BARCLAYS

Fireside Chat with Warren Ackerman and Danone | Barclays | May 25, 2022

Warren Ackerman:

Hi, everybody. Thanks for taking your time out to join us today for this Danone fireside chat. I'm Warren Ackerman, head of the Barclays consumer staples team. I'm delighted to be joined by the Danone team. We have Antoine de Saint-Affrique in Paris, CEO. Juergen Esser CFO, and Shane Grant, joining us from the US. So thank you gentlemen, for your time. It's a shame we're not all in Evian together, doing this in person, but this will have to do.

Warren Ackerman:

So there's a lot to talk about, so we'll get cracking. The format's going to be around 40 minutes of back and forward questions from myself. And then if you've got questions, please do email me, warren.ackerman@barclays.com, and I can pose the questions live, real time, at the end of the conversation.

Warren Ackerman:

So with that. Gentleman, I think we'll get cracking. So I'm going to open the questions for Antoine. And I guess Antoine, just thinking back, it's almost seven, eight months now since you've been CEO. Time flies. And I guess you weren't banking on a war or record inflation when you were sitting in the seat back in September. So the question, first up, is what has been achieved in those seven, eight months? And what would your top two or three priorities be for the balance of this year?

Antoine de Saint-Affrique:

Yeah. Thanks, Warren. Well, first, indeed, I wasn't counting on a war, but never waste a good crisis. So as you have it, you'd better use it. I think what as a team together in the last couple of months is first well, listen, and go around, and put our fingers in the engine, to try to figure out what works and what doesn't work.

Antoine de Saint-Affrique:

I think the second thing is really about facing the reality and taking stocks of what works and doesn't work, or didn't work, and built on that what we hope to be a very clear and a very simple course of action. So that's what's really rooted up to the CMD.

Antoine de Saint-Affrique:

And then really starting to walk the talk at different levels. So getting the company into a different rhythm, and I'm sure we'll get back to it. When it comes to what we discuss, how we discuss it, and at which frequency we discuss it, or bringing a few changes or to management, I'm sure we'll get back to that at some point as well. As well as, obviously, starting to transform the board. So really working at different levels, very operational, a bit more strategic and at governance level, and then being very systematic in trying to execute.

Warren Ackerman:

You mentioned the board, Antoine. There's a lot of changes, not just on the board, but also on the [inaudible 00:03:15] as well. Can you explain to us how those changes will empower you to drive the cultural change in the organization? Where do you think the teams are most engaged inside Danone and which areas is more work needed? Is it systems, is it people? I'm just trying to get a sense of how you are going about trying to upgrade things.

Antoine de Saint-Affrique:

So probably three different things there. I mean, the first one, when you look at the executive, and maybe stepping back for a minute, the thing that surprised me the most when I joined Danone mid September, was, in a company that has been under massive fire, with a big transformation, with a charismatic CO leaving the company, with quite a bit of a governance crisis and using the press, you had a bunch of people that were getting out of their way to just keep the boat sailing. So the degree of passion of Danone was a surprise, to be honest, given the magnitude of the crisis, and is really impressive.

Antoine de Saint-Affrique:

Once you've said that, we started doing a couple of things. At our executive committee level, I started with changing the chief HR, and goes to your question about culture, bringing someone with deep expertise. Someone that used to work in consumer groups, Johnson and Johnson, Colgate, someone that has hard industrial experience with value, but someone that has also done our transformation of Santander from a retail bank into a digital bank, with a clear mandate, which is to help us move the culture towards a more performance orientated culture. Something that is more meritocratic without, by the way, losing what makes the strengths of Danone, which is a clear sense of mission.

Antoine de Saint-Affrique:

Then what I have done is bring expertise and focus where I thought there was a need of expertise and focus. Operations. We had within the frame of the restructuring, [inaudible 00:05:38] first created a big monster called Design to Deliver where you'd learn together, plan, source, make, deliver, R&D to quality, food safety, et cetera. Put someone, a very good guy on top of it, but had never run an operation, was a marketeer by design.

Antoine de Saint-Affrique:

So we brought back some heavy tear from the outside, a clear focus on operations with Vicom, that has a long background in operations, same with R&D. With a clear view, with more focus on innovation, and bringing for the first time in Danone history, R&D to the executive committee. We put all the gentleman I was mentioning, heading sustainability and business development, to give it to different focus and to reunite it with the business. And off go.

Antoine de Saint-Affrique:

So that's the governance layer at executive committee. You've seen that at the board level. The board has agreed to renew itself totally in the matter of 18 months, which is probably never seen. We've done a first layer of it right now, with our five new board members, including myself. You've seen the quality of the CFRO [inaudible 00:07:00] the former CEO of [inaudible 00:07:04], the current CEO of Ralph Lauren. So people that are in the profit sector. So people that are extremely experienced, extremely senior, being able to challenge and bring us to the next level. And we are obviously working to the next stage.

Antoine de Saint-Affrique:

I think the third layer of change is less visible to the investment community, but is the way Juergen and I have started, together with Shane in North America, together with [inaudible 00:07:37] in the rest of the world, to change the way we manage the business, by being every 90 days in a religion, by every 90 days discussing what works, and more importantly, what doesn't work. By spending lots of time together, discussing performance, discussing execution, and discussing people, talents, teams, and doing it literally on cycles that are every 90 days. Which is fundamentally a way to give a different rhythm, a way to orient the conversation in a different way and to start focus the organization on execution. So, sorry for the long answer, but it's really three layers in terms of what we are doing.

