



Transcript

May 18, 2017

Question and Answer Session

Participant

Thank you very much for the granularity, which I think will be much appreciated. On the topline guidance, I see it has come down. What are your thoughts on that? Initially, you were saying that WhiteWave would add 50 basis points or more to the topline growth and you were talking about at least 5% growth from 2020. I am just wondering, on the dynamics.

Emmanuel FABER

I guess that Cécile, in a way, has indirectly answered that. The comment that she made about the fact that in the fourth category, Essential Dairy and Plant-based international, the growth of 4% was made from an ex-dairy business growing only short of 2%. If you remember the way we built the above 5% number in our 2015 guidance, this was 3% to 5% for dairy. This is the recognition that reigniting growth in our existing dairy business is taking more time. Fundamentally, there is no other change than this that has moved the needle, in a space of time that has halved since we gave that guidance, because we are now three years into reaching 2020.

Participant

Could you share with us the reasons why it would have been very hard, long and expensive to build a WhiteWave business, instead of spending USD 9 billion, if we exclude the net asset value of the synergies? It is a big amount and I know you have probably had a deeper look at WhiteWave and what they have built. It is probably much more tangible for you, although it is early. Could you share with us, how much more convinced you are than you were nine months ago about spending this USD 9 billion, if we strike the synergies?

Participant

In a way Pierre, there are two points in your question: why we could not have done that; and what is it worth? On the first part of the question, we tried. I think most of you have been with us for long enough know, and I have heard say, that we have made very interesting inroads in fermenting protein. Today, we even have a few SKUs, with one in Spain, one in India and we had one in Poland, where we mixed cereal and dairy. As Gustavo and the Dairy team said, this is a great way to lower the cost overall and create different taste profiles. With wheat, you get a sort of an interesting, biscuit texture. The fact is, that after five years of trials, we were still at the infancy of this and spending money, R&D, without reaching any skill. It is a little bit like, you are the leader in an industry that is disrupted, can you also be the leader that completely disrupts itself, at scale and fast enough? The answer to that was no. We could and would have continued to explore all of these. The fact that we created the Africa strategic business unit was obviously one of the avenues that we were looking at to continue that. However, we were convinced of what I said, when I said that there have been revolution accelerators, consumer shifts, trends that are really points of inflection. These points of inflection were there. Alpro had multiplied by three in size in five years and as, Koen said this morning, they are seven times the number two. We know the number two quite well, it is a French company. It was clear that we could have done that but we would not have led the way, because the trend has gone from a niche to a mass, household penetration, number of flexetarians, etc. WhiteWave is bringing us immediate access to a leadership position in this second generation or future of food. On the second point, we did our maths and our maths have not changed. We believe they are right for what we are creating here. You heard Cécile and myself repeat that we have not changed anything in our value-creation plans. The one qualitative point I would add to this question is something that Lorna hinted at in her presentation, there are a number of untapped opportunities. Most of the synergies, as you know, are focused on cost synergies and there are quite low hanging fruits in distribution gains, leveraging our sales forces, beyond the numbers that we have in the plan. There may be a case for us to accelerate those. Do not take them in the numbers in your models in any way. The point I would add is that it is a huge white space for innovation, but instead of having 500 researchers worldwide in Danone, coming from one view of the world and 20 guys somewhere between India, Africa and Spain, working in a little lab trying to develop vegetal, we have the whole slate of expertise. You have tried these products. Alpro and International Delight are delicious and incredible products. As the EDP team said this morning, we can now mix the two together and instead of the two companies fighting each other, as they have done in the past, we can turn to the broader perspective of how we create the food of the future. This is not in the number. This is value that we may see in five or 10 years and that frankly, we could never have had without the acquisition of WhiteWave. It is really an inflection point.

Participant

On the operating margin you said above 300 basis points. You have told us that there is no change on the dairy, which is still 200 basis points, so obviously there is quite a big margin expansion coming from DanoneWave. Can you tell us what the margin is for DanoneWave and what the margins will go to? How much margin is coming from the other divisions of Water and ELN? Could you give us an idea of the phasing of the margin in terms of trying to model this? You have said above 16%, but there is obviously no upper threshold. On the topline, I get the point on 2020, but getting from here to 2020 in terms of volatility is very high. I know that you do not want to give any numbers around 2017, but is it all going to be jam tomorrow, back-end loaded in 2019 and 2020, or do we already get some improvement on the topline in 2018? It would be quite useful just in terms of helping us a bit on the phasing of the margin and the topline.

