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BN.PA - Danone SA Adjusts its 2016 Guidance Call

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OVERVIEW:

On 12/19/16, BN provided an update on its adjustment of 2016 guidance.



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Alain Oberhuber *MainFirst Bank AG - Analyst*

Pierre Tegner *Natixis - Analyst*

Celine Pannuti *JPMorgan - Analyst*

Simon Hales *Barclays - Analyst*

PRESENTATION

Regis Massuyeau - *Danone SA - Head of IR & Financial Communication*

Good morning, all. Regis Massuyeau speaking. I'm with Cecile Cabanis and Celia d'Everlange. Thanks for joining the call this morning. We're going to go for call and Q&A, but I would like to hand over first to Cecile now.

Thank you.

Cecile Cabanis - *Danone SA - CFO*

Thank you, Regis.

Good morning to all. Thank you for joining the call this morning. We know it's short notice and probably just before the holiday, or some of you may be within your holiday and I'm really sorry for that.

As you've seen, we issued earlier today a short press release with the intention to give you an update on where we are for the year, and I would just like to take a few minutes to go through the messages, and then we can open for Q&A.

First of all, I think it is very important that you don't get the wrong signal or that you speculate on the timing and the content of this communication that is happening just before yearend. We do consider responsibly that our guidance for top line this year is not only a quantitative Company guidance, but more importantly, it is also a qualitative guidance, and it is, therefore, our accountability towards you to provide you with some business updates now rather than waiting until mid-February.

Indeed, what we had set as an objective is to stabilize Europe dairy in Q4 through mainly the re-launch of Activia, and we take it as a moral contract to come to you as the year is ending and when we have news to share on this particular objective.

At the same time, we took the opportunity to slightly adjust our guidance for the year because we have as well some very good news on the structural transformation of our model, and maybe I will start with this latter part of the equation.

First and foremost, we are continuing to drive for strong profitable and sustainable growth, which is what we've been sharing now for the past two years; and we have a current step that is making sure that we rebalance our model in a resilient manner, especially given the more and more volatile and complex environment.



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So what we have done is that throughout the year we have taken steps to rebalance the model, allocating resources in a disciplined manner to support strategy growth opportunities, and we have continuously worked on our cost optimization and the overall efficiency of the model while continuing to reinvest behind our brands, which was what we said in February earlier this year.

So when looking at that, Q4 is no exception. We have been ensuring that we remain solid and disciplined, well focused on our journey and midterm destination, making sure that we avoid to make a tactical resource allocation to push for expensive short-term growth.

So all this has enabled us to structurally improve our operating margin and I am pleased to confirm that we will deliver a margin that is above the upgraded target ranging 50 to 60 basis points on a like-for-like basis.

Now at the same time, as you all know, Q4 was an important step for our dairy European business, especially with the re-launch of Activia, and we have to acknowledge that we are not yet at the level we thought we would be at this point in time.

Even if the impact on the full-year Company quantitative guidance is very limited -- we are talking around 10 basis points -- we think it is important to give you an update on the performance of dairy Europe and on the re-launch of Activia more specifically. Before I do that, let me maybe remind you about the constituents of the re-launch of Activia which consists in engaging with the consumer in a new brand platform.

So concretely, our objectives have not changed. They are to first rejuvenate the brand and make it more contemporary; second, strengthen the brand premium identity and the product superiority; and third, create an emotional link with the consumer instead of being fully focused on the technical health benefit of the product.

This new identity is, of course, a significant change for the consumers. It increases the impact of shelf. It reaffirms the uniqueness of the brand. It strengthens the brand expertise, its premiumness, and reinstalls the Bifidus as a key point of differentiation.

The first communication started to install this new brand territory which is more relevant and more differentiated. The weight of digital investment has significantly increased in order to put the brand again back in the conversations, and those elements are very positive.

However, this is a very ambitious transformation for the brand. It's a genuine and deep change. We are not talking here about some adjustment or tactical changes, but of real brand evolution in markets that continue to be challenging.

We are totally convinced that the direction for the brand is the right one, but we have overestimated the speed at which the turnaround would occur; and given the ambition of the transformation, we have to acknowledge that it will take some time.