Warren Ackerman:

No problem. There's a lot going on, so no problem with a long answer. But talking about other big changes, portfolio change is another topic you've laid out. You've said that 25% of the portfolio is underperforming. You've said 20% high growth, high margin. Can you maybe just explain to us, you did a little bit of CMD, but maybe a bit more, what's in those buckets? Have you already decided whether they are a divest or keep, or is that an ongoing discussion? And the question I get all the time, is how long is it going to take from actually deciding to then executing?

Antoine de Saint-Affrique:

So, I mean, the easy part is the 20% high performer. I mean, they are creative in growth, they are creative in profit, and the only question is how do we make them go faster, in a way that, by the way, is yielding return. So not banging them everywhere, but doing it in a disciplined way, in the places where we have the capabilities and in the places where we have a return. So that's the easy part, in some way. We need to max it out. They have very good story. I'm sure Shane will allude to it at some point what we do in the US with protein or across the world with protein, where in the matters of two years, we've created almost a 400 million business.

Antoine de Saint-Affrique:

The 25% that are underperforming. Step number one, is get into the root cause of why is it that those businesses are underperforming? This doesn't take forever. This is actually relatively quick. We've done a large chunk of it, the rest will be done within the next two or three months. Then the question is, come to a place whether you think you can fix it. What is the plan? How long do you give to yourself? Or whether or it doesn't make sense because the returns are not good, the credibility of the fixed plan is not there. And then look at other options.

Antoine de Saint-Affrique:

In the 25%, you have a mixed bag of things. I mean, you have things that are very profitable, but are not growing enough. You have things that are going very fast, but not profitable enough. I mean, the simpler overall is the ones that are neither going or are not profitable, but it's really a mixed bag of things. So you really need to unpack them, agree what's the diagnosis, and then move into to action.

Antoine de Saint-Affrique:

What we've said is the rotation that we committed to will be over the period of the guidance, until the end of 24. The phasing of it is as fast as we can, but as slow as necessary to create value. I mean, probably one of the good examples, and it is since we last met, is, you've seen, we have been discussing a long time what we would do with water's emergence now. The easy thing was to say, we sell it and off we go, but the better way of creating value, which takes more time to unfold, is, you have a great brand with lots of expertise, but you are lacking the distribution muscle. You find the right partner. You do a joint venture, and suddenly you are in a position where you can create much more value for the long term. Takes more time, but makes more sense for the company.

Warren Ackerman:

Okay. Maybe shifting gear to Juergen. This is a recurring question, Juergen, Danone have been very clear that the top line issues are mainly execution rather than category, but there's still a concern out there that this is actually more of a category, not an execution issue. I'm sure you're going to say, it really is execution, but can you give us a little bit of color as to why you think the categories are good ones?

Warren Ackerman:

The feedback I get is, yogurts and water, Warren, aren't they ultra competitive with little brand loyalty? And even if you fix the execution, it's going to be difficult from the fact that the categories are still the categories. I guess you're going to disagree with that, but what can you say to reassure those people that think this is a category problem, not an execution issue?

Juergen Esser:

Yeah, good afternoon, Warren, and you are right. That this is a very, very important fundamental question. This is why we have been very straight at the capital market event. There's a couple of key messages. And the first, number one, is that we believe in the power of our categories and we see great potential where we play today. There's a few reasons for that. The first reason is that when you look at past performance of our categories, our categories have been growing on average between 3% and 4%, while we have been shy of the 3% threshold. You talk about execution, but this has not been the only element which made us underperform in our categories. It's point on execution. It's a point on insufficient investment, and we've been demonstrating it at the capital market event. It's about insufficient focus on the core, and it's about the suboptimal execution of our innovations and the way we brought it into the markets.

Juergen Esser:

So many reasons, I believe, well-identified reasons why we have not been capturing the growth opportunities the market has been giving to us. When you look at it through the lens of our categories, I think there's a few elements we need to keep well in mind. We talk about specialized nutrition. Obviously the core of the debate is about IMF, but let's not forget that almost 40% of our portfolio in specialized nutrition is either on special pediatrics, for babies, are on a dietitian. 40%. And these two buckets, going in the vast majority of our geography, is double digit.

Juergen Esser:

So gaining even more weight within the specialized efficient part, and it will be a very natural engine of growth. You talked about water, bottled water consumption and bottled water category. The vast majority of our categories is very closely linked to sociographics, meaning that in the moment population is going in Indonesia, in Mexico, in Brazil, in Turkey, the category is going. That is what we have seen before COVID, that is what we will be seen after COVID.

Juergen Esser:

So we'll be benefiting from this very natural trend and as will be accentuated by the fact that we have a very mechanical rebound, this mobility, now that things are going to restart in emerging markets. Plant based, I don't think I need to be too convincing on that one, because we see more and more flexitarians, people moving from animal diet, animal protein diet, to flexitarian diet, which means using sometimes animal proteins, sometimes plant-based proteins today. This is the reality for around 30% of consumers in the markets where we play, which means that there are 70% of consumers to convince to bring to our categories. An enormous potential. And we see penetration going, quarter by quarter.

Juergen Esser:

And then last is dairy, which is probably the most exciting part, because it's important within our portfolio. And on that part, clearly COVID has made the consumers rediscover the beauty of dairy, the health component of dairy, the health benefits, the power of the dairy [inaudible 00:15:51], the power of fermentation. And so the categories back to growth, we have seen that in Europe, we have seen that in North America, and now what we need to do is we need to use

Juergen Esser:

... rejuvenated trend and dynamic, and we need to drive this growth. And I think what we have seen recently in North America is a very good blueprint of what we want to do also in other parts of the world.

