CAGE 2013 – Danone

S1 Speaker 1 – James Amoroso
S2 Speaker 2 – Emmanuel Faber

S1 Now the investment community likes to worry about Danone and I've no idea why. Years ago it was about how the Biscuits Division could never be improved and would forever drag down group growth and profitability. Well, they improved it and they sold it for a great price. More recently it was how the re-set in France was the beginning of the end in that market. Instead it was simply the beginning. Then it was Greek yogurt phenomenon in the US and growth and profitability in Russia and surprise, surprise, management successfully tackled those issues too. Now it's Southern Europe. As we all know investment cases should not simply be about what the external environment throws at a company or we just become weathermen. It's about how rapidly and successfully its management deals with those issues. Emmanuel, please tell us more.

S2 So welcome to our presentation. There is no better way to start the day than starting it with Danone and I'll try to share our enthusiasm for our business with you this morning.
2012 has been a year of major milestones for us which all of them are promising a lot for the current year and the coming years and I'd like to spend a brief period of time with you on those. First of all, first major step change after a series of add-on acquisitions and through our organic growth, we have reached the 20 billion mark in our sales as you can see for many years through the re-focus of Danone we've been selling and buying businesses but over the last five years you can see a regular growth and you will see more both from acquisitions and organic growth in the coming months and coming years.

Second, we have reached the target that we had I think quite ambitiously set for ourselves five years ago of doubling our free cash flow generation in this overall difficult environment and we have reached our two billion mark last year of free cash flow despite the fact that we have continued to heavily invest in capital expenditure to continue to grow our businesses. This cash flow has been helped of course to add more exciting businesses to our staple brands and you can see a couple of examples or three examples: Unimilk, Wockhardt in India and Centrale Laitière du Maroc which we've just closed a few days ago ; an acquisition that we announced last year.

Third major milestone: we have now reached more than 60% of our sales in what we call growth markets and you can see how quickly that shift has been between 2007 and 2012 even in our top ten markets. Those growth markets represent 60% of our sales and they are major contributors to our growth obviously and this shift in our overall portfolio of business over the last five years is a very promising base for what the future will be for us in terms of overall organic growth.

Finally the fourth major milestone that we have reached last year I think is a symbol of the way Danone has been building sustainability over the last 15 years and many years before in its way of doing business. Not only we think we should or we will decouple our volume growth and our CO_2 emissions but as you can see from the top left hand of this chart we have actually done it. Over the last five years we have completely decoupled our CO_2 emissions from the volume growth having actually decreased our total CO_2 emissions while significantly growing the number of products that we continue to deliver as part of the Danone mission to our consumers. This is only one example of many others in which we have completely embedded business performance and sustainability over the last several years even into our governance. So this minus 35% CO_2 intensity reduction over five years was a key milestone that we had set for ourselves in 2008 that we have now reached by the end of 2012. We are confident that we will continue to deliver a promising agenda of sustainability for 2015 and beyond 2020.

All of this is basically building something that we have been on and on with you, building the unique mission that we have set for ourselves of bringing healthy food to as many people as possible. Between 2007 and 2012 we have actually increased the number of our regular Danone product consumers by 50% from 600 million to 900 million regular Danone consumers around the world now. We are actually very proud of the fact that we've been ranked number one in the inaugural Access to Nutrition Index that was launched a few weeks ago and has been under progress and work over the last several months, 18 months of work. Basically for us, it is a clear sign that the way we design our products from a nutritional standpoint, the way we market them including in emerging countries and the accessibility both from the route to market and the pricing standpoint, the way we are marketing and communicating in a responsible manner on our products are very significant competitive advantage for us in the long term both in terms of consumer and public acceptance of what we are doing every day.

If I turn to the shorter term and look at 2012 briefly, what you see on this chart is basically that it's been a year of two-tier momentum

- with our growth markets 60% of sales, delivering more than 12% of growth last year, very steady and I'll come back to that very soon and a continuous margin improvement of 80 bps last year on a like for like basis.
- on the other side Europe excluding CIS basically declining 3% last year with 190 bps decline in our like for like margin.

So let me spend a bit of time beyond what the results of 2012 have been, where you can see that basically we have reached our guidance of more than 5% in top line last year.
We've also reached our free cash flow as I said before, which we had set at €2 bn, but as you know in the course of June last year we revised down our guidance for 2012 to minus 50 bps in margin due to the Southern Europe situation.
So that's the effect of this two tier momentum on 2012.

