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DANO.PA - Half Year 2023 Danone SA Earnings Call

EVENT DATE/TIME: JULY 26, 2023 / 9:00AM GMT

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PRESENTATION

Operator

Good day, and thank you for standing by. Welcome to the Danone 2023 Half Year Results Conference Call. (Operator Instructions) Please be advised that today's conference is being recorded. I would now like to hand the conference over to your speaker today, Mathilde Rodie, Head of Investor Relations. Please go ahead.

Mathilde Rodie - *Danone S.A. - Head of IR & Financial Communication*

Good morning, everyone. Thank you for being on this call this morning for Danone's 2023 H1 results. I'm here with our CEO, Antoine de Saint-Affrique; and our CFO, Juergen Esser, who will first go through some prepared remarks before taking your questions in a second step. But before we start, I draw your attention to the disclaimer on Page 35 related to forward-looking statements and the definition of financial indicators that we'll refer to during the presentation. And with that, let me hand over to Antoine.

Antoine de Saint-Affrique - *Danone S.A. - CEO & Non-Independent Director*

Thank you, Mathilde. Good morning, everyone, and welcome to our half year '23 conference call. I hope you are all well and safe. Before we delve into the results, let me start with a few words on the situation in Russia. Obviously, my very first thoughts go to all our colleagues there, after our EDP business has been placed under temporary external administration of the Russian authorities. There are, of course, financial implications which we have referenced in our press release this morning, and Juergen will come back to them. Given the sensitivity of the situation, I hope you will understand there is not much we can say at this stage, other than the fact that we remain focused on people safety and on continuity of operations.

Let's now go into the results, starting with a brief introduction on Slide #3. As you will have seen, we close a solid first half of the year, further building our track record of delivery: this semester, like-for-like revenue was up +8.4% with broad-based growth across geographies and categories. Growth was driven by pricing, up plus 9.4%, and resilient volume/mix down minus 1.1%. Importantly, we made consistent progress on our strategic agenda, in an environment that remains volatile and challenging. The combination of resilient volume/mix, continued pricing where needed and high productivity allowed us to expand our margin from operations by 93 bps compared to last year. And this increase in margin from operations gives us the ability to further drive our reinvestment journey, which is at the heart of Renew Danone. This first half reinvestments were up 99 bps compared to last year.

And we did all of that while delivering on our ambition to moderately improve our recurring operating margin, which was up plus 14 bps versus last year and securing a healthy cash flow at 1.1 billion, up by 400 million compared to last year.

So, I am happy with the first half of the year, as we keep not only delivering consistently but as importantly as we are doing so in line with our strategy.

Let me elaborate a little on this, and start with our Core, now on page 4. Speaking of the Core, there is no better illustration of it than EDP in Europe.

We started the transformation of this strategic activity at the back end of 2022, making it clear that we were not after short-term tactical fixes, but rather aiming at structurally driving EDP back to value creation in Europe.

Over the last quarters, we have focused on getting back to category leadership fundamentals.

We have prioritized methodically the key demand spaces we want to play in, focusing on Health underpinned by strong functionality, Indulgence, Kids and Every day nutrition.

We started sharpening our portfolios against these 4 spaces, with less overlaps between brands, rationalized and more focused portfolios.

Having clearer swim lanes and more focused portfolios enable us to now start reinvesting more assertively in A&P, while making sure all of this is also visible to consumers through superior shelf execution.

This groundwork is starting yielding encouraging results: it shows for example on the Activia, Yopro and Danone brands. I'll come back to it in a minute.

And while we know that there is still work to do, I am now pretty confident in our ability to sequentially improve from H2 onwards and to progressively reconnect with competitive growth in Europe. We certainly have a good example of this with the Danone brand, and I'm now moving to Slide 5. Over the last few months, we have defined a new architecture for the Danone brand tiering and segmenting the brand by occasion, by format, price points and channels. On the one hand, we have strengthened the core of the offering, adapting formats and price points to recover volumes, and obviously operating leverage, but also, and this is important, to drive brand penetration at a time where some shoppers may start feeling the squeeze from inflation. On the other hand, we started developing a range of value-added propositions under Danone, from Skyr to Greek, with the objective of further building superiority and differentiation, which ultimately drive mix and profitability. This work, which we deployed since the beginning of the year in Spain, is showing very promising results. There, monthly brand penetration has, for example, doubled since the beginning of the year. And obviously, next to Spain, we are in the process of deploying a similar approach in France.

Moving now on to Page 6, I'd like to illustrate how we have further boosted our winners in the first half of the year. You have seen these winners several times already, and this is totally intentional. This is a clear testimony to our determination to be very consistent in driving these winning propositions further ahead, building on differentiating science, strong brands and execution. Yet again, Coffee Creations, evian and High Protein have delivered strong and competitive performance this semester, with strong double-digit growth. And again our Specialized Nutrition business posted a solid and competitive growth at plus 8% in H1. We believe these platforms have more room to grow, in and around the coffee category, in premium waters, in high protein dairy. We will continue expanding them across channels and geographies. This is the case, for example, with our dairy high-protein portfolio as we roll it out in the U.K. as we speak and as we further expand into new segments, such as desserts. And I will obviously be remiss not to mention Specialized Nutrition, where we will continue to leverage the full pallet of our portfolio, from Aptamil in IMF to Neocate in Pediatric Specialties and Fortimel and Nutrison in Adult across geographies.