Warren Ackerman:

Okay. And maybe turning onto the topic du jour on inflation, is there anything to update us on? Clearly feed costs are going up, which is filtering into dairy costs. You've said your inflation is mid teens. Is that still the case? And if it were to go higher, if it were, and I'm not saying it is, but if it were to go to high teens, what tools do you have in place to deal with that? And in that scenario, can you still do the 12% margin, or is that then becoming a risk factor?

Juergen Esser:

Yeah. That's obviously the topic of the moment. You're absolutely right. The volatility, as all of us can observe, continues and is extremely high. There's a number of elements, as you say, which are going up as an indirect result of the war in Ukraine. You mentioned feedstock, which is certainly one of the good examples. We see energy prices going up, knowing that energy for us is not a very important factor, but there's also a number of other elements where we are today seeing stabilization. And it's difficult to predict if that's only a short-term moment or if there's really a plateau coming, for example, on transportation. Here and there in some of our geographies, the pressure on transportation and supply chain is relaxing a little bit. Which means that net net, when I look at the volatility of global commodities and local commodities, we are not very far from where we have been a couple of weeks ago when we were together in the capital market event.

Juergen Esser:

So in that sense, there is no really new revised outlook on the free expectation on inflation. Having said that, we are super close to the situation, and obviously making sure that we are adapting our forecasts as we have new news. What is important? And to your point, whatever the inflation is, the name of the game is about maximization of price and revenue growth management. And this is what we have seen in Q1. I think that has delivered already good results in the first months of the year. And this is what we are accelerating, across the geographies and across the categories. And mixed with the record high inflation, we are targeting, and we had also a good start of year. As I was mentioning at the beginning at the Q1 release.

Juergen Esser:

Looking at all these moving parts of the year, there's no real new news. It means there's no real new news on inflation so far. There's no real new news on what it means for us in terms of financial delivery of the year. At the same moment, and I think we have [inaudible 00:18:40], we have been very clear at the capital market event. This is a foundational year for Danone. We are going to reinvest in 2022 into the three buckets, which is into our product [inaudible 00:18:49], into capabilities, and into A&P. And we are going to restart it this year.

Juergen Esser:

And that is fundamental, and that's non-negotiable, because we are here for long term. We are here for the long run, and we want to go into a sustainable, very creative business model. And so although today we do not have this discussion, but in the end, we need to decide about the 10 or 20 [inaudible 00:19:10] we invested on making a certain figure at the end of the year. We want to reinvest. We need to reinvest. Today, we don't see that we need to go into that discussion, but that's the mindset we are in.

Warren Ackerman:

Okay. And maybe at this point, let's bring Shane into the conversation. Thanks, Shane, for being so patient. When you joined from Coke, you said that EDP is a growth category in the U.S. And there was a few eyebrows raised to that comment, but you were steadfast in that view. And we have seen a turnaround in the U.S. EDP portfolio. Can you discuss the building blocks behind the improvement in U.S. EDP, and whether you can take that playbook into European EDP? Thanks.

Shane:

Good morning, good afternoon, Warren. Good morning, good afternoon, everybody. Yeah, happy to provide some comments on that. I mean, I guess firstly, you're right. I did say that, and I continue to say it. And I guess more importantly, beyond what I thought or felt, we now have, as you said, some pleasing evidence that that thesis, that we can make it happen. And so we're obviously really pleased with that acceleration in the North America business.

Shane:

I think in terms of the building blocks, a few things I would say. Firstly, and building on some comments Jurgen just made, and I'm maybe biased, having come, as you said, of 20 years of selling software. These are growth categories with unbelievable macros behind them. I mean, probiotics and gut health, protein, healthier hydration, permissible indulgence, plant-based, and we could keep going. These have got really good macros to be harnessed.

Shane:

I think secondly, you look at our market position, and we've either got clear quality leadership, or we're a really scaled challenger in a lot of really big growing categories, yogurt, creamers, ready-to-drink beverage, and beyond.

Shane:

I think probably the third bucket I would tell you, Warren, most important is what we have done and what we can do to enact the market. And that's a really important philosophy. I think it's certainly pervasive in the business here now, where we are the category leader. And if the categories are going to be vibrant, we have to grow them and lead them. And I think that is a belief system I think's really critical, which has led to, I think, some concrete actions, which have driven the result or some themes. I would say firstly getting really clear on the consumer segmentation and being able to access the parts of the market that can drive growth, be it protein, be it low sugar, be it gut health and yogurt, for example. That can drive market acceleration and our growth with it. And that's certainly happened in yogurt.

Shane:

I think secondly, I would say the bravery to modernize, and as Antoine said up front, fix the areas of the business that needed fixing, and on some big brands. So a brand like this, for example, needed some modernization, needed some pretty serious surgery, and repositioning that brand into a much more modern chassis. And how we've done that across a few important cells, with still some more to go, I think has been a really important component.

Shane:

The third one I would say is I think we pretty fast shift the innovation model from, I would say, trend hunting to scale bits so we can really impact the market. And maybe the last one I would say in support of all of that is what I would describe as much more commercial execution, muscle, and discipline. And by that, I mean core availability of our top 20 SKUs, active portfolio management to kill the tail, to make the space for quality and quantity of space with our big SKUs. And then starting, I would say, on the journey on format innovation and revenue growth management as a source of growth.

Shane:

So I think there are some levers. The last thing I would say, Warren, is underpinning all of that is culture, which is about, again, what Antoine set up upfront, market-facing culture that is focused on the outside. And I think here in North America, we went through a fairly painful integration process '16 through '19. So getting the teams focused on the outside was really important.

