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BN.PA - Danone SA Decides to Adjust Operating Margin Target and Reiterates Sales Growth and Free Cash Flow Targets for 2012 Presentation

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OVERVIEW:

BN.PA decides to adjust operating margin target and reiterates sales growth and free cash flow targets for 2012.

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PRESENTATION

Operator

Good day and welcome to the Danone decides to adjust operating margin target and reiterate sales growth and free cash flow targets for 2012. Today's conference is being recorded. At this time I'd like to turn the conference over to your host today Mr. Andre Terisse, Chief Financial Officer. Please go ahead, sir.

Pierre-Andre Terisse - *Danone SA - CFO*

Okay, thank you very much and good morning to you all. This is Pierre-Andre Terisse speaking. I'm here in Paris alongside with Antoine Guttinger. You've seen the press release this morning. The purpose of this call now is really to give you some more color on the adjustment of our guidance and to answer, I'm sure, the many questions you may have at the end of the call.

We've put together some slides for that and I'm going to refer to them. Before I start, however, there's something I would really like to convey loud and clear to you and this is that the fundamentals of our business are very good. I'll quickly come back at the end of the presentation on the American and the Russian markets and I'll tell you that things are progressing, basically, as planned and in fact slightly better.

So the purpose of the adjustment we've passed this morning, the margin adjustment, is really to deal with a specific market situation, which we believe requires specific actions and support and, therefore, cannot be dealt with in the usual management of our equation and I'm obviously talking here of Southern Europe and Spain in particular. So I'll try and explain you why throughout this small presentation.

I'm moving to slide three now, which basically tells that we've had -- in the past three to four years we've had to learn dealing with a complex environment. And the complex environment has been commodities, which have proven to be far more volatile for the past three years than they had been in the previous 10 to 20 years, under the effect of a fast growing demand in developing countries.

At the same time, the development of unemployment in OECD countries has resulted into weak consumption trends and, therefore, a slowdown of our growth, predominantly in Europe, while emerging markets keep growing and represent an increasingly important share of the world's wealth and economy. And all that is clearly no news, this has been a reality for the past four years and we have learnt to handle it.

Turning to page four, we have not only coped with it but it has, as well, somehow transformed the Group. Western Europe and emerging markets have had, interestingly, exactly opposite trajectories since 2007. In four years, between 2007 and 2011, Western Europe has gone down from 51% of the Group sales to 38% and emerging markets has gone up from 38% to 51%.

Today, with the US and Japan, Danone growth markets represent 62% of all sales, which is almost two-thirds and, at the same time, margin trends have been opposite as well. They've been stable to down for Europe, they've been up for the rest of the world and the margins are gradually converging and MICRUB, as I told you already, has been reaching the Group average margin last year in 2011.

So slide five, these different dynamics have clearly called us to define different answers to cost inflation, in growing markets on one hand and in Western Europe on the other. We've indeed faced in the past two years a double-digit inflation of our inputs and we have, in particular last year, established a practice of competitive price management in Europe, aiming at protecting our positions and passing price increase only when we thought consumer demand was strong enough to allow it.

And, for instance, this has not been the case in water in Europe last year and we chose last year not to pass price increase in this territory despite a 20% increase in the cost of our PET.

So that's for Europe, on the contrary in emerging markets we've been passing price increase where it was legitimate and adequate and we have, in addition, used operational leverage and mix to enhance the profitable growth of these businesses and to keep growing them and balance the overall Group equation. So that's really been the way we have progressively learned to deal with a new context and a complex environment and to balance the equation of the Group.

Now let's go to what has changed and I'm moving to slide six. Since the second part of last year and euro crisis, there has been increasing signals that the situation was getting more complex in Europe. This is because of unemployment, this is because of tax and austerity measures which have been taken and are being taken as we speak by various governments to the average Europe. And this chart on page six shows that consumer confidence in Europe has, indeed, been affected by that.

This is the case in Europe as a whole but this is, slide seven, even more so the case in Southern Europe and, in particular, in Spain which, as you know, represents an important country for Danone; important, by the way, because of the history of the Group but important as well in terms of size.

I will not stay too much on the macro elements, you all know that unemployment is clearly above the 20% mark now in Spain and sometimes above 30% in some regions, and there is a clear link being made between the level of unemployment and the level of consumption and, therefore, high unemployment has been pressing on consumption.

Maybe, more importantly, and that's what you see in terms of dynamics at the bottom of this slide, consumer confidence has been affected by that and it has dropped, pretty importantly, from levels of 70s a year ago to level of 50 in April, so by 20 points in less than a year.