So at this stage, the sales results are below expectation and are not yet enough to significantly change the trend for the brand. We need to keep working and we have already started to adjust the plans in the countries, improving certain elements of mix; for example, adapting the packaging in order to grant you clear sub-range differentiation. And also, we have started to reinforce the local activation in order to well complement the equity campaign.

Moving away from Activia, and I would say in addition to Activia, we have some positives in different countries in Europe, but we have the growth -- return to growth of Europe that is also penalized by aggravated market conditions in Spain. As we said, the category is very challenging. It's currently down low-single digit, which is below forecast, and our local performance remains negative and penalizes the total Europe dairy improvement.

In Spain as well we are adjusting the different plan. It's on Activia, as I described before, but it's also about making sure that we are working on the rest of the portfolio where we have some good news, especially on the indulgence range.

So given what I just shared on both the re-launch of Activia in Europe and Spain, the stabilization of dairy Europe will take longer than anticipated; and, of course, results will come at a different pace from one country to another, which is already what we've been sharing all along.



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The transformation is in progress. It continues also to be very successful in our ability to improve margin, which was another very important part of our commitment. And taking a bit of distance from the current trading in Europe, we can also say that the dairy division in 2016 is progressing on its agenda towards 2020 ambition. If you take the full sales dairy reported, the 0.6% growth in 2015, it will be around 2% this year. And in addition to that, we are progressing very safely and efficiently towards our 200 basis point cumulative margin improvement ambition towards 2020.

So once again the direction is the right one, and we need to remain focused and disciplined to work on the execution of our plans.

So basically, with this news on the quarter we should not be losing sight of the overall progress and performance we've made since two years, and I would like to make sure that we conclude around the overall transformation of our growth model, which is what will ensure a safe drive towards the agenda and the direction that we set for ourselves.

This is our priority and focus every day, and we are confident because, first, we have the right categories with growth potential, supported by long-lasting positive trends, because they are addressing the challenges of alimentation for the future. Second, as we shared in July, WhiteWave will enrich our portfolio into that direction and in stable geographies; and I take the opportunity, but you probably saw it on Friday that we got the clearance from the European Commission, which is a good step towards completion.

So to summarize maybe very simply and very consistently with what we've been sharing all along, we continue to be in a context that is complex and volatile so we need to continue to drive our agenda to build stronger and more resilient models towards our ambition of strong, sustainable and profitable growth, and be assured that this is what we do every day.

Thank you for your attention. I think I don't have much more to say for this morning's message so probably the best would be to go through your questions. I'm sure you have some.

QUESTIONS AND ANSWERS

Operator

Thank you, madam. (Operator Instructions).

James Edwardes Jones, RBC.

James Edwardes Jones - RBC Capital Markets - Analyst

Two questions, if I may. First, it's a very boring one.

What are Activia's sales and margins likely to be for this year, just the absolute level?

And secondly, what's happened to your marketing expenditure? Have you had to dial back on your expectations of growth in marketing expenditure? And specifically, can you confirm that marketing to sales is going to be up in 2016?

Cecile Cabanis - Danone SA - CFO

So I will start with your second question.

Yes, I can confirm we said early 2015 that we would make sure that we would reinvest behind the brands in marketing for at least two years and then probably stabilize, so we are totally consistent with that. It's a year where -- you will have seen in February -- you've seen already in July that we've been reinvesting in the first half, and we continue to reinvest in the second half.



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So what you see, which is an improvement in our operating margin, is really coming out of a more disciplined approach on resource allocation and the fact that we continue to work very closely to our cost optimization and efficiencies. And basically, that enables the gross margin to grow, and as a result we can continue to invest.

So let's not at all get confused to the operating margin levels. It is not about cutting the means versus the brand. We are reinvesting in marketing.

Then on the second part of your question, basically for Europe, Activia would be around [EUR1 billion sales] (corrected by company after the call).

James Edwardes Jones - *RBC Capital Markets - Analyst*

And can you give us any idea of the margin?

Cecile Cabanis - *Danone SA - CFO*

No, I won't.

James Edwardes Jones - *RBC Capital Markets - Analyst*

Okay. Thank you very much.