Cécile CABANIS

I will start with the margin, which is really everything I have said. There is an immediate dilution impact, given that the level of WhiteWave's margin when we acquired it was lower than the average of the company and we said that it would be dilutive as of year two. The margin of WhiteWave will improve and we have the synergies. We have the protein impact that I gave you, which will start kicking-off in 2018 at around 100 million per year. If you look at the rest of the categories, it is mainly Specialised Nutrition, which is already a very high margin business, so we will make sure that it grows strongly to ensure that it brings a positive mix impact into the margin. It will probably not improve the margin that much because it is already very high. In water, we have a good margin, especially compared to our competitors and again it is a matter of the sustainability of the margin and growing faster.

Emmanuel FABER

I will do the growth part. The short answer about whether it will be back-loaded to 2018, is no. As far as I can predict in our current environment, it will be a gradual improvement of the sales growth. You heard some of my colleagues and you heard Régis and Cécile, on how the reason we are guiding for moderate growth is essentially related to what is happening in the first half of this year. We will see in Q3 a sequential improvement from where we are, which neither I nor the team are happy about and which we would like to get out of as soon as possible. You will see a growth reacceleration. Cécile hinted at x this or x that, etc. just for you to understand what the key engines are that are not firing on all cylinders today. Gradually dealing with what are, most of the time, execution issues, will create a ramp-up into the growth of Danone from 2017, through 2018, 2019 and 2020.

Participant

In the presentation you talked before about local brands performing better. I think part of the reason is that local players can pick up local trends and adapt faster, and tailor more specifically. When I listened to the Protein presentation, the big theme was about simplicity, which I guess is another term for standardisation and actually negating the ability to tailor. Would you accept that there is a trade-off between driving for margin and delivering growth? I know it is too simplistic to say today that you have given us a little bit more margin at the expense of a little less sales, but do you think there is a trade-off? To the extent that there is a trade-off, who is policing that? Clearly, there is a target out there for savings which people will be remunerated for achieving, so who is policing the trade-off if there is one?

Emmanuel FABER

I do not think there is a trade-off over time but obviously there is one every day. The trade-off every day is that you do not get anything without investment. You do not get any result without an effort. The question is how big and how long for? I will come to who is policing that and how. Your specific point about Protein is a very important one, because we have started to build a model where we believe we have more granularity than 90% of our large competitors, even organisationally. We already have a portfolio of very local brands, so we are going to double down on developing those and we have this ability. A number of our businesses are local, fresh dairy is 90% local and a lot of our Water business are national brands, except for things like Evian, and they stay in the country and some of them in the regions. Then, we have Specialised Nutrition, which is about special care that can travel around the world, given how specific these

products are. We could discuss whether they will continue to travel, or whether other things, like political forces, will lead us to continue to localise production. We have some very important production in WuXi, near Shanghai in China, to serve the Chinese market as being the Chinese leaders in that market, but we also import a lot in medical nutrition. We have designed an organisation and strategy that is much more relevant to local than that global picture of the food industry would lead you to believe. Protein is not about this, it is about indirect spend. It is nothing that the consumer touches or experiences. It is not the packaging, water, milk, ingredient. It is nothing of that. It is about our ways of working, my way of travelling, my office, the way we run space and cars, the way we pay consultants, the organisation of logistics. This is absolutely not against the idea that you design your products, your brands in a way that is relevant to the local reality of where consumers are. It is serving with simplicity and simplification, the ability of the teams to be efficient and, as Cécile said, to reinvest part of that into growing any global or local brand. I want to insist on the fact that Protein will simplify. We had this question about the cost of all of this, but getting Protein right will make our lives simpler. We have already told you that we have gone from 34 travel agencies to one and it is just a simplification. It will not prevent people from travelling or meeting consumers or governments, they will simply have to go through one process and not renegotiate so many times with so many different agencies. We will just have one. I think you can really be reassured that the efficiency we are talking about is not going to prevent us from being adaptive to the local reality in any way. Cécile, do you want to talk about how we are policing the margin versus sales when there is a need to, the trade-off?

Cécile CABANIS

The trade-off is about what I said on the resource allocation process. Every quarter we look at where we are, the outlook for the rolling forecast for the next four quarters, what we want to build and the strategic mandate on the three years. Are we there and on track? Are we delivering against our commitments and results? Do we have initiatives that could accelerate or have a business impact? Do we have risks to mitigate on the business side? We have two days of conversation on each category and at the end we prioritise and decide. That is why I say it is both about agility, to make sure that we control the agenda and the right pace, the right balance in managing growth and profitability, and it is about discipline, ensuring the delivery of the results.

