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Q3 2018 Danone SA Corporate Sales Call

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PRESENTATION

Operator

Good day, and welcome to the Danone Q3 2018 sales conference call.

Today's conference is being recorded.

At this time, I would like to turn the conference over to Nadia Ben Salem-Nicolas. Please go ahead.

Nadia Ben Salem-Nicolas ***Danone SA - VP Investor Relations***

Thank you very much operator. Good morning, everyone. This is Nadia Ben Salem-Nicolas, Head of nvestor Relations team of Danone. Welcome to Danone's conference call for its third quarter sales, which will be given today by CFO Cécile Cabanis.

Before we go through the presentation and your questions in the second step, please let me draw your attention to the disclaimer on Page 2 related to financial indicators, definition and forward-looking statements.

For the Q&A, in order to allow as many as possible people to participate, please be so kind as to limit your number of questions and raise them all at a time.

And with that, I hand it over to Cécile Cabanis.

Cécile Cabanis ***Danone SA - Executive VP, CFO, IS/IT, Cycles & Procurement***

Thank you, Nadia. Good morning, everyone. Thank you for joining us today.

I will move straight into Slide 3.

You've seen that we have registered a quarter with 1.4% like-for-like sales growth, which is reflecting notable progress, especially in rebalancing and broadening the growth profile of our business.

If I go through the categories, the company delivered another quarter of meaningful acceleration in Essential Dairy and Plant-Based both in North America, which registered a fifth consecutive period of growth improvement, but also internationally with a significant step-up in its performance. Waters registered a very good performance, notably in Europe with a high summer season. And finally, as expected, Specialized Nutrition posted its first negative quarter as a result of a contraction in ELN China after 12 months of exceptional performance. Let me go through the details, starting with the bridge on Page 4.

Going through the bridge. In the third quarter 2018, consolidated sales stood at EUR 6.186 billion, down 4.4% on a reported basis. This is primarily due to the negative impact from currencies, minus 5.3%, reflecting the appreciation of the euro against the Argentinian peso, the Turkish lira and the Brazilian real mainly, which all depreciated by 20% or more in the quarter versus last year. The changes in the scope of consolidation marginally affected sales by 0.5%. This is entirely due to the disposal of Stonyfield that occurred last year, in August. Moving to the like-for-like growth, 1.4%; the growth continued to be driven by value at 3.3%, with volumes decreasing by 1.9%, which is mainly due to Morocco and the contraction of Early Life Nutrition sales in China. Value contribution to growth was driven by the continued efforts in enhancing mix in each category with products innovation that are launched at a higher net sales per kilo or liter compared to the existing portfolio and was compensated partly by negative country mix due to the ELN contraction in China. The value growth also resulted from targeted price increases in the Waters business and to a lesser extent in the U.S. EDP, helping to partly offset inflation in PET and U.S. transportation costs, respectively. And we had some specific price increase in inflationary markets like Argentina. I will come back to Argentina and the accounting implications later in the presentation.

Moving on Page 5. If we go in more details through the underlying performance of each reporting entity in the third quarter, first, I think it's important to note that, if we take the 9 first months of the year, both Specialized Nutrition and Waters, which represent 50% of the business, are growing more than 5%. And we have had significant progresses in our agenda for the growth on EDP as a whole.

If I start with EDP, which represents around 50% of our sales on the quarter. EDP Noram delivered 2.7% like-for-like sales growth driven by solid volume growth, 3.4%; and a minor negative value effect lower than what we had in previous quarter. Second, Essential Dairy and Plant-Based international posted flat sales despite the impact on the full quarter on the ongoing consumer boycott in Morocco. That weighted almost 3 percentage points, so this is a really great progress that we have registered in EDP International. And this positive progress versus last quarter mostly came from improvement in both volumes but also coming from the continued valorization strategy of the business.

