Danone Investor Seminar 2018

Monday, 22nd October 2018

Q&A

Pierre Tegner (Oddo & Cie): A personal question for Emmanuel, probably two. I will begin with the end of your speech. My first thinking is, is money and gaining more money a top priority for you?

Emmanuel Faber: And the second?

Pierre Tegner: The second one is, just to come back on all of what you said. Clearly, I am part of people thinking that you delivered since you took the lead, because since 2014, if we compare with 2014, just to resume what you said very nicely today, your EPS has grown by 45% from 2014 to 2018, invested capital has increased by 45%, free cash flow has roughly doubled on a reported basis. But the share price has increased only by 15%, so clearly, what are your much more general thoughts on this?

Emmanuel Faber: Thank you for the simple questions, Pierre. On the first one, I would say two things. What I am able to do with the money that I earn with Danone is very important for me. The second, I am interested in money, but not any money.

On your question on the share price, when I was in Cécile's position, I used to say that I did not believe I was in a position to comment on the share price. We are here to deliver what the drivers of the share price are. It is very difficult for us to make, I think, a bigger comment than that. Am I happy to see the share price where it is compared to where I think it could be based on the delivery that you have been describing and based on the long term and the mid-short term that we see for our categories, for our brands, for the business? No, I am not happy with that, and we are working hard to make sure that we are closing a gap of valuation, by focusing on what essentially we have been sharing today.

Jon Cox (Kepler Cheuvreux): Two questions, maybe one for Cécile and one for Emmanuel. For Cécile, what about 2019? Can you give us some sort of bridge where you think the growth of the various divisions will be, profitability. Will it be halfway between this year and the 16% plus, or do you think it is going to be weighted into 16% for 2020? Just something on that.

Then Emmanuel, you are saying that all the brands will become Manifesto in a couple of years. Do you not think people are getting a bit Manifestoed out, and it may be important at the moment, some of these issues, but actually, it is just a reflection of the Zeitgeist, and if you run all of the brands into being really purpose-driven, that actually, that may turn consumers off from 2020 onwards? Thank you.

Cécile Cabanis: On your question in 2019, when you look at what we have shared, and including the fact that we have the short-term deceleration in China, if you remember, this H1 was still a very strong and exceptional growth for China. As Bridgette hinted this morning, we would have an unbalanced year in terms of growth. Growth will start low and will accelerate on the second half. On the rest, we will obviously guide in due course, which is next February, when we publish the full-year results, but there will be improvements of margin consistent with the reasons where we believe we need to take for the agenda and to be successful for 2020.

Emmanuel Faber: To your question, Jon, on Manifesto brands. If I look at it in a very simplistic manner, in a world where you do not shop in a hypermarket anymore, but on

Amazon or anything else, you want to be on the first page of that Amazon. To do that, you either have to be extremely successful in terms of consumer engagement, and therefore, the platform wants you there, or you have to pay a lot of money. Being a Manifesto brand in any given category is a way to get there without paying for it. It is as simple as that. Some of these brands literally attract enough attention that they actually valorise the page on which they sit. It is far from being the case of all our brands today. There will not be any forced manifestation of the brand. We are not going to go for any artificial way of trying to pretend, or fake way of pretending we are a Manifesto brand. We are going to seek deeply what moves people around us – not consumers, but people – and see in this digital age where you do not proof-down. As Vero said, we used to have this job of assistant brand managers where we designed our TV copies, and we were pushing the message down. No one is instituting anymore, in that. There are still buckets of people who are, but the growing part, and where the most value is, looking forward, is with people who do not look at TV much more. If you want to interact with them, you have to make sure that you are part of an intimate conversation as a brand that has nothing to do with your brand maybe to start with, but your brand earns the right to be there because it supports something that is of interest to a tribe or an audience of people who then become consumers of your brand.

It is a totally different approach, and under Vero's efforts across the company, we are putting a whole revolution in our marketing teams in terms of expertise and what it means, to bring a brand into a situation where it can have those kinds of conversations with its would-be users. It is very different, and again, my fear would not be that we have too many Manifesto brands by 2020; it is that we do not have enough. That is really where I think there is a risk.

Question: You have said a lot today in terms of the 2020 plan, you have talked a lot about growth by category, and you have talked a lot about margin development at a corporate level. What I have not heard about is margin development by category, and some sort of sense of how the different categories are going to contribute to margin. The question was asked in the initial session; you said you would ask it about waters, where I think the sense was, the sustainability in Water, is that margin-accretive because you are paying less for recycled PET, or is it margin-dilutive because there is an overhead cost of dealing with the recycling? That is one specific.

I guess the obvious one to ask is with the uncertainty around ELN and how potentially accretive or dilutive relative growth in ELN is to the equation. You see where I am going: just paint us a picture. I do not need exact numbers, but how do category margins contribute to the 2020 goal? Thank you.

