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BN.PA - Q1 2015 Danone SA Corporate Sales Call

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OVERVIEW:

Co. reported 1Q15 YoverY reported sales growth of 8.1%. Expects 2015 sales growth to be 4-5%.



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Adam Spielman *Citi Investment Research - Analyst*

James Edwardes Jones *RBC - Analyst*

PRESENTATION

Operator

Good day and welcome to the 2015 first-quarter sales conference call. Today's conference is being recorded. At this time I would like to turn the call over to Cecile Cabanis, Chief Financial Officer. Please go ahead, madam.

Cecile Cabanis - Danone SA - CFO

Thank you. Good morning to all. Thank you for your attendance and welcome from Paris. I am sitting here with Regis and Marion and we are going to go through the presentation of the results of Q1. But first, before I start I will ask you to go through the Safe Harbor statement that you have on your presentation on our website.

Okay. So as an introduction I would like to say the following. With 4.8% organic sales growth, the performance in Q1 is in line with our expectations. It's in line with our guidance for the year. And it builds the growth conditions for the quarters to come. As well, as explained during the full-year communication recently, it is our main objective this year to build a sustainable profitable growth situation.

So before I take the time during the presentation to illustrate some of our actions, let's maybe take a quick look at the reported growth that you have on page 3.

So on a reported basis we are delivering a growth of 8.1% for Q1. As you can see, foreign exchange has a favorable impact of 3.7%, as expected, with some positive impact of US dollar, Chinese renminbi and Indonesian rupiah. And this positive impact offset the ruble negative impact.

The scope effect is 0.4% negative, mainly due to the divestment of our dairy operation in Indonesia that we did last year. And, as you might remember, this will have a positive impact on margin.

So as I mentioned, coming back to organic growth, this is 4.8%. And it's made of a slightly negative impact in volume of 0.2% and a price mix effect of 5%. The value part is the result of both price increases that we did last year and the work that has been carried out on improving our overall mix. It of course reflects different dynamics between categories and regions, but overall is the reflection of the steps that we are taking towards sustainable profitable growth.

So moving on page 4, as a first comment I would say that Q1 performance is in line with expectation for all our divisions. Sequentially we are coming back to a more normalized level of comparison. Even so, we still have some favorable comparison base from the impact of the Fonterra false alert in early life nutrition performance last year, but to a lower extent than we observed in the last two quarters.



So let's move to geographical dynamics on page 5 to have a first understanding of the trends. Overall, as you can see on the chart, all our regions are contributing to growth.

If I start with Europe, Europe remains solid and confirms positive trends. As we had in the fourth quarter of last year, Europe is positively impacted by the success of our international early life nutrition brands for the Chinese market. But overall I can say that the results continue to show signs of improvement, and this is the case in particular in waters, where we see progresses in many countries. I could take the example of UK with aquadrinks, Volvic and Evian in France and Turkey. So we continue to implement all the actions to create and develop the conditions for profitable growth.

Moving to NORAM and CIS, the 2.8% growth reflects the capacity of Danone to confirm its category leadership, even in a tough environment when we take into account the current background of these two important platforms. And I will go through the detail in a minute.

And lastly, ALMA is as well reporting a very strong growth in Q1, despite some destocking, mainly in Asia waters and Chinese infant milk formula. And we do not see any reason to question the rhythm of growth in this part of the world, where Danone continues to invest behind its four categories.

So let's move to the category dynamics. And I will start with fresh dairy products, page 7. So as expected, the fresh dairy product performance shows a less negative volume trend. This is the result of CIS that is improving this quarter. It is overall difficult to make a simple global message as stakes are different from one region to another. And I will go through the different regions, but what I can say globally on the division is that we are on track with roadmap.

Across regions we continue to optimize the way we operate, being more disciplined, making sure we create within the division the right conditions for investment, supporting the right bits in a pay-as-you-go manner. And we continue to build the categories through innovation and new initiatives with retailers.

So let's go by region, and we start with Europe on page 8. So as you see, our agenda of dairy Europe remains unchanged and aims at anchoring a new solid model of growth. And for that purpose, 2015 is key to root a profitable model of growth through the monitoring of the gross margin in a disciplined manner in order to be able to nurture investments behind our brands and product uniqueness.

If you look at the Q1 top line, this is, as expected, in a similar trend that we had in Q4 2014. It continues to be impacted by the carryover effect of our profitable revenue growth management program that you remember started at the end of H1 last year.