Shane:

Lastly, yes, it's exportable. And I think the business is now at a spot, have been through local first where we're in a position to do much more lift and shift, where we will learn from Europe and Europe will learn from North America and beyond. And I think we're in a space where we can be a much more networked culture to make some of those learnings exportable.

Warren Ackerman:

That's a great answer. Thank you, Shane. And I've got to ask you about private label in light of the comments from Walmart recently, where they called out dairy as a category in the U.S. where they are seeing a bit of a shift to private label. It's a more general question. I'm old enough to what happened in 2011, when we saw the last downturn and the price gaps versus private label were too big. Two questions, I guess. A, are you seeing any impact either in Europe or U.S. where we can see the Nielsen data in Europe is also showing private label gaining share, albeit down is also gaining share, interestingly, and then where are the price gaps today? I know it's hard to generalize, but give us a rough idea. Are they in a different place to where they were 10 years ago, or is this something we really should be concerned about, both in the U.S. and in Europe, given what we're seeing in terms of trends and comments from some of the big retailers like Walmart?

Shane:

Yeah. Thanks Warren. I mean, it's a super timely question. Firstly, maybe in a general comment, we are obviously very close with our biggest partners on what's happening in the market and given how dynamic the environment is. We obviously keenly listen to Brian's comments at Target and Doug and John at Walmart. And obviously they're in touch with their teams. The straight answer to your question, in terms of down trading in our categories, I would say very minor with little to no impact on our business today is what we have seen at least in the U.S. And if I maybe make a couple of comments on sort of the diversity of dairy, yogurt, and maybe organic milk, the yogurt pattern for us, and you all can see it in the Nielsen, our share sequentially every month this year has improved. So that we've seen that progression. Our primary competitor by the way is about where they were versus a year ago, but also sequentially improving.

Shane:

We have seen private label make some very minor gains this year, but they're essentially back to where they were this time last year. And we've really only seen the impact on the number three player in the market, in the U.S. in yogurt. And I'm sure you know who that is.

Warren Ackerman:

Yeah.

Shane:

Premium dairy, actually, some really similar dynamics. Our share in that market has sequentially every month got stronger. It's a bit more blurred, Warren, in the sense that we've improved our supply position, which has certainly helped us, but we've actually seen private label get weaker in that segment so far.

Shane:

This is not a perfect science. And I would say that we've got more assertive in our pricing in the last 12 to 18 months than we've ever been before. That has coincided with a reinvestment and revenue growth management capability, and really bringing that to bear on the business. So I think we're doing better than we have before, but I can tell you we're monitoring this by week, by customer, by region, by brand, by package. So we are watching it very closely. We are, and we may come back to this later, preparing for what could be next, which is if we see the consumer materially weakened, what are some of the levers we can pull commercially to respond to that environment? But hopefully that gives you a perspective, Warren.

Warren Ackerman:

And Shane, anything to say on price gaps versus private label where you are?

Shane:

Yeah, I would say generally-

Warren Ackerman:

[Inaudible 00:27:43].

Shane:

Yeah, I didn't mean to ignore that part of your question, Warren. I would say generally the price gap has widened, but there is certainly price inflation, which is broad, including the private label piece, but we're seeing that gap broaden. I think we were more assertive and early. We went far and fast on price with an ability to then moderate as we got further in. So I think generally we've seen that gap get bigger.

Warren Ackerman:

Okay. I'm going to move back to Antoine. Antoine, there's a question around digital. Best-in-class companies in staples are digital-first companies and leaders in eCommerce. I know you have pockets of excellence in China and maybe Happy Family in the U.S., but I don't get the sense it's broad based-excellence. Would you agree with that statement? And if you do, how are you going to go about making Danone a digital-first company?

Antoine de Saint-Affrique:

Sure. A couple of things probably there. We are not best-in-class. We are not where I want it to be. We are not also at the back of the pack. I mean, if you look at our eCommerce business, it's over 10% of our turnover. It's growing double digits. So we are moving. Indeed we have pockets of excellence. Our consumer-facing pockets of excellence are in China or in the U.S. Actually, trade-facing pockets of excellence are in our Europe, where we work with the [inaudible 00:29:14] of this world in a way that is quite innovative.

Antoine de Saint-Affrique:

But we probably have two things to improve. It's partly linked to what Jurgen said about our reinvestment. We to keep working on the fundamentals, so making sure that the quality of our pipes and wires, the quality of our infrastructure, the data architecture is at the level where we can systematically leverage the pockets of excellence that we have. And that's why we partly reinvest into data and our data infrastructure.

Antoine de Saint-Affrique:

I think the second thing, and Shane just said it on other things like price and revenue growth management, is getting the company into a place where culturally you steal [inaudible 00:30:11]. So making sure that we learn from each other in permanence, and we keep literally stealing things, moving fast. Actually, just for the anecdotes, but next week we are gathering the top 200 of the company. The vast majority of the days we are going to spend together is going to be about stealing from each other, because in some ways, if only we knew what we know and deploy it with discipline and consistency. So a bit of work to be done in the foundation still, and it will take time, and we will do it in a very systematic way, but also probably a bit more work to be done in just stealing with pride and executing with discipline.

Warren Ackerman:

Okay. And can I ask you about... I'm going to ask about Russia, Antoine. You're one of the few companies are still in Russia. I know you're not importing, exporting. You're doing local for local, but you're still there where many of your peers have pulled out. It has been a massive source of volatility in the past. Isn't it the right thing to do both ethically and maybe even strategically to follow some of your peers?