Page eight, for us this has meant several things. It first means a slowdown in our categories. Fresh Dairy as a category has turned negative since April/May of this year. It means that private labels have progressed and keep progressing. This is very much the case, first of all, when you look at the left part of the charts of the retail and Mercadona to fight it has been making a lot of progresses. This has been as well the case of the other private label against branded products, sorry, and you see on the right-hand side that the consequence for Danone has been that we have been losing market share.

The third element or the third consequence is that it has meant for us as well some down-trading from the consumer within the category I've just mentioned, but also within our portfolio.

So that's true for Dairy, that's true for Water as well, which has been difficult, it's true as well for Medical, with different dynamics of course but it's clear that the public debt issue, which we know are quite specific in Spain, have created some pressures on the reimbursements for medical in this country, affecting the performance.

Moving to slide nine, I told you before Spain is an important market for us and it's an important market because of history but also because of the size and that's clearly a market where we have the intention to fight and to make what we think needs to be made to maintain the equity.

We're already acting on several fronts. I've listed on this page a series of levers which will be necessary to maintain the equity and which are in the process of being activated. It basically ranges from supporting and differentiating our brands and nourishing the differentiation of both the content and the price of brands like Activia, Densia and Actimel. This goes through innovation in packaging; we've already showed you that last year, it's the new pot but also new copies and so on.

The second lever is clearly to increase the competitiveness in front of a consumer which has different revenue, different need, we need to be able as well to adapt what we are offering him and to develop promotions and loyalty pack.

It goes with innovation and we have here on the page several ideas which are going to be pushed; Griego 0%, which is very much a concept close to the American Greek; Yolado, which is a new concept of yogurt, and there are some others. And it also means continued productivity; there is no doubt that this is, as well, a key lever in this environment.

So these levers are, again, going to be progressively activated as we talk in the rest of the year. They will be activated in the coming weeks and months with the objective to have the consumer going through this difficult period and to keep protecting the equity of our brand. This will obviously have a cost and this is the main reason for the adjustment of margins, which we have decided today.

The other reason is, turning to page 10, raw materials. We told you earlier this year that we expected raw materials to remain sequentially stable throughout 2012, from the exit level of 2011. That meant that we expected average-to-average mid single-digit inflation from 2011 to 2012.

Certain specific materials have seen their costs increasing materially since then; I'm talking in particular of the milk proteins, I'm talking of the milk whey as well as some of our packaging. Altogether this means mid to high single-digit inflation instead of the half single-digit which we anticipated previously.

In front of these, obviously we're working to increase further productivity and this will offset part of the additional inflation. For the rest, we believe consumer demand is too weak in many areas to allow it and we have decided, therefore, at this stage, not to pass additional price increase.

So to summarize a bit, these news, the adjustments and how we are dealing with it, I'm referring to page 11. If you look at the top inflation is above our expectation and that's going to mean more productivity to cover part of the gap, but part of the gap only.

On the left-hand side, Southern Europe has been deteriorating, the answer to that with specific support and adjustments and last, on the right, emerging markets continue growing strong and delivering operational leverage. This leverage is reinvested for a part to fuel the growth and keep building long-term position. This has been our model successfully for a few years now and we believe that building this market is critical for the Group and it is, therefore, our choice not to make any compromise on that.

If you look at slide 12, I want to take this opportunity to give you some update about these markets. They represent 52% of Danone sales now, they've been growing 13% to 20% over the past five quarters, they have last year contributed to 80% of the incremental profit and they keep working very well. This is Mizone in Asia, this is Dumex and Nutrilon in Asia as well, this is Neocate and Fortimel in China, Turkey or Brazil, this is Levite and Activia in Latin America and, again, continued good performance of those platforms.

This is as well, page 13, Prostokvashino in Russia and in the CIS. This is clearly an area which was important for us in 2012. This is an area where we are absolutely in line with our targets for 2012. After four quarters of negative volume growth, the first quarter of 2012 has seen volumes turning positive and progresses are continuing with improvements in volume, in sales and in profitability.

In the US, page 14, the second important focus of growth in growth markets in 2012 is the US. In the US, Oikos has now indisputably become the number two Greek brand on the market and this has made Danone the only player who is meaningfully present on all segments of the market and, therefore, has become the market leader with a difference which is close now to 10 points with the number two.

So the year is not over, but here again I think we can say that the performance of the Group is strong and the fundamentals of our business are strong as well.

So this is clearly, page 15, allowing us to confirm our top-line target. For the year, we expect to be well into our 5% to 7% objective for 2012 thanks to strong trends outside Western Europe. Reaching this is going to require adjustment to our operating margins so that we can adjust our model in Southern Europe to consumer demand. Hence we expect our margin to be down 50 bps on a like-for-like basis.