Cécile Cabanis: As you mentioned, every category is not at the same point of maturity in terms of agenda, and also in terms of level of margin. We have a Specialised Nutrition business which is very strongly profitable, of course, and then we have an EDP business where, a few years ago, we undertook that we needed to improve the margin, and this will be the bigger improvement of margin from the overall agenda, including the plant-based acceleration.

On Waters, we are clear that it needs to be a profitable growth agenda, so there will be some enhancement in the margin. We have been hit in the short term by PET costs, but today, we are looking at improving margins for all of our categories, but at different paces and different timings depending on short-term headwinds that we have. Remember that Protein is going cross-category; it is not a programme that is only on one category, so it will also play a role for all the categories to mitigate inflation and continue to maximise efficiency. That is overall the pattern for the different categories.

John Ellis (Goldman Sachs): I want to ask you a question about procurement, because you talked a lot about local sourcing, but I wondered what proportion of your procurement is set up globally versus local. Then I wondered if you felt it was a competitive advantage versus some of the big food players to have a more localised structure there, especially when it comes to building these brands, these Manifesto brands. If that is the case, how are you balancing that local setup versus the savings within Programme Protein?

Emmanuel Faber: Well, if any, I think it is much easier to go from local to global than global to local. I am quite happy that today, if I look at our various categories, being dairy, we are basically 95% local. It is clearly a competitive advantage. I am sure you are travelling as much as we do, and you keep seeing everywhere little flags of the countries in which products are being produced and sold, actually. There is a very clear re-localisation of consumer tastes and preferences, for many reasons: political, safety, environment, control. I was talking this morning about sovereignty. People want to understand what they eat, and they believe that if they eat this cheese or this yoghurt that comes from a factory that is only 50 km from here, they have better control than if it is from China, for a variety of reasons. In dairy, it is very clear.

In plant-based, most of the cases, this is local, as well. For the soy we use in Wevelgem in Belgium comes from the Benelux. Same in France, where there is a factory with a soy plantation around, in Alsace, for instance. The almonds are grown in family farms around the Mediterranean countries, in Europe. They come from California in the US. The trustability in where the ingredient comes from is a fundamental approach of the transparency, traceability, that consumers, retailers, are really asking for. The trick is, if you buy global and you only buy one species of tomato, globally, you do not even know where the concentrate has been coming from, because it has gone from China to Nigeria, then to Italy, to have a little Italian label somewhere, and you can sell it in the US to your consumer. It is much more difficult to then go local and try to find something that makes sense for the next generation of US consumers. This is very true, as well, for water, except for two brands, essentially: Volvic and evian, that are travelling all around the world, given their status, I would say. evian is even beyond a water brand: it is an absolutely status brand in the consumer space, and we can discuss that at another occasion.

For our medical nutrition and our baby food business, when it comes to instant milk formula and very, very specialised, they travel a lot. They travel a lot under very specific circumstances. There is an incredible amount of traceability, including with the regulators, about this, and it is really about getting the best science and the best production capabilities, the safest production capabilities, when you are dealing with these kinds of products, and it is about a quarter of our total portfolio. First diets, for instance – vegetables, desserts, whatever, fruit purées for kids – they are increasingly local, except for China, that continues to buy a lot from the countries where they believe, Chinese mums continue to believe, that the food is safer.

Do you want to comment, Cécile, beyond?

Cécile Cabanis: Now it is local sourcing, but it is now the overall centralised and functionalising procurement organisation, and it is back to what I said: it is to ensure that we leverage the skills as well as the scale, and sometimes, the scale is not the matter, but for indirect, for example, when we go for Protein Programme, we need to make sure that we leverage also the scale, and this is really about what value creation we can create from bringing expertise, but making sure it is still very locally grounded and relevant. It is a team that is local, but reporting to the same expertise centre, and making sure that they are linked with our milk cycle organisation or our plastic cycle organisation, to also prosper sustainable practices and best practices around the world.

Emmanuel Faber: I have to add that my comment was mostly about the ingredients in the product. One thing I could add is on packaging. I have a very short word to say, that there are some very global platforms and players which we are leveraging, but the market is increasingly becoming regional, for many reasons, including tariffs, the plastic bans – China has been radically changing things – in PET, you have several buckets of markets around the world that are not correlated in terms of price, supply and demand, regulations difference. There is really an element of regionalisation even on packaging.

Alan Erskine (Credit Suisse): Can I just ask a question about Mizone? We have not heard a lot about it today, but I think it is close to 20% of the Water division, therefore, a key part to that algorithm which gives you 5%-plus growth there. The performance this year I think has not been so great, and my question is, are you sure you are not sub-scale in this category? In most of your other water businesses, you have strong market positions. In China, you are just one brand in a big market, and are you really master of your own destiny there?