Antoine de Saint-Affrique:

The first thing is obviously this is something that is very personal to us. I mean, we have 1,000 people in Ukraine. We have two factories in Ukraine. We are every day on the phone with our people there, making sure by the way we keep delivering in Ukraine, not only the daily products, also the medical products, the infant products,

Antoine de Saint-Affrique:

Having people going through [inaudible 00:32:02] Entecon, into our business in Poland, Hungary, or Romania. So that is something that, besides Russia, we are living every day. And is really personal and burning, I think, to each and every one of us.

Antoine de Saint-Affrique:

Which is why, from the outset, we were extremely clear. And we are extremely clear on the fact that we were stopping all investments. That, with the exception of things like medical products or very specialized baby products, we are stopping the exports to Russia. But we felt that on the very core products that we were selling, like a number of our peers, it was both the moral and the business thing to do, to remain in Russia for as long as we can remain in a way that is ethical and is making sense. And that, for a number of reasons. The first one, and you've probably seen the bill that was passed at the [foreign language 00:33:10] this morning, but which was in the works for a number of weeks now, is if you are a core product, we are selling a milk-based product, we are selling medical nutrition, and we are selling baby product. If you stop, you're nationalized. So you don't help Ukraine, actually you make a gift of your asset to the Russian government.

Antoine de Saint-Affrique:

The second thing is if you stop, you kill people. Or you kill the people that are living on your medical nutrition. You don't feed the babies that are living on your baby thing. And you don't help families that never wanted the war and that are living on your product.

Antoine de Saint-Affrique:

The third thing is you have a responsibility to your 9,000 employees. So there, we believe that we have taken an extremely ethical position which is very much aligned with whatever the French government has said. But what you heard also from Biden, which is, not do war to the ordinary people on ordinary thing. Obviously, all the options are always on the table because you need to be able to obey it and you need to be able to obey it in a way that is making sense and in a way that is compliant. So doing the difficult route rather than the easy one, but with all options open.

Warren Ackerman:

Okay. I'm going to shift gears back to Juergen. There's lots of different questions coming in, but the one on brand support is obviously topical. €300 million directed to spend. How is that going to be phased, Juergen, this year, next year? And where will that spend go? And how do we know it's going to be enough?

Juergen Esser:

Yeah. When we were announcing the reset and the new strategy, very clearly we need to kickstart it with a number of investments. On one side, into fundamentals, building what Antoine was just saying, building fundamentals in data and IT, in operations, digitalizing our supply chain. But also investing into [inaudible 00:35:19]. And then this bucket, as you say, of €300 million into AMP. That's the start. To start this journey of sustainable value creation. Why €300 million? €300 million is basically in order to make sure that on the core we are again competitive, which means that our share of [inaudible 00:35:38] is at least representing our share of market. Which has not been the case everywhere in the past. And to make sure that we have sufficient resources to fund the winners in order to roll them out faster, to scale them faster.

Juergen Esser:

What is very important is that this is incremented €300 million, and we are going to phase them over the period of the guidance. As the savings of Broker First are coming into the P & L. But what is as important as the returns we are expecting from the €300 million, is to make sure that we are getting better returns from the baseline of the [inaudible 00:36:13] we are already spending. Which is a multiple of these €300 millions. Which means increasing the working AMP in the total AMP envelope, and making sure we are allocating the existing baseline on where we get the best returns. Moving it away from the under-performance, for as long as we don't have a plan how to fix them, and moving them where we have profitable, fast growing brands.

Juergen Esser:

And this is what we are doing as we speak. For us, very clearly, this is a kickstart. Because we want to go back into a sustainable, very creative, business model. And that means going three to 5%, but not only going in mix or price, but also going in volumes. And as soon as volumes are coming back into our factories, it will create operating leverage, and that will allow us not only to expand margins, but also to reinvest part of the operating leverage into our brands. And so it becomes a self-financed, very creative model.

Antoine de Saint-Affrique:

And maybe to insist on two points that Juergen just made. One is, and you've seen that during the CMD, but that's a bottled point. The fact that we have identified what is the core, what needs to be accelerated, what needs to be fixed, gives a very clear compass internally on the role people have to play on the way we allocate the money, and on the returns we are expecting for the money. In the same way, talking of returns, working versus nonworking, be it in media, or by the way we invest our CapEx, is something that we are getting much more disciplined about. So getting into a logic of retail invested capital. Sorry Juergen.

Juergen Esser:

[foreign language 00:38:00].

Warren Ackerman:

And I'm moving gears again, trying to inform formula, there's a few things I'm going to try and jam in if I can. One is, is the current lockdowns having any impact on your business and any impact on birth rate? Just trying to get an understanding of the lockdowns in China. I guess my zone must be impacted, given it's mainly out of home. But any comments on that will be great. And then the other question, of course, always on China, is around the margins being very high. We can all see the margins are 35% plus. Can you give us confidence that those margins are at least sustainable, even if they maybe cannot grow?

Juergen Esser:

Yeah. Maybe [crosstalk 00:38:44].

Warren Ackerman:

That's a two part question there.

Juergen Esser:

Maybe starting with the last part of your question one. You are right at IMF, China is a category which offers very interesting profit margins. And that's not only true for us, that's true for the whole category. When you look at some of our peers, like [inaudible 00:39:02] is also publicly available information that they are also trading at the very nice profit margin. In order to sustain those profit margins it's a lot about continuing to win in the marketplace, and you have seen us winning over the last quarters. We have been growing our market shares on Chinese level. We have been growing our market shares on international level. We have a fantastic brand asset with Actimel, and this is what we are nurturing.