Let me finish this performance overview on Page 7, with a brief mention to Mizone. Last year, we told you that we would address our Underperformers with method and with courage. It is exactly what we have done with Mizone. We took the time since the Capital Markets Event to do a proper root cause analysis to understand the reasons of Mizone's underperformance. On that basis, the team built a turnaround plan, leading us to dramatically simplify our portfolio now down to 4 SKUs. We have also reinvested in the superiority of our formulation, making sure Mizone is back to being among the best functional hydration options in the market. And we have delayered our distribution system with the goal to improve in-store execution. All of this, range, product, quality of execution, higher investments, all of this is now starting to pay. Even though we are at the early stages, we see tangible signs of turnaround. Mizone, as you've seen, grew by +15.9% in like-for-like in H1, driven by a strong volume recovery. And the market shares were positively oriented for the first time in a very long time. It is obviously not yet time to celebrate as we have to sustain this performance in the long term, but this is certainly encouraging and something the team should be proud of.

Let me finish this introduction with Page 8. Since last year's Capital Markets Event, we have been consistently delivering against our strategic roadmap. This shows in the results you have seen us publish over the several last quarters, but also in the progress we continue to make on our key battles. What we are doing, systematically and with confidence, is about restoring Danone's value creation model. And we do it for the long run, not going for short-term tactical wins, but striving for sustainable long-term value creation.

On A&P, we are investing more, but we're also investing better. We continue to improve the allocation of our resources, across geographies, brands and channels, improving our working versus non-working media ratio, but also progressively strengthening the quality of our advertisement. I'm sure that you have seen the evian Live Young advertising and the Danone ads played in the waiting room of today's webcast: they are great examples of ads that we can be proud of. And there is obviously more to come.

Next to A&P, we continue to step change the way we leverage our cutting-edge science and technology assets at the service of patients and consumers. And it is not only about the science assets we have, it is about bringing more discipline in the way we develop and execute our innovations. There too, we are making substantial progress from bringing a superiority imperative in our renovations to delivering fewer, bigger, better and accretive innovations. All our categories are moving to the front foot, with a clear focus on developing superior differentiated products, supported by strong claims and, in some cases, clinical evidence.

And as you also know, value creation is about making the most of our ecosystem. And here, we are starting to reinvent the way we work and collaborate with our partners. I'm happy to announce that Danone will host, by the end of the year, its first Partner Summits in a long time. This is a great opportunity for us to learn, to leverage and to expand our reach and impact. So all in all, Danone is starting to move to the next level. All the pieces of our Renew Danone framework are coming together. And despite the volatile environment, we continue to make consistent progress. Expect us to keep at it, with determination and with focus. And with that, let me hand it over to Juergen for the financial review.

Juergen Esser - *Danone S.A. - Group Deputy CEO*

Thank you, Antoine, and good morning to all of you. Let's start the financial review with Page #10, and our topline performance of the second quarter of this year.

We are reporting for this quarter a solid performance of like-for-like net sales growth of plus 6.4% with again, all our geographies contributing. Very consistent with our first quarter sales, we are reporting broad-based growth. I would like to especially mention the resilient delivery of our China zone while highlighting also the fact that we are making good progress on our European transformation according to our plan outlined earlier this year. But let me come back to the performance by zone in a minute in more details.

Couple of comments on the performance by category: the growth in the second quarter was supported by the solid contribution of our EDP category at plus 6.2% net sales growth - with our High Protein, Every Day Nutrition and Coffee Creation platforms all growing double digit.

In parallel, our Specialized Nutrition category sustained its competitive growth with plus 4.9%, led by further market share gains across most geographies like in China or Southeast Asia, to name a few. Reviewing the dynamics of this category, important to look at the first semester performance with a growth of more than 8%, as this is providing a better view on the underlying dynamics neutralizing the Q1-Q2 phasing effects, which we discussed at length with the first quarter results. And finally, our Waters category that delivered another quarter of strong growth at plus 9.6%, notably driven by the evian brand, growing well into double digits in Europe, combined with the encouraging momentum behind our Mizone brand in China, growing mid-teens for the second quarter in a row, as Antoine just mentioned.

Moving now on to our Q2 sales bridge on Page #11. Our Q2 like-for-like net sales growth of plus 6.4% was composed of a price effect of 8.7% and volume/mix down minus 2.3%. On the pricing, we can clearly observe a deceleration versus previous quarters: as you will remember, our Q1 sales were still benefiting from as much as 10% price effect. We are starting in many geographies to lap last year's high price increases, and we'll, therefore, see further reduction of the price effect during the remainder of the year. On the volumes, and as mentioned already, important to keep in mind the calendar related phasing effects between Q1 and Q2 of this year, especially in our SN category, which make that the underlying volume performance is better understood by looking at our first semester volumes of -1.1%, demonstrating the improving resilience in many geographies and categories.

Outside of the like-for-like, ForEx had a negative effect of minus 4.3% as a result of a number of currencies depreciating against the euro. And finally, scope effects that had a negative contribution of minus 0.5%, due to the deconsolidation of our Waters business in Argentina in December of last year.

In total, reported growth reached plus 2.4% for the quarter, bringing our quarterly net sales to EUR 7.2 billion up from EUR 7.1 billion in Q2 of last year.

Let's now have a look at the performance of each zone in more details, starting with Europe on Page 12. Europe delivered a second quarter of solid growth, growing at plus 6.5%, with price up 11.7%, while volume/mix was down minus 5.1% as we are progressing with the transformation of our EDP portfolio.