As we shared previously, part of the volume decline is related to the management of this program. And this program is aiming at having a stronger portfolio going forward, looking at assortments, promotion efficiencies, that is delivering significant gross margin improvement and will create and create the conditions for the return to growth in dairy Europe.

Sequentially we do expect that we get an improvement of the [sales] along the year, with a consecutive contraction between volume and value contribution.

If we go to more concrete results, and you have some illustrations on the chart, Actimel continues to perform. The global European performance is positive this quarter, with countries like UK growing double digit. And we have a third range, that is Actimel Kids, being double-digit positive also this quarter.

We have also some good sales signs and initiatives around indulgence. It's the case of Danet Spain. It's the case of Danette Le Liegeois in France growing nearly 50%. And we have just launched a range on white indulgence under the brand of Gervais in France.

Activia remains negative but with signs of improvement in some countries.



So let's turn to US. In the US we continue building our agenda to create new dynamic of growth. The global category is still growing, although at a lower pace. And in this environment we have been successful in maintaining Danone leadership, having been able to reach a position of co-leader in the Greek segment, where we still see opportunities of growth and where we're having successes with our new launched Oikos Triple Zero.

Also, as we shared in our full-year 2014 results, the category has expanded around 4% in terms of shelf space as a result of the Greek expansion. We now need to rationalize the shelf and make sure that velocities are increasing. As category leader, we are best placed to work with retailers on managing the shelf.

As well and as you can see, we continue to animate the category with different initiatives. Here you see the Light & Fit protein shake, which opened a new moment of consumption and which is starting well. And as well a new type of availability of product with our alliance with Starbucks. That is now live and will come soon in groceries.

So basically for the US in 2015, our agenda remains to invest behind the category to reignite growth in the category, with great potential.

Let's move to CIS on page 10. So in CIS, as you see, Q1 is showing some improved growth, with volume development continuing to be negative overall. We need to remain cautious and we continue to monitor the consumption trends very closely. But this confirms that our model is very resilient and our market share is solid. And as you can see, our key brands remain strong pillars for the development of the category, with double-digit value growth.

As well, what we have done recently was the launch of the Danone range. And it shows our capacity to well adapt to new market conditions and also leverage our international expertise for consumer preference.

In a very uncertain environment, we ensure that we have the right discipline behind our initiatives and we continue to work on efficiency and simplifying the organization.

So to finish for the fresh dairy division, I would like just to come back on page 11 on some of the innovations that we had in Q1, because innovation remains of course a key part of the dairy agenda. And some examples that you see this quarter show initiatives around the hunger need scope, and this is the case with Oikos Triple Zero and Taillefine Plus, and also around the segment of indulgence, and I was mentioning earlier the white indulgence with the launch of Gervais in France, where you see the pack on the chart.

So let's go to waters, page 12. With nearly 9% growth, the waters division confirms again its capacity to keep building a very balanced model, with volume growth and value creation through new brands, through better mix and geographical dynamics. The growth is solid in all regions. And despite a destocking effect in China after a high level of sales upfront Chinese New Year in Q4 last year, the performance is very strong and is now back at the same level as we had last year.

Overall Danone won market share. In Europe, Evian remains very solid and we have a very good reception by consumers of the 500-milliliter new pack. Volvic maintains its growth path more particularly in aquadrinks. And we have a very good mid-teens performance in Turkey as well.

Going into Asia, Asia remains a key engine of growth. Mizone keeps growing its market share. And we have recent launches of new flavors with Mizone that prove again the potential of that range in this region.

Overall on aquadrinks, we can say that it's continued to be a very resilient lever to expand categories through healthy hydration offers.

So to make a long story short on waters, I would say that all elements are deeply rooted to support in the division a profitable and sustainable model of growth that will deliver the same quality top-line results in the coming quarters.

And as you can see on the next page, this agenda is also supported by a great innovation pipeline. You have some examples on the chart that shows a very dynamic portfolio through new packaging, new brands, flavor expansion (inaudible) this quarter all around the world.



So let's move to early life nutrition on page 14. With 11.6% organic growth this quarter, the growth performance in early life nutrition is strong. The basis for comparison remains favorable, but is more normalized, I would say, than it was the case in Q3 and Q4. And we have a performance that is solid in all regions.

Europe keeps growing double digit. We have flat volume in weaning food and continued strong dynamic in infant milk formula. And it's mostly driven again by the success of international brands like Aptamil or Nutrilon for the Chinese market.

Sales also keep growing double digit in the rest of the world, with continued market share gains in Latin America. We have solid business trends in Indonesia, Malaysia and Australia.