Emmanuel Faber: The shorter way of answering this question at this stage is that, someone asked me whether we had seen the trough of the Mizone situation in China, and I think we have. This is what I said pretty recently. However, I do not think we have yet the keys to really grow that business again. There is a transformation, a transition also, in the beverage category in China, in many ways, including channels, and the performance this year, which I think we characterise as being a weak season – and I would concur with that – does not allow me to say we have found the keys. We will rework it.

It is true that we have around 5% market share, which is one of the big brands in China, but yet that is only one, and it is 5%, it is something like 20. We have launched over the last several years innovations that have tended not to stick – outside of the Mizone brand, I mean – as most of the Chinese innovations, the category has been hugely innovative, recently, recently meaning the last four or five years. Some of our competitors heavily investing, like, launching 20 new SKUs, 15 new SKUs, people like Kang Shi Fu, Tingyi, etc., or Uni-President. Most of them failed after one or two years. There have been some pretty good successes, bringing some brands from zero to a promising future, probably, but they are not from the big players, at this stage, and they are the random Chinese innovation that sticks. I would say that I do not have today a reading that I think is satisfying in terms of what it really takes to take our Water business in China from where it is to the next growth level. It is still work in progress at this stage.

James Edwardes Jones (RBC): Emmanuel, I was very impressed by your comments at the end there about your personal wealth. I have not heard anything like that before. What I was wondering is, how do you drive that attitude about the importance of thinking and acting as an owner further down the organisation? There are not going to be many people working at Danone who have 80% of their personal wealth in Danone stock, but it is obviously a very important part of how you are thinking about the organisation and how you are wanting people to behave.

Emmanuel Faber: Yes, thank you, James, for the question. I think the governance and the way the incentives are built, which I touched on, and Cécile had a slide on it as well, shows that 1,500 managers of Danone are incentivised on shares. Their mid-/long-term incentives are based on performance units that reflect mid-term profitable growth, and shares: half and half. This has proven an important aspect of the discussions, the conversations, that we are able to have with them. What we intend to do with the 100,000 shareholders is create the same conversation at all the levels in the company, which I think can be truly transformative. We have insisted on the fact, and got agreement from the Board, that any given individual employee shareholder at Danone would be given one share, whatever your ranking, your salary. It is not proportionate; it is one person, one share.

I think an important aspect is that that share right is going to deliver a dividend access that is going to be a multiplier of the dividend, so it means that a meaningful amount of money is going to be expected every year on 11th May, or 10th May, or 7th May; whenever the dividend is getting paid after you get it approved at the AGM, they will expect some money to come from the AGM. The AGM, instead of being something in Paris held somewhere, and we are talking to a crowd that they do not even know, from Indonesia, Russia, etc., they will be expecting news: has the dividend been voted? Has it grown as we expected? Why did it not grow more? What happened in the other part of the business? Therefore, you are basically creating the opportunity of having a conversation about, the dividend is related to the recurring EPS – at least, that is our policy so far – so what is the recurring EPS? That is different from what I manage at the local level, for instance.

You start having a conversation that is really completely different, and this creates an obligation of having this conversation. It is not an opportunity anymore, it is an obligation, managerial obligation. I think this is, for the next probably two to three years, going to drive something really meaningful from that end, and this is also correlated to the One Voice. We have asked their opinions and priorities for the 2030 goals. 77,000 of them have answered. Not only they will have a dividend access, but they also can express an opinion, which we want for them to be correlated to their attitude of owners, and we will be able to balance the conversations between what they express in the 2030 goals, what it means in terms of dividends. 'Oh, you would like us to go and move faster on lowering sugar, or improving the plastic thing, or growing ecosystems somewhere', but this is going to put pressure on the EPS this year, so what do we do? That is a conversation that we cannot have today: we do not have the organisation, the space to do it. I really believe that it can be a game-changer for an organisation that wants to empower people really to make decisions closer to the market, and keep and create this mindset of being a co-owner of the company.

James Targett (Berenberg): I think there are a lot of people who maybe think that there is no growth in big food companies, and all the growth is in the small food companies. I think obviously, today, you have done a lot to show why that is not the case. Perhaps specifically, you could talk about some ways that the size and scale of being a big food company like Danone perhaps gives an advantage in a way that is perhaps underappreciated.

Emmanuel Faber: I think a very simple one is the fact that a number of these small companies are facing a ceiling in their growth, when – depending on the country, but let us focus on the US for a while – they are beyond $30 million or $50 million, because then they start to hire a lawyer because they can have any problem with the FDA that the FDA would not even care until they are there. Then they would have a lawyer because any class action could start, because as soon as you are a $100 million company and you have only one brand, probably, you can be very hurt by a class action, successfully. You start being on the radar screen of what bigger companies are facing every day. As much as, yes, there is growth and a lot of creativity and initiatives in the space for these start-ups, they are also facing their own difficulties when they start having that scale.