Let's look now what are the engines behind these, this momentum. One of the key engines last year and continuing this year is obviously, you know, the fresh dairy US market. We are building a very strong market leadership position. If one thing has changed over the last five years in the US, that's the Greek phenomenon and as James mentioned in his introduction some of us and some of you were worried about whether that was going to be a big thing or only a fad. It took us a bit of time, a few months, to decide that it was going to be a strategic change in the overall US market and you can see from this chart that the very early choice and actually we were by far the first incumbent player in the market to react to this trend, has created an incredible gap in competitive terms to General Mills-Yoplait that you can see here in red on this chart where in only a matter of a year we have created a five points market share gap on the magnitude of a market as large as the US dairy market and you can see that this is driven by the Danone Greek line that you see on the bottom part of this chart where as we speak we are not at 9% market share in total but actually above 10%.

So there is a continued momentum behind the transformation of the US market that makes us extremely confident on what we are building here and you can see here how fast and how profoundly the Greek phenomenon has changed the market when you see the shares of overall segment or overall category of the Greek segment that has went from nearly nothing and in three years last year was 35% and as we speak is 42% of the total yogurt category in the US. That's what we are riding with all the launches that we've been creating on the US market, all the capacities that we've been adding and we continue to add capacity, there will be more capacity with Danone behind our Greek brands in the US in the coming months.

Another big engine of growth behind our 60% growth markets is our CIS business and the merger of Danone and Unimilk in 2011 has now transformed it into a powerful player with a very clear number one position in overall dairy and in yogurt in the Russian market with all the key brands now growing very fast. As you can see on the right after the very significant cuts that we brought to the portfolio of Unimilk in '11 by cutting unprofitable, traditional, local brands SKU's that were heavily present in the portfolio of Unimilk and that we have, as you can see on the left hand part of this chart, that we have cut and therefore cut also underlying volume growth in total. So we're back to growth fuelled by the value added brands of the Unimilk and Danone portfolio in Russia, Prostokvashino, Tema, Biobalance, three big examples of the growth that we are driving there. Delivering mid to high single digit growth for this huge country and delivering on the 100 bps margin improvement year after year that we have committed at the time of the acquisition. We are well on this plan with the synergies flowing in, and the margin improving actually at a fast pace.

Another big engine of course for us is our wonderful baby nutrition business delivering last year close to 12% growth on an organic basis with market shares on the Danone universe, so the countries in which we operate - I remind you that we are not in the US for instance - market shares are improving year after year. Last year again we improved that market share by 30 bps. That has been fuelled by significant market shares growth in a number of key geographies, the UK for instance is our fourth biggest market in baby food where our market share has grown last year with Cow & Gate but also in China where our market share has grown last year. We finished in China with a market share in 2012 which is an all time high and of course a leading position in China. This is fuelled by the two big blockbuster concepts that you can see on the right, one being our functional baby food approach, for experts and ambitious mums with brands such as Nutrilon, Aptamil, Gallia in France and others and our more holistic position brands on the right the example here being Dumex which has been re-launched in China very successfully last year delivering strong growth as I said in market share or another example being SGM Sari Husada in Indonesia which is a heritage brand for decades in Indonesia. You should expect our baby nutrition to continue to deliver very strong growth. We see no change in the overall momentum that's driving the growth of this category.

Another significant engine of growth for us in the 60% growth market has been overall our waters business which in total last year has delivered a 10% like for like growth where we've been able to grow both our traditional spring water business but also we've been capturing the opportunity created by the aquadrinks.

The aqua drinks business where you can see on the right hand side of this chart how much they have been delivering growth for us on average over the last four years it's been a 20% CAGR in the aquadrinks segment. You have a couple of good examples of how brands have been nurtured or created through that over the last several years and you can see Mizone on the right which in China and Indonesia represent now more than €500mln of sales and continuing rapidly to grow. We just introduced a test of a similar concept in India last year and we are continuing the test this year. On the middle of this chart you see the Bonafont brand more than €500mln, balanced brand both in terms of water -the elimination concept- and aquadrinks. And Aqua on the left hand: ten billion litres within Indonesia of Aqua water which is by far the largest single water business in the world, packaged water business in the world.

Water is a growth engine for two reasons: one is because the growth markets are 62% of our total water business and you can see that in these growth markets we have huge growth basically but there is also an engine of growth because in Europe excluding CIS which is still 38% of our water business we have been able through the incredible work that was done by the teams three, four, five years ago to restore the category growth and resist to the current difficult trends of macroeconomics in Europe as you can see. We have been able to stabilise and even slightly grow our businesses both aquadrinks and waters in Europe.

Turning to the less easy part of this discussion - 40% sales in Europe excluding CIS for Danone, last year minus 3%, 190 bps decrease in margin last year.

What are we doing in Europe?

Well, first of all, we have an incredibly wide and profound number of top line activities that are dealt to bring to the consumer in her or his new normal way of living in Europe: continued excitement with our products, delivering the best product.

We have reinvested money in the recipe, in the formulation, in the quality of the ingredients of our products across the range whether that's weaning food in baby food or fresh dairy or aqua juices; we've been incredibly demanding with our teams on the quality of our products and the consumer preference.

