Danone Investor Seminar 2018

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Introductory Remarks

Emmanuel Faber

Chairman and CEO

I enjoy your warm round of applause. Here I am. Thank you, Nadia. Let me extend each and every of you a great welcome to our Chiswick offices. As just Nadia said, it is a great excitement for us to catch up with you today. I have my full small executive committee team with me to share an update on the business model and our progress in the business model of Danone today with you, with a few other leaders of the transformation with us here today. So, it is a great pleasure to be with you.

It is also my first Investor Day as Chairman and CEO of the company. So, it is an important moment for me to reconnect in that capacity with you all. In that particular capacity, I would like to say that I have decided that it would be a good idea to have our new lead independent director being with us today. I would like to introduce you to Michel Landel. Michel, if you may just rise so that everyone can see you. Thank you. So, Michel will be with us. You can catch him whenever you want at the pauses, coffees, breaks, lunch, etc. We thought it would be a good idea that having joined about six months ago now, Michel would be exposed to our discussions, your questions, our answers basically, being in the mainstream flow of our discussions with you.

Before we start and probably in my capacity as chairman of this company, I would like to start by killing a few, I think, big elephants that have been in this room some time already. I think killing them might help clearing the conversations of today. So, let me start with one important one.

This was an article in The Economist last summer and I know it had some resonance in your community. You can start with the bottom line of this article that says, 'The food industry is going nowhere.' That is our first point. We can always re-discuss that. If you do not believe that is the case, I think we have a case for that.

If you go upstairs, it says, 'We have a tradition of both economic and social goals as a company.' We have chosen to rethink the role of a firm in this environment and indeed going for a plan B which is this little red title there. The plan B can be plant-based. It can be B Team. It can be B Corp. However, it is B. It is B because we need to be the change. This industry is just going nowhere if it does not change. It will not, and Danone will not change enough, we think, if we do not restart from a different place.

So, starting from the place that has been driving the food industry and the large corporates in the industry with the idea that our ultimate goal is shareholder value maximisation is the wrong way to start. We restarted from the fact that we have a case that companies that will pursue broader goals than these ones will be the ones that will generate a better shareholder value in the mid and in the long term. So, that is really case.

If you follow down to the bottom line of this article, there is a very important sentence here. It says, 'Mr Faber does concede that ultimately, he himself will be judged by Danone's share price.' I would like to insist on this. Not only I concede, but I want to. I fully endorse the fact that we would not have proven our case if that does not show in the share price, if the externalities in the long term in the vast space around us are not valorised and monetised in our share price.

So we summed it up in one page here, that talks about one of our goals, delivering superior sustainable profitable growth, as we, the first sentence, ambition is to be the best at embracing a food revolution. By doing this, we will by the way serve a few important SDGs – the one about decent work and economic growth and the one about responsible consumption and production, which are core to our business model.

So if I look at how this blue arrow speaks in terms of numbers recently, well, we have been accelerating on our top line sales. However, as you know, we are not yet where we would like to be. There will be updates about this today. In terms of the margin, we have been improving, about 180 bps cumulative since 2014 which is an unparalleled progression in the previous decade. So, we are really accelerating on the margin improvement. That allowed us to deliver consistently so far at 10% EPS growth since that journey started in 2014 and a strong free cash flow progression which cumulated this year on the first half with a 20% growth.

Well, then you could say what is the point about rethinking the firm? Well, the point is that there is a big tension within these numbers that you do not see. That we live everyday about how do we build the short, the mid and the long term. How ultimately the long term is translating into our performance in the short term.

There are a growing number of people that are saying, in your community by the way, ESG is a driver of performance. Frankly, I do not think they really mean it. If they meant it, they would probably behave a different manner in driving us in doing this. If you look at this, even consulting companies are now shooting for these things. Here is a BCG thing that says there is a strong correlation between ESG and non-financial metrics and their superior model of valuation. If that was truly the case and if all of you were convinced about this, well, you would have paid that study – you did not. Second, I would not be discussing this today. We would not discuss about rethinking the firm.

So to make my case further and very concretely, EY have put this chart very conveniently. Basically, what is says is that you have a little circle, a grey circle which is value that we see in our discussions with you, the value that is dollar-ised, that is euro-ised one way or the other or pounds here soon. The shared value then which is a broader thing that we share with our communities one way or the other directly in our supply chains and what they call externalities – the CO2, the water footprint, the things that we should not really care as a business if the business of business in the modern days continues to be business. We do not think it is the case because you can look at it in a static manner. However, you can also look at it in a dynamic manner. That dynamic manner says in the food industry where the United Nations have voted the rights to nutrition for everyone in this planet and many governments have actually ratified that right for nutrition where more and more people believe that water should be free. Then my theory is these externalities, this yellow thing is going to collapse right down on the grey zone. So, this is what is at stake if we do not do it properly.