From a country perspective, France, Poland and Spain were driving the growth, all of them starting to benefit from a streamlined and repositioned EDP portfolio, as well as from an increased brand and promotional support. In Germany, we have also started to recover by rebuilding listings and distributions after the supply disruptions we had during the past period. The overall dynamics of the last weeks and months make us confident that you would see our volumes sequentially improving, further supported by an increased level of reinvestment.

On the other categories, Specialized Nutrition and Waters remained resilient in this quarter, with especially the evian brand reporting a strong performance over the last months.

Looking at the numbers of this first semester, Europe closed the first half with like-for-like sales growth of plus 6.4%, while recurring operating margin declined by minus 232 bps versus last year, down to 10.6%. Margins are temporarily down as a result of the portfolio transformation, the still high inflation, and the timing gap of materializing our price increases for prescribed and reimbursed products of our Specialized Nutrition business. With the volume dynamics sequentially improving moving forward, we should have reached now an inflection point for the profit margin of Europe despite the fact that coming quarters we'll see higher levels of reinvestments.

Let's now move on to North America on Page 13. North America delivered plus 5.0% like-for-like sales growth in the second quarter. This quarter, pricing started to sequentially normalize after we lapped the pricing waves of last year, moving from 11% price effect in the first quarter down to 7.7% in the second. Volume/mix dynamics in the second quarter were a bit softer, recycling a high base of comps in some categories.

The growth in North America was notably led by our Coffee Creations business - Antoine spoke about it. It posted strong double-digit growth this quarter, coupled with continued market share gains under the International Delight and Stok brands.

Next to Coffee Creations, our Yogurt business also delivered a solid quarter, driven in particular by Oikos that registered another quarter of steep double-digit growth and by Activia growing mid-single digits, with an accelerated performance in key strategic channels.

Plant-based lapped a particularly high base of comparison, considering the extra sales we registered last year related to supply issues experienced by one of our main competitors. We are at the same moment also clear that we have here still a job to do to reestablish consumer-led competitive growth in the plant-based portfolio.

And finally, while our evian brand posted another quarter of steep double-digit growth, our Specialized Nutrition category was lapping this last quarter, the shipments realized in the context of the Operation Fly Formula last year. The good news here is that our competitive position on our Neocate business - our allergy proposition - remains very resilient, a great base to build upon.

Overall, the zone closed a solid semester at plus 8.3% like-for-like sales growth, supported by resilient volume dynamics. Importantly, in North America, our recurring operating margin is improving this semester, up by more than 200 points compared to last year, driven by gross margin expansion - something we are happy about and that bodes well for our ability to consistently invest and support our brands over time.

Moving to the next page, Page #14, for our China, North Asia and Oceania zone. The zone registered plus 9.6% like-for-like sales growth in the second quarter, mainly driven by volume/mix, up plus 8.8%.

Let me start with China. In Infant Milk Formula, Aptamil delivered another quarter of solid growth, with continued market share gains. Our competitiveness in the category remains supported by the combination of the strong brand equity and disciplined execution. We continue to carefully and intentionally navigate the shift of the entire category from old to newly registered recipes, a process which will probably last until the end of this year.

Beyond IMF, our Medical portfolio also posted a strong quarter, with our key brands, Nutrison in Adult and Neocate in Pediatrics delivering double-digit sales growth.

And finally, in Waters, Mizone registered a plus 15% growth this quarter, notably driven by volumes, and more importantly, with market share gains. As Antoine mentioned already, we are very pleased to see that the turnaround of the Mizone brand is underway, with encouraging first results from both the renovated core range and the recently launched innovations. Beyond China, our EDP business in Japan posted another quarter of double-digit growth, led again by the Danone and the Oikos brands.

Overall, this second quarter led the zone to register like-for-like sales growth of plus 12.4% in H1, mostly driven by volume and mix. Recurring operating margin stood at 30.9%, down 107 bps versus last year, mainly due to mix effects - with the Waters and EDP categories, both growing at double digits - but also due to higher investments across the segment. Let me just remind you that all categories in this zone are having an accretive margin profile versus company average.

Moving now to Latin America on Page #15. Latin America registered plus 10.8% like-for-like sales growth in Q2, with price up plus 12.9% and volume/mix down minus 2.0%. All countries of the region contributed to this performance, with brands like Danone, Danonino, La Serenísima and Danette driving the growth.

All in all, Latin America closed the first semester with plus 11.7% like-for-like sales growth. Recurring operating margin stood at plus -- stood at 2.8%, increasing by plus 291 bps versus a very low base of last year. Our business in Latin America has a very seasonal profile, which makes that profit margins are higher in the second semester. Having said that, overall margin profile is here not yet at the desired level, and we are taking actions to correct this. An example of those initiatives is from Brazil, where we have discontinued our low-margin Waters business, as well as licensed out our existing milk business under the Paulista brand, which will enable us to focus our resources on the more value-added and profitable part of the portfolio.

Finally, let's have a look at the Rest of the World zone on Page #16. Like-for-like sales grew by plus 3.9% in the second quarter, led by a price effect of plus 8.2%, while volume/mix was down minus 4.3%. As expected, sales and volumes normalized this quarter after a first quarter boosted by calendar-related phasing effects, especially in Specialized Nutrition.

Looking at the quarter more in detail, Specialized Nutrition business posted a good quarter, like in Indonesia where our SGM and Bebelac brands continue to gain market shares, as well as in countries like Thailand or India, where we posted strong performances coupled with market share gains. In parallel, we are making good progress on the transformation of our EDP portfolio in Africa, streamlining and optimizing our operating models and product portfolios.