Juergen Esser:

And winning also means controlling your prices in the market of IMF China. And this is where we have also been very successful with the business model, which is mostly a digital business model, which is very efficient business model. And this is sustaining our profit margins as of today. And we believe we'll also be able to sustain our profit margins as we travel into the future. Very important for that is that we are investing and reinvesting into our brand. Actimel, which today is the synonym of immunity in the Chinese market and which makes that the mom and baby store cannot not have up Actimel on the shelf. And that is the key level to sustain our profit margins. But it's also true that we are not only relying on one leg in China. We are building as we speak with the teams in China, but also outside of China and more structural resilience. What I mean is that it's not only in IMF China where you have attractive profit margins. We have similarly attractive profit margins in the pediatric specialty segment. This is going very fast and we are reinvesting into it.

Juergen Esser:

We have similarly interesting profit margins in the diet and nutrition space in China and we are investing behind it. And we have a [inaudible 00:40:43] business on the beverage side, which, as you know, is a very profitable business for us and where we are working very hard in order to bring it back to sustainable growth. So it's not only relying on one leg, but to make sure that we build structural resilience in China. But also outside of China, and this is very important because, as you know, when we talk about specialized nutrition, business for us and the company, there's only one third which is coming from China. There are still two thirds of our business outside of China, and this is what we also strengthening with all the components I was just mentioning as we speak.

Warren Ackerman:

Anything to say on lockdowns?

Antoine de Saint-Affrique:

[crosstalk 00:41:16]. A word on the lockdowns. The lockdowns obviously are, for IMF, limited to a number of cities. Actually, there is something very interesting that's happened during the lockdowns, you probably know, but lockdowns are incredibly severe. So not only you cannot get out of your block of building, but you cannot order on Alibaba or Tencent. The delivery doesn't happen, delivery is done through the government. Well, the China team managed in Shanghai to put Actimel part of the deliveries. Obviously it's not a huge volume, but it's an enormous buzz on the brand being next to the people at a time of crisis. Which is super good for the brand. All in all, we are not doing bad even in terms of lockdown, as you said, the more affected business is my zone when you don't have mobility.

Warren Ackerman:

Okay. If I can just go back to EDP again, but in Europe. You talked a lot about the US. But has there been any down-trading in Europe that you've seen so far? I'm thinking specifically about Spain, because I remember 10 years ago when we started to see the downturn it was Spain that kicked it off initially. And I saw that, in Spain, you called it out as being very weak in the first quarter, in dairy. And I now see that you are rationalizing some production facilities in Spain as well, which would suggest that volumes are pretty weak. Can you maybe just update us because we can see the private label share accelerating in Europe and we can see what's going on in Spain. Can you just maybe reassure us this isn't history repeating itself?

Antoine de Saint-Affrique:

You want to take it? We can do it, juergen will answer.

Juergen Esser:

[crosstalk 00:43:18] do it. I think probably the starting point is not the Q1 story, Warren, as you say.

Warren Ackerman:

Sure.

Juergen Esser:

When we have been doing the diagnosis for the company on where we are strong and where we are today not strong enough, we're very clear that this is not only a question of a country or countries. This goes beyond country and countries. Dairy Spain, or Spain, in particular dairy Spain, is certainly one of the business sales where we have identified significant opportunities to improve. And we were not shy on explaining that. And this is also why we called it out when we were talking about the Q1 results. The reality is that, that's a heritage business for us. Super strong brand, a very complete portfolio, and a Danone brand which is not only leading in the dairy category, but is one of the most powerful brands across all the industry in Spain. So we have a fantastic asset, but an asset which in the past has been absolutely under-leveraged.

Juergen Esser:

And so the leadership team in Spain has one clear mandate, which is to fix it. You were referring to an announcement which happened this week, I think, or last week about the closure of a factory. Let's not be carried away, this is a relatively small project. Yes, we are closing a small factory in Spain, but this is not the core at the center of the solution of the acceleration of Spain. The center of the solution will be to accelerate the attractivity of our brands, and to optimize the execution within our sales and commercial activities. And this is what we are working on. In that sense, what's happening in Europe in terms of consumer shift is only, I would say, I think, creating more sense of urgency for us internally. And as much as you could see it as a threat, we could see it as an opportunity to go into action. And this is what the team is working on.

Antoine de Saint-Affrique:

There are maybe two additions to that. We haven't done over the history of the past few years, a good job in Spain. Let's call a spade, a spade. We are the category there and we have been, in some ways, exemplifying what went wrong. Which is proliferating innovation, not being clear on the brand proposition, and, as a result, taking the category. We were the category, we're a large part of the category. So impacting the category, but losing our team. There will be a new team in Spain. We've announced this week, actually, a new head for Spain with a clear mandate, which is in some ways back to the basics. And, in some ways, the good thing about the crisis is it forces you to rediscover the might of a Danone yogurt, which is not a yogurt, but a Danone yogurt.

Antoine de Saint-Affrique:

So it's the power of the ferments. It's the power it's unleashing all the life elements in milk in a very unique way. With a mix of naturalness, taste, and health, in a way that is extremely affordable. But then I'd seen some ways back to what was created by Daniel Carasso in Barcelona over a hundred years ago, which was something that was selling in pharmacies. And which was unleashing through science, the ferments, all the good things you find in milk, and which are absolutely essential, both for your bones and for your guts. So it's in some ways back to the basics and there the crisis has helped for that.