Specialized Nutrition sales decreased by 1.5%. The volume growth turned negative this quarter, 3.9%, while value growth remained positive but slowed down to 2.4%, reflecting primarily a contraction in Early Life Nutrition China sales that I will comment on later. Finally, Waters delivered a very strong quarter with like-for-like sales growth at 6.4%, including a strong rise in value contribution, which is reflecting what I was mentioning on targeted price increases and also the benefit from successful valorized innovations since the beginning of the year, especially in Aquadrinks.

So let's move now through each of the category to have some deep dive on the performance drivers.

I will start on Page 7 with EDP Noram. We are overall very pleased to report the fifth quarter of acceleration in a row. So that today, with 2.7% growth and 3.5% growth if we exclude Fresh Foods, EDP Noram is really representing the new growth engine for the company.

If we go through the different segments, the Yogurt segment delivered solid growth in Q3 and achieved 34% market share in the U.S. This excellent performance was realized through our leadership positioning, especially in fast-growing segments like probiotics, kids and plant-based, but also top velocity in our innovations. And I will comment on Yogurt on the next slide.

Silk and So Delicious posted strong growth in plant-based segments, thanks to a buoyant demand on nut-based products. Innovation in adjacent segments such as So Delicious mousses and innovations in formats around the Silk brand are also part of the growth driver.

Vega registered a weak quarter, with Vega One Organic powder under challenge after the recent reformulation. And we are changing that to recover the growth on that part.

Growth in Coffee Creamers was strong in Q3, with ready-to-drink and better-for-you creamers as key contributors. We also added a new license with Bailey's that will further enlarge our offer in the trendy Coffee Creamers category.

We had some better news in the Premium Dairy, where Horizon is improving. Volumes are turning positive. Sales were reinforced by gallon format and value-added offer while still being slightly negative versus last year.

So given all these progresses, we see EDP Noram in Q4 around the same performance than Q3.

If I move to the next chart. I know that there had been quite a few questions about especially the attractiveness of the Yogurt category in the U.S. The truth is that, as I mentioned I think before, the Yogurt category is composed of different realities. And that's what you can see on the chart on the left part. You have on one side the Greek and regular segments, which are suffering. And on the other side, you have kids, indulgence and newer trendy segments, which are increasing in weight and growing strongly. For example, our plant-based yogurt is still small in retail but already represents, as a category, more than 10% on the natural channel. And this is a channel where the Yogurt category is growing globally. We are clear leaders in the most dynamic yogurt segments with Activia in probiotics, Danimals in kids yogurt and Silk and So Delicious in plant-based yogurt. So this overexposure to the fast-growing part of the category is allowing us to consolidate our leadership in Yogurt as a whole and to improve our mix because these segments are better valorized than the rest of the category. Lastly, the potential of the category is also confirmed by the retailers that, year after year, bet on yogurt, continuously increasing the shelf space dedicated to yogurt.

If I move to EDP International. So as you've seen, the sales were flat overall and up 2.6% if we exclude the impact of the Moroccan boycott. Every region has made progress in Q3. Europe made another significant big step towards full stabilization, and I will share that in a minute. Russia delivered another quarter of growth superior than 5% in a category led by valorized yogurt. Sales in Latin America were up mid-single digits, while Mexico and Argentina keep delivering strong growth. All the improvement versus Q2 came from Brazil. In the country, the sales were still decreasing, but all the actions that we've implemented and I shared with you over the past quarters both on portfolio and route to market are starting to bear. We also relaunched Silk through our own sales force. In ASPAME, sales declined, with Morocco continuing to be severely affected by the boycott of the Centrale brand. Sales in Morocco were down approximately 35%, especially in the milk category, while yogurts are now improving.

Given the strong progresses and the continued headwinds, we expect overall for EDP International a Q4 that will be roughly in line with Q3.

Going to Page 11, where you can see the Europe progress. In Europe sales growth was slightly negative, and the performance has been improving for the last 18 months. Execution, local relevancy and disruptive innovation are the main drivers of this continued progress towards stabilization. I said in Q2 that some countries, like U.K. and Nordics, were growing solidly. This is still the case. Spain is showing good progress as well. We are putting on the shelf a slate of innovations such as Light & Free, some new on-the-go cereal topping by Activia. Danet has been relaunched as well with a new visual identity, and results are promising. In France we are rolling out the Danone Bio and Activia "touch of" as well as the Danone from the world. And we activated a call for action towards our consumers, where all the sales that we achieved in France on September 21 from all Danone products were devoted to regenerative agriculture projects to favor biodiversity. The results exceeded expectations, with more than EUR 5 million collected.