Despite this, we feel confident to deliver our EUR2b free cash flow target. We are continuing to operate with the same level of capital expenditure and we are slightly ahead of our plans on working capital, with in particular very good progresses made at Unimilk. I think this shows that, besides the management of new circumstances, Danone model remains very strong.

I thank you for your attention and I'm now going to take your questions.

QUESTIONS AND ANSWERS

Operator

Thank you. (Operator Instructions). And we'll take our first question from Alain Oberhuber from MainFirst. Please go ahead.

Alain Oberhuber - *MainFirst - Analyst*

Yes, good morning, gentlemen, I just have a question about promotion and these four issues concerning the lower EBIT margin. Could you highlight a little bit which is the biggest impact on your downturn on the margin? Is it productivity, is it because of promotion, is it because of innovation, could you give a little bit the feeling of it?

Pierre-Andre Terisse - *Danone SA - CFO*

Well, essentially it's a combination of deleverage and negative mix, I would say, in the case of Southern Europe and Spain. Clearly now we're in negative growth territory, mid single-digit plus, which was not the case in Q1 and has become the case since the end of Q1/beginning of Q2. And that's been on the back of, on the one hand, indeed a loss of market share, I'm talking about Spain specifically and that's on the back as well of category which is going down.

That's part of the answer. The other part of the answer is that we are indeed seeing down-trading from consumers. So that's the starting point. Now clearly we've started reacting already and there's going to be a combination of the different levers I've shown you. I am not and I don't want to be in a position to comment these levers now, because the way we intend to use them is, as usual, as we do in Danone, i.e. to do it in a very selective manner, in a very focused manner, in a very dynamic and productive manner.

And, basically, we know that we have a palette of levers and tools which are the ones I described and we'll be making the best out of that in order to not only maintain, but possibly to make our position progress on this very difficult market, which is Spain.

Alain Oberhuber - *MainFirst - Analyst*

Thank you very much.

Pierre-Andre Terisse - *Danone SA - CFO*

You're welcome.

Operator

We'll take our next question from Simon Marshall-Lockyer from Jefferies. Please go ahead.

Simon Marshall-Lockyer - *Jefferies - Analyst*

Yes, hello, Antoine and Pierre-Andre. Just a couple of questions. Could you give us, excuse me, a more detailed indication of what Southern Europe actually represents in sales and maybe an indication of profitability? And the second thing is could you give us what Spain specifically represents within that, or at least some gauge?

The second point is you're mainly talking about Spain and Southern Europe and about input pricing in terms of the 50 basis point impact compared to previous guidance. Can you give us an idea of what each of those sectors represent? Would it be correct to understand this is more about geography, this, than input prices at this point or is that not correct?

And then finally, on input prices, is the fact that it's in relatively narrow categories of input, whey, protein, fruit, which are more difficult to hedge that you've been impacted? Is that one of the reasons why the impact has come so rapidly from the inputs compared to what you were saying in the first quarter or at the annual results? Thank you.

Pierre-Andre Terisse - *Danone SA - CFO*

I guess the answer to the second and the third questions is going to be the same, i.e. the bulk of the reason for the adjustment is indeed coming from geographies and not from raw material. , Raw material is not going in the right direction. We've seen these very specific input costs going up since the beginning of the year, that's been increasingly the case.

We thought at some stage we could have some positive news on other materials but we have not see that yet and, therefore, we thought it was important to flag that, especially in front of many people who thought or have been of the position that raw materials are going down and therefore would provide an uplift. They don't, they give us some downside although, again, this is not the majority of the explanation, if you wish, on the adjustment of the margins.

What has led us to adjust the margins is indeed the necessity to manage the situation in Southern Europe and in Spain in particular and, as you rightly suggest in your first question, the fact that these have a specific weight for us. Spain represents about 7% to 8% of our sales, it represented 8% of our sales last year and it represents about 12% of our profitability last year.

So it is a country which has an important weight and adding up to other geographies, Southern Europe represents altogether about 10% of our sales and it represents high teens in terms of share of our profitability. So, because of its size and because of the trends which we are seeing and the rapid change we have seen on the market, we thought it was essential for us to be able to manage that.

And at the same time, as we have tried to explain both in the presentation and in the press release, to keep being able to invest and develop the other markets, which are absolutely key to us and key for the future of the Group and the values we are trying to create, which are the US, Latin America, Russia and the CIS, China, Indonesia and so on.

Simon Marshall-Lockyer - *Jefferies - Analyst*

Thank you.

Pierre-Andre Terisse - *Danone SA - CFO*

You're welcome.

