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# EDITED TRANSCRIPT

BN.PA - Half Year 2013 Danone SA Earnings Conference Call

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## OVERVIEW:

BN.PA reported 1H13 sales of EUR11b, underlying net income of EUR873m and underlying EPS of EUR1.48. 2013 sales growth guidance is at least 5%.



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## PRESENTATION

**Pierre-Andre Terisse** - *Danone SA - CFO*

Okay, I think we're ready. Good morning all, to those in the room and to those who are connected over the phone. I'm very glad to meet you this morning here in London again where we are this year again for the second time hosted by Nomura for this presentation of Danone's results for the first half of 2013 and let me thank them, Nomura, for this.

So this is Pierre-Andre Terisse speaking. I'm the Danone Group CFO. I am here alongside Regis Massuyeau here, Marion Cazenave who is at the back of the room and for the last time also Antoine Guttinger. Antoine has spent three years with us; he'll indeed take the responsibility of finance for one of our business which is Evian Volvic Worldwide. And I would like to take this opportunity to thank him very much for his significant contribution to what has been a real step-up I believe in the quality of our relationship with you and with investors. I think this has been as well an important driver of the stock performance since his arrival.

I would like to thank him but also to thank you because you have been, you all buy-side, sell-side analysts helping him develop and I do encourage you to continue and to do equally so with Regis Massuyeau who is taking on board today with the same spirit, I can tell you, of openness and commitment. So all the best to the two of you, Antoine and Regis in your respective jobs.

After these few words of introduction, let me now move to some highlights of the H1 performance in order to put into context, before I come back to the numbers in more details. I'll start with page four for those who are following us by video conference.

This page shows our key KPIs for the first half. An organic growth, which has reached 6% for H1 which is in line or better than our guidance of at least 5%, with an acceleration within the first half itself and a Q2 which has been higher than Q1.

Trading operating margin has declined by 49 basis points at 13.34%. This as well is in line with our guidance of minus 50 to minus 30 and consistent with our expectations that H1 will be in the lower part of the guidance on the back of Europe.

And last, our free cash flow for the first half was EUR714m, excluding close to EUR40m of non-recurring cash out linked to the cost saving plan.

So the numbers for H1 are fundamentally in line with our guidance and expectations. But maybe more importantly for this half, and I turn to page five, we have during this period of time, since the beginning of the year, made a lot of progresses towards our objective to come back to what you have on the right of the screen, which is a strong sustainable and profitable growth as soon as in 2014.



We've done so by following our action plan in Europe first, by completing our consultation process throughout Europe, which will allow us to start the implementation of this EUR200m-cost-saving plan early in the second half. We have done so in Europe as well by stabilizing our market share in Dairy Europe and improving our sales performance outside Europe, by accelerating in the CIS and North America, by investing behind our brands, as well as strengthening our presence across our emerging markets through small, well-targeted transactions which I'm going to come back on in a minute.

So of course there remain steps to be accomplished in Europe. Now that we have finalized the procedures, we will need to implement the cost saving plan and we will need to relentlessly look for simplification in our processes and to strengthening our competitiveness. Outside Europe we will need to keep adjusting our model to better capture the huge opportunities which we see there in front of us and to manage volatility. So there remain things to be done, but H1 was definitely an important milestone towards Danone growing strongly, sustainably and profitably.

I will have a brief look at the sales first, and turning page six looking at the dynamics which has basically remained unchanged, with a strong growth in the growth markets at plus 13.5% like-for-like for a share of the business which now represents 62% of our sales and on the other side, Europe which has remained negative at minus 4% like-for-like and now represents less than 40% of our portfolio with 38% of all sales.

Europe therefore has remained negative but this is some improvement versus the previous half. You can see that on the right of the screen, with minus 4% versus minus 4.5%. And more importantly, there's a been positive dynamic within the half, with a minus 5% in the first quarter and a minus 3% in the second quarter of the year.

We've been focusing very much our action during this first half in what we have been setting as our plan, as our plan for Europe at the end of last year. This is around the five levers you have on the screen. It's about the best packaging and we show here some examples with the execution of BebeDino in Spain or DanUp in Portugal which have renovated the range, with the best products as well and some improvements in the recipe and formulation of the product. Actimel in particular in Spain has been renovated and a new, a very indulgent version of Danette has been launched in France with Danette Le Liegeois.

Right price point, bottom left. This is about finding the right level of price and the right positioning vis-a-vis consumers. And from that perspective, Ecolean has been an interesting initiative in Portugal that's basically launching a very affordable format to consumer in a pouch. We look for differentiating innovation and one has been the launch of Danio, which is a Greek high-protein low-fat yogurt here in the UK which is very successful. And last but not least, we have been working on setting up the right organization as well.

The result of all these actions put together at the same time and at different times in different territories is basically the following. You can see on the right-hand part of the chart, we have stabilized our value market share and that's been now for two consecutive quarters in a row. In some markets they have even increased. That's the case of Portugal, but basically the gradual -- or the sequential, sorry, stabilization of our market share is a very important factor, which is not everything because we continue operating in a category in particular in Dairy which has remained negative in most European markets. But this has clearly helped, and you can see that on the left-hand side, our sales growth to improve from one quarter to the other, in particular on the back of volume which is the light -- sorry, the dark grey area which has gone from strongly negative to less negative, helped by price and again as a result of all these initiatives as well and primarily.

So Europe has been very much about that but Europe has been about this trend for competitiveness. I think given the complex context which we are facing throughout Europe, having the whole process being managed, run and successful in just one half has been a very good achievement. We are now ready to roll out this plan.

Again, I repeat this is for us absolutely key because we need to make sure Europe is more competitive, we need to give back some competitiveness to Europe and we need to stabilize margins and that's the key element of the plan. That will be our key priority in the second half, executing this plan. So that's for Europe and certainly there's been an element of improvement in the top line of Europe which has contributed to the improvement of the acceleration of the top line overall.



Growth markets is the second leg of our Group and you can see that growth has remained strong and has even strengthened in part of the world and this is NORAM and the CIS. And within the half there's been an acceleration as well between Q1 and Q2 in NORAM and the CIS. Latin America, Africa, Asia and the Middle East have remained strong as well.