If we go on a brand perspective. Activia, our biggest brand in Europe, is well on track, growing in countries, representing around 40% of its sales. In Italy, for example, sales were up double digit, thanks to a successful activation around probiotics and "0% fat" range. Alpro continued to deliver another double-digit growth quarter, with sales led in particular by nut-based beverages, plant-based alternatives to yogurt and ice cream. We continued to expand in France and Spain. And we pursue our top line synergy plan deploying the brand in Poland starting in July. Finally, young and local brand continued to be at the core of our strategy with Light & Free, I mentioned it, in Spain; and Les 2 Vaches that are growing double digit.

Moving now to Specialized Nutrition on Page 13. I told you at the beginning of this year that the growth rate for Specialized Nutrition was going to be unbalanced throughout the year. We expected H2 to be significantly weaker after 12 months of exceptional growth in China, and as a result, Specialized Nutrition posted in Q3 a sales decline at minus 1.5%. This decline is entirely linked to Early Life Nutrition, while Advanced Medical Nutrition grew solidly this quarter again both in pediatrics category, which performed well, driven mainly by products for faltering growth in all regions; and also in the tube segments, where we launched in several countries a new packaging called OpTri, which offers a better tube feeding usability and safety for patients and is also better for the planet, as it's recyclable.

Moving to the performance of Early Life Nutrition. It was negative on the back of a steep drop in sales in China of around 20%. Outside China, Early Life Nutrition registered solid growth. In Asia and particularly Indonesia, we are gaining market share. In the U.S., we registered double-digit growth. And in Africa, Middle East, growth was very strong too. On the other hand, we had Europe affected by social and mainstream media coverage after the formula upgrade in July of Aptamil in the U.K., where the brand lost locally market share. We put in place a communication plan to better convey the product benefits and safety and restore parents' confidence, but it will take time. Besides, Cow & Gate, our second brand in the U.K., was relaunched in Q3, and results are excellent. This allowed us to partially compensate Aptamil market share loss. This Aptamil innovation has been successfully launched in several other markets in Europe, so it's really a situation that is locally affecting U.K.

Let's now go through China on Page 14 and focus on the different drivers of the sharp contraction that we've seen in Q3, with as I said sales declining at around minus 20%, with negative volume but positive value effect. It's overall 3 main factors that we already mentioned. It's the base of comparison. It's some changes in market dynamics, especially given the lower number of births in 2017; continued premiumization; and continued channel shift.

So if I go through each of them: the performance was first due to an unfavorable year-on-year comparison. If you remember, last year, Q3, sales rose by more than 50%, including at that time strong restocking from cross border players.

The second driver around changes in market dynamics is following the slowdown of births that we had in 2017, where we have a decline in volumes on products Stage 1 milk and Stage 2 milk, so it's 0 to 6 months and 6 to 12 months. Growing-up milk remains pretty dynamic, but we expect it to progressively soften in the coming months. The IMF category is overall still very supported by valorization trend and ultra-premium and specialties products that are increasing their share in the market. And accordingly, our Aptamil Platinum keeps performing well in our portfolio.

On the channel side, cross-border e-commerce continued to be under pressure given the regulatory changes, where we've seen some increasing custom control. The rebalance of channels is not new, is continuing to happen and will require us to continue to adjust our model and build on our direct channels, which is what we've been doing and is now representing 70% of our business.

So looking at that, overall, sales will continue to contract over the next quarters, after years of exceptional growth. We are confident in our assets and strengths and ability to capture the growth beyond that. And Bridgette will have the opportunity to deep dive on Monday, on our Investor Day, on this topic. For the short term, we expect sales to remain negative in Q4 in China. This will weigh on Specialized Nutrition global performance. And we expect that Specialized Nutrition sales should be broadly flat in Q4, and as a result, Specialized Nutrition should be around mid-single digit for the full year.

