Danone
Conference Call

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Danone Conference Call

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Welcome

Good morning everyone. Thank you for attending this call on short notice. You have seen the press release of this morning, and we believe it is useful to take a few minutes of your time in order to share the details, and obviously give you the opportunity to ask some questions. Basically, having more clarity on our objective for the full year, we felt it was important to adjust our guidance for the year.

Why now? Basically, we have an H1 release which is quite late in July, and we will have a certain number of interactions with you between now and the end of July, starting obviously with the Deutsche Bank conference tomorrow. So, having shared the update on the model and our renewed full-year objective will help us to have more meaningful interaction with you on how we are moving on our agenda.

Continuing the transformation

So maybe to start, I think overall what you have to keep in mind is that we are not at all changing any of our agenda. You have it on slide 3; our agenda is still the one that we have set for Danone, which is basically to rebalance our model of growth in order to make sure that we deliver sustainable growth, and then to re-accelerate towards 2020, for which we have fixed our main financial KPIs that we already shared with you.

Basically, moving back: 2015, as we said, was a crucial step in the rebalancing of the model. This included delivery of profitable growth for the first time since 2011, re-investment for the future and the start of our 2020 transformation journey. The results were very solid and fully in line with our agenda. 2016 is another important step in our journey towards 2020, and another key year for us to build more balanced and resilient model of profitable growth.

Rebalancing the growth model

So maybe, on the model, this is a chart that you have seen in the past. I will come back later on the global environment in more detail. It is clear that it continued to be very volatile, especially in some of our key emerging markets. However, the priority of Danone in 2016 remains the same, which is to build a more resilient and balanced model in order to absorb this volatility, and make sure we progress safely towards 2020.

The objective of rebalancing our model is basically central, and it is about first making sure that we continue to be agile, to grasp opportunities for growth, making sure that we invest properly behind this growth and that this growth is profitable and sustainable, because ultimately growth will be a key element for driving long-term value creation. At the same time, it is about working on our efficiencies, being disciplined on our resource allocation, in order to fuel appropriately, and at the right pace, short-, mid- and long-term initiatives, and as well balance properly our risk to make sure that we deliver our results in a consistent manner.

Progressing on our key battles

In addition to the overall rebalancing of the model, we continue to focus this year on our four key battles, that I remind you on this chart. Basically, regarding Dairy it is about making sure that we sustain the re-acceleration of the growth in the US. It is also about implementing sustainable solutions to support safe return to growth in Europe. In Water, it is about continuing the transition of the Mizone brand in China to a lower pattern of growth. For Early Life Nutrition, it is about making sure we take the right steps to build a more sustainable model of growth in the context of short-term acceleration of changes in China.

USA: sustaining the re-acceleration

So maybe quickly on each of these battles: I have taken the same slides as in Q1, which I will comment on quickly. So starting with Dairy in the US, you remember that in Q1 we have confirmed the re-acceleration that started in Q4 2015, with mid-single-digit growth. This reflected the success of our plans to re-accelerate and reignites the growth in an important market, where we continue to see a lot of potential in the future. There is a new momentum, and we are making sure that our plans – which include innovation, close dialogue with retailers and efforts to support the growth – will continue to consistently deliver quarter after quarter.

Europe: returning to growth

Turning to Europe, we continue to progress in our agenda for a safe return to profitable growth. I will not add much versus what I shared in Q1. Basically as you know, the key the focus of 2016 is about the re-launch of our global brands. We have started with Actimel and Danonino, and we are seeing some positive results and good signs of progress. The next step will be the relaunch of Activia in H2. So as of today, we are convinced we have what it takes to complete the transformation and stabilise the sales by the end of 2016.

Strong growth excluding China, pursuing the transition of the Mizone brand

Let's switch to Waters, and to Mizone in particular. Basically, regarding Water division, it is really about having a two-tier momentum approach for 2016. The first one is of course to continue leveraging a strong platform of growth everywhere geographically, and both on plain waters and aqua drinks; continuing to focus on activations of our brands, innovations, and initiatives to support healthier hydration.