Operator

Jeremy Fialko, Redburn.

Jeremy Fialko - *Redburn Partners - Analyst*

Just a few short questions.

So the first one is you're saying that overall dairy organic will be around 2% for the full year, so that implies Q4 will be flat to slightly down for the division; and then on a Group basis, probably you'd be looking at around 2% organic growth. If you could just clarify that those numbers are broadly in the ballpark.

And the second question is if there's any quantification on the margins and how much above the guidance range these might be for 2016.

Thanks.

Cecile Cabanis - *Danone SA - CFO*

Okay. Thanks, Jeremy.

So on your first question, the fact that the fresh dairy would be around 2% for the full year is actually implying more in Q4 than the number you're mentioning. But today, I am not here to comment on the full-year results, the books are not closed. But basically, to give you a guidance, it's more than what you're implying.

And then on the Q4, I'm sure you get your math approximately right.

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And then the next question?

Regis Massuyeau - *Danone SA - Head of IR & Financial Communication*

Second question was on the margin versus the guidance.

Cecile Cabanis - *Danone SA - CFO*

Yes. On the margin, I don't want to be too much precise but it will be between 5 and 10 bps more.

Jeremy Fialko - *Redburn Partners - Analyst*

Okay. Thank you.

Operator

(Operator Instructions). Alain Oberhuber, MainFirst.

Alain Oberhuber - *MainFirst Bank AG - Analyst*

A question regarding the markets. Could you give us a little bit more insight? You said Spain was obviously very difficult. Could you go into the other big markets like France, Germany, Italy and the UK?

Cecile Cabanis - *Danone SA - CFO*

Well, basically, the main news is the one we shared. So the main news is the fact that we have overestimated the speed of the turnaround of Activia. Also, we are sure of the direction we've given to this re-launch. So obviously, Activia has a different weight in the different countries, but then it is overall impacting the different countries depending on the weight it has; and Spain is really weighing more as a market.

The rest is unchanged versus what I shared in Q3, so I really just commented now on updates, on news. But on the rest, you can consider that what we shared in Q3 is still valid except for these two items.

Alain Oberhuber - *MainFirst Bank AG - Analyst*

Thank you very much.

Operator

Pierre Tegner, Natixis.

Pierre Tegner - *Natixis - Analyst*

Just a question on next year.



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Considering all of what you say during the call, have we to expect next year more in line with what we will have in 2016; I mean closer to the 3% range in terms of organic growth versus 4% and better than 4% organic at this stage?

Cecile Cabanis - Danone SA - CFO

So basically, it's not the time to guide precisely on 2017; we will do that in February. But I can maybe deliver three messages.

The first one is that we continue to drive our agenda towards our destination of strong, sustainable, profitable growth. Second is that the current volatility that we experience, we discussed in Q3 China and some countries in LatAm. And the current Europe stabilization that is taking more time is, of course, amplifying the rebalancing of the model.

So basically, for 2017, the trajectory is in line with everything we shared in Q3 and we will make sure that we continue to be very disciplined and go for efficiency so that the overall equation continues to ensure a solid EPS growth for 2017.

Pierre Tegner - Natixis - Analyst

Okay. But in terms of rebalancing margin and growth for next year, due to the lag effect in Activia, considering the lag effect on the re-launch of Activia, are you expecting to reinvest more in terms of marketing behind Activia to accelerate the speed of the re-launch? And so have we to expect probably lower-margin improvements for next year versus what we could expect?

Cecile Cabanis - Danone SA - CFO

We will continue to drive the journey as we did this year. So basically, when we say being disciplined in resource allocation, it's not deciding today for the next 12 months, but it's making sure that we are looking quarterly in a dynamic and efficient manner and that we always keep control of the risks and opps in order to rebalance the model.

And again, the current volatility will probably amplify the rebalancing of the model, but we will really continue to work on the equation in the same manner that we did this year where it showed that we had control over the risks and opps. And we were able to at the end of the day really walk the talk on what we said about the rebalancing of the model, the efficiencies and the discipline, and we will continue to do that.

Frankly, Pierre, it's too early and it's not the objective of this call to guide for next year. We will have a full meeting to do that in February. But I think you have all the constituents between what I shared in Q3 and today in order to make your own assumptions.