So maybe let's go to the Chinese market. Regarding China, what I can say is that I can confirm the trend that we explained when we commented the Q4 and the full-year results of 2014. What does this mean? It means that first the category keeps moving towards a more e-commerce balanced model, made of successful international brands. So for Danone, basically that means that today we are quite close to the position of the past in terms of market share. But what was two-thirds based on Dumex is now two-thirds based on e-commerce, including local and international.

On top of this, and this is the second part, the Nutrilon Platinum in Mom & Baby store is gaining market share. And the specific Chinese Nutrilon program is starting strongly in the channel of mom & baby stores that is dynamic.

And the third thing is that unfortunately Dumex is still having difficulties to find positive trends, also because, as we expected, the retail channel continues to decline.

So in a nutshell, China market remains a key part of our agenda. And the success of our international brands, like Aptamil, Nutrilon and Cow & Gate, confirm that what matters to Chinese mothers is the equity of brands made of safety and quality.

Moving to page 16, you can see also some examples of new products launched this quarter. I would specifically outline products for pregnant and breastfeeding mums, like Nutrimum and specialties. You have here the Nutrilon without lactose. And I think these are focusing on key segments for growth, for namely pregnant and lactating mums and, on the second hand, the specialties.

So medical, medical nutrition, page 17. I am pleased to report an excellent Q1 growth performance for the division that is outperforming historical average. We have, on one hand, Europe reporting a very solid performance that is above mid single digit, with UK, Poland and Turkey being very dynamic. And on the other hand, in terms of products, this quarter Neocate in pediatrics and Nutrison in tubes performed very well. And the division confirms its strong potential of growth outside Europe, with a level of growth above mid teens again.

As part of this performance we continue to have a good innovation agenda, as you can see on page 18. So you can see some innovation around nutrition, which I just mentioned as a very dynamic brand. And then you have a new improved formula and new flavors around Fortimel.

So this is the end of the world tour. And probably let's move to our roadmap. And I will start with page 20. It's a chart that you've already seen. Just to tell you that the team are fully focused on an agenda that we summarize around four key words: optimize, invest, build and nurture. It's about optimizing the model in improving gross margin through portfolio management, efficiencies and discipline. It's about investing behind the right initiatives towards sustainable profitable growth. It's about building our categories and regions and shaping our Danone 2020 guiding vision.

So within that roadmap, 2015 will be and is, I should say, both a year of delivery and preparation in an overall context that will continue to be complex and volatile. Delivery of profitable growth in 2015 and preparation for 2016 and beyond to make sure that profitable growth is sustainable beyond 2015 and that we can then accelerate growth towards 2020.

So turning now to the guidance. I can confirm our objective of delivering a 4% to 5% sales growth with a margin that will be slightly up. And please remember that when we say slightly up, it's also because we want to make sure that we have enough investment in order to prepare 2016.

So to conclude, what I would say is that Q1 is fully in line with this agenda and rightly sets the conditions for the next quarter.

Thanks a lot for your attention, and I am now ready to take your questions.

QUESTIONS AND ANSWERS

Operator

(Operator Instructions). Jon Cox, Kepler.

Jon Cox - Kepler Cheuvreux - Analyst

Yes. Good morning. It's Jon Cox with Kepler Cheuvreux here. I have a couple of questions for you. Actually I'll go for three. First question just on the gross margin improvement you're seeing in that dairy business in Europe. Can you give us an idea where you are in terms of the plan? I think you lost about 500 basis points of gross margin over the last couple of years in dairy. Just wondering where we are in terms of the rebuild.

Second question, on your guidance for the year, trading operating margin slightly up on an underlying basis. I wonder if you can just give us an idea of what you think the non-underlying elements will be this year. Should we be factoring in something like 30 basis points' improvement just on currencies and the change you mentioned regarding the Indonesian stake?

And then just a last question on minorities generally with what you've done in Spain. How much will that benefit your earnings this year because obviously you now have reduced minorities in Spain? And how much did you pay for that stake you mentioned in your Annual Report and today again? Thank you.

Cecile Cabanis - Danone SA - CFO

Thank you, Jon. So about your question regarding Europe, I can confirm, and we had several occasions to talk about it, that with the adaptation plan and with what we are doing as work in terms of profitable growth revenue management, we are significantly improving the margin. And it's all part of building a new virtuous circle of growth through rebuilding gross margin in order to make sure that we can invest behind our brands and create the right conditions in order to get back to growth and stabilization in Europe. So I would not give you a number, but I can tell you that gross margin has significantly improved.