I will just go with a few elements by division in these markets, starting with Dairy. There's been a lot of initiatives during the first half to try and strengthen our position in this division, logistic JV in Russia. Clearly we have a very nice logistic asset and we think it needs to be leveraged and for doing so we have concluded a partnership with a logistics company called Norbert Dentressangle, with a view to progressively open our logistic network to other categories and therefore to reduce costs and to leverage it. So that's something which over time is going to help Russia keep improving its level of profitability and its competitiveness.

In main China you all have in mind the partnership with Cofco and Mengniu. This has led us to buying 4% of Mengniu before the end of the first half and the other steps, the following ones will be completed during the second half.

The US has definitely been a key market for us in this first half, many initiatives taken by the way in the different businesses. But I would limit my comments to those in Dairy for now. On the Greek segment, where we now are clear number two, which has helped us reinforce our position as leader in the market, we have launched two brand extensions, one in the dips, under the Oikos brand and the real objective here is to create new moments or new occasions of consumption, and Activia Greek which has been launched so as to allow people, being convinced of the benefit of Activia, to be able to have it in the Greek version with the Greek texture. So these have been two important launches in the first half for Dannon in the US.

And you have seen very recently that we have as well concluded a partnership with Starbucks. This is a pretty interesting and strategic one. We basically will leverage the distribution footstones of Starbucks and their very high quality of digital marketing. We'll leverage as well the distribution capabilities of Danone in modern retail as well as our technology and knowhow in the area of yogurt to create a co-branded product called Evolution Fresh, inspired by Dannon, which is going to be distributed in both channels, as we move into the coming quarters. This is very exciting because again it opens the yogurt category to many additional American consumers today and that's going to create as well an additional brand in our portfolio which again looks very promising and exciting.

So the US has been of course very important. One word about Centrale Laitiere. After having taken a majority stake in February of this year, we have completed our process of increasing our control, first, by launching a tender offer on the stock market in Casablanca, which was compulsory and by getting 2.6% additional; and in addition to that, by concluding the options with the current holders, to get an additional 26.75% by 2014.

And therefore, this is really becoming a Danone company. We have started the integration as soon as March. The integration means on the back of a company which was already Danonized to Danonize it further, i.e. setting up the level of quality of the products, setting up the level of marketing, financing, internal control and so on and we are much going through that.

So that's for Dairy and as you can see there is Europe of course, but there is the rest. And the rest is working absolutely, is showing very, very strong dynamics and is giving us the opportunity to keep improving the portfolio.

Waters, many actions as well. That's been a very exciting first half for Waters. I will mention the new Evian premium bottle called Essence which has been launched in the US and Japan and I'm sure is going to be coming to Europe soon. I was about to buy one in France on the streets, but it appears to be only an exception. So I hope it will come soon. It's a wonderful bottle. As well the partnership with Sirma, which I'm sure you have seen, which allows us to become a real number one in the very dynamic Turkish market and that's good news.

But most of the efforts of Waters during this first half have been focusing on aquadrinks, at unlocking the potential of the category as you can see at the top of this slide. I would mention two examples. One is the launch of B'lue which is the aquadrink version launched in India, in the region of Delhi and is going to complement propositions in Indonesia and in China. B'lue is on the right part, bottom-right part of the screen.



I will mention as well Brazil which started from zero about four years ago, and start being not only meaningful but more and more exciting. We have completed the portfolio. We are not only in HOD and waters but we are as well in aquadrinks and we are progressively getting penetration in regions away from Sao Paulo so that's definitely an area of growth which is extremely important for us.

Baby and Medical have been the object of many initiatives as well. In the case of Medical, I would emphasize on the acquisition of Nutrimer in Brazil which is helping strengthen further an area of medical which is one of the most dynamic, i.e. Brazil. And with respect to Baby we keep progressing step by step and that's very important because it's building the future. We keep progressing and building our presence in Latin America, with a very strong performance in Brazil and very strong performance, very good progress in Africa. And we have been as well, making the acquisition of Happy Family, I will come back on that, and working to expand our range in China.

So a word about China. That remains a market which is very good and very important for us. We are convinced of its fundamentals. We are convinced as well of the need in this market to behave in a very responsible manner and to try and build sustainable growth and not to be too short-term minded. I've always told you, I think, in the past few years that it was important for us to have a broad portfolio in China and to be able to offer good-quality adequate-price products towards the consumers, so that's what we continue doing.

Dumex is one of our local brands and we have been adding to that, international brands with Nutrilon and Karicare. We are now fully in Hong Kong with the brand Cow & Gate and we are as well being distributed through e-commerce with a performance which remains good and which again we keep looking at with a view of making it, not only strong but also sustainable.

So China has been one of the levers and let me just come back on Happy Family one minute because I don't think we've had really the opportunity to discuss that. That's a pretty interesting move. The baby food, but foods like in jars, this category in the US has been for long a category which was not growing. For the past few years now, it's been very dynamic growing mid-single digits. That's on the back of a few companies which have been launching really modernized products with different products or packaging formats, with different ingredients, with organic version. And we've chosen to enter this category, which is very dynamic and growing fast by having a partnership and acquiring in fact the majority of one of the key actor which is called Happy Family.

So as you can imagine that's very interesting for us because it's our first step in Baby in the US. That's something which probably will have complementarities with the Fresh Dairy part and we have to find them. That's something which as well can be interesting for us to leverage for the rest of the food businesses in Europe. And therefore we'll be very much looking at that and we're very excited by it.

So that's for sales and as you can see the numbers are very important but what happens is maybe even more important because we are really progressing and building things. Margin-wise, H1 has been as well for sales a two-tier momentum. This is absolutely clear, very much the same as last year. You have on one side, Europe which is decreasing at 4% in terms of sales and in addition to that or as a result of that is negative from an operating margin standpoint at minus 120, minus 118 to be precise, basis points like-for-like at 14.3%. And on the other hand, you have the growth markets growing strongly with margin accretion, albeit modest, but on the back of fueling the growth and trying to capture all the potential we have in front of us. So that creates clearly a two-world equation and this is in line with the priorities I showed you before. We have to leverage and invest on the left and we have to fix and adapt on the right.

Not a lot of surprise from a margin standpoint in this first half. We expected a moderate inflation of the raw materials. It's been in reality, a bit more than what we thought, say, mid-single-digit versus low to mid on the milk. We've covered that through pricing, through additional supply versus what we expected. And we have kept covering it as well through productivities with an amount of productivities in the first half of this year which has been EUR254m, so very much in line with the EUR500m target we have for the year.