Moving on Page 15 because we talk a lot about China because it's the biggest market worldwide in terms of category for IMF. But Specialized Nutrition is more than Early Life Nutrition China, which accounts roughly for 25% of the reporting line. We have a number of exciting growth platforms that you can see on this chart. Bledina in France launched earlier this year a range of organic baby food that has already achieved 10% market share. In Indonesia, which I mentioned earlier, we relaunched our 3 leading brands SGM, Bebelac and Nutrilon Royal; and results have been outstanding in terms of share and brand equity. We have now more than 40% market share with our first brand, SGM, in that country. Happy Family, #1 player in organic baby food in the U.S., is consolidating its leadership and guiding the growth of organic product in the baby food space. So overall, there continues to be lots of opportunities for Specialized Nutrition in these regions.

Finally, moving to Waters, Page 17. Water growth in Q3 was strong, 6.4%. It was driven by both volumes and even more by valorization, combining some price increases to offset PET inflation and positive mix, thanks in particular to a number of innovations that we've put on the shelves at a price 50% higher than the average range.

In Europe, we had a particularly strong momentum for the category overall due to temperature around 10% higher than same period of last year. And in addition to that, we put on the market some new Aquadrinks that were particularly well received by consumers.

In North America, evian keeps growing steep double digit, benefitted on both distribution gains and a new campaign this summer involving famous U.S. influencers.

Asia registered strong growth in Q3 despite a weak season in China for Mizone. Growth was led by Indonesia, where Aqua sponsored the Asian Games, the second most popular sport event in the world after the Olympic games.

In Latin America, finally, growth was positive, with Mexico growing moderate, and Argentina challenged, mainly on Aquadrinks as consumer look for more affordable drinking options in this moment.

Despite the high comparison base given Q4 2017, we expect the next quarter to be roughly in line with the growth registered during the first 9 months of this year around mid-single digit.

And to complete on Waters, important to stop Page 18, coming back to a very strong innovation pipeline, especially in European Aquadrinks. You can see here the 3 most successful launches put on the market earlier this year, Badoit bulles de fruits, Volvic organic infusion and the lemonade of our local Polish brand, which drove the growth of Aquadrinks in Europe. And as I was saying, these innovations are sold at a higher net sales per liter versus the basic range, bringing value growth to the category.

Moving to the overall performance. On Page 19, this is the mirror of what I described in July probably, where I flagged strong headwinds that impacted our H1 results. These elements will remain in the back half of the year and will impact H2. On the left, we continue to have a challenging macro environment including strong inflation on input costs, increase in transportation costs in the U.S. and particularly on the raw material side on PET and emerging market currencies that are devaluating and that are being very volatile for some of them.

Second, the boycott of Morocco will continue to impact us in the second half.

And finally, as we were expecting, the contraction of Early Life Nutrition China sales versus a high base of comparison.

If I move, Page 20, before going back on the overall guidance. I wanted to give you an update on the way we were going to manage Argentina. As you know, consensus has been recently reached that all necessary conditions are in place to now consider the country as hyperinflationary as defined by the IFRS rules. So Danone will obviously apply IAS 29 to the country from July 2018, with the effect from January 1. And since Argentina is now considered as hyperinflationary, to have a better readability of the performance, we will exclude Argentina entirely from our like-for-like definition, starting January 1 next year. However, as you know as well, our like-for-like current definition excludes the effects from changes in applicable accounting principles, so for this year, it will have no impact on the like-for-like sales growth and margin evolution. For reference, however, you should know that Argentina represented around 3% of Danone net sales in the first half, contributed to the total company like-for-like sales growth for around 10 basis points in Q3 and 30 basis points year-to-date. In Q4, the contribution will increase because it's the high season in Argentina.

Finally, on this topic, I want to make clear that the full year guidance that we communicated at the beginning of the year was set, obviously, without considering the application of hyperinflation accounting to Argentina and therefore excludes any impact from IAS 29 on recurring EPS. Given the current volatility in the country, it is very difficult to predict the impact for the future, but in any case, this represents an accounting effect and it doesn't change the value fundamentals of our model.

