the end of the 2001 crisis we emerged with more than 60 percent market share.

And ever since, we've been growing about 2 points of market share a year in Argentina. So we now have close to 80 percent market share.

But to do this, we have been walking across all the pyramid of consumption, not only talking to the rich guys that can afford the nice pot of Activia. We've been talking to all Argentineans. And, as you can see on this, we have a range -- under the same brand -- we have a range of products that can give you a serving of yogurt from 0.75 dollar -- sorry this is reais, so this is 23 cents of U.S. dollar per serving on the sachet, and it goes up to this nice pot of dual-cup where per serving we are talking 76 cents of a U.S. dollar, so about three times, with the same positioning and, what is important for us, the same health benefits.

So what we bring with this product, we bring the same on the left and the same on the right, different consumer occasions, different way of consumption, different channels of distribution, but at the end of the day, this is the same health benefit and the same Danone health benefit for the consumers.

The result is this one. We've been growing Yogurisimo, as you can see, year after year, extremely significantly and that continues to grow.

Another example is what we do in Brazil. We have this Danonino brand I was just talking about, which is about reinforcing bones and ensuring growth through calcium for kids. This brand is a significant brand in Brazil, but also in 20 other different countries and we have entered the powder market.

For the first time, we are offering a dairy product, which is under the form of powder. This is the first time in the world. We have started the project this year in Brazil. It has received incredibly strong consumer acceptance and you can see those numbers here, whether this is in the form of a can or whether this is in the form of a sachet. Basically three quarters of consumers are saying they have a very high purchase intention versus competition to buy this product.

We are testing the product as we speak right now, particularly in the Nordeste region of Brazil, where there is a significant tradition for powder markets. We could not reach Nordeste consumers with cold chain, which would be in an affordable manner for them, so for us the ability to really work with the whole pyramid and really grow through our mission of bringing health through food to all has been to develop this unique powder product.

One day, probably, we will be able, also, to freeze-- dry freeze probiotics, bacterias, put them into a form of powder, which will-- and they will basically revive again when they will be put in any kind of form of liquid. So it will mean that with the dry form we will be able to bring the probiotics benefits to consumers.

These are completely new blue oceans, I would say, kind of innovations that we are launching and that, again, allows us to grow beyond the traditional way of addressing our mission for our consumers.

Another example in Brazil, as well, is Activia. Activia will be more than 100,000 tonnes for our Brazilian market this year. You can see that the classical Activia has been growing. The scale is from 2006 to 2008. You can see the classical Activia continues to grow in green, despite the crisis in Brazil and I acknowledge that the crisis in Brazil has been okay in terms of consumption. Brazil is a pretty-- in pretty good shape compared to many other countries from a macro standpoint.

Anyway, we decided whatsoever to launch more affordable products and you can see that we have actually not cannibalized, but built, on top of this Activia range, a much cheaper range, the yellow and actually also the purple one, but really the yellow one, which has been launched at a 25 percent discount in terms of price to the classical range and has created additional volume.

I would like to say that none of this affordability strategy that I've been talking about for already half an hour has any significant consequence on the profitability of the business, provided we accept to reengineer the processes of the business itself. If it was just cutting the price, yes, of course, that would affect the profitability of the business.

But really the rule here for us is that we have been developing affordable health strategies in emerging markets for a number of years now, which we-- this is a good example, which we are now applying in some big countries like Brazil, which we are also applying when in Poland, for example, part of the repositioning I was mentioning before has been achieved through the launch of a product which is a mix of milk protein and vegetable protein, which is cheaper, obviously. Because of the Danone technology, we are able to make it extremely tasty and it's been a great success.

So we reengineer the cost as we move, reengineering the price, as well, and ensuring that our consumers can get our products in a way that makes sense from a business standpoint for us, as well.

The last part, I would say, of new approaches and new products is NutriDay. I touched quickly on this. We have developed in the poorest areas of some emerging markets a range of products of yogurt, which is extremely well engineered from a research and development standpoint with very significant macro nutrient solutions for the poorest people and kids in those communities, which quite often are reinforced with micro nutrients, vitamins, iodine, zinc, iron, et cetera.

The cocktail of those is a fairly complex cocktail to engineer. We are working with NGOs. We are working with the WHO, with the organizations-- the food United Nations organization, to make sure that we can develop solutions. That will not-- you will not see the results in the numbers for the next two to three years, probably, but long term we believe that is going to create a completely different Danone in probably five to ten years time.

And finally, this will be my last word, we are opening new geographies. If you take any of our new geographies, we are basically opening two to three new geographies a year. After a couple of years a new geography for us is about EUR 20 million sales, so if you say you have opened, let's say, two or three a year in the last couple of years, it means an additional EUR 100 million. An additional EUR 100 million is already more than 1 point of growth for our dairy business, globally.

So you can see how the organic growth engine is also being fed with the opening of new geographies for us. I have two examples here which are, I think, quite striking. Egypt, which we entered a couple of years ago. We launched Activia in May '08 and we have doubled the size of our business just with Activia in one year and a half.

We have grown the market share of that business from 20 percent to 28 percent now in 2008. When we bought the company it was the fourth player on the market, three years ago. It's now the number one player in the market in Egypt.

The second example is Chile where we entered in June '07. We launched Activia a couple of months later. We've grown that business 30 percent. Our market share has grown by 4 points now. It's grown to 20 percent.

So this engine of Danone-izing the brownfield and the small acquisitions that we're making -- either we enter a greenfield or a brownfield or a small acquisition, but we then push our broad list of programs into the companies to create long-term, sustainable competitive advantage.

Last word will be about China. You can see that we relaunched Bio after being out of Shanghai markets for a couple of years. In five months in Shanghai, Bio has achieved the number one position, above the local competitors, with a 15 percent market share, in total, in the Shanghai markets. Just to say this is a promising result and we will be proud to continue to grow our Chinese business.

South Korea is the last example, sorry, I've used, just to say we entered the South Korean market. It's very interesting, because it's a market which is already very developed form a fresh dairy consumption in terms of formatted and functional, but it's a very small one, only 8 kilos of per capita consumption. And our product, our approach, we think, we will-- will also redefine the way this market is structured and I would like to share with you briefly the ad that we launched in Korea.

(advertisement in Korean)

Emmanuel Faber: So I assume it sounds familiar. That's the way we are managing Activia in South Korea.

I would just like to finish by saying that if you look at this map, not only-- I mean, we have built, obviously, a number of geographies over the last several years, but we believe that there is more than what we can even address in the rest of the world for the coming five or ten years ahead in terms of opening new markets and, therefore, that the fresh dairy category for us will continue to be a unique growth engine for this company, allowing us to deliver our mission to our consumers and, hopefully, deliver our mission to our shareholders. Thank you.

Questions.

Suzanne Seibel: I would suggest that we would like to invite you to go-- to come next door for the breakout session for questions and thank you very much for the presentation.

(applause)