We keep moving not only on making productivities, one year after the other but also trying to find systems which are going to make us more efficient overall and year after year. And I will mention the example of global sourcing organization for the Dairy division which is being set up and will as we go, as we move forward, provide some benefits margin-wise to this division and to the Group.

We're not only working on margins, but we're working on efficiency on all the other elements of the equation and in particular we're trying to take advantage of a very strong and unique cash negative cycle and cash capability to make the difference. So A, by focusing on CapEx for growth, by



investing in CapEx to grow the business, either because we need to add capacity or because we want to use CapEx as a way to build differentiation. And that's a tool which we've been very much using during this first half.

Secondly, by working on the working capital for the rest of the world. Now you see that the rest of the world is still an area of progress which is very significant. We have been working and we keep working on it. There's been significant progresses made by the US, the action in Danone CIS now in particular this half and we'll keep working on it.

We keep working as well on stabilizing and making sustainable the tax rate which has gone up very significantly from last year to this year and due to the additional French tax from 26.7% to 30.3%. And again we're working to avoid as much possible double taxation and make this 30% sustainable, which we believe is going to be. And all that of course is operating in a French environment which remains volatile but this is something we have now been used for many years.

So all that, I mean these plus and minuses, surprise, positive and negative, is basically not making us diverge any way from our priorities. It gives, thanks to very strong business dynamics, the possibility to confirm our guidance, obviously, on sales growth with sales growth of at least 5% of the year which given the first-half results is going to be fairly, pretty much achievable I must say.

Trading operating margin minus 30 to minus 50 basis points, which means in effect that the margin of the second half is going to be at least at the level of the first half and probably better. So that's what we are looking for.

And last, the free cash flow excluding exceptional items which we view as being around EUR2b for the year.

So that's really what I wanted to tell you about the business dynamics which lie behind the figures. I will now go through them and try to give you some additional elements before we move into Q&A and Antoine or Regis will tell me about the timing, if I'm okay. Okay, I'm okay.

Key figures H1, you've all seen them. Maybe to remind, so EUR11b of sales, which is up 6% like-for-like, 5.6% reported. The margin at 13.34%. I'll come back on that and EPS which is EUR1.48. I think this is absolutely in line with consensus and with your expectation and free cash flow of EUR700m.

So sales growth analysis, for the first half you see that 6% like-for-like which is equally split or almost equally split between volume and value at least in a balanced manner. We have a negative currency impact and a positive scope impact. Negative currency comes from the weakness of some emerging currencies versus a year ago. This is the peso, Argentinean. This is the Brazilian real, this is Indonesian rupiah. This is to some extent the ruble as well. All that has created -- and the pound -- all that has created a negative currency effect of 2.5% which we expect, if the currencies were to stay where they are today, to become 5% for the second half of this year.

Scope and others is positive 2.1%. This is very much reflecting the addition of Central Laitiere to the Moroccan operation for the first four months of the year and obviously the impact on the quarter is going to be bigger and volume and value are both positive for like-for-like sales.

On the quarter, therefore you see very much the same. The same on currencies with negative 2.6% in Q2 and a scope which has been stronger because obviously we have included Central Laitiere not only for four months out of six but three months out of three and therefore this has a bigger impact on the quarter. Volume, as you see, has strengthened. It's moved up from 3.5% in the first half to 4.1% in the quarter only and therefore there is a positive volume dynamic and value has stood at 2.4%.

That's interesting because it shows that we are very much in positive dynamics. After three quarters in a row last year where we delivered 5% top-line growth, we are now progressively taking that up to 5.6% in Q1, 6.5% in Q2 and you've seen the dynamics where it's coming from, i.e. a pace of decline which is reducing in Europe, an excellent quarter in the CIS and in North America, which has exceeded altogether 10% growth and continued mid-teens growth in the region which we call ALMA which stands for the emerging markets really.



And you see that geographically, the deceleration I don't know what to call it of Europe, which is attributable both to better dynamics and to one day more in Q2 versus Q1, which has helped, are technical and real factors. CIS and Noram really stepping up and this has been the case of both of them. CIS has made its first growth above 10% since the merger of Unimilk and Danone and ALMA has remained very dynamic.

Volume/value is almost an ideal situation, of course with different balance depending on the divisions. But two-thirds volume, one-third price and mix, that's really the way we see sustainably the equation as of Q2.

I'll move into Dairy first, so a very good quarter in CIS and Noram, again exceeding 10% growth with better trends versus Q1 in both geographies, both Noram and the CIS. In Dairy, taken in isolation as well, the rest of the world, i.e. the emerging markets is doing well. Brazil in particular continued being a very strong engine for growth of the Group but also the others. And we've seen some first sign of stabilization in Europe with base of comparison which from now are going to get easier.

Part of the equation has been in Europe the adjustment of portfolio which I have described to you before, i.e. the fact that we are in Europe, I repeat trying to adjust what we are, our proposition to the consumer, by adding products with better value added, better formulation, better packs but as well the price positioning which is more fitting to what European consumers are looking for. And this has led to a negative price and mix of 1%. This has led as well to positive volume growth, to an acceleration of volume growth which has gone from 0.5% to 3.6%.

Now a few points about that. When I'm talking of price and mix being negative I'm talking of Europe exclusively. I'm not talking of the rest of the geographies which have remained from that standpoint.

Second thing, for those who have in mind the reset episode of 2008/2009, we are not at all talking of things of the same magnitude. We are not talking at all of things of the same form first of all, because we are not talking of price cuts or very significant promotion. We are talking of an adjustment more like the one I just described to you. And we are not talking of the same magnitude in the sense that this minus 1% is unlikely to grow much further. And what you should expect for the quarters to come is things to stay around that or gradually improve, but not to go to the levels which we have seen for the reset which went down to minus 4% or 5%. So that's the Dairy equation which is obviously showing that we are taking a lot of actions in Europe on that.

Regarding innovation I'm not going to come back on that. I just encourage you if you go to Mexico and have a lot of chili to try and drink Benegastro because that will maybe help you have very nice holidays in this country.

Waters, a continued strong performance and the weather has not been precisely very nice. But I think what you see here is demonstrating that the reliance of Waters to the Western European business is far less important than it was in the past. Asia and Aquadrinks have kept outperforming. Europe has remained soft obviously on the back of poor weather conditions but with market share gains and that's important to emphasize. And the market shares as written below have been growing or stable in most of our markets.