So maybe to wrap up on the overall performance and why we are confident that we are taking the right steps toward our superior profitable growth model is that, if you look at Q3, we have been doing great progress in many underlying parts of our model and notably around rebalancing our growth profile with meaningful acceleration in Essential Dairy and Plant-Based as well as strong delivery in Waters. And I think this is a great achievement. And at the same time, we've been facing an exacerbation of the headwinds, as I just said, but given the full focus that we've been putting on both driving value growth and efficiency agenda, we will be in a position to post and to ensure another semester of sustained like-for-like margin improvement, as we did in the first half of the year. And therefore, our EPS guidance for the year remains unchanged.

Thanks a lot for your time, and I'm now open for your questions.

QUESTIONS AND ANSWERS

Operator

(Operator Instructions) We will now take our first question from Jon Cox from Kepler Cheuvreux.

Jon Cox ***Kepler Cheuvreux, Research Division - Head of Swiss Equities and Head of European Consumer Equities***

Jon Cox, Kepler Cheuvreux, here. Just a question on the Chinese nutrition, no surprises. I understand the regulations will change at the end of the year regarding indirects after being postponed for 12 months. And as a result, I expect some destocking in Q3 offsetting the restocking we saw a year ago. You also seem to be saying now actually the custom controls at the border now is having a negative impact. I wonder if you can just give us a bit more granularity on what the regulation changes are at the end of the year. Or do you still think there will be changes? And maybe you can give us a bit of insight into the start of next year what you think will happen in China and Nutrition generally. We know that Q4 obviously is going to be again a tough comp, and you've given guidance for a flat development there. Should we start to think about a re-acceleration in the second half of the year? Or some of those things you're talking about, regarding, you know, less births, et cetera, et cetera, will that continue to weigh in the first part of the year in nutrition? And then the second question is just a point of clarification on the whole Argentina issue. What impact does that have on your guidance? You seem to be inferring that actually your guidance is unchanged excluding now what's happening to Argentina, but what would the impact be there in terms of your like-for-like sales growth being better than 2017, which is the guidance we're working on? I think consensus is about 2.9%. In 2017, you're about 2.5% organically. Thank you very much.

Cécile Cabanis ***Danone SA - Executive VP, CFO, IS/IT, Cycles & Procurement***

Okay, thank you, Jon. So overall, in terms of your first question regarding Chinese regulation, there is no new news. What we are observing is that there is a continued trend of increased custom control and including inspection, quarantine and origin certification, putting the channel under pressure, but there's no new news. We've been saying that the channel shift was starting, given the fact that there would be the implementation of the regulation. There has been nothing new. And yes, this is after a restocking of Q3 last year. It has implied some destocking in Q3 this year, so it has affected the performance, obviously, but the situation is still that it should occur earlier in the next year in terms of change in regulation. And we have no new news on that front. Overall, if we take the China dynamic, there are probably 3 things that we know today as being the underlying trends of the category. The first one is, as we said, there has been a lower number of births in 2017. And that was what I was explaining regarding the start of the decline, especially on Stage 1 and 2 milk, with the continued performance on GUM growing-up milk. Second, there is a channel shift, and this is no news. We continue to rebalance the avenues of growth. There are also more avenues to be opened, like lower-tier cities, that will be avenue of growth for the mid to long term. And finally, there is premiumization. Premiumization is continuing to happen, especially with the development of premium and ultra premium. We've been launching Aptamil Platinum, which has performed well and continues to be a driver for value growth. And given our strength in terms of science and innovation, we have a good innovation pipeline. However, the rhythm at which we'll be able to launch these will depend on regulation. So overall, we see today an adjustment, a short-term adjustment, but that will last several quarters given the fact that we had exceptional growth, starting Q3 last year, but still in H1 we recorded a very strong growth. There will be a basis of comps that will lead to an adjustment of growth in the next quarter. So growth will not be linear in 2019, nor it was in 2018, but we are confident that we have the assets and strengths and the ability to capture the growth beyond that. And I think I will let Bridgette, on Monday, go in details through the different drivers and our different assets to capture that going forward.