Looking at the first semester numbers, sales increased with a solid rate of plus 7.7%. Recurring operating margin stood at 10.4%, increasing by as much as plus 127 bps versus last year, particularly driven by the progress we made in EDP Africa, but also by the growth of our accretive SN business in the region.

Let's now move on to the margin bridge for the first semester on Page #17. Recurring operating margin stood at 12.2% in the first semester, an improvement of plus 14 bps compared to last year which is positioning us well to deliver on our full year guidance of "moderate margin improvement".

As you can see, we are making tangible progress on establishing the value creation algorithm we are striving for. In H1 and after many semesters and years of erosion, we were able to turn around our margin from operations, that increased by plus 93 bps. This has not only been the result of the sequentially improving quality of our topline growth, but also thanks to another record delivery of productivity gains, which supported us in offsetting a material part of the still high inflation we incurred in this first semester.

With our margin from operations expanding, we are creating the conditions for continuing our reinvestment journey in an organic self-funded manner. Our step-up in reinvestments in A&P, product superiority and capabilities had a negative effect of minus 99 bps in this first semester. Beyond the pure number, it is the quality of our investments - especially in A&P but also in R&I - that is also stepping up. This is starting to feed our long-term value creation algorithm.

Other effects remain relatively minor, as you can see, with Overheads before investments continuing to have a positive effect in this semester with plus 7 bps, as well as a positive contribution of changes in Scope, of ForEx, and of the organic contribution from hyperinflation countries, for a total combined effect of plus 13 bps.

Moving now on to the EPS bridge and Free cash flow on Page #18. Recurring EPS reached EUR 1.76 in this first semester of 2023, which represents a plus 7.6% increase compared to last year. Main contributor of recurring EPS growth was the operational performance that we just went through. All the other effects altogether basically compensated each other and had an almost neutral impact on EPS. Among others, Tax, Equity-accounted companies and minorities had a -0.7% effect, while Currency and other effects had a positive plus 0.5% effect on EPS growth. Reported EPS stood at EUR 1.70, up plus 48% versus last year, driven by the sharp decrease in non-recurring costs in this first semester, as we move towards the end of the Local First project.

On the cash generation side, Free cash flow reached EUR 1.1 billion in H1 2023. This represents an increase of more than EUR 400 million compared to last year, on the back of a disciplined return-oriented capital allocation and working capital management.

Let's now move on to Page 19 to share with you some elements about the year 2023 moving forward.

First, on the accounting treatment related to the recent developments in Russia: as we stated in our press release one week ago, our EDP business in Russia was placed under the temporary external administration of the Russian Federal Agency for State Property. As a result of this, and as per the applicable accounting standards, we will be fully deconsolidating our EDP Russia business as of July this year, triggering a cash impairment of around EUR 0.2 billion, as well as the recognition of a currency translation difference of around EUR 0.5 billion.

Coming back to what we already said on the last quarterly call, we are confident that year 2023 will be the year where we start establishing our desired value creation model, as we demonstrated in this first semester. Concretely, we are confident that our volumes will sequentially improve, building on the hard work our teams have done over the last quarters on our portfolio. EDP Europe will certainly be a key driver of it being on track to deliver on the plan we outlined at the beginning of the year. This sequential volume recovery will bring us more operational leverage and will solidify our gross margin expansion, which will create the conditions for further reinvestments. Our aim remains to build a business model which is consistently and sustainably creating value quarter after quarter, year after year.

A quick word then on our guidance 2023 to conclude the financial review on Page #20. Taking stocks of the solid first half of the year, we reiterate today our full year 2023 guidance with like-for-like net sales growth between plus 4% and plus 6%, and more precisely expect it to be at the upper range of this corridor.

At the same time, we are confirming our full year guidance for recurring operating margin, which is to deliver a moderate margin improvement versus previous year.

This outlook reflects our confidence that our Renew Danone strategy is into action, yielding first results, and reflects also our commitment to reinvest into our brands and assets, to build the future for the short, mid- and long term of our company. And with that, let me hand it over back to Antoine for the conclusion.

Antoine de Saint-Affrique - *Danone S.A. - CEO & Non-Independent Director*

Thank you Juergen. So, moving straight to Page 22, let me conclude with a chart that you will recognize from last year's Capital Markets Event. As you remember, the Renew Danone framework is made of 4 strategic pillars and 4 enablers.

Our efforts over the last 18 months are starting to pay off: we have worked hard on restoring the fundamentals, but also making significant progress on the enablers of Renew Danone, from culture to capabilities, sustainability - as you've seen from the Danone Impact Journey -and cost competitiveness. This shows clearly with our gross margin turning green in the first half. This, as Juergen said, is key to us as it gives Danone the room and flexibility to reinvest. This shows in our commitment to keep investing, while delivering healthy cash levels. And while a lot still remains to be done on Winning where we are, Expanding where we should be, Seeding the future and Managing our portfolio, this further strengthens our confidence in our ability to drive consistent value creation for our shareholders. With that, let me hand over to Mathilde for the Q&A. Mathilde, over to you.

QUESTIONS AND ANSWERS

Mathilde Rodie - *Danone S.A. - Head of IR & Financial Communication*

Thank you, Antoine. So now we're opening the Q&A I don't know if the there's further reminder of the method. I think the first question we have will be from Warren Ackerman from Barclays.