You all know the Baby and Me campaign which is a tremendous success again. And for the rest we've been progressing in expanding the range in our aquadrinks, not only in countries where we are pushing then very hard to develop, i.e. Asia, China, Indonesia, but also Mexico very much and Brazil but also in some other countries like Poland and Spain.

Baby, outstanding dynamics again. I think it was clear for everyone that Q1 was a bit exceptional because of the positioning of Chinese New Year, but also the close of the strong sales from Europe to Asian markets, which have remained in place. So we keep having a performance which is made of A, strong underlying demand trends which would probably put Baby at 10% around plus or minus and an element of over-performance which is this 3.5% which you see on top to make it short and broad, which corresponds to the fact that we still see a demand from Asia for European products which is strong.

I have said that several times and I'm just going to repeat it, long term we see China and Asia as markets with a very strong and sustainable growth profile but we also see some ups and downs building. And there's been illustration of that in the news flow in the past few weeks. We are definitely prepared to it and managing it.





Outside Asia, again to flag the very strong progress we've made in some geographies and in particular in Latin America. In Brazil, we were basically nowhere four years ago. We are progressively building market share. And on the back of the sustainable business we keep having double-digit growth but very, very strong double-digit growth.

I'll end up with Medical from the sales part which has delivered a soft performance for this quarter at 4.7% top line. This reflects the dual trend again, very strong growth, double-digit growth outside Europe and a Europe which continued to be under pressure of the reimbursement. We know what the answer to it is. We know it's OTX and we keep developing it. It just takes time. And therefore we expect the performance of H1 overall to remain the same for probably the rest of the year. And meanwhile, of course we keep working on the development of Fortifit, Souvenaid and a few other products which we want to build in the appropriate manner in several markets. We keep adding, of course, offers with a view to differentiate from consumers.

So that's for the sales. I'm going to quickly go to the margins now. You know this table. It shows the total operating profit of the group which is EUR1,184m for this first half. This is made of two series of elements, one which is called the trading operating income EUR1,475b. And the other one is other operating items with negative EUR291m which obviously this year is very strong because it corresponds to the costs, the first provision for the booking which has been booked for the cost of the EUR200m cost saving plans. So out of this EUR290m, this is the vast majority.

Out of that, the trading operating income therefore is EUR1,475m and that gives a margin of 13.34% which is down 51 bps in reported terms with some scope elements negative. And this is due to the addition of Central Laitiere primarily, which level of margin is below the margin of the Group and with some positive element of ForEx because the depreciation of currencies has been in average on businesses with a narrower level of margin than the average level of the Group. But the bulk of it is obviously like-for-like and this is I think a very important slide to understand again where we are coming from and going to.

If you look at the same for the full year, you will see something which is very similar with pricing and mix and leverage, so growth altogether which is indeed providing leverage. Wherever we have growth we have leverage and this is true in the US, this is true in Brazil, this is true in the CIS, this is true in many, many places. In front of that, we've had higher-than-expected input costs but a significant portion of that has been erased by productivity. And the important factor has been the deleverage which you see under the current -- other COGS, the deleverage of Europe which continues to hurt the European, the Western European margin.

So, of course, this was expected during the first half because we knew we will have to go and negotiate with the unions the modalities of the cost saving plan, but now we'll have to take action to fix that with the prospective of stabilizing European margins by the end of 2014 and therefore having the ability to go back to profitable growth in the Group by 2014 overall.

By division it very much corresponds to what I said, i.e. what has been weighing on the Group has been Fresh Dairy in Europe and therefore logically you find negative margin evolution in Fresh Dairy and in Europe. Waters, we have been doing some strategic investments in Latin America to develop and fuel the business and therefore you have a negative number which you find in ALMA as well.

Baby Nutrition has continued to be very strong with 43 bps margin development. CIS and Noram as well has been very strong, Russia and the Danone business. While the Medical Nutrition business has been recovering a bit, even though the top line was not excellent from the level of margin last year, which was pretty low. So, all that gives you a minus 49 bps.

If you want to go from operating income to net income, the two first columns show you the underlying parts and then you have the non-current items. I'll start with the non-current items where you have the minus EUR291m which are essentially the cost of the plan, the EUR200m saving plan. Below there are two elements which correspond to the acquisition of the majority stake in Morocco. A, we have disposed of a holding we had been having for long in ONA which then became SNI and that's been giving us a capital gain of EUR52m on the total financial expenses. And B, on the net income of affiliates we have for accounting reasons made a gain as well on the disposal of the minority stake of Central Laitiere before we reacquired the majority. So Morocco is giving you most of the positive elements which you see. And which altogether allow us to have non-recurring items which are positive by close to EUR100m. This is the non-recurring part.





If you look at the recurring part you will see an increase in the financial expenses, which basically you will find the reverse or the opposite or the counterpart in the number of shares and therefore this is neutral to positive to the EPS -- in fact positive to the EPS. And income tax which is increasing by EUR50m and that's 3 to 4 points of effective tax rates and I'll come back on that. And other lines which are not moving very significantly for a net income which is going down globally from EUR911m to EUR873m.

On taxes we're moving up from 26.7% to 30.3% underlying. This is reflecting essentially two things; A, the dividend of 3% in France, which has been established in France, and B, the limitation of the deductibility of the financial interest which is hurting us this year again. So altogether that made our tax rate jump to 30% from now and in the absence of any dramatic very significant additional measures in our key countries we expect to be able to maintain this rate at this level.

So underlying net income goes from EUR911m to EUR873m. The fully-diluted number of shares is decreasing as well. So the minus 4 at the top is mitigated by plus 2 in the middle to give you a minus 2 at the level of fully-diluted underlying EPS from EUR1.51 to EUR1.48. And you see that this minus 2 is predominantly explained by currencies with a minus 2.5 which is basically the one you add at the level of sales. Scope effect is flat and the like-for-like effect is basically flat. So it means that ex-FX we are stable in terms of underlying EPS on the back of the margin and tax for the most of it.

Cash bridge from a trading operating income of EUR1,475m, taxes payment has been important as well, EUR400m. Working capital has been negative as we are facing negative mix issues but also some seasonality issues. CapEx has been reasonable for the first half EUR454m which is slightly above 4% of our sales. And that gives you a free cash flow which is EUR714m before the cash out non-recurring corresponding to the EUR200m cost saving plan.