And Celia and Regis will have some calls with you throughout the day and the week to go into more details, if need be.

Pierre Tegner - Natixis - Analyst

Okay. Thank you, Cecile.

Operator

Celine Pannuti, JPMorgan.

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Celine Pannuti - *JPMorgan - Analyst*

My question relates to the rest of the businesses. I understand that the focus today is on dairy, but if I remember, Q3 they were a disappointment, especially in the ELN division, so just wanted --

I know November or the year end is quite a big time for this business so if you could share a bit of trend into the quarter in that division. Especially there have been some negative news coming from Yashili, as well from some of the Australian baby food players.

Thank you.

Cecile Cabanis - *Danone SA - CFO*

Yes, sure. Thank you, Celine.

So basically, from what we shared in Q3 on the rest of the business, there is no change.

You are mentioning, and I have to correct you that we had some difficulties in ELN. We were very clear in the Q3 to mention that outside of China both ELN and waters were enjoying very good dynamic of growth, and continue to do. So there is no specific news to share.

On China, there has been some communication on both Yashili, which is to be dealt with the local market, and Bellamy's. For us, there is no news.

We continue to make sure that we convert and we work properly on the direct model. As we shared, there will continue to be volatility because the pace at which the indirect business is deleveraging is not the same as the direct's. But really, you can refer back to my messages in Q3, because there is no specific news in Q4 on the rest of the businesses.

Celine Pannuti - *JPMorgan - Analyst*

Okay. Thank you. And just one extra question.

At some point during your speech this morning, you mentioned 10 basis point impact. Was that what you are referring as the Activia impact for the full year, the Q4 Activia impact?

Cecile Cabanis - *Danone SA - CFO*

No. I was referring at the adjustment in top-line guidance.

Celine Pannuti - *JPMorgan - Analyst*

All right. Thank you.

Regis Massuyeau - *Danone SA - Head of IR & Financial Communication*

Thanks, Celine. I think we have another one or two questions on the line.

Operator

Andreas von Arx, Helvea.



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Cecile Cabanis - Danone SA - CFO

Maybe I answered your question already, which is good.

Operator

Alain Oberhuber, MainFirst.

Alain Oberhuber - MainFirst Bank AG - Analyst

I just wanted to come regarding WhiteWave, because you mentioned it. When do we expect now that it will be consolidated? Beginning of March still?

Cecile Cabanis - Danone SA - CFO

So today, we continue to have the assumption that it will be integrated and closed in Q1. The fact that we got the clearance from the European Commission is a good step towards completion. We are still under review from the DoJ in the US, but we are still contemplating a closing within Q1.

Alain Oberhuber - MainFirst Bank AG - Analyst

Thank you very much.

Regis Massuyeau - Danone SA - Head of IR & Financial Communication

Okay. I think we have a last question now.

Operator

Simon Hales, Barclays.

Simon Hales - Barclays - Analyst

Just want to follow up. I just wanted to understand a little bit more what aggravated market conditions in Spain actually meant in Q4. Now what's really changed there versus what we saw in Q3? If you could just provide a little bit of detail, Cecile, that would be perfect.

Cecile Cabanis - Danone SA - CFO

Sure. I think in Spain it's really about the overall market and the market conditions that have a tendency to get less positive than what they were; and there today the market is at minus low single digit in terms of numbers. And we continue to be negative so we really need to be rework on the food portfolio in Spain and adjust the plan in order to push again and make progress and stabilize in Spain. But as Spain is a big market, it impacts overall -- the overall performance.

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Simon Hales - Barclays - Analyst

Okay. Thank you.

Regis Massuyeau - Danone SA - Head of IR & Financial Communication

Thank you.

Thank you, all. I think we have covered the different questions so I wish you happy holidays. Cecile, if you want just to conclude.

Cecile Cabanis - Danone SA - CFO

Yes. Just to conclude, thanks a lot. Have great holidays. All the best for you and your beloved ones. I hope you can get some rest and we talk again next year.

Goodbye, everybody.

Regis Massuyeau - Danone SA - Head of IR & Financial Communication

Thank you.

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