Second, we have heavily invested in packaging, new packaging. Probably the best example and the one that you know well is what we call our Kiss cup pack in the yogurt area which is this round pack that you can see here on the left for Vitalinea and Activia, two examples, which are bringing a completely new consumer experience and a completely new facing on the shelves, highly visible, highly differentiated which has been able to grow some of our brands by 10-20% compared to the base line when we changed in Europe from the former packaging to this new pack.

Third, the right price point. Obviously we have to work on price points with many consumers working around their budget constraints and their arbitrage between consumer patterns. So we've been embarking on specific promotion programs across Europe to address these issues rather than price decrease, through promotions and continued promotions to ensure the visibility and maintain the frequency of purchase of our products for our less loyal consumers and therefore continuing to maintain the expansion of the Danone consumers in Europe.

And finally creating differentiating innovation and you have here three examples of dairy:

- One is Vitalinea Pro which is a very successful launch in Spain of a Greek yogurt, that's a US recipe of Greek that we brought into Spain under that name and that pack, very successful last year.
- The liquid version of Densia with high calcium content called Densia Forte which is also very successful in Spain.

- Yolado which is also an example in Spain which is a frozen yoghurt with a completely new technology that we have started and launched last year and you have an example with Bledina of new packs in the weaning food area and as well new recipes that we've launched.

The level of innovation and effort that we brought to our markets has actually made Danone the company that has most driven the development of the category. I cannot even say the growth of the category because in most of these countries the yogurt category itself is declining but if you look at the Portuguese example for instance you can see that from packaging innovation, a price point innovation and new products like the Griego we have had a three pillar innovation strategy that has actually driven a two points gain in market share in only one year. So, in a category where in Southern Europe at least, Germany and a couple of other markets, private labels are a significant competitor and sometimes the only competitor, the Portuguese example shows that there is no excuse when we do the job properly then we gain consumers back and that, I think it’s a promising example for a small country.

Another example is in the UK where for instance we have introduced both versions of the Greek yogurt; you have the European yogurt recipe with Oykos, and Danio which is again the US product that we have re-engineered for our UK market.
We have also significantly reinvested in the way we are doing advertising with solutions that are gradually getting our brands back into the minds of the shoppers despite the fact that for some of them and that’s the case for Actimel, they seem to be out of the radar screen given how expensive they have become for a number of people. So we’re addressing that gradually and by the way the UK is not doing so badly.

Other examples of how are we addressing the growth in Europe: you’ve seen from the numbers that we don’t have a growth issue with our water business in Europe. However we’re committed to accelerate our businesses, there has been a strong work on the brand identities and here is an example of Badoit but you also have an example of Fontvella in Spain with a crowdsourcing design of the new bottles. A very interesting example in terms of price positioning with Salvetat in France, a small sparkling water brand that’s been growing fantastically well over the last three years and on the right part of this chart the aquadrinks rollout.
So what’s happening in emerging countries in Indonesia, in China, in Latin America, Mexico, Argentina, Brazil with the aquadrinks, we are committed to do the same here in Europe and not only we are going into flavoured water as you can see on the top part but we are now directly targeting the soft drink consumption with Better For You propositions through a water plus juice innovation and you have here the example of Volvic Juiced which was launched in this country mid last year and the Volvic Jus in France which is currently being launched.

These are topline initiatives and I think Pierre-André and the team have made clear to you that none of these initiatives should lead you to believe that Europe will turn around immediately strongly. That’s work in progress and it will take time before we can get our European businesses back to growth. So what we have done in the meantime: we are addressing our cost base. Not only addressing the drop in our margin but also the way we organise and the way that can shift our teams to a world creating stronger initiatives and top line.

So the plan for competitiveness that we have announced on December 13, 2012 and detailed on February 19, 2013 this year is a plan that addresses both a topline and a cost issue. We confirmed the fact that we expect that plan to deliver a €200mln savings by the end of 2014 and also it will allow us to simplify our organisation to ensure that we can accelerate our time to market on many initiatives.

I will just share with you briefly a bit; I'll give you a bit more colour on what this project concretely means. You know that Danone's culture is based on the country business units by category who have a lot of autonomy locally and we continue to believe that it's important that they do not work altogether, so we are not looking at merging our water, baby food, medical nutrition and dairy businesses together and go for a "power of one" or whatever kind of strategy; that is not the issue. We continue to believe that what ultimately delivers customer and consumer preference is the fact that our teams are really focused on one category locally. So we are not touching that. What we are touching is the organisation that's just above that.