Warren Ackerman - *Barclays Bank PLC, Research Division - Head of European Consumer Equity Research*

It's Warren here at Barclays. I hope you guys are doing well. Two from me. The first one is on EDP. So we've seen a bit of a slowdown in U.S. EDP on Nielsen. I'm just wondering what's happening in the U.S.? And then on EDP Europe, what's your expectation as we exit this year in terms of SKUs and underlying volumes? I know you gave us that Spanish data point, which is great. But do you have any other data points in other countries that give us the conviction this is real and will come through in the back half? And then secondly, on Specialized Nutrition, can you tell us what the growth was in China Infant Nutrition in the quarter and maybe by channel? And obviously, at the R&D event in Paris, you mentioned 7 new SKUs on Aptamil in China as you push into Ultra Premium. Can you remind us why that's important? And then maybe also why SN like-for-like margins were down 350 bps in H1. Is it related to those launches or something else?

Antoine de Saint-Affrique - *Danone S.A. - CEO & Non-Independent Director*

Hi Warren, we'll do as per usual a duet with Juergen, I'll take the first one, and Juergen will probably take the bulk of the second one. In the U.S., we are actually quite happy with the performance of EDP. We have Oikos that is going from strength to strength. The high protein range is doing super, super well. We have a good performance of Activia. We saw a slowdown, and this is what is also reflected in the market shares of Danimals, which is our more affordable kids range, where we saw some elasticities after the last price increase. This product is targeted toward a more modest part of the population. So that is something that we are in the process of correcting, but by and large, the dynamic of EDP U.S. is a good one.

In Europe, I mean, we showed the Spanish example for a number of reasons. I mean, the first one is, as you would recall, we had a large number of years of underperformance in Spain. And the team there for the last number of months, have done a work that is exemplary and which we leverage in other places. By doing in some ways what we had done in the U.S., creating very clear swim lanes, making sure that there is a proper segmentation, a segmentation that is not only by brand and by benefits, but by price points so that we can tackle the various levels of the market: being quite aggressive actually at an entry point, but aggressive not only on price, we are aggressive also on the benefits we offer so that we have a value proposition that is differentiated. By the way, supporting it with advertising. If you haven't had the opportunity, look at it, it was shot with Danone employees. Super cool.

And this model that is now proven and has a real impact on penetration in Spain, also a real impact in the way we start discussing with some of the key distributors or retailers in Spain, this model we are deploying into other countries. We have a good or a solid performance in France, where things are moving in the right direction as well, but still more to be done. You will have seen, if you were in the waiting room, the advertising we put on air in France which is a re-creation of something that worked in the past done to the taste of today. We are there getting extremely clear on the swim lanes, and on reclaiming the fact that Danone yogurt is not a yogurt, it's a Danone. So, testing and proving in Spain, moving next to France, doing the same architecture work in places like Germany, reclaiming product superiority around Activia, but also reframing our product portfolio in places like the U.K. So we are just deploying, I mean, country after country, the method that we have put in place. On China, I hand over to Juergen.

Juergen Esser - *Danone S.A. - Group Deputy CEO*

Yes. Warren, in China and on the overall Specialized Nutrition margins. On China maybe first, you saw China second quarter of very good delivery in Specialized nutrition, almost +7%. Contributions from all the segments, including IMF, so we see good contribution from IMF to this number. Clearly outpacing the market as the market continues to be pretty soft in the moment. And when it comes to the channel contribution, clearly, our controlled channels contributed to growth; uncontrolled channels, further declining. So now clearly below 10%. So we are, I would say, continuing the dynamic we have been starting many, many years ago. So very solid performance in the moment where, as we know, the whole category is shifting from old recipes to new recipes. We have, as you know, quite a few exciting innovations to the pipeline. First one is to enter market towards the end of the year, so they are not yet in the market, which means that the market share gains we are today delivering are still with the portfolio you know now, which we have in the market since many years.

On your second question, Warren, on the overall margins of Specialized Nutrition. So, you are right that the margins of Special Nutrition are down in this first semester. It's not so much linked to the performance of China. It has only with the element of recipes, because there are 2 drivers basically. They are the first drivers of investments into innovation and recipes, China being part of it, but also Europe and the other parts of the world. The other element, which has put a temporary pressure on the margins of this first semester is the fact that in Europe, we have part of our portfolio, which is going through prescription and reimbursement. And here, price increases take a little bit of time - between 6 and 18 months - to materialize into our P&L. So, this will materialize over the coming quarters in our European P&L. And so, what you can expect is that the margins of Specialized Nutrition in H2 will be superior to the one of H1; and we are also confident that we can maintain and sustain the margins of SN globally speaking, at this very attractive level where they are today.

Mathilde Rodie - *Danone S.A. - Head of IR & Financial Communication*

Thank you, Warren. So, next question is from Guillaume Delmas from UBS.

Guillaume Delmas - *UBS Investment Bank, Research Division - Analyst*

A couple of questions for me, please. The first one is on pricing. I mean, at this stage, do you expect that you will have to make some downward adjustments to your prices during the back half of the year? And here, I'm just thinking in particular of EDP, because in the scanner data, we see private label gaining shares, we see promo activities still below the levels of 2019, and then looking at your gross margin development at the group level, but also your recurring operating margin in EDP, it seems that you've clearly reached an inflection point. So, does it make price adjustments inevitable in the second half of the year, particularly in the developed world? And then my second question is: Antoine going back to the strategy road map, I mean, you are still in the fix and seed phase as per the slide you were showing at the CMD in March last year. But based on the progress you've made so far in establishing the desired value creation model, do you think you could enter the second phase, which is the accelerate phase, as early as next year? And if so, I mean, how should we think about this acceleration? Is it being able to do consistently 4% to 6% like-for-like sales growth? Or is it being able to do a little bit better than moderate margin expansion going forward?