Warren Ackerman:

Okay, perfect. Right. I'm going to take some questions that I've got coming in. Quite a few, I've got an avalanche of questions coming in. So if we could try and do these relatively quick fire, 30 seconds, a minute answers? Because there's lots of them. I'm keen to get through as many as possible. There's one for Shane, which is, is there any evidence that your supply chain challenges are easing in the US? Where exactly are the pinch points and what are your current service levels like to retailers?

Shane:

Short answer in 30 seconds is evidence of the supply chain tensions easing, but not being easy, I would say.

Warren Ackerman:

Okay.

Shane:

Pinch points have shifted across different phases from input availability, transportation, COVID upstream. I would say the major pressure points, today, has shifted from capacity to input availability, but the list of input availability tension points is narrowing.

Warren Ackerman:

Okay.

Shane:

Our service has improved

Shane:

... approved consistently and still has a way to go to be best in class, is the summary.

Warren Ackerman:

Okay. [inaudible 00:48:07] yogurt, and it's on returns. Your return is 8.7% last year, which is very low. What should the return of this business be, and where is the biggest upside? And how do you bed returns into your decision-making?

Juergen Esser:

Yeah, we were very upfront about the 8.7% figure. And you know, Warren, that in the past it was not a number and not a KPI, which was at the center of the discussions. We have been very clear that we want this now to be in all of our conversations externally or internally to be one of the compass and one of the KPIs to measure success. And in that regard, we're very clear that we want to bring that into double dig territory in a sequential way. What does it take to do that? It means first and foremost, to do very disciplined in the way we allocate our capital. And I think that means that this KPI will be in the center of all discussions of capital allocations, when we talk about portfolio rotation, when we talk about capital expenditure.

Juergen Esser:

It also means that in all our other investment business cases, that will be at the center. Because in a way, the way to drive our [RIC 00:49:19] we go through two measures. One is to expand our earnings, and to expand our earnings through profitable growth, so we need to invest into the right growth engines which deliver great returns. And at the same moment, driving our cash conversion rate to pull down our invest capital. And so we are working on those post segments, and we make sure that the return on this capital is part of every single discussion. Not only at corporate level, but also at local level when we talk about investments.

Warren Ackerman:

Okay. Question for Shane coming in. Shane, EDP is 90% of the US, it's very focused on one category. What are your thoughts about the currents rumors of a potential opening up of the US, [inaudible 00:50:05] infant formula to other brands, given the potential changes in the WIC system, given the shortages going on in the US. You've got Happy Family, we know that, but it's very small. Would you be interested in entering the US market? And would it even be feasible under a CapEx or advertising point of view?

Shane:

Firstly, let me take maybe the first assumption on that. I think the EDP groupings and internal grouping, and the one we've got used to as a community. The reality is, the business [inaudible 00:50:36] super diverse yogurt, creamers, drink coffee, etcetera. It's a super diverse business already, and the footprint we've got to growth footprint. So the opportunity in front of us with that is enormous. And you see the business starting to respond. I think with specifically the SN, we've obviously got a small but vibrant mainstream baby business with Happy Family. We've got a very specialized formula business in Nutricia. Our focus, honestly, in the last weeks, 10 days has been serving the business and serving babies. And we have been very active in discussions with the FDA and the White House on bringing what I would say is the full power of our system to help.

Shane:

We've already communicated together with the FDA that we are in a position to help immediately with some specialized product. And we have made the offer of a much larger quantity of regular formula that we can make available through our global system. I can tell you, I've not been more proud of our business than I was last week of what we've been able to do for the country.

Shane:

Look, I think part of those discussions, clearly what was on the table was some of the barriers to entry in that market. Be it WHO guideline, be it the WIC system. And that part of those dynamics has what has kept the market too restricted, and kept the market not as competitive as it could be. So, while we're obviously monitoring that discussion, we know we've got a lot of strong assets globally, and in the short-term, we're going to bring some of those assets to bear into the US. Beyond that, we'll continue to monitor.

Warren Ackerman:

Okay. Thank you, Shane. Two questions on water. The first one is, you've got three great international water brands Evian, Badoit, and Volvic, but we don't hear enough about them. What are you doing to push these brands harder and innovate? I've heard about sparkling Evian, what's your plans around that? If I could squeeze in another one around Myzone, which is, Danone have tried and failed to turn around Myzone the last five years, why do you think you will be successful this time round? Which is two questions. One's Myzone and one on your international [inaudible 00:52:57]-

Antoine de Saint-Affrique:

Two very different questions, we'll probably do it a bit. On Myzone, to me it's symbolic actually of what we are trying to do. Until recently, we didn't go to the bottom of the issue. So, what has been done over the last couple of months by the team there, led by a very strong [inaudible 00:53:18], is really going deep and deep, and deeper again. And try to really understand the root cause of the issue. Take the time to do what it takes to fix it. Agree on a plan, and do it. The key issue with Myzone, which was one that was in some ways difficult to phase two, is Myzone is being sold in fridges. We started [inaudible 00:53:47] innovation, the proliferation of innovation that was non-performing, or was coming at the expense of the facing of the core. As a result, the core was out of stocks.

Antoine de Saint-Affrique:

The rest wasn't rotating, and our distributor was stuck with cash that was idle. And our products that weren't selling. To solve it you, number one, need to be clear on the quality of your innovation, the way you execute on store. Second thing, you need to be ready to break out of a cycle of mindless innovation and pipe filling, and take the time it takes to clean your portfolio. Including, by the way, be ready to kill a number of SKUs that maybe are tens of millions of euros, but not really relevant in the great scheme of things. So you need to be able to face difficult choices. You need to able to execute them, and then being very, very, very consistent. And that's a journey that will take a while. But the starting point, and start back to what I said at the very beginning, is call a spade a spade. Face to the truth, go to the bottom of the issue. And only then decide whether you can fix it or not.