Again, as I told you, we keep working on the cash. Working capital we certainly have a lot of opportunities in emerging markets and we keep working on it. CapEx, as I said in previous slides, has remained low in the first half, it will accelerate in the second half as we have many projects which we need to fuel.

This cash flow has been used essentially for two things; A, to pay dividends and buy back shares, that's a total of EUR1.4b for the first half and B, for a different M&A transaction on top of the put option cancellation which took place at the very beginning of the year, that's something new already. And the conclusion of the put option with respect to Centrale Laitiere which I told you during this transaction.

On top of that we had cash out for Morocco, for China with the acquisition of the 4% stake in Mengniu but also Happy Family and Turkey and therefore we have been investing some money during this first half to reinforce the quality of the perimeter of the Group for a total change in net debt of negative EUR2b which brings the debt to EUR8.2b, still very, very much in line with what we have targeted and what the targets are for credit rating we have. In fact, we had some room at the end of December and we've been using that between share buyback, dividend and acquisition. We know from a metric perspective that's a level which is very much the one we should be at.

In terms of balance sheet management, we have been buying back shares, you know that already, in the month of April for 2.3m shares to be exact and we did have at the end of June EUR49m of treasury shares representing 7.8% of the Company's share capital. We have been cancelling some of them, this has been decided by the Board of Directors, in order to get some ability to buy again and as a result of that our share capital has decreased and is now amounting to 638m shares now.

So that's really what I wanted to say, to be a bit exhaustive, sorry, about this H1. Let me repeat the outlook. Considering everything I said we confirm our 2013 objectives, sales growth of at least 5%, trading operating margin which will be for the year between minus 30 and minus 50 and free cash flow excluding exceptional items at around EUR2b. Again the the most important takeaway for me in this first half is that we are on track. We are on track with the objectives which are on the right of the screen which is to go back to strong sustainable profitable growth and the whole of H2 will be dedicated to complete the actions and keep being on this trajectory.

That's all for me. Thanks very much for your time and patience. It has been a bit long today and we take some questions now.



## QUESTIONS AND ANSWERS

### Operator

(Operator Instructions).

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### Jeremy Fialko - Redburn Partners - Analyst

Jeremy Fialko, Redburn, here. Two questions. First of all, can you talk about European Dairy, what you think the prospects are of your sales actually sequentially increasing in that market or do you think that sequentially stable is where you are going to be in the second half?

And then also on the second-half margin, if you can talk through some of the moving parts here. So obviously you've got some of your savings coming through but at the same time you've got input cost pressure and you've got the impact of the price reductions in the Chinese baby food market. So if you could talk about some of those and what you think the prospects of the H2 margin being a better outcome than the first half? Thanks.

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### Pierre-Andre Terisse - Danone SA - CFO

Thank you. At the end of the day the goal in Euro Dairy is to find some growth. I'm not saying that our objective is to grow again by even mid single-digit, at least not immediately, that would be unreasonable; our first goal is to stabilize businesses and then our second goal is to start growing them again. There is one example which has taken place in H1 which has been very much in line with that i.e. Portugal has first stabilized and then grown; it's been growing in the second quarter.

So I told you already when it had stabilized in the first quarter that I was very careful with that and I wanted to make sure that we had confirmation of it. We have had it during the second quarter and I will tell you that I need to have confirmation of that but basically it's going in the right direction. So I think what we've done in Portugal, what probably is [viable] only in Portugal for what it is but is giving some indication that we can probably grow this business low single-digit.

But it takes time and not all the countries will follow at the same pace. So the UK is clearly doing well; it's a bit of an exception. And then if you take the others, there are some in which we have signs of improvement, some others in which we have less signs of improvement, and we need to keep them progressing. Overall, if you look at H2 I would not expect them to grow overall, if I take them altogether. I would expect them to stabilize sequentially and therefore comparing to bases which are better to show an improvement in reported performance or in like-for-like performance.

On the margin of H2, the elements you've mentioned are indeed going to be present. I can't predict exactly what the evolution of the input costs is going to be. It seems that there has been some stabilization which is good but we need to keep monitoring it. The savings, we'll do everything we can to have it fast but at the same time we want to make sure that we are setting up solutions which are going to be here for good and therefore last for not only this year but next year and the following one. And there is indeed this price reduction in China which will have some impact but manageable impact on the overall good equation.

I think if I take all that into account I'm not willing to be more precise than what I've said and what I've said is that we will be in H2 at least at the same level of margin as H1 and we are obviously trying to get more than that. And for sure the savings are going to be an element of it.

Warren and then Eileen. Warren?

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### Warren Ackerman - Societe Generale - Analyst

Good morning. It's Warren Ackerman at SG. Pierre-Andre, just carrying on on Chinese theme, obviously a lot of news flow on this in the last few weeks, I'm just guessing, how should we think about modeling this? If I assume China is, I don't know, 20% of overall baby and pricing down on



average 10%, I think you said 5% to 20%, if you say 10% average, should we then think of a minus 2% price mix impact from China baby from Q3 onwards? Would that be a sensible way of thinking about it?

And then more broadly if everybody's bringing down pricing on average 10% in China, I know some companies are more, some companies are less, but what do you think volumes do? Do you think volumes increase as formula becomes more affordable or do volumes not react because the number of babies born is the same, i.e. what is the volume elasticity of the lower pricing, what's your best guess? I know it's early days but if you can give us any kind of idea on that I think it would be helpful.

Then secondly just coming back to this other COGS line on the margin bridge, down 135 basis points, I'm just a bit confused about that because if I look at the European margins which were down I think 120 basis points like-for-like and we know Europe is roughly 38% of the Group, if I gross that up that would be a minus 40 bps impact from other COGS. So, I was wondering how you get to the minus 135. Is that just Europe deleveraging or are there other things in the other COGS line? That would be helpful. Thank you.

