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BN.PA - Q1 2014 Danone SA Sales Conference Call

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OVERVIEW:

BN.PA reported 1Q14 results. Expects 2014 topline growth to be 4.5-5.5%.



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PRESENTATION

Operator

Good day, and welcome to the Danone 2014 first-quarter sales conference call. Today's conference is being recorded. At this time, I would like to turn the conference over to Mr. Pierre-Andre Terisse, Chief Financial Officer. Please go ahead.

Pierre-Andre Terisse - *Danone SA - CFO*

Thank you, and good morning to all. Welcome from Paris.

I'm in the office of Danone, together with Regis and Marion. And we're going to go through the presentation which you have on the website. I'll try as much as possible to refer to the page numbers.

First, I'll just ask you to go through the Safe Harbor statement, page 2, and to read that, of course, as usual.

I'm going to start with page 3 and maybe a summary before we go into details of this quarter. Trying to find a formula to reflect it, I would say that this is showing solid progress amidst volatility, and in fact you can read those elements on the page 3.

You can read the volatility very clearly with the negative 8.9% foreign exchange currency effect, where the ruble has been adding to the Argentinean peso, the Brazilian real, the Indonesian rupiah negative effects to amplify the foreign exchange effect versus the previous quarter at minus 8.9%.

The scope and others are positive 1.5% and they reflect the addition of the various entry of perimeter which we have done last year, including Centrale Laitiere and Happy Family, but also Sirma and YoCrunch.

The organic performance, the like-for-like evolution of our sales is positive 2.2%, and I believe reflects solid progress, the one I was mentioning. It clearly shows an equation which is increasingly price increase driven or value driven. It does reflect the price increases which we have decided to pass throughout the quarter in various geographies, and I will come back on that.



It does reflect the steps we have taken to manage both top line and margins, trying to do it in a sustainable manner. It does reflect positive mix and significant progress on the mix in several regions. I will come back on that as well. And it obviously does translate into negative volume at minus 1.9%.

But overall, an equation which, as I said, is now driven by value, and will probably remain so in the coming quarters.

If you move to page 4, you will see that sequentially we are talking of the lowest quarter since the beginning of 2012. This is obviously reflecting high comps in baby, and in fact high comps twice; one because we are talking of a base of comparison which is pre-Fonterra, and two because we had a very strong performance of baby division in the first quarter of last year, with 17%.

This should not hide the fact that the performance is very much in line with what we expected for Q1. And we do expect that this is going to be the bottom of our cycles in terms of top line evolution, with progress from now on, and in particular, obviously, in the second half of this year, when the base of comparison is going to be completely different.

Geographically, page 5, I think the numbers confirm very much the trend which had been seen in the previous quarter. The EU, first, is improving and for the first time since 2011 is positive at plus 0.5% throughout all the businesses, with one business which remains at minus 3%; this is fresh dairy, yet progressing, and I will come back on that.

CIS and North America are solid at close to 8% top line growth, and again with different dynamics within this perimeter. I will come back on that.

ALMA, which is the emerging world, is overall low at plus 0.5%, but it is primarily the reflection of the baby Asia comparison base. If you look at the rest of ALMA, i.e. without baby Asia comps, you will see that it's in line with Q4 at 12.5%, with a robust growth engine performing well. I have in mind the Aquadrinks, of course; I have in mind Brazil, all businesses, Africa, Middle East, and baby in emerging markets more globally.

It does reflect, as well, a few more difficult situations, and I would primarily mention Argentina, which has suffered a further accelerated devaluation in the first -- in the course of Q1, impacting or participating to some slowdown of the ALMA performance of 12.5% here.

That's what I wanted to give you as a global overview of the business, and I will now move into the presentation by business line, starting with dairy, page 7.

So, fresh dairy, 3.9% growth, close to 4%. This is solid performance, a touch down versus the previous quarter, but again very solid. It's been very solid in key markets in particular. This is the case of the EU, of the CIS, of North America.

And the switch from volume to value is confirmed. You had already seen that in Q3 and Q4 of 2013. This is confirmed and amplified in Q1 of 2014, with negative volumes of 3.7% and a positive mix and price of 7.6%. And again, the equation is expected to last for several quarters, at least, this shape of equation.