Mizone brand in China

At the same time, we are pursuing the transition of Mizone in China. On this specific topic, we continue to progress according to our plan, basically adjusting the level of inventory in the Chinese distribution network, in line with the new pattern of growth. You have to notice that the current period is an important one, because it is the preparation of the season and the pre-loading has just started. As you know as well, it is in absolute terms an important quarter, and last year was specifically high due to strong anticipation of the season. So there will be for Q2 a high comp.

At the same time, we are making sure that we have a steady and disciplined approach of investment and optimisation, of course, to appropriately fund and prepare for after the transition. So that is it for Mizone.

China: building a sustainable model

Let us move to ELN China. As we shared in Q1, and as you have seen recently, there is news, and changes are accelerating and creating a bit of short-term volatility in the trends, which will last until everyone has full clarity on the end game of regulation. We are driven by fast-moving dynamics, with new elements of regulation to be implemented, and we are very careful not to push for short-term growth, but to remain focused on making sure that we are building a more sustainable model of growth for the future.

So it is really about making sure that we have a safe and consistent approach in resource allocation to implement accurate and sustainable solutions, in order to properly drive the conversion of the model and safely progress on our mid-term agenda. This is really our day-to-day focus. It is a complex battle. Long-term vision combined with a great execution plan, designed properly – a step-by-step approach, which is a must – to guarantee that we are building a sustainable platform for ELN around our major brands in China.

In addition to that, you have seen that we have closed the transaction between Dumex and Yashili at the end of May.

Continuing to build a strong model in a challenging context

I would like to come back to the environment that I mentioned earlier. We are clearly operating in a volatile environment, with some complex and fast-evolving dynamics in some of our key emerging markets. I put some of them on the chart. It is important because we mentioned that, earlier this year, the transformation that we have started in order to structurally change the way that we look at resource allocation is absolutely key to ensure that we can consistently deliver our agenda. You remember our initiative 'Beyond Budget', which is about going from a budget-type approach where resources are pre-defined and locked for a calendar year, moving into a quarterly resource allocation process which is based on an 18-month rolling forecast approach. This is enabling us to have a much more dynamic approach in our investment plans, which is very useful in a volatile context, and indeed we are now able to adjust, accelerate, postpone some of our investment plans on a quarterly basis, to make sure we appropriately fund short- but also mid- and long-term initiatives at the right pace.

In addition, since the beginning of the year, coming back to the way we are rebalancing our model and working on making sure it is getting more resilient, we have been able to extract efficiencies from the model; through very disciplined resource allocation, but also mix management, cost optimisation and growth. In this context, when we have reviewed our 2016 investment plans to ensure that we fund our growth initiative at the right pace, we have decided not to push for short-term growth, and as such we have decided not to allocate all these extra resources from the model in our H2 plan.

2016 guidance upgrade

As a consequence, we are upgrading our objective of margin improvement from solid, which is what we told you in February, to a range of 50–60 basis points' improvement like-for-like, and we are confirming our sales growth to be within the range of 3–5%.

Conclusion

In a volatile 2016 environment, with some fast-evolving dynamics in some of our key emerging markets, we really need to use 2016 to continue the rebalancing of the model. It will make us stronger, and that means we will not push for short-term growth at any cost, but we will make sure we give priority this year to margin improvement, to continue to improve the resilience of the model before we accelerate.

So everything is built today to make sure that we are progressing safely and consistently on our 2020 agenda. It does not at all change either the path of the destination, or the destination to the Danone 2020 ambition, which is strong, profitable and sustainable growth. We believe that we have what it takes to go there in a consistent and safe manner.

So this is all for me. I am happy to answer all your questions.

Q&A

Warren Ackerman (Société Générale): Hi everybody. Cecile, can you give us a bit more colour as to the timing of this decision? I am just trying to get a bit more understanding of the dynamics. You are obviously saying that in the second half you are going to be pulling back a little bit on investment to allow more to drop through to the margin. Can you explain exactly where that is happening and how that decision came about, so we can understand that dynamic? Would we conclude from that that maybe the organic growth as the compensation might be at the slightly lower end of the 3–5%? Just some colour on that.