Then, on Argentina, what I said is that on the growth it had an impact of 10 bps in Q3, overall 30 bps year-to-date. It's accelerating a bit in Q3, so the overall impact for the year will be a bit more. And there won't be an impact on the margin, anyway. So when we say it will not impact the like-for-like, this is what you can retain in terms of like-for-like impact if it was to be adjusted.

Operator

We will now take our next question from Eileen Khoo from Morgan Stanley.

Eileen Khoo ***Morgan Stanley, Research Division - Equity Analyst***

Cécile and Nadia, 2 questions from me, please. The first one is on EDP International. It's nice to see good progress here. Can you give us more color on Brazil possibly, so how your sales are progressing here? Where are you on portfolio and route-to-market change? And then secondly, just on China ELN again. Sorry. Just wondering if you could give some indication on your market share in the various channels and how this has evolved over the year. And also, your comments on the indirect channel: One of your competitors, a2, has just reported that their momentum is still very strong here, so I wonder how we just square your comments on this particularly.

Cécile Cabanis ***Danone SA - Executive VP, CFO, IS/IT, Cycles & Procurement***

Thank you, Eileen, for your questions. So regarding Brazil, sales were still decreasing but to a much lesser extent than what I had commented in the previous quarters, so we are seeing an improvement in terms of trends. We've been, as you know, implementing action on both the portfolio and the route to market, especially the cleaning on the distributor space in terms of route to market. For the products, we've been launching the Activia probiotic shots especially and it's working very well. We have also relaunched the Silk brand but through our own sales force, which is contributing to the improvement. And we had some initiative on indulgence. So all this was really to rebalance our portfolio, recreate some momentum on the trendy part of the portfolio, and plant-based and probiotics are good example of that. So that's for Brazil.

In terms of your question regarding market share in China and channel shift, I think we cannot probably compare the different comments as they are because, as you know, we started very strongly for several years now on the indirect parts, for many good reasons that we had a chance to comment on the origin of milk and the fact that the moms were willing to get their products from Europe. And we were leading in Europe and we had very strong brands, so it skewed the demand towards our brands, so we had a starting point in the indirect channel which is not the same as the other competitors. And that's why the dynamic for us and for them is not the same. However, on our side we have many opportunities in continuing to adjust and build other channels, and all the question will be the rhythm and the path in doing that. So that's it for China. Thank you for your question, Eileen.

Operator

We'll now take our next question from Alain Oberhuber from MainFirst.

Alain-Sebastian Oberhuber ***MainFirst Bank AG, Research Division - Head of Equity Research Switzerland & MD***

Alain Oberhuber from MainFirst. I have 2 questions. The first is regarding the mix change. I know it's a call regarding revenues, but giving that we see slower growth now in the Specialized Nutrition part, could that be a negative mix effect which could hurt you more than expected? And the second question is regarding Fresh Foods. Could you give us a little bit more insight where we stand regarding the development there and when you expect the turnaround to come through and how much sales you currently have with that category?

Cécile Cabanis ***Danone SA - Executive VP, CFO, IS/IT, Cycles & Procurement***

Yes, sure. Thank you, Alain, for your question. Maybe the easiest way to comment on mix would be to go through each category. On Specialized Nutrition, we had positive mix, resulting from continuous valorization strategy. And this positive mix in terms of segments and products has been offset by a negative country mix which is due to the contraction of sales for Early Life Nutrition in China. In EDP International, we had a part of the value effect that came from price, and within that Argentina, but there is some slight improvement in terms of mix as well but a good improvement in volume, which is really an important thing for EDP International as we are stabilizing Europe, as we are improving the overall performance to make sure it's a driver for superior growth later. In EDP Noram, we had a negative mix, but as you know, it's mainly linked to the Premium Dairy unbalanced, where the good news was that volumes were positive but it continued to have a negative mix effect. In Waters, I commented it, the mix is coming from very successful innovations that are priced at a higher range than the overall existing range. So overall, there have been progresses in terms of mix. And especially, mix is driven by premiumization in Specialized Nutrition and value innovation in the rest of the categories. Regarding fresh food, overall we continued to be working on the turnaround. It is improving. It is improving also because of the base of comparison, but it's not yet solved and coming back to positively participating to the agenda of growth, so we continue to work on that quarter after quarter to make sure that we can stabilize it.