Operator

And we'll take our next question from Jon Cox from Kepler. Please go ahead.

Jon Cox - *Kepler - Analyst*

Yes, good morning, thanks for taking the call. I have a question really on the whole commodities issue. I wonder if you can just give a bit more granularity in terms of your commodities basket, because from what I understand milk costs, as a proportion of sales, are around 15%, but we've seen milk prices in Europe and in Asia as seen by the Fonterra auctions coming down pretty rapidly, down by around a third. Just doing some simple mathematics that should have helped you with maybe a 5 percentage point gross margin gain. Now I understand that some commodities may have risen out of the blue, but I find it hard to really put together all of these pieces, the fact that the raw milk prices are coming down pretty much across the board, that's your biggest input, but you seem to be saying that the one-off commodities are having more of an impact.

Which leads me to the second question, just on your sourcing and purchasing are you actually satisfied with the team there and what they're doing and potentially not being quite able to benefit from those milk price declines? Thank you.

Pierre-Andre Terisse - *Danone SA - CFO*

Yes, I'll first go to the second part to say that yes, I believe we have extremely competent and proactive teams on the purchasing side and I can tell you we are very confident in what they do, I mean, there's no doubt about that. Raw material has been a bit of an argument as your point is showing, not only for Danone in 2012 but also for Unilever and Nestle and the likes. I've read at length a lot of suggestion from the market that raw material costs will go down; I have so far seen companies saying that they did not fully see the same reality.

So read us correctly, we're not saying that the cost of milk is going up sharply, there are some areas in which it is going up and there are some areas in which it is going down. Overall we've seen so far stable versus the exit point at the end of last year. Certainly if there are good news in the rest of the year they will be welcome, I'm not fighting against that and I'm sure our purchasing department will take advantage of that, but so far this is not what we have seen.

And buying milk is obviously not as easy as going on spot market and buying it every day, because this is not the way you can get sustainable sourcing of sufficiently good quality to operate in as many countries as we do on a fresh base. The reality, I think, is that we buy milk, we source, we have long-term, sourcing contracts of milk with prices which are adjusted with formulas which have a certain time horizon with some excess of milk, which we are using differently, some which we are selling. So the combination of all these factors means that simply today we are not seeing any benefit from the milk going down and, again, if there is in the rest of the year we'll be very happy.

On the contrary, we've seen two very specific raw materials showing increases which we had not seen in the past, and I'm talking of the protein of the milk and I'm talking of the whey, as well, of the milk. It's probable that the emergence of Greek, for instance, has somehow shaped the market differently, so the first thing we have to do is basically to take the news and to try and compensate with productivity, which is what we have done and will continue doing, but this is not enough. The second thing is to think about how to organize ourselves to limit the weight of the impact of this increase in the future and this is what we are doing today and what the teams are getting prepared to.

Now back to the question of Simon in the previous question, we are mentioning input costs again because there are many people thinking that we should get some good news and, again, maybe will but this is not what we have today and we thought it was important to say. But it's clear that's the reason why we are going through this modeling adjustment, is more to have the ability to manage the Southern Europe situation.

Sorry it was a bit long, but I think it was important.

Jon Cox - *Kepler - Analyst*

Okay, I wonder if I can just have a couple of follow-up questions. I understand the long-term contracts, the sourcing, etc. Can you give us an idea of the lag from what we see in terms of Fonterra auction prices or from CLAL Farm-gate in Germany, Austria and France, etc? How long would the lag be in terms of those prices coming down, is it six months, is it 18 months, that's the first.

Pierre-Andre Terisse - *Danone SA - CFO*

It varies market by market and this is the reason why and I'm not going to do that on the call. I think, to answer your question, we need a bit of time with you as we have tried to spend in the past few years with investors and to give you more granularity market by market. If you're okay I suggest we do so in a separate call following this conference, okay?

Jon Cox - *Kepler - Analyst*

Okay, I just have a second follow-up question. Obviously the focus of attention is on Spain, can you just give us an update on trading conditions in France, because the concern is the situation you see in Spain may start to drive into what's happening in France?

Pierre-Andre Terisse - *Danone SA - CFO*

Yes, that's pretty important as a question. We see France as very different from Spain for two reasons. The first is that we don't have the same structure of portfolio. The weight of baby activities in France is higher; the weight of Dairy is lower. And this is true not only in sales terms but also in terms of profitability.

And you may remember that back in the year 2008, 2008/2009, we had to manage a deceleration of the consumption in France, which has basically driven us to make some adjustments to the portfolio, and to put it today in a fairly different position in terms of stake for the Group.