Participant

Just to add to my initial comment that you cannot get a return without investment to start with. One very important aspect of the process that Cécile has just described, is time horizons. Every quarter we have a spreadsheet that we share, where the resource allocations that come from the business and that we discuss are classified into short-term, mid-term and long-term buckets. Depending on where we think we should be going and building the short, mid and long-term horizons, it could be about allocating to the very short-term, such as a very important promotion that we could double down. This was the case when we decided to put more money on Oikos in the US, supporting the NFL promotion and everything else. Doubling down on this was very short-term and a few dozen million dollars and it paid-off a lot. At the same time the American Medical Nutrition people wanted more money to start a clinical trial that would probably support the authorisation from an important government three-years from now. That is how we are looking at this, really looking at the time horizons and managing that risk and the horizon of how we allocate our resources.

Cécile CABANIS

Lastly, there is efficiency as well. Local organisation adaptation costs money and it is something we put in the margin. It is an investment for sustainable efficiency, so this is also the type of resource in this conversation that we discuss allocating.

Participant

On your deleveraging target, could you not be more aggressive on that? You still have an over 20% stake in Yakult and we do not know if it is core or non-core for you. Is there the potential for you to deliver quickly on that? You said that your underlying Dairy business like for like growth is up 2%. The maths suggests that the underlying implication for volume growth invested in Europe is likely to be subdued over the next few years. Am I right in that deduction?

Cécile CABANIS On the deleveraging and the three times, when we announced the acquisition in July we said that we had one objective, which was to retain our strong investment grade rating, because we think it is the right level to ensure both discipline and flexibility in the investment we continue to want to build. Yes, we could be more aggressive. We have set a ratio of three times and we have milestones to deliver since then and we will deliver through free cash flow generation. Yakult is not on the agenda. It is a strategic stake. We have some R&D alliances in Japan. The deleveraging is really about cash flow generation from the model, continuing to ensure that NOPAT converts into cash and that we keep our level of best in class in working capital.

Participant

You say that you will continue to pay dividends as always, no change in policy. Could you elaborate a bit more between cash payment and scrip dividend? What is in your mind for the next four years? Will you be happy to see big players entering the organic dairy category? That is a very open question.

Cécile CABANIS On dividends, we have in the past used the option of scrip dividends. We do not always use it; we used it two years ago, but not last year. It is an option, but we have not fixed whether we do it next year or the year after. It is certainly very important for us to show that the deleveraging plan is according to the objective we have to reach. We are comfortable on the cash flow generation and we will be disciplined in terms of investment, but we will make sure that we do make the investment we need to make. It will be an option, not a certainty.

Emmanuel FABER

On whether I am happy that big players enter the organic category, provide they pay a big price, I would love it and as soon as possible. If this is a real open and longer-term question then where is Stonyfield going at the end of today? The answer is still yes. I think this category is completely under developed and needs more recognition than it has today. When it comes to fighting against larger players than today populating the organic dairy space, I think that probably not only today, but through the transformation we have been talking about, Danone would be pretty well-placed to face that competition. The answer is yes, we need more people to go into the category and make it more mainstream, to spend the dollars in advertising why organic is important and push customers to bet on the category themselves. You still have a price gap that is anywhere between 30% and 50% and sometimes more, depending on how big the raw material, and particularly the milk, is in the formula. It is a real barrier, which is why we started this non-GMO option in the US, which is a great way of creating a mid-way, which is really convincing about naturalness. You heard me say that everyone is using the word 'natural' and consumers do not understand what that means any more. You have been through the breakouts on non-GMO today and it is a way for us to get into the mainstream the organic concept, ingredient concept, soil and farming behind it. If the same could happen on organic, I would welcome it.

Participant

Can I just come back to the revised topline guidance, specifically on the original Dairy business, where you are looking at growth now of less than 2% versus 3% to 5%? I am just trying to understand what has changed in the last 18 months. I appreciate that Spain is clearly more difficult. It feels as if Activia is an execution issue, by all accounts you have a plan to turn that around. You have 700 million in incremental investment and presumably some of that is going to go into the original Dairy business. What has really changed in the last 18 months to come out with a significantly lower target for three to five years? You are a global leader in dairy but it feels as if you under index in Asia. What is your strategy for Asia? I think I saw that you exited your business in Indonesia, though I am not sure that was the right interpretation.