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**Pierre-Andre Terisse** - Danone SA - CFO

Okay. I'll start with that maybe. It's essentially that. There is some elements as well of fuel addition because you all have seen that on the right of the same chart you have a positive 47bps of A&P if I'm not mistaken. But it reflects the fact that we are not looking at investing in our markets the same way or the simplistic way which used to be by just looking at A&P. When I presented you a chart a bit before that I'm telling you that we are investing in packaging to make the packaging more attractive; we're investing in recipes to make the recipes more attractive. All that has an impact on COGS and costs and depreciation and that's part of the effect you can see on the minus 135 bps. So part of it is essentially, and we have not modified the way we present it usually not to trouble too much things but part of it is in effect investments behind our brands.

Now this is only a fraction of it. The big majority remains where I've said. From what you commented I would just say two things; A, that Europe is more than 38% from an operating income standpoint, it is 38% in sales but more in terms of operating income, B, in Europe you have part of the portfolio which is growing and part of the portfolio which is not growing and the part of the portfolio which is not growing is deleveraging a lot, that's Dairy Europe. And basically when you see Dairy Europe negative -- sorry Dairy negative 128 bps and Europe negative 118 bps, in Dairy you also have the US, Brazil and the CIS which are growing which means that Dairy Europe is deleveraging more than what you see on total Dairy and that's impacting Europe.

So I don't know if I'm giving it clear to you but it means basically that in Europe we have businesses which have grown and Baby is a very obvious example and this is why for us, and I keep repeating it, I know there is nothing new, just the fact that we have achieved a negotiation but I keep repeating that putting in place this cost saving plan is absolutely essential and that's going to be the big objective of the second half but we are definitely committed to it.

So that's for the negative 135 bps and a confirmation from me that the big majority of it comes from the deleveraging of Dairy in Europe.

On China, I think I did during one of the conferences this spring say that -- and even during Q1, that we fundamentally are and have every reason to be positive about the prospects for growth in China because there is demand, because people are having more money and therefore are willing to get more premium and better quality products, because we are extremely well established in China, because we have been acting in a very responsible way all along, including at the time of the melamine crisis. We chose not to increase our price when there was not enough or too much demand on the market. So for all these reasons I really see no motive not to be positive. And by the way we have seen that besides this particular case or this business we are trying as well to step up our level of presence in China and be more involved at all levels of the society.

Now because this is on one hand very sensitive for obvious public reasons, this is about kids in China, and because there has been a development of the market which sometimes has been a bit erratic and going in all directions, we are today entering a phase which is going to be a phase of blending I would say of this market. So there have been ups and there's probably going to be some downs. But if you had asked me six months ago or one year ago I would have told you this was the case.



So it doesn't change fundamentally anything to our vision of the Chinese market. It doesn't change anything to the fact that we think we need to be present local, abroad; we need to be present with international brands, local brands; we need to be present with what we call Blue House, Red House which is a scientific positioning or an emotional positioning, answering the mother's needs; we need to be present alongside the authorities to help them deal with the matter of public health. And by doing all that we will keep making this category attractive long term.

So I'm sure, I'm absolutely clear it doesn't help you to model the performance in the coming quarters. Just think about what I said. To me the central thing is that not only China but worldwide the performance of Baby has been since the acquisition of Numico recurrently at the level of 9%, 10%, 11%. I think this is the core of it and around that there can be plus or minus a few points but that's basically it.

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**Warren Ackerman** - *Societe Generale - Analyst*

On skimmed milk powder, I think you've said before that you're hedged until the year-end on the powder side. So if the pricing's coming down in China but your input costs are going up on powder, does it mean that profitability of China Baby that we've all thought was well above the average, is that something that going forward, whilst the top line may still be interesting the profitability of the category structurally starts to come down a bit? Would you -- how do you think about that?

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**Pierre-Andre Terisse** - *Danone SA - CFO*

I think it will keep -- as long as -- I think it will keep reasonably interesting I would say. And the second thing is that this is absolutely, and we say that and I repeat it, manageable for the Group and I basically go back to the question of Dairy. Between this and this and between all these elements what I'm saying is that H2 margin target for us is at least minus 50 bps and we are trying to get a bit more, taking also this into account.

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**Eileen Khoo** - *Morgan Stanley - Analyst*

Hi there. Eileen from Morgan Stanley. Two questions, Pierre-Andre. The first one's just a bit of a follow-up on China. You talk about the impact being manageable. One of your competitors also said last week that the industry could bring down promotional spend in China in order to manage margins if need be. Would you agree with that view? And also can you update us on what your actual underlying volume growth was in China in the second quarter?

Second question on CapEx and A&P, where has the increase in A&P focused on and then on CapEx (technical difficulty).

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**Pierre-Andre Terisse** - *Danone SA - CFO*

On the last one look at the growth we have been delivering in the rest of the world last year and look at what we have been delivering this first half. It's been in both cases double-digit, it's been 13.5% this first half, I think it's been probably the same number or something very similar for the full year last year. So you can imagine we are in many areas reaching issues of capacity which we do anticipate by the way and we have to put CapEx in front of. This is all the aquadrinks basically, very much in Asia but also in Latin America. This is as well waters in Asia which we keep growing. You see the aquadrinks but don't forget that there is water and water for instance keeps growing very much in Asia. This is Baby overall. I'm saying overall, everywhere. We are sometimes in the situation of capacity shortage so we have to increase it.

This is the US, you have mentioned it, and for the time being we have a pipe which is going to allow us to keep increasing our capacity on the Greek side. This is Russia. Russia development has been very strong I would say in certain regions volume-wise. There have been some regions in which we have achieved not 10% growth but 20% growth. So as you can imagine, given that this is essentially volume driven it requires us to put more capital expenditure. So there is a number of areas. There's not only one point of focus, there's a number of areas in which we have to invest. We obviously do it very carefully, very mindfully, but at the same time it's important that we keep with these dynamics and the good thing is that our cash generation capability allows us to cover it. So it's not like we would have been having problems of cash and therefore we will be a bit struggling to find cash to fuel CapEx. It's not the case. Our cash flow side gives us this possibility.

A&P, the same thing as what I've been saying depending on the countries but basically building the brand Prostokvashino keeps being important. That's very important for us. Building the brand Thema in Russia is very important for us. Keep building brands in Mexico in water in a context which has become for the past one year now more competitive is important. Building B'lue in India is important. So there is a number of areas in which we open it and at the same time we also need to be able to spend less A&P in the places where we think the opportunity is not going to react the same way.