So now, the theory is if we do it properly, we will not only protect the grey zone but we will expand it. Here is it how it works from a very local – and I am sorry you have to go micro to understand that with us. The livelihoods fund is a fund we created about ten years ago. It is CO2-powered fund. Basically, we invest money, we get CO2 credits in exchange for that as investors. Other companies have joined us.

What it does is building resilient rural communities' ecosystem and businesses. An example is Kenya that I took here. In Kenya, the blue in the middle is our associate, Brookside, our partner, the largest dairy business in Kenya. They have probably 50% market share. Their big problem is there is a huge seasonality in Kenya with milk. In the dry season, they have to wet powder. In the wet season, they have to dry powder so therefore CAPEX costs, etc., low quality of the milk, big under efficiencies from an operational standpoint.

On the left part, 30,000 family farmers in Mount Elgon, living in extreme poverty, only three cows per person basically and three litres a day per cow. On the right part, the ecosystem of Mount Elgon is it is one of the water towers for the Lake Victoria. The Lake Victoria authority is very worried that there are more and more sediments going into the lake because of the deforestation, because of the under productivity of agriculture over there.

So, what is the solution? The solution is basically what this fund is doing that we do with them. We are basically going from left to right in many ways by planting trees, creating shadows for the plantations, reducing actually the area. That is the only wrong thing about this graph. Most of the time, we are actually reducing the extensive farming into intensive farming, lower parcels than this one.

At the end of the day, what it produces is this. Socially, we multiply by three the number of people that are above the absolute threshold of poverty. The food security is increased from 16 to 60%. The milk production has been multiplied by 30 times, from 5,000 to 135,000 litres per day in five years creating $200 million in the local economy.

From an environment standpoint, we are now talking to the Lake Victoria authority because they are ready to pay us based on the fact that if they measure that there are less sediments in the lake because of the water capture of these agroecology systems, they are going to pay us, output-based. So, that is how it works in Kenya.

In France ten years ago, when we started to speak about the fact that we are working directly with our milk farmers, here is how it moved the recognition by consumers about the brand and their preference basically doubling all the attributes on the brand even including on the taste. Bon Gout in France means on the taste from 10 to 20, double the attribute in taste just knowing that that milk was not coming from a powder in New Zealand or whatever but actually from farmers in France, 50 kilometres from any of our dairy factories in France.

So now, we are doubling down in France. We went for a green Friday, giving away for the organic and regenerative agriculture one day of all brand sales in France ten days ago. That was €5 million that we have actually given, a big invest from a brand standpoint, a big action from an activist brand standpoint. We are doubling down on launching a new organic fair trade brand called Faire Bien which will give 5% of its sales to its ecosystem and its externalities to grow regenerative agriculture in France.

We are doing this because we believe this is business, the business of tomorrow. The business of tomorrow, actually look at the Danone pledge in the US. You know this story. We moved 50% out of GMO of our production in the US two years ago. The first brand we applied it is the kids brand because moms are really concerned. This is what happened. In 12 months, market share shot from 33 to 41%. The brand in a stagnant market grew 9%. So, this is happening as we speak.

Let me use another example, plastic. This is Google searches on plastic basically global. You can see it is a ten-year or more, 15-year kind of timeframe. It has been horizontal for ten years. Suddenly in 2018, it is a vertical. Five times more searches on plastics on Google.

Well, what does it mean for us? It means that if I take Indonesia for example, you see the grey curve is the virgin PET. You heard Cécile, myself explaining this year how inflation was back. That is one of the inflations we see on PET, a lot of inflation. However, for the first time also, the yellow colour is that the recycled PET in Indonesia starts to become lower priced than virgin by 16% in this year. The small good news for us in this is that we have established for some time, ten years already, social work with NGOs through an endowment fund that helps scavengers in the land fields to get proper safety, proper work environment, proper social coverage to make sure they work better, they produce better, higher productivity that allows us in the blue line compared to the yellow line to buy our bales of rPET in Indonesia about 20% price lower than the spot market.

So if we had been able to capture much more of that externality over the last ten years, we would be hedged against any increase in price of rPET now. When I say now, one of the topics is that this collapse that I just mentioned is actually happening now in many cases. It is not only for tomorrow.