Antoine de Saint-Affrique - *Danone S.A. - CEO & Non-Independent Director*

Thank you. I'll start with the second question. I will probably do a duet with Juergen on the first one. I think, as you you've seen from the results, as you heard also from us, we are happy that we are making good progress on the fix and seed parts of our agenda. It has been now a number of quarters where we have delivered consistently; and consistently not only in terms of numbers, but also in terms of the make of the numbers. So, reinvesting behind our brands, doing the right thing in terms of productivity, striking the right balance and keeping a rather resilient volume/mix dimension. So yes, indeed, we are making good progress, which gives us the confidence that we are heading into the right direction. Before moving to something that is more ambitious, we need to keep delivering consistently on the transformation of our business. I mean, all of you have told us over the past year that - or past years - that we were too fast in moving to the next phase. We are delivering consistently on a model that is a value creation model. So, are we preparing the next phase? Yes. Do I want today to discuss the next phase? No, because we need to continue to deliver and to consistently improve the model. So, are we active in the background? Yes, we are. But the focus, and especially the focus inside the company, has to be consistently delivering and strengthening the model all the time because this will deliver very significant value creation.

So yes, we are working on it. No, we are not ready to disclose it because there is still more work to do on the basics and more opportunities, by the way, of growth and value creation. On pricing, we'll do a duet with Juergen. I mean, the first thing is when we are doing what I was explaining a minute ago in terms of swim lanes and segmentation, it enables you to move from a discussion that is a broad-based pricing discussion to a discussion where some SKUs have a role to play to be fighters, some SKUs are driving premiumization. So, you start being much more sophisticated in the way you play. By the way, using promotion rather than pricing. Because inflation is still there. It's lower, not on everything, by the way, but it's still there. So, it is getting also much more sophisticated in the model through segmentation, through promotion and through very clear swim lanes on the various elements of our mix. Juergen?

Juergen Esser - *Danone S.A. - Group Deputy CEO*

Yes. Just to build on what Antoine was just saying, when we talk price, we need to talk inflation. Inflation was still high in the first semester. A little bit decreasing as we go through the next quarter, but there will be still inflation, which will be fed by cost of labor, by some agricultural ingredients like sugar, but also by milk, and this especially in Europe. And so what we will see is indeed that the price effect is sequentially coming down. You have seen that 10% Q1, 9% Q2, and we will have price effect to a lesser extent in the next 2 quarters in front of us, but pricing will stay positive while pricing will normalize. That is the first very important element. When it comes to the impact it will have on our topline and our bottom line. Very important that we have created the conditions over the last quarters and you can say almost over the last 2 years for reinvestments. And those investments will help us to restore volume growth, to go back to the balanced growth model we are aiming for. This balanced growth model will continue to deliver gross margin expansion, because the gross margin expansion you saw in H1 is not only the consequence of the improved quality of growth- and this will further improve - but also of the productivity gains we have beyond industry norms, as well as by the fact that we are starting to fix the underperformers. And that is true for Europe, and that is true for the other parts of the world. So, there are several drivers which we make that we will continue to expand our gross margin to self-fuel reinvestments and to deliver the margin expansion we have committed to.

Mathilde Rodie - *Danone S.A. - Head of IR & Financial Communication*

The next question from Pascal Boll, Stifel.

Pascal Boll - *Stifel, Nicolaus & Company, Incorporated, Research Division - Analyst*

First question would be on your SKU rationalization plans you have discussed at length over the last couple of quarters. You always said that this will take an end by the end of Q2. Can you confirm that? Or will that have a negative impact also for the following quarters? Then maybe on free cash flow, can you elaborate a little bit more on what do you mean by capital allocation? How did, for example, CapEx change year-over-year, and maybe also on the net working capital impact? For example, what happened to inventories? Did you need to build more in that semester? And then finally, on cost, could you give us some more details on what was the cost impact in H1 year-over-year and what you expect in an absolute amount for H2?

Antoine de Saint-Affrique - *Danone S.A. - CEO & Non-Independent Director*

Pascal, I'll take the first one and Juergen will take the second and the third. On the SKU rationalization, as you remember, we started the SKU rationalization in Q3 last year. It was in full force by the end of Q4. So, what you will see is indeed progressively over the course of H2, we will lap the SKU rationalization. And towards the end of the year, we should be on the base that is a normalized base for the big or significant SKU rationalization. Once you said that, we've entered also, but that's less of a one-off if you will, into a discipline where we will keep our SKUs under control. So, we'll go into a permanent rhythm of pruning, but which is going to be more the normal course of the business. So, to your initial question: yes, progressively over the course of H2, we will lap the significant SKU rationalization. And we are entering into a more normalized way where, as part of keeping our portfolio healthy, we prune the less performing SKUs, we challenge the return on capital invested, and we drive the clarity of our portfolio - by the way, without giving up on share of shelf, which is all the secret of managing this. And on that, Juergen.

Juergen Esser - *Danone S.A. - Group Deputy CEO*

Yes. And just to say that when you look back at Page 17 of our full year presentation, we totally confirm what we showed you at that time, which is the evolution of our EDP European volume sequence with volumes recovering from now onwards.