China. In a market which is really booming there's obviously a lot of competition and a lot of promotions and a lot of -- many things. So, yes, part of the normalization of the market probably is going to be through a more fair level of promotional intensity. So that's a level which is going to compensate the price action. But in fact it's not compensating it, it's going with it in the sense of having the market in a more normal shape, better balanced between volume and value and not only driven by mix and price which we all know long term is not something which is sustainable.

And on the growth I would not make comment. We keep growing well, we've kept growing well in this market in the second quarter, not growing to the sky but generating very good growth level, sustainable.

We'll take questions from the phone.

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#### **Operator**

We will now take a question from Celine Pannuti from JP Morgan. Please go ahead.

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#### **Celine Pannuti - JP Morgan - Analyst**

Yes, good morning. I have two questions. My first one is on the dairy market. First of all, can you talk about what is your pricing outlook in dairy specifically? And the other question I have on dairy, if you could give us a bit of a flavor whether there was a difference in the double-digit performance between CIS and NORAM and whether in NORAM -- what's the market? We've seen that there has been a lot of promotion. Are you seeing that continuing in the marketplace or was that just a quarterly -- one of your competitors having a quarterly promotion there?

And my second question is on the emerging markets which for you have remained very strong. Some of other staples are talking about a slowdown and obviously some countries like China, Lat Am have been mentioned. Obviously you are in specific categories but I would like to have your comments regarding that. Thank you.

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#### **Pierre-Andre Terisse - Danone SA - CFO**

Welcome. I hope I will answer appropriately to your questions because I'm not sure to have taken everything but if I don't, tell me. On the second question maybe first which is the emerging markets and the slowdown, I think the nature of our business, the fact that we have been present in a lot of these markets for a relatively short period of time, not 100 years or more like some of our competitors, puts us in a situation where we have more potential and where probably we have ranges which are more adapted to the current generation.

That's adding to the fact that we have portfolios which generally speaking are not only premium but going from affordable to premium is probably the reason why we are indeed in neither of the markets you have been mentioning, so not in China, not in Brazil, not in the CIS, not in Asia. In all these markets we've not seen a slowdown, what the Economist cover was showing this week. It doesn't mean that it's not going to impact us at some stage but frankly for the moment we are still performing well in these markets and I think it has to see with what I said before.

Maybe there is something which we have seen however and that's a bit more volatility. Not in the big markets but in some smaller markets. Egypt, for instance, is clearly a difficult market. Argentina, which is a large market but is a market which we said repeatedly was difficult, and it's become increasingly difficult as we go. And the evolution of the currency which I have been talking to you about internationally, Brazil and so on, that's not impacting us but somehow still it's impacting the number. So no slowdown for us. Maybe it will come but I think we have a model which is a bit different. A bit more volatility and we have to live with this but again from what I've shown I think this is manageable.



On the Dairy, I understood most of your question was about CIS, NORAM and in NORAM about the promos so I'll try to answer this part. The performance has been good in both markets, CIS and NORAM. In CIS I mentioned that we have some regions growing at 20%. Overall we've been growing double-digit in the second quarter. We keep building the brands and that's very important. We keep building Prostokvashino; we keep building as well the Danone brands, Activia and Actimel. Actimel has been positive in this market which is one of the few frankly speaking in Dairy. The team is really doing a good job. They keep working as well of course on productivity which is allowing them to keep fueling the business.

A lot of the performance has been volume driven. Now it's going to be for a part price driven because you probably know that the inflation of the cost of milk in Russia has accelerated and that we have taken a price increase in fact at the end of July by a few points and we'll take -- at the beginning of July sorry and we will see whether or not we need to take some more in the coming months. So it's likely that the performance is going to move from being volume driven to value driven. We are trying to control very much this equation in a context in which we have significantly changed the portfolio and the organization of the Company since its acquisition in 2010 and therefore we feel much less vulnerable than we were at that time. But CIS is basically doing very fine, gaining market share as well.

North America, it's been doing well, it's been delivering a strong performance, high single-digit. The market has become, you're right, a bit more competitive. That's not something which is a surprise. There's been many of you telling me that there's going to be a price war in the US at the beginning of the year and I think I consistently answered that it's very difficult to expect a price war but it was likely that we would get some more promotional intensity and that's what we have been seeing in this first half which has not prevented us from developing and growing nicely. We don't expect that to fundamentally change so we think there's going to be probably a bit more promotion going forward than there has been in the Greek segment for the past few years now.

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**Celine Pannuti** - *JP Morgan - Analyst*

Good, thank you so much.

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**Pierre-Andre Terisse** - *Danone SA - CFO*

You're welcome. We have two others on the phone before we come back to the room. Jon I think was the next one.

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**Jon Cox** - *Kepler Cheuvreux - Analyst*

Yes, good morning. Jon Cox with Kepler Cheuvreux in Zurich. Congratulations on those top-line figures. They look very impressive indeed. I have a couple of questions for you. The first one just on cash flow generation, you're talking about a negative geographical mix impacting your cash flow generation. Should we think this will be an ongoing factor i.e. potentially results might actually start to improve next year in terms of profitability and you've got the growth but because all of the growth is coming from emerging markets, the free cash flow generation we'll see going forward won't be as good as it has been in the past? Or is there a seasonal impact because obviously you are committing to your EUR2b free cash flow target? That's my first question.

Just on the second question, you gave this infamous guidance once upon a time just on margin, splitting the world into the Western Europe and CIS US and emerging. At that time you were talking about Western Europe coming down 200 to 250 basis points whereas CIS and US would come up 100 to 150 and the rest of emerging by 50 to 100. What has changed because basically what you're delivering doesn't look anything like those former targets? Is it the fact that Europe is probably not quite as bad as you expected in terms of the compression on the margin and the rest of the world isn't so good? Or are you using the fact that Western Europe isn't quite as bad to actually spend a lot more on marketing in emerging and CIS and the US to drive this impressive top line growth? Thank you.





**Pierre-Andre Terisse** - *Danone SA - CFO*

You're welcome. So interesting questions. On the negative working capital first, is it going to stay? The answer is no. The answer is no because we do expect the negative mix, we do expect to improve the performance of Western Europe and therefore the mix is going to be playing less against us. But more importantly, as I told you we have decided to take specific actions with respect to working capital of emerging markets and we did not wait in fact for this first half to do that but for the past two years we've been working on that, for Unimilk for instance which we have been bringing from a negative cash flow position to positive cash flow position and then to a negative working capital position. So we still have things to do but I think you won't recognize that we have the track record which allows us to be pretty confident in our ability to do it.