Look at France. For years already, farmers have been invading hypermarkets and shouting and devastating because they want fairer prices. Look at plastic, plastic attacks here. DAF, Tesco, The Daily Telegraph article literally yesterday, another story this morning in The Guardian about straw ban in this country. It is happening now.

One thing even more radical, Morocco. Morocco where there is a whole social movement that has been there for years but there is now a writing on digital because people are fed up with the fact that they cannot buy food. So, what did they do? They went for the largest company in the most daily purchase you can do, fresh milk, which happened to be the king's family's property. It is now a multinational property. Easy target. That is us. You know the results. We have been sharing that with you.

What it took to solve it? Well, we have not solved it yet, but we have good directions. The first thing is on the bottom left, we decreased the price. However, not only we decreased the price, we decided and committed that we would not make any profit anymore on our business model in selling fresh milk in the groceries in Morocco. That was the price to pay to restart the dialogue with the population there.

Then we launched a completely new SKU, a sachet in half skimmed milk, completely new that worked so well a few weeks ago that we have now to increase capacity to meet demand.

However, what it also took is my own commitment, my coming in there because until I came there and people wanting to see who is behind that brand, who is behind that multinational company, the dialogue did not stop. So I spent a whole day talking to the bloggers, to boycotters, to the moms, to the NGOs, to the government, to the farmers, etc., etc. When I came, we shot a video. That video has been viewed 20 million times in a country of 35 million people.

So, that is why you see me here, not because of my hubris and I want to be seen in this picture. Because this is the danger: Some day, all these anonymous offshore accounts will belong to shell companies of which you will deny all knowledge my son. That is the danger. If food companies continue to be perceived that way, we will not succeed.

So even closer to us, Catalonia, the middle of the EU. Danone was born in Catalonia, in Barcelona 100 years ago. We have lots of businesses in the rest of Spain as well. So, is it irrelevant for Danone Spain to go for a B Corp accreditation where external people will tell about all the good things that we are doing in Spain not only in Catalonia but also on the rest of the country? That we are joining a list of cool companies from Kickstarter, Seventh Generation, Patagonia, Lorraine and others that the generation of people that are changing the way they consume, the way companies like us behave are fond of.

We are so serious about it of empowering locally that we have launched this programme, One Person, One Voice, One Share. One share is I want every people at Danone to be a shareholder of this company. So by the next AGM, we will start a programme where all Danoners will become a shareholder. We have a specific dividend access scheme to really feel each year that their hard work is also a story of ownership, a story of shareholders. So, that we can build this bridge between their position and the shareholder's position, the owner's mindset.

One voice is that we want everyone's voice counts in Danone. So, it goes with one share. One voice is a programme, a consultation we have just launched that is covering the 100,000 people at Danone. We went for a survey asking them what they think is the priority in the nine integrated goals that we have set for ourselves by 2030.

So, we launched that consultation. People have got a lot of pressure, a lot of things to deliver in the short term. We did not know how well it could work. We have not announced any official results yet. However, this has been a great success.

We have, as you know, an internal Facebook at work, a programme on which many posts came. This is the medical team in Nutricia in Benelux. This is Beheira, the distribution centre in Egypt. This is Turkey. This is Indonesia in a logistic base. This is Indonesia, a salesperson. This is again the team.

At the end of the day, 77,000 people at Danone out of 100,000 expressed their opinion on what they think the priorities should be for their business unit, their factory, their lab, their sales force, their product, their brand locally. We are right now compiling these as an input for our next strategic plan. This is basically building on and going further on the huge engagement of Danoners – 86% employee engagement, four points about the 2015 numbers last year when we ran that bi-annual study. Eight points above the FMCG norm and even one point above the high-performing norm of Towers Watson that has been running this stuff for 15 years.

We are so serious about it that this releases nine goals, they become the compass of everyone at Danone. They include the arrow that you see on the left of sustainable growth, strong sustainable profitable growth delivering shareholder value. We are so serious about it that beyond the short-term incentive as you know at Danone where we have about a third of our incentives which is on social management and environmental topics, we decided to go this year with your agreement at the AGM that we would do that for our long-term incentives as well.

So on the performance compensation, we have introduced a 20% employee commitment relative to peers as an indicator of the top 1,500 managers at Danone compensation in the midterm. Same on the performance shares where we introduced the climate disclosure project, climate leadership level that we want to maintain or improve in the future as 20% of the total long-term performance shares conditions for attribution to our managers.