On free cash flow: EUR 1.1 billion, a good number - EUR 400 million more than last year. Two drivers: first driver, definitely being what I call disciplined CapEx and working capital management. CapEx, EUR 300 million, I would say, a very return-oriented approach, at the same level as last year, well below the cap we have set ourselves. Working capital moving into the right direction on several elements: on receivables, particularly, but also on inventories, we are starting to make a good job. And Pascal, on your last question on cost and COGS: I think the element which is worth noticing is that you see that we are able to offset now more than 1/3 of the cost inflation by productivities, because we are delivering more than industry norms in terms of productivities. This is really becoming a competitive edge. And so already as of today, more than offsetting a 1/3 of the inflation, and that will be an even larger part moving forward.

Mathilde Rodie - *Danone S.A. - Head of IR & Financial Communication*

Thank you, Pascal. Next question from Celine Pannuti, JPMorgan.

Celine Pannuti - *JPMorgan Chase & Co, Research Division - Head of European Food, Home, Personal Care & Tobacco and Senior Analyst*

Two questions for me. First on EDP, is it possible to understand how gross margin progressed? Because clearly, EBIT margin had a nice increase. And when you think about the duality of what you presented, I think it was on Slide 5, where there are Everyday Nutrition and value-added proposition, I presume the second one having higher gross margin, would it be possible to understand what percentage of your total portfolio is now in this higher value-added proposition? And whether in an environment where things could be difficult from economic standpoint, you could still maintain a good balance between the 2 sides of the portfolio? And whether that changes value proposition, I presume higher gross margin, changes your view on the midterm profitability of the portfolio? And my second question is on Latin America - and apologies if you mentioned that in the presentation - I just wanted to understand what drove the volume mix being negative in the quarter? And we've seen that you've gone from a loss to a positive profit in the region: what should we expect in terms of the turnaround for this region?

Antoine de Saint-Affrique - *Danone S.A. - CEO & Non-Independent Director*

Bonjour, Celine, I'll take question 2 and part of 3 and Juergen will take question 1. I mean, if we get back to the Slide 5 of the presentation, actually, it goes back to how you architecture your portfolio, and how do you make sure that you allocate roles to the various parts of your portfolio. Having something that is a lower gross margin but is protecting the bottom of the segmentation - and by the way, driving penetration and volume - has an impact on the leverage of your factory and is helping the rest of your mix. So, we have restarted looking at the various roles, both from a consumer standpoint, but also from an economic standpoint, on the various components of the portfolio. And both are working together. There is plenty of room, and we see lots of healthy growth in value-added proposition because they have a distinctive positioning, because they are adding perceived value for the consumer. At the same time, a Danone - and not a yogurt - at EUR 1 is seen as great value for money, increases the penetration of the brand in the category, but has also a positive impact in terms of factory occupation and therefore, has an overall impact on the P&L. And so, management of portfolio is the name of the game, with obviously an overall impact which is driving the profitable model when it comes to EDP. Maybe you want to complete Juergen on EDP before we get to Latin America, or not.

Juergen Esser - *Danone S.A. - Group Deputy CEO*

No, maybe on EDP maybe just on the profitability, and coming back to what you said, Celine, on gross margin and profit margin. So, you can see that for the total company across categories, we have now reached the inflection point of gross margin, as well as on profit margin. It's the same for our global dairy category, and this is driven, as I said, by the fact that we are fixing the underperformers and driving more quality into our topline growth. That will also mean that, when we take a look at our overall European profitability, we are now at an inflection point where we will see the gross margins and profit margins increasing as we are going into the second part of the year.

For Latin America, more precisely, yes, I think the team is doing a great job increasing the profit margin. Yes, from a low base. Organically and to some extent inorganically, you heard me talking about Brazil, where we gave up a bit more than 10% of our portfolio by discontinuing the Waters business, and licensing out our existing liquid milk business. And on top of that, we can expect the H2 margin to look even better because we have a bit of seasonality in that business, which makes the profitability more skewed towards the second semester. So, we are well on track, I would say, totally in line with what Antoine is saying on managing our underperformers across the different regions.

Mathilde Rodie - *Danone S.A. - Head of IR & Financial Communication*

Thank you, Celine. So next question from Jeff Stent from Exane.

Jeffrey Stent - *BNP Paribas Exane, Research Division - Research Analyst*

Very quickly, just on Russia. I see you're going to be deconsolidating EDP, but I thought that the sort of Russians had moved a little bit beyond EDP, i.e., they've actually taken the entirety of the business. So, if you could just clarify exactly what's happening and exactly what would be deconsolidated? That would be great.

Antoine de Saint-Affrique - *Danone S.A. - CEO & Non-Independent Director*

So Jeff, what the Russian authorities have done is: they have put our EDP business under temporary administration of the agency of Russian state participation. So, it's the EDP business.

Mathilde Rodie - *Danone S.A. - Head of IR & Financial Communication*

Next question from Rashad Kawan from Morgan Stanley.

Rashad Kawan - *Morgan Stanley, Research Division - Equity Analyst*

Just 2 questions from me. First, can you talk about any shifts in consumer behavior you've seen over the last quarter by region? I know volume mix was weakest in Europe, but some of that, I'm sure, is noise from the transformation program. So, if you can break down in terms of what you see by region and category that would be great. And then the second question, just overall on your margin progression in H2 versus H1, just trying to think what can drive upside to your margins from here and what your reinvestment plans are in the second half?

Antoine de Saint-Affrique - *Danone S.A. - CEO & Non-Independent Director*

So listen, I'll take the first one, and Juergen will take the second one. I mean, if you look at the behaviors of consumer; first, as you said, I mean, they are very different region by region. I mean, the China market is still very active. The China market reopened when it comes to mobility. So, you have a Chinese consumer which is reasonably confident, still absolutely passionate about science, still absolutely passionate about added value and reacting to very strong mixes. So, very much a continuation of what we have seen for a long time in China, with the plus at the very beginning of the year of the opening of the markets.