This is the case for Russia but there are other countries as well which gradually as they have grown have taken more importance and we need perhaps to be a bit more aggressive in the way we manage working capital. I'm talking of -- I'm thinking of Latin America. I'm even thinking of the US and we need to push a bit more on that. So there is no fatality. If your question is are you going to sustain the pace of growth of free cash flow which you have seen between 2009 and 2010 where it has been basically almost doubling, the answer is, no, but working capital is going to keep being a very important tool in the profile of the Group and in the development of the Group and definitely this is not something which is this negative mix which is going to remain in place medium term.

On the margins, there's two elements. I would say that there's no fundamental change basically. Things are going in a way which is not so surprising. CIS keeps being very robust. In the US we had very strong and probably non-sustainable step-ups last year and we've been clear since the beginning of the year that probably they will need to consolidate at these levels before they can keep going on. And this is consistent with the fact that the market is becoming a bit more promotional. So nothing to worry about. The performance is very robust and they remain a growth driver, not only of top line but of margin medium term. Just this year and in particular during the first half we've been having dynamics which are not the same as last year.

For the rest of the world, as I told you we have been very much during this first half working fixing Europe but also at fueling the other geographies. The rest of the world for us and the emerging world in particular remains made of many engines which are generating profitable growth. It is itself an engine which is generating profitable growth and I think you will see during the second half that this is absolutely true looking at a multi-half basis. So in other words, you should not draw conclusions from this first half in terms of ability from the emerging world to generate margins. The engines are absolutely working very well.

As for Europe, we need to improve the situation. There was some improvement in the first half which was not really due to fixing the deleveraging but more to the fact that the Baby business was particularly strong in the first half. But we'll need to attack the Dairy part which is obviously the core of it and the most important part of it.

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**Jon Cox** - *Kepler Cheuvreux - Analyst*

Great. Very helpful. Thank you.

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**Pierre-Andre Terisse** - *Danone SA - CFO*

Next one on the phone and then we'll go back to the room.

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**Operator**

We will take a question from Pierre Tegner from Natixis. Please go ahead.

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**Pierre-Andre Terisse** - *Danone SA - CFO*

Mr. Tegner, hello.





**Pierre Tegner** - *Natixis - Analyst*

Good morning, everyone. I have a question on working capital requirement as a follow-up to what you said and another one on aquadrinks. On working capital requirement are you referring to a negative mix effect geographically due to the fact that you have less fresh dairy business in emerging markets i.e. excluding CIS and NORAM or are there specific elements that structurally explain the fact that you have working capital requirements less optimized than elsewhere?

And secondly on aquadrinks, could you remind us what is the weight of aquadrinks and could you come back on the rationale of keeping aquadrinks versus your strategy of healthy foods to the larger number of people? Thanks.

**Pierre-Andre Terisse** - *Danone SA - CFO*

Because aquadrinks are healthy. I'll explain a bit on it. First, working capital and mix -- no it's not a factor of their impact. If you look at the working capital in percentage of sales you will see that it's very much the same now between Baby, Waters and Dairy. There must be maybe one point of difference but nothing major. The only one which has a different working capital profile is Medical. So no, that's not a question of business, that's really a question of geography and perhaps it's a question of priority as well because when you grow 20%, 15%, when you have brands to develop, when you have new things to address you focus less on improving your working capital because you have many, many other things to do.

So I'm not saying that there is no growth and it will be the right time for us to focus on working capital but maybe as a transversal initiative we'll need to focus a bit more on these markets which have been growing very fast, which keep growing very fast, but we need to make some changes to allow that this is generating as well more cash and coming back in terms of profile to the profile we have in Europe. So more a question of geography and profile of growth than a question of business.

Aquadrinks, 30% of our water sales. I was not kidding really when I was saying that it's healthy. In most cases people buy it because it does provide at the same time taste plus the assurance of healthy spring water or mineral water plus a very low content in sugar. So of course you could argue that aquadrinks are containing more sugar than water and therefore that this is bad for health but it's a relative question. A lot of our consumers are taking aquadrinks not really to replace water but because they want to have something more exciting and at the same time they want to drink something which contains less sugars than the alternatives they are facing every day or they are making every day in this part. And this is why aquadrinks is really at the heart of the health strategy of Danone. It's really consistent. It's because it provides an opportunity for people to keep drinking nice things but in a healthier manner than most traditional soft drinks. I hope I'm convincing. I'm a fan anyway; I'm drinking that all the time and not too bad. Joking.

I think that's all. We'll take -- thank you, Pierre. We'll take one question in the room and then we'll have to stop. Apologies for that but because we're running out of time.

**James Targett** - *Berenberg - Analyst*

Hi there. It's James Targett from Berenberg. Just a question on -- two questions on Europe actually. Just looking at margins first of all, so you talk about wanting to stabilize -- aiming to stabilize margins in Europe next year. I just wonder if you -- a lot of that's coming from cost savings obviously. If we look at the gross margin in Europe over what sort of time frame looking at mix changes and pricing do you think you can stabilize the gross margin in Europe?

And then secondly just on the impact on the extra trading day you called out for Europe as well?

**Pierre-Andre Terisse** - *Danone SA - CFO*

Sorry, the impact of?



**James Targett** - Berenberg - Analyst

The extra trading day in Europe, if you could quantify that, if relevant.

**Pierre-Andre Terisse** - Danone SA - CFO

Well, it basically explains half of the progress, from minus five in Q1 to minus three in Q2 you would have 2 points of improvement and half of that is due to the trading day. The rest would be organic performance if I may say. I think gross margin wise that's going to take a bit more time than just 2013. We'll need to have a look at -- we'll need to see improvements meaning no increase of the gross margin but some first result in terms of stabilizing gross margin as soon as next year and then we need to continue working. But it's clearly not something which is for now. The choice we've made is really to first simplify the business, chase costs in terms of overhead organization and at the same time to reposition the portfolio. Once we've done all this -- these two things, stabilize the portfolio in Europe -- sorry, the operating margin in Europe we'll need as well, that's very clear to work on the gross margin.

Okay, we'll have to stop. Thank you very, very much for taking the time. It's late in the season. For those who go on leave have a good vacation, especially for the French who take very long ones, and for the others good luck and we'll be back in September. Thank you.

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