So yes, we are rethinking the firm. However, the truth is if you go again back to the bottom line of this article, I have a much better plan than robbing your money and use it for my good conscience. I can tell you I am not interested in that. What we are interested in is actually what is before this sentence. Before this sentence, it says that finance team of Danone has been able, under the leadership of Cécile, to negotiate a syndicated banking loan where the margin is going down as we are going to become more and more of a B Corp. This is where this stuff is hitting the financials.

We are becoming the company that takes into account the externalities in a big way, is hitting either our alpha or our beta and at the end of the day, I hope our profit. So this is the model. This is what we want to build.

That takes me to a secondary important point which is capital allocation. This is what we shared in 2014 with you. There was a big elephant and there is still an elephant about how we allocate capital. So when Franck and myself joined, this was in 1996, ROIC was 7%. We took it to 16% under your applause by 2006. Then we went for the Numico acquisition, went down to 9% in 2008. Well, we would have hoped that by 2013, we would be back somewhere. However, there is a part missing here. That part, this is what we discussed in New York, again, four years ago.

It showed basically that the big guilt part was the dairy business. Dairy business ROIC had declined from 2008 to 2013 by 35 points, from 64 to 30%. That was the big problem. Then what you can see was medical nutrition was still very low, below cost of capital and early life nutrition was already slightly higher than cost of capital but not where it needed to be.

So ever since what happened, well, what happened was a series of acquisitions in the space of food. A lot of them actually happened. All of them anywhere going into pretty high multiples, an average of 16 to 18 times EBITDA. That made us cautious. Our deals, except for WhiteWave which is a big exception and we will come back to that today, our deals have been anywhere between 12 and 15 times.

So, let me concretely not go back to the deals you know but the deals you do not know. The ones that we decided not to go for, Tirumala, a great entry point in South India for our dairy business. We decided to pass on Tirumala and Lactalis got it. Quorn in this country as we were researching our first topics about getting out of dairy and animal, go for vegan and all this stuff, we let it go to Nissin Monde. Chi Hollandia, Nigeria, biggest country in Africa in the next 20 years, been looking for that for a long time, leader there. We let Coke bid and win on it. Promasidor, you do not know probably any of these brands, a great slate of brands in Central Africa with a great company, some of them like Cowbell, exactly the kind of stuff we would like to have to build our franchise in Africa. It is a several hundred-million-dollar deal that went to Ajinomoto taking a 40% stake in this family business. We did not overbid.

Something you probably know well, Enfagrow, Mead Johnson. How many of you heard me say, yes, this is strategic? Yes, it would make sense. The conditions are not met at Mead Johnson and at Danone to do this deal. Until conditions are met, we will not do it. They were not met. We did not do it. It ended with Reckitt.

Aspen, crumbles of the Wyeth deal, great brands in South Africa, a couple of other countries in Africa, Latin America. We looked at it twice. Twice we said no, we are not going to buy it. Lactalis bought it at the end like a month or two months ago.

I can tell you fresh news that we are not going to bid for Horlicks. We have exactly the same product. Actually, Bridgette would tell me a much better product than Horlicks in India, exactly the same target – nutrition. We will not go for Horlicks because we do not believe that the valuations will meet the metrics that we need to grow our business in India. So we will pass on this huge fantastic opportunity, sorry.

So the result of this in terms of ROIC now, so you have numbers here. What do these numbers meant? From 2015 number you saw to the 2017 numbers. Water, as you can see, has been continuously delivering in the 20s, good job. AMN, medical nutrition, you remember in 2014, we had these long discussions. Maybe we should sell it. Maybe we are not the right owners of that business. Well, we finally decided not to go because we saw value creation potential and it is now seven which is beyond their cost of capital and hopefully will continue to increase in three years.

Early life nutrition had already in 2013 met its cost of capital. It is now 12 and increasing. You had a question on China already at that time. We shared that our Chinese investments, Mengniu, Yashili, Dumex, the whole story of the long ups and downs of Danone in China led us to have in 2013 an ROIC in China of 15%. It is now beyond 20%.

The same question was about dairy and our big Unimilk acquisition that had no margin when we bought it. It is now double-digit margin as you know. From 9, the ROIC of dairy CIS grew to 17 in 2013, a number we shared already. It is beyond 25% now in Russia.

So the big change is essential dairy and plant based. From 65 to 30, the number I just described already on the bottom line. The 30 was still the one in 2017 until we bought WhiteWave where it went down to 12. The math would tell you that with the full consolidation, full year this year in 2018, the trough will be 18 going even deep further down from that year on.