If I move into the various geographies I've mentioned, fresh dairy Europe first, to start with, page 8. The improvement continues as planned. We're now back to minus 3%, up from minus 6% in the previous quarter, and a value element which has come to zero versus negative in the previous quarter.

There have been a few more launches this quarter in the process of renovation of the range. In Spain you have two examples on the chart, with some indulgent and traditional products with Veloute and Flan de Queso, and with Danio, which is progressively being rolled out in different countries in Europe and has had a very good start in France, as those living in these countries may have seen in the shelf.

In terms of market share, this is a quarter which has shown some progress as well. This is the case in Spain, Portugal and France and the UK, which has been holding up well, basically. Sorry, in Spain, Portugal and the UK.

With respect to France, Germany and Italy, there's been progress, as you can see on the chart. With respect to the two last countries, which are Germany and Italy, the situation remains, however, under pressure and we still have some work to do to make them come and join the rest of the pack in stable to positive territory.

We passed some pricing in Europe as well, as a result of the inflation of the cost of milk. And the reaction of the consumer and the retail has been pretty good, with no inflection on the volumes.

To finish on Europe, we are still working and there's still a lot of things to be done. This is true with respect to the evolution of the portfolio. We continue working on renovation, innovation and adaptation of the portfolio to the new environment.

This is true, as well, in terms of cost reduction, and we keep working on a number of initiatives in order to lower our cost base. All together, we need to keep working to make Europe sustainably competitive, but I would say that we are in a very, very good direction and doing progress very much in line with what we had as a plan for the beginning of this year.

I'll move to the next page, page 9, with fresh dairy US, where this quarter has been a bit of a paradox, a paradox because it has shown very clearly further market share improvements and at the same time this has taken place in a context of growth which has been slow at the beginning of the quarter and progressively accelerating as we have been moving in the quarter. And in March in particular, we've reached back a level of high single-digits, which was not the case at the beginning of the year.

The Greek segment continues to progress. It's now 50%, 49-point-something, of the segment in value terms, so we are very much at 50% and continue progressing. On this segment we have gained the co-leadership.

This is thanks to the performance of the overall portfolio, but in particular one brand which is Light & Fit Greek, which as you can see on the right-hand side, sorry, of the chart is now reaching levels which are comparable to Oikos. So we're operating on the US Greek market with a portfolio which is complete.

And within this portfolio, with two brands which are performing very strongly, Oikos and Light & Fit Greek, this is clearly confirming our leadership on the overall category, which you can see on the top half of the page, on the left side.

And last, we continue innovating on this market with the launch of Danimals which has taken place in satisfactory condition at the beginning of the quarter.

So that's for the US, with a slow start and a gradual acceleration in a market in which we keep winning.

In the CIS, we clearly have two things happening at the same time, on the one hand an inflation which has been in excess of 30% now. We've reached some points at 35% plus. And even though there has been some recently positive signs of cooling down of this inflation, it remains very high. And this has led us to pass two additional price increases in February and March, for a total price increase which if you cumulate for the past 12 months is therefore in excess of 15% now.

This has obviously had a significant negative impact on the volumes, but specifically, in fact, on the volumes of the market entry brands, as well as on the volumes of the low value-added products. And this is in particular the case, as shown on this slide, of the fermented and milk.

On the contrary, and this is an extremely important fact, the volume has been up on our key brands and on the high value-added products. I'm thinking of Prostokvashino, which is up in volume, Activia, Tëma, Actimel, all up in volume. And therefore this has generated a significant mix up.

So we clearly have an equation which is going two ways. One is the passage of inflation and the weakness of low value-added products, and at the same time the strengthening of the value-added products and the key brands we are trying to develop.

This is shaping an agenda with three very clear priorities for the management of Danone CIS in the coming months and quarters, and they're sticking to it very much. One is working to save money on the milk, so trying to find ways to reduce and cap and limit the inflation of the cost of milk in Russia, and they are doing some progress against that now. Secondly, to adapt the cost base of our operation in Russia to their volume environment, and in particular in front of a lower volume demand on the milk and market entry brands, try to adapt and lower the fixed cost base.

And the last part is what we have been doing in these countries for the past several years now, which is showing a good result. This is continue building brands, and to building in particular the brands which are key in the development of our portfolio, Activia, Prostokvashino, Actimel and Tēma. So we'll continue to work on the strengthening of the portfolio in Russia in the second quarter.