Then if I go to your second question on different items. So on scope it's basically what we have said already, meaning that there will be a positive impact on scope and it will be somewhere between 10 and 15 basis points in margin. And as far as ForEx is concerned, there will also be a positive impact. And we estimate that, based on current rates, but you will have to be careful because it keeps evolving, there will be a positive impact on EPS between mid single and high single digit for this year.

Coming to your question on Spain, so on Spain, the price we have paid slightly lower than the value that we had booked in our debt. And I think that's it. And yes, sorry, there will be a very slightly positive impact of the fact that we have bought some part of the minority in the EPS but it won't be material.

Jon Cox - Kepler Cheuvreux - Analyst

Okay. Sorry, just as a bit of an add-on on that minorities, is the plan to basically take that all in house this year? Or is that really up to the minority holders and whether they want to participate?

Cecile Cabanis - Danone SA - CFO

Today there is no plan. We just -- we have now 91% and then it will be between us and the minority to see at what pace and how far we go.

Jon Cox - Kepler Cheuvreux - Analyst

Thanks very much.

Operator

Alain Oberhuber, MainFirst.

Alain Oberhuber - MainFirst - Analyst

Good morning, everybody. Alain Oberhuber, MainFirst. I have two questions. First, could you elaborate a little bit on the Activia development and when do you think the volume growth or the organic growth in Activia becomes positive again?

And the second question is also in fresh dairy, about Mexico and Brazil, if you could give us a little bit of development in these two big markets for fresh dairy?

And the last question is about Waters in Mexico as well. What was the development, in particular regarding the tax increase we've seen of beverages in Mexico last year, if you could benefit from it or if aquadrinks had some issues or negative development?

Cecile Cabanis - Danone SA - CFO

Okay. Thank you. So I'll start with Activia. And on Activia you have to remember to separate between different geographies, because the dynamic of Activia is different in the geographies. So I guess your question was on Europe, which is the one I mentioned in the presentation.

In Europe this is basically what we explained. So today it's still negative. And it's still a big part of the sales, but we are working and we are seeing some signs of improvement, especially in Spain, to name it, in Q1. And we continue to work in order to improve the overall sequential volume and with the objective to stabilize it somewhere end of this year, beginning of next year. So that's what would be the plan for Europe Activia.

Then on your question about fresh dairy in Mexico and Brazil, in Mexico the performance is very solid and has been for a few months already. So we have a position that is very strong and a growth that is dynamic there, around mid single digit, I would say.

And then in Brazil, Brazil is having a difficult context overall, but it really depends on the category. We are really dynamic on all the categories. But in dairy we have been seeing in the past months some softening of the growth that we need to monitor. But we have the right actions in order especially to push again behind Activia and Danonino. So it's holding.

And then regarding your question on waters Mexico and the tax, you have to remember that the tax was on all sugared beverages, so it also included the aquadrinks. However, we continue to have in Mexico a very strong platform with a very solid market share. And what I can say about the tax is that it didn't give any competitive disadvantage or advantage because it was applied to all sugared beverages.

Alain Oberhuber - MainFirst - Analyst

Thank you, Cecile. Just an add-on question. Did I understand you right that in Q1, fresh dairy development in Brazil was already negative?



Cecile Cabanis - Danone SA - CFO

No, not at all. I said the growth has softened. But we are holding well and it's still positive.

Alain Oberhuber - MainFirst - Analyst

Thank you very much.

Operator

Jeremy Fialko, Redburn.

Jeremy Fialko - Redburn Partners - Analyst

Hi. Good morning. It's Jeremy Fialko from Redburn here. A couple of questions. First of all, can you just give us some more details on the destock in China? You mentioned that in both the waters and also in the nutrition side of things. Is that just the post-New-Year phenomenon or do you think it's just more an underlying signal of a slowing economy there?

And then the second question is on your fresh dairy volumes. Clearly the sequential trend there was better having done -- it was minus 8% in Q4 2014. How close on a divisional basis do you think you can get to flat volumes by the second quarter or the third quarter this year? Thank you.

Cecile Cabanis - Danone SA - CFO

So I will probably comment on fresh dairy volumes first. So here again we need to be careful not to have one global message because it's different amongst the regions. And you have to keep in mind that what I mentioned about CIS that is improving in Q1, and about CIS we need to be very cautious because the consumption is still fragile and we need to monitor it closely.

About volume, what we have said, and it's still the same agenda, is that we will have a sequential improvement in Europe quarter after quarter and that we expect in Europe to stabilize between end of this year and mid next year. So we are still on this agenda.