However, today's discussion will be also about our full intention to make it an incredibly value-accretive acquisition for us in the future paralleling the acquisition that we have done in the past and probably even going beyond that.

So with those two big things cleared, what is the purpose of this company and how does that relate to your business? Second, how do we allocate, to try our best to allocate the money you give us to create value? I would like to turn to what is the essence of Danone which is the organic growth model of Danone. There are basically three things that we would like to update you today on.

The first is China. China is basically following on demographics Japan with a 20-year difference. So when you are a business that is in both early life nutrition and medical nutrition as the number one medical nutrition company in China, you have a lot at stake in the short, in the mid and in the long term of it.

The demographics is important enough so that the 12 years ago, year of the monkey is on the left. The 2016 year of the monkey is on the right, two kids. That is how serious the government went and you know how symbolic the Chinese government can be. So in 2016 when they opened the two kids policy, this is what happened.

I do not know what the future will be but this is how the pig year is looking like for next year, 2019. So, the government is moving because they see they have a problem there. The good thing though for our categories is this chart, entering the era of upper middle class. It starts with the orange line. This is the affluent middle class. It will basically be multiplied by five by 2030 to which the same number of households than today the upper middle class. That upper middle class is going to triple by 2030, double by 2025.

So, if you have concerns about the pricing ability, the innovation weariness about the Chinese market, you should not. The issue will be our own ability to continue to capture this valorised market in all dimensions, in actually all our businesses in China.

Another big topic we would like to update you is about millennials and the boomers being the big eaters in this world. You know that. So, I will go very fast with a visual tool of where it takes us. Changing very fast our packaging, innovating and bringing packaging you did not see from us a number of years ago, even quarters with some of them in all parts of the businesses capturing the young and the hungry because they are on social media.

Just two things, 70% of teeners cite cooking and recipes as the top item they pin. Another point, 40% of them share content about brands on their pages. If we have a brand that really engages about the food revolution with them, we have a very special recipe.

So, we will discuss about innovation in many parts of our businesses. We will also discuss about the new power here, the young educated millennial mothers because they change the way the world eats because they change the way their families are eating today. That means a lot of changes and opportunities for our early life nutrition business and also from an organic standpoint and digital because organic which is a growing number of moms and parents, they are also extremely biased towards digital. So, we would also discuss digital today. So, that is the second topic.

The third one is about the story of the three Ps, the probiotics, the protein and the plant-based with a kicker, with fat is back. If there is one strategic move, one decision that Danone made which is going to really change the game, this is the fact of betting on the plant-based, betting that if we owned this triangle of probiotics, protein and plant-based, we can be part of the future of human nutrition. I am serious about it.

We are not ingredient specialists. We are ingredient agnostics. So, whether this is in dairy coming from regular cow milk, to A2, to organic, to lactose-free, to goat milk, to sheep milk the same way we can go from soy to many other ingredients tomorrow. We can leverage the whole number of emerging shades of being a vegan, to being a meat eater with all kinds of tribes evolving from one to the other in very subtle manners, different needs, different moments of consumption and we have the technology and the solutions for these guys.

This will build on the fact also that the average BMI of a vegetarian is five points below the average BMI, body mass index, of a meat eater. The prevalence of Type 2 diabetes is 50% lower if you are vegetarian. Your CO2 footprint is about half what it is. So, they are the fundamentals of why this plant-based acceleration is there. We will go for it. In a nutshell, if I may say, we are going to put plants first and we will update you on this.

None of these would be possible to finish without the power of protein of course. You know what we mean with protein. So, we will update you on how the protein programme is transforming the way we work not only for protein but in many other ways and fuelling both the growth and the profitable growth that you are looking for.

So, I will finish with that. I hope you will have an exciting day with us about all these topics. The agenda will look like this, sorry. Go back here. It is too small anyway so trust me. We will start with our friends at water with Henri and Katharina on plastics. We will then go for specialised nutrition in China with Bridgette, a small break, essential dairy and plant-based with Paco, fit for growth and innovation with Véronique. Then we will go for lunch, finger lunch. Breakout session is afternoon about our Danone Manifesto Ventures incubators. You will meet the team and some of the great portfolio companies. Our nutrition team will update you on how big we are working on these important topics as much as our climate and agriculture team. Then we will have the efficiency and the power of protein session.

That sums it up. Cécile will go back for the delivery on our business model, the growth model. I will wrap up and we will try to make sure we are ready to go by 6.45. Thank you. Enjoy the day.