Operator

We'll now take our next question from Celine Pannuti from JPMorgan.

Celine A.H. Pannuti ***JP Morgan Chase & Co, Research Division - Head of European Food, Home & Personal Care and Tobacco and Senior Analyst***

So my first question. I would like to come back on China. I see from the slide that locally it seems that you have grown, so could you tell us what was the number? And also, do you still expect the market to grow, the IMF market to grow in China? Given your comment on premiumization, does it mean negative volume? And within that as well, could you tell us what percentage of your business is indirect China for that division, please? And then my second question is on raw materials. You mentioned...

Cécile Cabanis ***Danone SA - Executive VP, CFO, IS/IT, Cycles & Procurement***

Sorry, Celine...

Nadia Ben Salem-Nicolas ***Danone SA - VP Investor Relations***

Celine, we cannot hear you very well...

Cécile Cabanis ***Danone SA - Executive VP, CFO, IS/IT, Cycles & Procurement***

We can't hear you very well. So I'm not sure that I get your full question every time because your words are not coming through very well, so maybe you can try again. Sorry.

Celine A.H. Pannuti ***JP Morgan Chase & Co, Research Division - Head of European Food, Home & Personal Care and Tobacco and Senior Analyst***

Okay, I'll try again. Can you tell us what is the local growth in the Chinese IMF market? And it seems you have been growing locally. And also, can you tell us which percentage of your sales is indirect, for the IMF division, for the Specialized Nutrition division?

Cécile Cabanis ***Danone SA - Executive VP, CFO, IS/IT, Cycles & Procurement***

Okay, yes. So in terms of growth driver and for the category, we still had a double-digit growth category in H1 which was driven by the growing-up milk segment consumption dynamism and the continued premiumization. Now we are seeing a decline in volume in infant formula and follow-on, IFFO volumes. GUM segment is starting to soften in H2 but still growing. And we expect overall the IMF category to slow down but still grow. So for the full year 2018, overall, we assume a category that will grow at mid- to high single-digit range. Then on your question around the split in terms of direct and indirect sales, we are now 70% direct and 30% indirect.

Operator

We'll now take our next question from Martin Deboo from Jefferies.

Martin John Deboo ***Jefferies LLC, Research Division - Equity Analyst***

Cécile, it's a brief, sort of technical, question but an important one. I mean it goes to the role of Morocco in mix. Price/mix is consistently beating market estimates, so something is going on there. And you've given good account of that, but it just occurs to me: Is Morocco positive for mix? Because it's a low-price liquid milk market that's obviously declining sharply. So, just, is there a material influence of Morocco in your positive mix equation?

Cécile Cabanis ***Danone SA - Executive VP, CFO, IS/IT, Cycles & Procurement***

So Morocco is positive in mix, you're right, exactly because of what you said; and also because, when we look at the overall sequential performance of Morocco, we are seeing better news in Yogurt, which are driving also the mix inside the country. So yes, we have a positive impact from Morocco in terms of mix.

Martin John Deboo ***Jefferies LLC, Research Division - Equity Analyst***

Is it material, Cécile, within overall group mix, Morocco?

Cécile Cabanis ***Danone SA - Executive VP, CFO, IS/IT, Cycles & Procurement***

In overall mix for the company, it's not the major part, but it's there. But then on mix, Martin, you should go back to when I was commenting each category. And you're right that I should have mentioned Morocco, which I didn't. But otherwise, for the rest, it's basically what I described in the earlier question that was asked on the mix.

Martin John Deboo ***Jefferies LLC, Research Division - Equity Analyst***

It's all very clear, thank you.