The second difference is what we see in terms of consumption. I mean, reading the papers about the debt issues in Spain and France, it clearly shows that the situation is not the same. Reading about the reforms which needs to be engaged, or which has been actually engaged, shows that we have two different situations. And when it comes to looking at consumptions we indeed see two very, very different situations.

I think the fact that unemployment in Spain is above 20% when it's in France in the region of 10% is a difference, which shows at some state in terms of consumption evolution, and explains the fact that we are seeing absolutely different pictures between Spain and France which is basically holding up pretty well. I am not saying that things are easy, but it's holding up pretty well. And not at all looking like it's about to turn to something similar to Spain.

Jon Cox - *Kepler - Analyst*

And just to follow up in terms of profitability, France is, I think, the sales is around 10%. In terms of profitability I presume it's again high teen for the group.

Pierre-Andre Terisse - *Danone SA - CFO*

Yes.

Jon Cox - *Kepler - Analyst*

Yes, okay.

Pierre-Andre Terisse - *Danone SA - CFO*

This is correct, but again with a different portfolio, Baby has a much bigger weight in France than in Spain.

Jon Cox - *Kepler - Analyst*

Great, thank you.

Pierre-Andre Terisse - *Danone SA - CFO*

Thank you.

Operator

And we'll take our next question from Alan Erskine from UBS. Please go ahead.

Alan Erskine - *UBS - Analyst*

Good morning, guys. Two questions. Firstly, when we talk about the sales guidance you've left that at 5% to 7%. But I'm slightly perplexed, because I guess a large part of what you're going to do in Spain to protect your volume is to reset price, put more promotional activity behind the brand. So I'm just -- is it the fact that 5% to 7% is quite a broad range that you felt you didn't have to move that, but that we should maybe assume that there is a little bit of slower sales or is there something else compensating for a slower Spanish performance?

And my second question is just, as we can see from that chart you put up on Spanish consumer confidence this is a little bit of a moving target. And I'd just like a sort of qualitative feel from you as to how much you've stress tested this 50 basis points.

We've still got six months of the year to go. Have you built in some wiggle room to that number? What comfort level can you give us that we -- that this is the number we should be thinking of for the year as a whole? Thank you.

Pierre-Andre Terisse - *Danone SA - CFO*

Thank you, Alan. On the 5% to -- on the top line target, essentially what's happening when you look at the group is that Western Europe is weaker than what we thought at the beginning of the year, slightly weaker in the case of Western Europe as a whole, and very clearly weaker in the case of Southern Europe. And at the same time when we look at the other geographies this is true for Russia, this is true for the US but also for Latin America, for Asia Pacific and Africa, Middle East, sales are better.

If you combine that basically you get to the conclusion that the impact of our sales is not very meaningful. There is going to pluses and minuses, but at the end of the day we feel confident we can deliver 5% to 7% and probably be well into this 5% to 7%.

If you look at it from a profitability standpoint, given the weight of profitability of Spain, given the weight of profitability of Southern Europe, and given the fact that we don't want to disinvest or lower the level of investments and developments we have in the geographies which are building the group for the future in order to protect Europe.

And at the same time we think it is important we protect our base camp. And there are some examples of other very close industries where people have forgotten to protect their base camp, and they've paid quite a high price. I'm talking of some people in the US in particular.

So because we want to protect our base camp we think it's important to take all the measures which are necessary. And that calls for an adjustment of the margin. But the fact that the adjustment is not the same -- I mean that there is no adjustment on top line and an adjustment of margin basically comes from the fact that at the very beginning from a static perspective, the difference of profitability between the part of the world which is growing and the parts of the world in which we have to deal with that is extremely different.

One could think by the way that at some stage cash should be impacted. The reality is that we are on cash benefiting from other levels. And in particular the management of working capital, which as you know we've been making a lot of progresses in the past. We continue to do that. We take every single opportunity to keep improving the cash. And this year we are delivering pretty good performances in Unimilk in particular. So we believe with that we can deliver the EUR2b free cash flow target we have.

So, that, to give you, I mean to explain basically the reason why we are adjusting the margin because we are keeping in fact the rest of the parameters.

Again to me this is a sign that the shape of the group, the shape of the business, the shape of the portfolio is extremely good and extremely robust, even though we have to deal with a very specific situation which is the Southern European one.

And I forgot your second question, sorry.

Alan Erskine - *UBS - Analyst*

My second question was just as we saw with the consumer confidence in Spain it's a bit of a moving target, and difficult to predict. I just want to know have you spent a bit of time stress testing this minus 50 basis points that you've built in a little bit of almost a margin for error, so that you really have drawn a line in the sand for the year as a whole.