Cécile CABANIS

On Dairy and what has changed, 2016 Dairy grew by 2% and in Q1 Dairy was slightly negative. What has changed is that the turnaround of Europe that we expected to happen and stabilise sales by the end of last year, did not happen and will take longer. We have also been impacted by the Brazilian macroeconomics, you saw Mariano's presentation. We are in 2017 and have a starting point where the Dairy former perimeter will probably be flat. Deceleration will happen but it will be under control and just about acknowledging where we are and that we have three years to accelerate the growth.

Emmanuel FABER

I do not see us prioritising the further development of our presence in Asia in dairy. We have a small Indian business and I could, what Cécile said about Nigeria, where we passed on two great opportunities because we believed the price was not right for us. The same happened in India a couple of years ago. I think we need to fix the fundamentals first of our core countries in dairy, as we are doing now, before thinking about growing the business on an organic basis

across Asia. In China, which is by far the largest market, we already have a structuring alliance with COFCO on Mengniu, in a joint venture on dairy, with sales already over EUR 1 billion and a more than 25% share of the Chinese market. Mengniu itself is a EUR 7 billion company, so for us China is Mengniu or nothing. We have a strategic partnership with Yakult and two joint ventures with them in India and Vietnam. Yakult has a great presence, in China in particular; they have been growing a great business, but also in Indonesia, Korea, Thailand, etc. We are keen partners of Yakult and we think the partnership is where it should be today. We have no urgency in moving things. In a nutshell, I agree there is an opportunity but we have to make choices and these are the choices for the next few years.

Participant

On the 3% to 4% growth you gave on international dairy and plant-based, you said less than 2% for dairy. Does that imply double-digit growth for plant-based and how do you get to that assumption for 2020? On the margin side, if when we get to 2020 and growth is below the 4% you are looking for, would you be willing to invest more of the Protein savings to get to that 4%?

Cécile CABANIS

On international dairy and plant-based, we have an assumption that Alpro will continue to grow strongly and this is the base of the objective until 2020. Resource allocation is what we do every quarter, as I told you. It is not something we look at and then address in 2020. We need to have the right initiatives to make sure that they have a sustainable business impact and that are right in terms of value creation for Danone. If we have the right initiative our delivery agenda is secure and we will accelerate growth.

Participant

I may not have understood about the margin and the question about where it will be driven. Did you say that most of the margin improvement, 200 business point Dairy, ELN, Water is more or less where we are? That means implicitly that everything comes from WhiteWave, which would mean that WhiteWave would have to go to 20 plus margin. Could you clarify if I am right in understanding that? Emmanuel you said that with WhiteWave you took a leap forward in the food of the future and with so much description mentioned by yourself and snacking, changing, what is your inner comfort that plant-based is there to stay and that smoothies, beverages or other forms of protein-based snacks will not come in?

Cécile CABANIS

On the margin, you forgot Protein, which will be back in the margin of the businesses, so that once you have looked ELN, Specialised Nutrition and Water, the business has a very strong margin, but the Protein impact the core point cost and the margin of the businesses. Yes, a big part of it will also come because we have 300 million synergies at every level from WhiteWave.

Emmanuel FABER

On the question of whether plant-based is going to stay or be replaced by another fad or fashion, I think our point of view is based on rational analysis and consumer understanding that we undertook and accelerated before discussions and the conclusion of the deal with WhiteWave. They say that there are inflection points. Vegans are about 3% or 4%, but the penetration in households, as Blaine explained, is 30%, which makes it mainstream. That is a rational analysis. There is of course an element of point of view. Do you believe that there will be renewable energy long-term? Do you believe that you will have driverless cars? Do you believe that there will be more electric cars than fuel cars in large cities 20 years from now? It is a judgement call at some point and making a decision like this one is a combination of both. For me, the reality is that it will be either animal or plant-based. I do not know any other source of protein. We have animal with milk and we are gaining global leadership in soy, almond, cashew, nuts and tomorrow we could add others. You heard me say on other occasions that we have been fermenting lentils as a trial in India and millet in Africa. With all the taste profiling, the technology of our friends at Alpro and Silk in the US, we would now be able to bring this to another level. We are buying a company that has a broad array of protein sources for the customers and, as Blaine said, Silk is not seen as a specialist on one, but a broad company that through the Silk Man is bringing the nutrition benefits of plants. This is an anchor for more product development and there is a whole white or green space, that probably none of will see for up to 10 years, but there are truly embedded in the value of this acquisition.

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