The next aspect is the ability to roll out and multiply. Frankly, I do not think that Alpro on their own would be able to present to you today a €5 billion case by 2025. They just would not be able. They do not have the scale, they do not have the muscle, they do not have the expertise. You look at Russia. In Russia, the market today for plant-based is probably a couple of dozen million dollars, maximum. It can be ten times that, but it will be ten times that only if we do it. If we do it leveraging the presence of the Danone Unimilk distribution that we have in all hypermarkets, in all capillarities – general trade – in any city in Russia, pushing for that, leveraging the fact that when we are going to go to media and negotiate plans, or digital and negotiate plans, we are going to negotiate as being the largest – actually, one of the top three – food business in Russia. This is what we are.

The advantage of scale in speeding up the ability to roll out the innovation I think is critical, provided, though, that you keep this disruptive mentality that it is not just copying a US thing and rolling it out: it is re-inventing it in many ways. I shared briefly a Russian product in my visuals, but Russia is an incredibly innovative business for us, because they keep re-inventing the Russian way of looking at recipes that they find all around the place, and they have been visiting our Denver, Colorado Whitewave research and innovation thing. Same in Belgium: they have been there, and they are already acting in a way that is very interesting in terms of bridging the dairy and the plant-based situation.

I really believe that a company that is ready to disrupt itself in terms of looking at categories, how brands travel and everything, can be successful where small companies may not be, and I would like to finish – because I realise I am very long – by saying that, yet you find the risk, and many have seen that, that one day, people will understand that this cool brand is actually part of a bigger company, and that can be a problem. I think that – and it is public – when you are Innocent, you are not really advertising the fact that you are part of Coca-Cola Company. Well, I think that when you are Happy Family, you are absolutely happy to make publicity about the fact that you are part of Danone North America, the largest B Corp in the world. I am back to B Corp, which is not the answer, but it is simply to say, you really need to work on both ends.

If these cool brands become part of the companies with the little cartoon of the New York Times I described earlier, these opaque companies where you do not who is owning what and why, and who and what the owner's purpose is, then these brands have a problem. You need to go the whole way in disrupting your own company and adopting the ethos of these smaller guys if you want to be successful about it.

Question: I was wondering if you could give us an update on the scrip dividend, if there is anything to say on that?

Cécile Cabanis: I am afraid I cannot give you update, for the good reason that it is really a policy where we keep the flexibility. We have been distributing in cash. Last year, we distributed in a scrip to accelerate the deleverage plan, and I gave all the reasons, and next year, the Board will decide and then we will present it into the results.

Question: Just to go back to the China situation – and I am probably in danger of oversimplifying things here – but it looks to me like you have had four quarters where maybe, if we add indirect and direct, sales in China were up 40%, 50%, and now that is your tough comp, as you describe it, for another four quarters. If we assume that sell-in must sell out, then you have sold that product in; the implication would be then, you are going to lose share. My question is, was there a question of just inventory build that led to that, if you like, sell-in exceeding the sell-out? If that is right, were you aware of the degree to which that was impacting? Could you have controlled that better? Could you have created a smoother sales progression?

Cécile Cabanis: Several comments on that, which I commented last week. In Q3 last year, we believed that on the indirect path, there was some restocking, because if you remember, the Q3 of the previous year was where the regulation news started to come, and that is where the indirect traders are starting to behave with volatility, decreasing their level of stock and having some adjustment in the way they were behaving. Now, we do not know exactly how this is happening, because we are not controlling this channel. We have said very clearly, there is some short-term volatility. We need to remain solid. We have built a very good performance. We have the right brands; you heard Bridgette about the right assets. I think we should really focus on making sure that we stay on our agenda spot on to rebalance indirect and direct, because on indirect, we are not controlling.

There is volatility, there has been news in 2016 about regulation, and then there was a big decrease in terms of performance from the indirect. Last year, there was a peak of births, and a reorder very significantly, including, we think, restocking – so yes, there was some restocking on the indirect part – and volatility will remain until the next quarter. Now, regulation is no news, so today, we have the same assumptions that we had, and we were not surprised by the fact that the performance turned negative in Q3, because of the reasons that I explained. Today, we still have the assumptions that we had at the time.

Nadia Bensalem-Nicolas: Thank you, Emmanuel, thank you, Cécile. This concludes our seminar. Thanks for everybody. Thanks for joining us here in our offices in London, and via our webcast. Thanks to all the Danoners also who helped to make this day happen.