The second point: on baby food – on ELN, I should say – I think you said at the Q1 stage that you expect an acceleration in the organic growth from Q1 into Q2. Are you able to confirm that acceleration, given the changes happening in China with regards to all the legislation and the taxation? Thank you.

Cécile Cabanis: Thank you, Warren. I will start with your question on ELN with the acceleration of Q2. Yes, we can confirm that there will be an acceleration in Q2 versus Q1. You remember also that Q1 had a high basis of comparison. You are right to mention, however, that there is some volatility in the short-term trends, because some of the traders are being careful in managing the inventories until they have more clarity on what will be the end-game regulation. However, overall, yes, there will be an improvement Q2 trend versus Q1.

On your questions on the model: so basically, it is really about coming back to the agenda that we have decided to build, and the process that we have set for ourselves in order to make sure we can build it. Every quarter now and after the quarter, we are having meaningful discussions on looking at our investment plan and resources, looking at our efficiencies and what have happened in the year-to-date. We are now also exiting the discussion on our strat-plan for the next few years. As a consequence, basically, the timing that you are asking is what happened between May and June discussions internally on our plans.

In terms of what you mentioned, we are continuing to reinvest. 2016 is another year of reinvestment behind the growth and the model. It is not like I am cutting some investments for any reason, no. It is really basically that I am able to extract more resources from my model. Given the fact that in some markets – and you have them on the chart that I showed – you know that we have been monitoring Russia for more than 18 months now; Brazil, you know that the trend is very volatile in Brazil as a context; we have accelerated changes in China. So we do not want to be in a situation to push for short-term growth. As a result, we are not going to allocate more resources than what we had expected. Basically, we believe that continuing to build also our profitable growth model, rebalancing it, is something that we absolutely need to do.

Now, given everything I said, based on the high volatility short-term context and the fact that we have decided to make sure we take the investment plan at the right pace for markets where there is some volatility: yes, there is a possibility that we will be full year on the first half of the range of the guidance. However, we will be within our sales guidance. We are not changing our objective, and we are upgrading our margin objective from solid to 50–60 basis points, which is really for me an illustration that we are in control of our agenda and that we are doing our job in order to make sure that we are moving safely towards our destination.

Warren Ackerman: Okay, thank you very much.

Pierre Tegner (Natixis): Yes, good morning. On a follow-up to Warren's question, I will be probably a bit more direct: is it a sales warning?

Cécile Cabanis: No, it is not a sales warning; not at all, because we are confirming the range of the sales objective that we set in February. We explained in February why we were putting this range, between 3–5%. So it is absolutely not a sales warning; it is for me a sign and an illustration once again that we are managing our agenda. We are deciding how it makes sense to build it, and we are making sure that we are not pushing for short term but we are really controlling our agenda to make sure that we are able to consistently deliver.

Volatility in key emerging markets has been there; it is here to stay. We explained when we met in November and when we met in February that it is not something that we need to take specifically. It is an assumption, it is here and the strengths of the agenda will be our ability to manage the pace of resource allocation and the pace of growth. We always said it is not about speed; it is about making sure we have the right pace to move safely to our agenda.

Now, once again, we have absolutely not changed the 2020 objectives or the path to go there, and we are fully comfortable that we have the right agenda to go there. No, it is not a sales warning.

Pierre Tegner: Thank you, Cécile. That is clear. Thank you.

Jon Cox (Kepler Cheuvreux): Yes. Good morning, guys. I have a question linked to what all the previous guys have been saying: how much is this to do with the fact that your cost-cutting measures are actually delivering more than expected, and you just did not want to spend it all on marketing given the volatile environment? So the question is: is it really to do with the cost-savings and the various other things you have got going on coming through, more than this being an announcement of a marketing spend cut?

Cécile Cabanis: Thank you, Jon. Yes, it is definitely not a marketing spend cut. Once again, 2016 will show a reinvestment versus last year in marketing. We are absolutely not cutting the means. It is basically what you said: there are some extra efficiencies that we are extracting from the model in H1. It is a mix of cost optimisation, of mix management and also of growth, and we have decided for all the reasons I mentioned not to reallocate all of them in H2. It is sound management of resource allocation and extra efficiencies, and as we will not allocate all of them in H2, we have decided to put them in the margin.