If you look in Europe, actually, there is no such thing as consumer in Europe. The degrees of inflations are very different country by country. I mean, you see what happened in the U.K. or in Poland is very different from what happened in France, to take an example. I mean, the degrees of inflation - therefore the degrees of consumer reactions - are very different. What we have seen, this being said, a couple of things: Whenever you have a very strong brand with very strong benefits, consumers tend to be very loyal and follow those brands. When the brands are less differentiated or places where the brands are less differentiated, you saw, I mean, a greater competitiveness of private labels. I think what we have seen recently in Europe, and we've seen some of it also in the U.S., is a tailing off of the growth of private label. What we saw as well is private label was taking a lot out of smaller brands. So, there was also a bit of cleaning of the market, so to speak.

In the U.S. for a very, very long term, there was no price or sensitivity, so no real consumer reaction. We saw a bit more of consumer reaction in the last quarter, once again, differentiated category by category, which translated in a greater weight in some channels. So, discounts and clubs did very well while some other channels did less well - which by the way, is not fully captured by Nielsen because they don't properly follow clubs. So that you don't see. In the rest of the world, it very much depends. I mean, Turkey and Argentina are in hyperinflation, it's literally place by place by place.

So, I mean, that's the beauty of having, by the way, I mean, a strong team in every country, which allows you to adapt your pricing and your position to each other country to make sure that you remain relevant.

Juergen Esser - *Danone S.A. - Group Deputy CEO*

On the margin question, Rashad: yes, we do also expect in the second semester the gross margin to expand on the back of, as we said, the further improving quality of our topline growth with volume sequentially recovering, on the back of continued productivity, on the back of further progress in managing up our underperformers_ - all this will contribute. We may face a bit less favorable geo mix and category mix however, but overall, we will be positively driving our gross margin, so that we will be again in a position to significantly reinvest into our business, confirming our intention to deliver moderate margin improvement. And if the inflation should come down a bit faster than what we expect, we will reinvest any good news into the business to build the future.

Mathilde Rodie - *Danone S.A. - Head of IR & Financial Communication*

The last question from Jon Cox.

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

J, Kepler Cheuvreux. A couple of questions. Maybe, first of all, for Antoine. Just on the outlook for the year: I think there were some people assuming you may just change the wording a little bit on the 4% to 6% for this year. Consensus is already above 6%, you're reiterating 4% to 6%. Just wondering if you see something coming up that maybe we don't expect because you're talking about volumes probably accelerating in H2, even if pricing just comes down slightly sequentially. Incidentally, I know we don't want to talk about the next step. In the financial report today, you actually mentioned that the 4% to 6% is in line with midterm targets. I think originally, you were talking about 3% to 5% currently, and obviously, you've had inflation and the rest of it. So, there's a question on the topline. And then maybe 1 for Juergen, just on the free cash flow side of the equation. It looks like a very decent result there. Just wondering what you think about full year: can we think about maybe towards EUR 2.5 billion free cash flow for the year? And I'm wondering is this really like a new baseline for you guys? Because you're talking about how all your margins have hit bottom and everything is going to get better. If you look at your free cash flow margin, it was 10% plus a few years ago, and there were around 7% or 8%. Just wondering, should we expect that to sequentially improve? Typically, Danone actually has negative working capital, should we see a return to that? And just an add on Russia: you talked about the impairments, et cetera - this EUR 0.7 billion -; would that be it? Or would there be any more? Just wondering if you see that EUR 0.7 billion being everything in terms of exiting Russia dairy?

Antoine de Saint-Affrique - *Danone S.A. - CEO & Non-Independent Director*

Jon, on your first question, no, I don't see on the horizon things that you don't see. We said we will be in the upper part of our guidance. So we slightly changed the wording as I'm sure you have noticed, and this is the reflection of the fact that pricing has reached a peak. And so over time, it will positively normalize while we'll see some of the volume and our mix kicking in. So indeed, actually, we changed a little bit, say, we would be in the upper part of the guidance. And no, we don't see things on the horizon that you don't see.

Juergen Esser - *Danone S.A. - Group Deputy CEO*

Jon, on the free cash flow, yes, I think a good start of the year, as you say, I think we are making progress really managing a return-oriented capital expenditure management, but also, as you say, managing better and better our working capital, which is negative and which is more negative today than it was 12 months ago, which bodes well for the future when growing our company. We don't give guidance on free cash flow, as you know, but we want to expand and accelerate our cash conversion cycle moving forward.

On Russia, the EUR 500 million plus EUR 200 million, EUR 700 million, I think it's fair to say that we do not expect a material change on that. Yes, we have booking debt into the second semester. So there could be some currency-related minor variations, but that should be it.

Mathilde Rodie - *Danone S.A. - Head of IR & Financial Communication*

Okay. So now the Q&A ends. Thank you very much, everyone, for attending the call. And we remain available to answer any follow-up questions you might have in the coming days.

Antoine de Saint-Affrique - *Danone S.A. - CEO & Non-Independent Director*

Thanks, everyone, and see you soon one place or the other. Take care. Bye-bye.

Juergen Esser - *Danone S.A. - Group Deputy CEO*

Take care. Bye-bye.

Operator

That does conclude our conference for today. Thank you for participating. You may now disconnect.

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