Antoine de Saint-Affrique:

I think there I see good progress, by the way, but we are not there where I want us to be, but we will do it in a disciplined way. I'm delighted that someone share my view that Badoit and Evian and Volvic are great brands. They are absolutely great brands. And the duty of the Evian sparkling is suddenly you will be able to put Evian still and sparkling together, hopefully, on all the tables of the premium restaurants in all the key geographics. So it's a channel play. It's a geographic play. All the resource that is limited because our Evian water is limited, and that's good news. And we take enormous care of the well, by the way.

Antoine de Saint-Affrique:

Which means that if it's limited, it's going to go premium. So there, the way forward example, we just launched in the UK, we are in the process of having it in the US. The way forward is keep driving the premium of Evian, keep driving development to Evian, keep driving a multi-channel play. Which, by the way, is also enabled by our various company coming together with our local first giving us access to channel to which we didn't have access.

Warren Ackerman:

Okay. [inaudible 00:56:42] Yeah. No, absolutely. I think Evian sparkling could be a really interesting concept, especially given the rapid growth going on in carbonated water right now, especially premium carbonated water. [inaudible 00:56:56] in a couple more. There is a question around Dumex. You acquired Dumex again in China after selling it 10 years ago. And you've cleaned up some of your positions with menu and [inaudible 00:57:10]. The question I'm guessing is, how much extra capacity does Dumex give you in China? And how far does it move your sourcing from outside China into China? Do you need to do more of this, or is GMX enough?

Antoine de Saint-Affrique:

Do you want to take it, or you want me to take it?

Juergen Esser:

I can take it. You have seen that after the announcement of last year already, where we have announced that we are stepping out of the menu direct participation, where we had almost a 10% participation. That also basically led to discontinuation of ... which shows we had this menu at the time. As part of these discussions, we have decided to acquire back, as you said, the Dumex brand. But it's not so much about the Dumex brand, it's about the industrial platform and the recipes, because this is definitely for us an enabler to continue strengthening our Chinese label strategy, localizing our production, localizing our science, making sure that we are relevant for the Chinese babies and the Chinese mother.

Juergen Esser:

So it's perfectly embracing the overall strategy. And this has not been the first move. On this part we have seen us earlier last year already announcing a number of acquisitions to strengthen our local capacities to go in that way. That is another step, I would say, bringing resilience to our model, and we will continue to do so. Now, you have seen that the announcement we did is not an announcement of immediate take over of that plant. It's a conditional to a number of elements, and so it will probably take a couple of weeks or months in order to get that into our hands, and then we will make good use of it.

Antoine de Saint-Affrique:

Yeah. It's conditional to actually us being able to make good use of it.

Juergen Esser:

Absolutely.

Antoine de Saint-Affrique:

To be absolutely clear. It's a byproduct of us unwinding the relationship and doing it in a way that is of interest for both sides.

Warren Ackerman:

And right on the buzzer, so this is the final question. I think it's an important one, it's around innovation. Danone are always seen as a fast follower, rather than leading trends. And the classic example is Greek yogurt 10 years ago, a little bit now in oats. How do you actually get ahead of trends rather than always being a fast follower? And how important is the appointment of [Isabel Essa 00:59:46] as your head of R&D to allow you to change the mindset, so that as the category captain people are worrying about Danone and what you are doing, rather than you worrying about what other companies are doing. Because I think this gets to the real nub of the matter, that if people can see you as a category captain driving trends, it will change perceptions. I'd just love your thoughts around that question.

Antoine de Saint-Affrique:

No, it's super. It's a super good question, Warren. Two things. It's not either/or, so it's not either leader or fast follower in my book. It is being obsessed with our trends and it's being obsessed with the market, and it is making sure that either you lead the trend or you jump on the trends very, very fast. And it's not one or the other, it is the two at the same time. It's also your ability to assemble things. I mean, Apple didn't invent half of what it launched, but it bundled them in a different way. Then back to your question, you're absolutely right, one of the reason why I brought Isabel onboard, one of the reason I put R&D at the executive committee, is because I truly believe that we need to much better leverage some of the assets we have from an innovation standpoint. We have amazing knowledge of fermentation, but we didn't leverage it.

Antoine de Saint-Affrique:

We have amazing knowledge of gut health, but we don't fully leverage it. We are in medical nutrition with things that are doing wonders, either for people that are oncology treatment or to prevention of dementia, or people having problems to metabolize. And all of that science can cascade also into our products in different forms. But there, we need to have a very clear long-term research and development agenda with someone that is owning it and doing it across. And that's, well that's in some ways what I did in my past life, proving that you can do it in chocolate. If you can do it in chocolate, I can tell you, you can do it in the portfolio of Danone. We will do it. That's the reason why we brought Isabel. Then, how long will, or how fast will we be? Time will tell. It's a clear priority and focus.

Warren Ackerman:

Listen guys, I think we are definitely out of time now. Thanks for all your time and effort to [inaudible 01:02:33] been a really super conversation. I hope we an do it again in person, and hope to see you in Boston at out back to school conference later this year. But good luck with the journey, very much looking forward to keeping in touch with you guys. And thanks again for your time. Cheers.

Antoine de Saint-Affrique:

No, thanks Warren. And next time [inaudible 01:02:53] hopefully.

Warren Ackerman:

Definitely. Take care. [inaudible 01:02:55] Bye-bye.