Jon Cox: Thank you.

Jeremy Fialko (Redburn): Hi, good morning. Quick one on Russia: can you just give us a bit more detail on that market? It seems as though some of the economic news there is starting to get a little bit better, inflation is coming down. Are you seeing any signs for improvement in your business, and is the outlook getting a little bit better?

Cécile Cabanis: Russia is still a situation that we monitor very closely. It is very early to say that there are some positive signs that are here to stay. We are continuing to be very careful with growth, and at the same time to work drastically on our mix management in order to make sure that we protect margin and we have a platform that is ready to accelerate. Today, we are not seeing specific rebound.

Jeremy Fialko: Okay, thanks.

Adam Spielman (Citi): Hello, thank you. I would like to follow up really on Jon from Kepler's question. In the answer to him, you talked about extra efficiencies coming from cost optimisation and mix; I was just wondering if you could be a little bit more specific about those two items, and where the extra efficiencies come from?

The second question: in your list of countries where there is uncertainty, Russia, Brazil, Argentina are quite easy to accept. I wonder why you have put China there, and if you can just give us a little bit more colour about what is happening in China? I know you have already made some remarks. Those are the two questions. Thank you.

Cécile Cabanis: Okay. Basically, on extra efficiency, it comes very naturally from mix management; we had a lot of opportunities to comment on that, both in Europe but also in Russia, so we continue to be very strict in the way we manage our mix. This is obviously creating some value. In terms of efficiency, it is around cost optimisation. It is the start of what we have put as one Danone organisation. It is also the fact that we are managing our key strategic resources in a more central manner, and there are starting to be cost efficiencies from there.

I think it is basically all the initiatives that we have set and all the discipline in terms of cost control that we put in place that are now starting to pay off, in the context where we have continued a favourable context in input costs. That would be for your first question.

Why do we put China? Well, we put China because, as I described, given the changes in regulation in China for ELN, there is some short-term volatility. We need to make sure that we are really focused on how we want to build our model for the future, and not trying to push for short-term growth. Because some of it is not in our hand; especially, you have some traders that are looking at how they need to manage inventories, so that is third. Also, overall China have become more volatile since last year, so it is one of the countries where we are being very sure we monitor closely the trends and the situation.

Adam Spielman: Very, very quickly, if I understand your first answer correctly, most of the improvement in margin versus previous guidance is going to come in Dairy? Because you talked about mix improvements in Europe and Russia. Have I interpreted that correctly?

Cécile Cabanis: No, because you missed half of my answer which was about cost control and cost optimisation, so it will not come only from Dairy.

Adam Spielman: Yeah, I did say 'mostly', but thank you.

Alex Smith (Investec): Yes, thanks. It is more of a follow-up again really, just to clarify these helpful resources coming through. It does sound to me like it is mostly your own initiatives, whether it is cost control or self-help. Can I just confirm: are you seeing any incremental benefit from input costs coming through?

Then I had a second question which is just on the technicals around scope. I think at Q1 you were saying that you should get some margin benefit from scope around 15–20 basis points: should we still be expecting that on top of the 50–60 basis points underlying? Thanks.

Cécile Cabanis: Thank you, Alex. Basically, on input costs the assumption has not changed since we gave the outlook for the full year, so there is no change in assumption for 2016. We are still expecting a rebound. The rebound might come a bit later than expected, but in terms of depth there is no change in assumption for this year.

Then basically your question on scope: now that we have closed Dumex, we are clearer on the scope effect and it should be between 10–15 basis points' incremental margin.

Alex Smith: Thank you.

Cécile Cabanis: Célia and Regis will be fully available to have follow-up calls with all of you. We want to make sure that you will get all the details that you need. I really thank you to have taken the time with the short notice. Thank you for your attention and for your questions, and have a good day.

Regis Massuyeau: Thank you very much to all of you, and I am sure we will talk soon. Bye-bye.

[END OF TRANSCRIPT]