And regarding the rest, we still have positive volume of course in ALMA. And so I think that would complete what I can say on fresh dairy volumes.

Then about destocking in China, so we have two elements effectively. We have the waters China. And what I said is that basically we had some impact entering the year in January/February. March was fully back to a level of growth at the same level as we commented last year. So this is for waters. And we had also some stocking effect in infant milk formula that had some impact in January and February trends.

Jeremy Fialko - Redburn Partners - Analyst

But similarly March back to normal there as well?

Cecile Cabanis - Danone SA - CFO

Yes, we think -- we believe it is back to normal. Yes.



Jeremy Fialko - *Redburn Partners - Analyst*

Yes. Okay.

Operator

Adam Spielman, Citi.

Adam Spielman - *Citi Investment Research - Analyst*

Good morning. Just a couple of questions. Just to follow up straight on that destock question. Are you able to quantify what the waters like-for-like sales would have been without the destock? I suppose that's one question.

Another question, please. On -- if I turn to European dairy, I'm interested to know what's happening to pricing. Now clearly -- and I want to try and exclude your actions. So if I look, obviously input prices have come down. But I want to know for the SKUs, and I'm expressing this badly, but your price mix has been boosted because you've taken out some low-value SKUs. If you try and remove the mix effect, can you talk about pricing in Europe?

Cecile Cabanis - *Danone SA - CFO*

So on pricing in dairy Europe, basically we have not seen, and I think I commented that earlier, we have not seen any material impact of price decrease following the fact that the milk price has decreased. And we have not seen that because what we've been saying about the category is that we are in a category of differentiated products. So we were not expecting that, and this has not happened. There has been some adjustment here and there, but overall what you see in price is the carryover of the price increase of last year. But nothing specific in terms of price decrease from this year. So that's what I would answer on dairy Europe pricing.

In terms of destocking, I think what is important is what I said earlier, meaning we are back to the trends that we had last year, which is double-digit growth, very dynamic. And I think that matters. So we had some effect between Q4 and January/February. But now we are back to the, let's say, normalized level that shows that there is still great potential. And I think that's what matters rather than trying to do many calculations on precise impact.

Adam Spielman - *Citi Investment Research - Analyst*

And just a very quick follow-up on the European dairy pricing question. Have you seen any change in pricing for private label?

Cecile Cabanis - *Danone SA - CFO*

No.

Adam Spielman - *Citi Investment Research - Analyst*

Thank you.

Operator

(Operator Instructions). James Edwardes Jones, RBC.



James Edwardes Jones - RBC - Analyst

Yes. Morning, Cecile. I have two questions, please. First, your comment in the statement that you expect dairy prices to rebound in the second half. Is that a result of what you're seeing right now or is that just caution on your part?

And secondly, what am I missing? It seems to me that your comps clearly get much more difficult as you go into the second half of the year as far as like-for-likes are concerned. So why shouldn't we be expecting a significant deceleration in organic revenue growth as we move into second half of the year?

Cecile Cabanis - Danone SA - CFO

Okay. So about the milk price, this is not cautious and this is what we continue to see. When we commented in the full-year 2014 results, we already said that we had a favorable impact that was specifically strong in H1 and that we expected a rebound. And it's not to be cautious; it's because of different factors, including the fact that we expect that the Chinese imports will start again and they will create more pressure on demand, hence have an impact on the prices.

So today, the latest projection that we had from the teams is still showing -- and basically the evolution -- the recent evolution of S&P is still showing that there would be a rebound somewhere between Q3/Q4 and beginning of next year. So it's an assumption that is serious and that we continue to have in our forecast.

Then on the comps, I think there are two different effects. You're right to say that on early life nutrition there will be a less favorable comparison base, and that I mentioned in the presentation. But on the other hand, we have in waters some seasonality and the fact that the growth will accelerate a bit. And then we have also the fact that, as we mentioned, the volumes will sequentially improve in dairy Europe.

So all in all, we have no reason to change what we say in the full year, which was we expect that the growth will be quite balanced between H1 and H2 as a percentage.

Operator

As there are no further questions in the queue I would like to hand the call back now to our speaker, Cecile Cabanis, for any additional or closing remarks.

Cecile Cabanis - Danone SA - CFO

Okay. Thank you, everybody, for attending the call. And I wish you a very good day, and I'm sure we'll stay in touch. Bye-bye.

Operator

That will conclude today's conference call. Thanks again, ladies and gentlemen. You may now disconnect.

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