Operator

We'll now take our next question from James Edwardes Jones from RBC.

James Edwardes Jones ***RBC Capital Markets, LLC, Research Division - MD and Analyst***

Two quick questions, please. Mix again. Can you just tell us what the split is in the value increase in Q3 between price and mix? And secondly, are the U.K. Aptamil problems now over, or is it still an issue?

Cécile Cabanis ***Danone SA - Executive VP, CFO, IS/IT, Cycles & Procurement***

Sorry. Your second question -- I didn't hear...

James Edwardes Jones ***RBC Capital Markets, LLC, Research Division - MD and Analyst***

The problems of Aptamil in the U.K. on the reformulation. Is that now all sorted out, or are you still having problems?

Cécile Cabanis ***Danone SA - Executive VP, CFO, IS/IT, Cycles & Procurement***

Okay, so maybe I'll start with the second part. So in Aptamil U.K. we've been implementing a new and a reinforced communication plan to really make sure that the parents are rebuilding the trust as well as understanding the benefits and the use of the products better. As I said, in the other countries it was very successful. In U.K., it continues to impact the performance even if, as I mentioned, Cow & Gate is partially compensating this drop for the Early Life Nutrition performance because the relaunch was successful, and it's taking part of the Aptamil U.K. market share. But yes, it will continue to impact until we are fully recovered with the parents' confidence through our different actions. And then on your question on the price/mix...

James Edwardes Jones ***RBC Capital Markets, LLC, Research Division - MD and Analyst***

It was just the value increase in Q3. How would you split?

Cécile Cabanis ***Danone SA - Executive VP, CFO, IS/IT, Cycles & Procurement***

The value increase, if we exclude the impacts of price of Argentina, it will be around half mix, half price.

Nadia Ben Salem-Nicolas ***Danone SA - VP Investor Relations***

I think we have maybe a last question, operator.

Operator

We'll now take our last question from Cathal Kenny from Davy Research.

Cathal Kenny ***Davy, Research Division - Senior Analyst of Food and Beverage***

One question from my side. Just would it be possible to get a little bit more granularity on the current cost circumstance? I'm just interested to know if some of the headwinds have intensified or not, particularly for PET and U.S. freight inflation? And also, on dairy you speak to low to mid-single-digit inflation. Is that closer to low now?

Cécile Cabanis ***Danone SA - Executive VP, CFO, IS/IT, Cycles & Procurement***

So overall, we are seeing for the full year, in terms of input costs, mid-single-digit inflation. PET costs versus H1 would be around the same kind of inflation, so more than 20%, which is what we had already in H1. The milk price inflation will be low single digit. And we also have some currencies impact in our overall input cost, especially if you take for example Brexit, because we are importing for 2 of our categories, for example, in the U.K. So overall, in input costs we observed the kind of the same situation than H1 overall. And then what we have in addition in H2 is the full half effect of the impact of the Moroccan boycott. We had it in H1 only partially because it started on the 27th of April. And the deceleration of Early Life Nutrition China as a mix to the company. As I said, despite that -- and I think it should also really be noted as a consistent focus on discipline and making sure that we are increasing our efficiencies and our model overall. We will be able to post an improvement in margin as we did in H1.

Cathal Kenny ***Davy, Research Division - Senior Analyst of Food and Beverage***

And U.S. freight costs, please.

Cécile Cabanis ***Danone SA - Executive VP, CFO, IS/IT, Cycles & Procurement***

It's around the same as H1. What we have in Q3 which we didn't have in H1 is that we started to pass some price increase to mitigate the impact.

Nadia Ben Salem-Nicolas ***Danone SA - VP Investor Relations***

Thank you, everyone. Thank you for having joined this call. I think this is concluding the call up for the day. We'll remain available with the team all day long to follow up.

Thanks for attentions, and we look forward to meeting most of you next week in London.

Cécile Cabanis ***Danone SA - Executive VP, CFO, IS/IT, Cycles & Procurement***

Thank you. Bye-bye.

Operator

Thank you. This concludes today's call. Thank you for your participation. You may now disconnect.