Pierre-Andre Terisse - *Danone SA - CFO*

Yes, we have. I can't obviously exclude that things could get significantly worse in Spain and in other markets. But it would take that it gets significantly worse in Spain and in other markets for us to need to re-question the series of actions which we are taking. And that's not what we are seeing today. So -- we've been careful indeed in figuring what we need to deal with the current level of the situation and potentially slightly worse news coming.

Alan Erskine - *UBS - Analyst*

Thank you.

Pierre-Andre Terisse - *Danone SA - CFO*

You're welcome.

Operator

We'll take our next question from Robert Waldschmidt from Merrill Lynch. Please go ahead.

Robert Waldschmidt - *Merrill Lynch - Analyst*

Morning, gentlemen. Just wanted to have a follow up -- we've got really good growth outside of Europe, can you shed any light if your 50 basis points is also capturing some of the negative mix implications of faster growth in Russia and in places like that where you're investing more in particular?

And two, can you just remind us, I know you're going to get the EUR2b free cash flows you've just illuminated here, what your preferred uses of cash will be in this context given clearly Pfizer has gone the other way, and your net debt is going to below your target this year on your announcement. Thank you.

Pierre-Andre Terisse - *Danone SA - CFO*

Okay. Well, there is no negative mix coming from growth markets. In other words the fall through profitability is good and it's at the level we expected it to be. Simply, when we have better sales than expected outside Western Europe the fall through profitability can be good but it's not as high as the negative fall through profitability coming from foreign sales in Western Europe.

But -- so it's a mix issue which predominantly comes from the fact that the pull through is quite negative in Western Europe, not from the fact that the pull through will be weak in the rest of the world. This is not the case. On the contrary, things are going very well. It is just one level below what we would need to compensate for the rest.

In terms of use of cash, well, we have not changed policy. We have the same strong cash flow generation. And again our commitment to the EUR2b I think is an important thing.

Second, we pay dividend and we have a payout which is 45% to 50%. We've paid this year 48% of our profits through dividends. And we are trying to get regular increase of our dividend per share.

Next is possible acquisitions, so you said about Pfizer that indeed this is not, at least for the biggest part of it, on the table anymore. There is probably another part which will have to be sold by yearend. And there are potentially other things which are on the table, depending on the evolution of thus files will be as we have done last year and as we have done the previous year I believe, we'll decide to what extent and whether or not we use the tool of the share buybacks to adjust the net debt and to keep basically the credit metrics at the same level.

Robert Waldschmidt - *Merrill Lynch - Analyst*

Thank you.

Pierre-Andre Terisse - *Danone SA - CFO*

You're welcome. Is there any other question?

Operator

Yes sir. The next question comes from David Hayes from Nomura. Please go ahead.

Pierre-Andre Terisse - *Danone SA - CFO*

Hi, David.

David Hayes - *Nomura - Analyst*

Morning, gentlemen. I am sorry if I'm repeating things because I missed the beginning of the call, but just in terms of the minorities in Spain, obviously the minority situation there. I just wondered whether you can remind us how we should think about that in terms of the profit impact at the bottom level -- the EPS level in terms of an offset.

Just in terms of the margins, I don't whether you've covered this off, but should we think about margins still being flat to up in the three non-dairy divisions?

And then just in terms of the additional cost savings you mentioned, could you just give us a feel for where they are coming from. And from an A&P perspective should we assume that A&P as a percentage of sales will be fairly constant this year, just trying to get that into some perspective in terms of the moving parts. Thanks very much.

Pierre-Andre Terisse - *Danone SA - CFO*

You're welcome. So I'll work backwards. On the A&P, we'll give you more elements in H1. As you know this is not -- it's a KPI which is pretty complex to follow because it combines advertising which we try and develop regularly and promotions which are more volatile. Given the environment I don't want to commit too much on that. We want to keep flexibility. So if you allow me, we'll get back to you at the time of H1 with more precise element about that.

On the margins, I'm basically staying, apart from dairy, to what we had in mind since the beginning of the year. Baby is expected to be stable to up knowing that part of the raw material impacts we are talking about falls in baby, the whey, the cost of whey increase is a Baby factor more than a Dairy factor, but we expect it to be stable to up.

Medical is going to be at best stable and basically the balancing factor would be the amount of the investment we decide to put or not to put on the table in relation with Souvenaid. And we expect Water, given the carried inflation and carried price increase, to be about stable. And the adjustment to what we are talking about now is indeed going to be on Dairy. So that's the vision we have at this moment of the year on margins. Again we'll try to give you more elements during the first half conference call.