So in each of our business lines we have regions and from this example which is a dairy example what we are doing is that instead of considering that Germany, Switzerland, Austria and Slovenia are four different country business units we are merging these organisations and considering that they are just one. So the project is to have only one management entity for the Danone dairy business following this reorganisation for these four countries. With a differentiated role for what we call the cluster organisation which will go for strategic planning, operations and support functions, and at the country level there will be a focus on mainly two things: customer activation and consumer attention. So the topline teams will be focused on executing strategy locally at the country levels. So this is ensuring the fact that we are able to operate with about 900 jobs less than we are operating today in Europe. Most of them are management jobs so we are basically cutting about 13% of our total manager workforce in Europe through this effort and secondly we will simplify the organisation and make sure that there is a very quick time to market at the local level by focusing these teams only on topline customer and consumer activations.

We are also going through mutualisation of a number of support functions and strategic functions; and this is a conceptual chart to tell you that we expect that through the rationalisation of our formulation and purchasing strategies we will be in Europe able to seize significant cost opportunities; I'll just give you a perspective: we have several hundreds of supplier spec's for the fruit preparations of Activia overall. We are at the stage where we believe in Europe there is probably room for simplification in the number of spec's for the Activia whether that's vanilla or strawberry or whatever it is. So there is a significant focus as part of this plan on the simplification as well of our formulations and its relationships to our global sourcing strategy.

At the end of the day, what this year of 2012 of two tier momentum, 60% growth market, 40% Europe excluding CIS, is creating in terms of financial equation, I think is very interesting set of reality that I'm sharing on this chart and I think it's important that we just spend a minute on this because this is basically what is today creating the future of our financial equation for the coming few years. Basically you have three regions. Two are the growth markets and Europe is the third

You can see that in 2012 the Asia Pacific, Latin America, Africa, Middle East region is close to 40% of our sales. It's been growing last year 16% organic growth. It's already at a margin which is above the average of the group at 14.8% and this margin last year has continued to expand. We see no reason for this pattern to change. Everything that I shared with you about our baby business, our water business I should have or I could have been talking about our Brazilian dairy business, our Argentinean dairy business; we see continued growth in these markets and we see the continued leverage of that growth flowing into the margin. So there will be continued sustainable topline profitable growth from this region of 40% of our total business and a 40% which is obviously growing as we speak, it's already significantly more than the average of last year.

The second area is the light blue here, North America and CIS. We have not put them together for ideological reasons but simply because for us they are very similar strategic opportunities. For us they are mostly dairy markets, not only but mostly dairy markets. They are dairy markets where the level of consumption in those two countries is still very low. The per capita consumption of dairy in both markets has been growing steadily over the last ten years. There are two regions where now we have a clear leadership, clear leadership in the US, clear leadership in Russia. Starting from a low base margin in both cases but you know that, and I will restate our commitment to grow this margin steadily over the next few years as we have already done since 18 months. So what you should expect from this 20% plus of our business is higher than average topline, mid to high single digit topline growth from that big region and higher than average margin improvement starting from a low base. As you can see a 10%-ish margin last year.

The third region is Europe where you can see that, as I said, 40% minus 3% in sales, last year minus 190 basis points decrease in the margin. We have shared already that this will continue in 2013 so there will be a continued decline in sales and decline in margin in Europe in 2013 until gradually but only at the very end of this year the savings plan will start to kick in. This plan will be fully in place by the end of 2014. So it means basically that 2013 and 2014 will be years of transition for our European businesses during which the remaining 60, 61, 62, 63% gradually of our businesses will continue to deliver both superior topline growth and margin improvement overall. So that's the equation in which today we operate our businesses.

I think it's important for you to understand that we are allocating our efforts, our investments against each of these regions. The way these regions are gradually evolving is basically designing the way you will read the numbers of Danone in 2013, in 2014, in 2015. For 2013 as you know we have set our targets overall. The net impact of the way we will manage these three big regions will be topline of at least 5% organic, a trading operating margin which will continue to decline due to this transition in Europe that I've just described of 30 to 50 bits decline from the 2012 basis and a free cash flow which, excluding exceptional items - those exceptional items being mostly the costs of our restructuring in Europe-, continue to stay around €2bn we continue to believe that this free cash flow is basically what allows us to create the future for Danone and we are therefore very committed to continue to operate one of the best in class - in the consumer goods industry at least-, cash conversion cycle which is a challenge for us when the dairy business is not delivering growth because as you know in dairy we have a negative, natural negative working capital. So despite that challenge we continue to be committed to be around €2bn of cash flow which will fund acquisitions and allow us to return cash through various forms as we've done in the past when we think this is appropriate.

This year of transition, 2013, allows us to be very confident for what we are building and what we have started to build last year already by fixing and adapting Europe and continuing to invest and leverage in our growth markets to be back to our historical equation in 2014 where we will deliver a strong profitable and sustainable growth.

So I hope you will keep with us until 2014 to celebrate that and in the meantime I'm ready for your questions. As well as the team, Pierre-André, Antoine and Marion who are with us today as well, thank you.