On the EPS, the interesting thing to say is that indeed as part of the issue is coming from Southern Europe, and part of the adjustments we are making is going to be in Southern Europe, part of it is going to be in Danone Spain. And as you know we have minority shareholders in Danone Spain, so part of that is going to be offset.

The second element is that today I mean the currency has been a favorable factor versus what we had in mind at the very beginning of the year.

If you combine all that, if you take the adjustment of our guidance on the margins, the guidance maintained on the top line, the sum of all the other elements and the compensating factor on the minority interest line, the current level of currency, the current level of tax rate assuming there is no big reshuffle made by the French or Spanish or British tax authorities even though Cameron seems to be in a different mood than other people in Europe. If you take all that into account the visibility we have today on the EPS is that it should be pretty close to EUR3.10, which means that it's not at the level we expected when we made the full year conference call but it's not fully reflecting the adjustment in the margin guidance.

David Hayes - *Nomura - Analyst*

Okay, that's very helpful, thank you.

Pierre-Andre Terisse - *Danone SA - CFO*

You're welcome.

Operator

And we'll take our next question from Andreas Von Arx from Helvea. Please go ahead.

Andreas Von Arx - *Helvea - Analyst*

Yes, good morning. I was wondering with another reset program coming in Spain if you could indicate -- given an indication how your dairy product basket price index will then look versus competition? I mean are your products still -- how much are they still more expensive let's say that the average competition and how much does this look for Activia specifically?

And then the second question I have is on Actimel, this is one of your more important brands in Spain. I was wondering whether that deterioration you see that also, let's say, in Germany continued and whether you could give an update here.

And to stress my luck is there anything you can say on your discussions with Yakult. Thank you.

Pierre-Andre Terisse - *Danone SA - CFO*

So I'm not going to answer the third question. I think we've already expressed our position several times.

On Activia, Actimel, well, in Germany which is a country close to your heart, frankly no news, we have a very specific situation in this country, we've been having it for the past few quarters now and we keep trying to manage it with some success but not sufficient so far. So we keep working on it.

On Spain specifically, Activia and Actimel are indeed an important part of the portfolio with two different trajectories however. Actimel is indeed, as in many other markets in Europe, suffering negative trends. This was the case and keeps being the case. And obviously as the consumption trends have worsened Actimel has been impacted relatively speaking similar to other brands.

Activia is a brand which is far more resistant. This is true overall. This is true in Spain as well. I remind you that in Spain we've been transitioning in particular on Activia but also on other brands for spoonable yogurt. We've been transitioning to the new cup, and this has clearly been helping a bit the performance. And Activia altogether is not the brand which has the more difficulty. I would say it's reacting in a relative ways towards the rest of the portfolio in Spain pretty well. And it's one of the positives of the performance in Spain so far.

Andreas Von Arx - *Helvea - Analyst*

But is it then more indulgence range where you're going to significantly adjust prices? Thank you.

Pierre-Andre Terisse - *Danone SA - CFO*

Sorry on the price, yes, you're right I didn't answer what you said. On the price gap with competition basically, there is no real evolution in many of the markets in Europe. There will have to be one on some SKUs but this is something we want to do SKU by SKU almost in Spain, because indeed the price difference in Spain is higher than it is in the average of the Group.

Thank you. Next question.

Operator

Our next question comes from Jeremy Fialko from Redburn. Please go ahead.

Jeremy Fialko - *Redburn Partners - Analyst*

Morning. Jeremy Fialko of Redburn here. A couple of questions.

Pierre-Andre Terisse - *Danone SA - CFO*

Morning, Jeremy.

Jeremy Fialko - *Redburn Partners - Analyst*

Hi there. The first one is clearly in Spain your operational efficiency is not as good as it -- perhaps you would were hoping it to be given the fact you've had these volume reductions. How seriously do you think you start to need to consider some sort of more significant restructuring of your manufacturing footprint within Southern Europe such that these inefficiencies aren't allowed to last?

And secondly, while you're on the call, can you give a bit more detail about what's the overall Group Q2 sales development has been? Is that something you'll talk about at this stage? Thanks.

Pierre-Andre Terisse - *Danone SA - CFO*

Thanks, Jeremy. On operational efficiency not really any comment to make. Perhaps to remind you that Danone usually behaves a bit differently from many other multinationals. We put pressure every day. We try and deliver productivity every day, year after year. There is not one single day without that we ask ourselves questions proactively about the level of resource and the level of assets we have, and if there are not any opportunity to reduce those.

And therefore, we tend not to be in one-off and significant adjustments and into the kind of restructuring you are mentioning. So that's really the only thing I can tell you. Remind you the way we practice and then we'll obviously manage things.

On the Q2 sales we are similar to what I said for the full year. I had said in the Q1 sales that I expected Q2 to be at the bottom of our guidance which is 5% to 7%. I am expecting indeed Q2 to be close to 5% having in mind that apart from the fact we are mentioning here, but I remind you that we have, on the one hand negative news in Europe but on the other hand positive news elsewhere.

The additional elements may be that you should have in mind, is the fact that the weather conditions in Europe have been particularly poor, and therefore that this is going to have an impact on Water. But altogether, yes, around 5% top line in Q2, so basically in line with what I expected a month ago.

Jeremy Fialko - *Redburn Partners - Analyst*

Thanks a lot.

Pierre-Andre Terisse - *Danone SA - CFO*

You're welcome. We'll take a last question.

Operator

And our final question is from Jeff Stent from Exane. Please go ahead.

Jeff Stent - *Exane BNP Paribas - Analyst*

Good morning. I've just been doing some quick sort of back of an envelope math, and 50 basis points on the Group to my mind equates to roughly about a sort of 10% reduction in your sales in Spanish dairy. And looking at sort of Nielsen data on a sort of cost per tonne basis your products are selling at sort of twice the price or if not more of private label. I'm just wondering in that sort of context is the 10% reduction enough. And I realize it will vary across different products, etc., but on average it doesn't feel that material given the sort of gulf in the price differential. Thanks.

Pierre-Andre Terisse - *Danone SA - CFO*

That's a sensible comment, but again coming back on Alan's point we believe this is what we need today. Certainly we are not going to need a few weeks or months to do that. We are likely to need to fix this market and make this market land more than a year. So that's going to be helping as well.

But, yes, I am absolutely mindful of what you say. The size of the issue or the size of the country is such that indeed this is the reason why we have done something which we normally do not do which is adjusting our margins. But we believe the parameters we have chosen are the right to take care of that.

Jeff Stent - *Exane BNP Paribas - Analyst*

Okay, thank you.

Pierre-Andre Terisse - *Danone SA - CFO*

We'll take another one, sorry, which will be the last one.

Operator

And our final question is from Xavier Croquez from Cheuvreux. Please go ahead.

Xavier Croquez - *Cheuvreux - Analyst*

Yes, good morning, gentlemen. I actually have a question on the timing of the warning, because if I listen to what you said on input costs basically you have 50 bps of a shortfall on your margin changing from mid-single to mid to high single, let's say it's 200 bps on raw mats, that's around 50 bps.

So basically another way of explaining the warning is to say Spain is worse, the rest is slightly better, all in all it's neutral. And then I have a problem on raw mat where I can't price.

You chose to present things differently. I actually do not understand why you chose to present things this way, because if raw mats revert actually by yearend things could revert.

And secondly, and that goes to the timing of the warning, to what extent you say no compromise on building the future, but the reality is that you always fine tune things. Is the room for maneuver so thin that you anyway need to warn today? So isn't there any room for maneuver to mitigate things and possibly buy time a bit? I actually do not understand why you focus on Spain and not on raw. And why you actually do not buy time because you actually have really no options.

Pierre-Andre Terisse - *Danone SA - CFO*

Well, I think on Spain the calculation which Jeff just shared with us a minute ago are giving some idea of the dimension of what we have to deal with. I do not agree with you when you say that we have no choice.

We have chosen to make this adjustment because we think it's urgent that we deal with that, that we can't just wait until a later time. We have chosen to communicate you this news now because we think that's relevant information. And the credibility and the honesty of the management also calls for the management to be able to communicate bad news when there are bad news. I mean that's really it.

Again, to come back on one of my answers earlier, the bulk of the reason why we think we need an adjustment in margin and to pilot, to manage 2012 with lower margins is not at all coming from raw mat, but it's really the need to have a specific management of Spain. Raw mat can maybe evolve differently in the coming months, and we'll be more than happy with that news. But we are neither overoptimistic as some of you have suggested on this call in the way we look at what we need to handle the situation in Southern Europe, neither overoptimistic and/or trying to pass other things.

We are just genuine, respectful, honest and passing you the news so that you have the ability on what we are trying to do, which will have consequences by the way as soon as H1.

Xavier Croquez - *Cheuvreux - Analyst*

Okay, thank you.

Pierre-Andre Terisse - *Danone SA - CFO*

Merci a tous. Thanks to all of you. We will have other opportunities to talk in the coming days, and in the meantime I wish you a good day. Thank you. Bye-bye.

Operator

That will conclude today's conference call. Thank you for your participation, ladies and gentlemen. You may now disconnect.