I will finish with the fresh dairy products with selected innovations of Q1, page 11. We have not shown the European ones, which are on the European page, but the rest. And you can see that we keep -- there keeps to be a lot of innovation in our portfolio.

This is obviously extremely important in the reacceleration and the growth of fresh dairy. This is true in Europe and outside Europe. This is true in the US. You see Activia Greek Light, which has been launched this quarter. This is true in Canada, with Danino Greek, which is the Danimals version for this country. This is true, as well, in Russia, where an Activia Bilayer has been launched in a very indulgent form, and this is true in Latin America.

Overall, a lot of the innovation at the moment is coming from the Greek, on the one hand, so healthy food, and at the same time on the indulgent side, and this is giving pretty good results.

So that's what I wanted to say on dairy. I'll move to waters now, page 12. Well, basically we've continued to grow very solidly. The volume/value shape of the growth is very solid, with 5.4% volume growth and 3.5% value growth for 8.9%.

The [plain] (corrected by company after the call) water part is -- keeps being very resilient. Aquadrinks has been the one which continued to boost the performance in Europe and outside Europe, in all geographies. And the weight of Waters in Q1 is obviously low versus the rest of the year, and at the same level of performance it's going to increase as we move into the year, in Q2 and Q3.

In terms of the innovation, page 13, it continues, and it continues basically along the very same dimensions, which are for the water innovation and the premiumization. And I hope you have seen, and if not I invite you to see or to watch the advertising about "Baby and Me" with the Amazing Spiderman. You can find that on YouTube. This is a very, very good one, and continues to build the image of a brand which is extremely young, dynamic, modern and premium.

And at the same time, we innovate on the Aquadrinks. And there's been three launches in Asia this quarter; one in China with a one-liter version of Mizone, which is completing a range which was so far extremely narrow, and in Indonesia with the launch of two additional versions of Aquadrinks, Mizone Fres'in, which is very much the China mix adapted to Indonesia, so we'll have a second Mizone in Indonesia and this is the Fres'in version. And Levite under the brand Vit, which is playing on the juice side for Aquadrinks. So we'll keep in the year, in 2014, innovating on this dimension of the business.

Page 14, I'll move to baby nutrition, where we are basically on track with our plan. With respect to Asia, we keep recovering. First to mention Thailand, Singapore, Hong Kong are now close to being back to the previous level, to the pre-Fonterra crisis level. Malaysia and Vietnam are getting closer to it. New Zealand and China remain low, at levels which are ballpark in the range of 30%, but this is pretty much expected.

In China we have been re-launching several products, or launching several products. I will mention three.

Dumex mainstream has been re-launched at a discount to the previous version of Dumex, in order to have a wider reach within the country. At the same time or, sorry, a few weeks after, we have launched Dumex International, which on the contrary is playing at a premium, not at a discount to the previous Dumex, and which is a formula which is going to be made or sold in the main cities.

And the last part is Nutrilon Platinum, which has been launched at the beginning of the year in China. All those are showing a good start, with in addition Karicare, which is performing well.



And in China, which is going in the right direction, obviously you will understand that these are pretty early days and that we need to be careful in drawing conclusions, but we basically have succeeded in our first launches. Others will come. The reaction of the trade and the consumer is positive. So we're confident to continue moving in accordance with our plan.

In the rest of baby, it has continued, as you've seen, growing double digits, 13.3%, with elements of strength in Latin America, Africa, Middle East, Indonesia as well, and Europe, which is definitely in positive territory.

If you look at innovation, page 15, this is very much the axis we have been putting in place for the past few years now, which is continue building the Red House, on the one hand, and you have Dumex re-launch as well as Golden Gate in UK. The Blue House, and you see the example of Nutrilon Platinum. The specialties, with the example of Dumex Supermix for pregnant and lactating mothers in Thailand.

And we are, as well, progressively re-innovating and re-launching new products in the food area. I have in mind Bledina, launched in pouches in France this quarter.

Last division, medical, page 16. A sustained solid growth, 5.2%, with most of the growth coming from volume expansion, some growth coming from positive price/mix. A performance in Europe which has been solid, in particular in the UK, and a performance which all together has been specifically strong in the area of pediatrics.

And you have an example of products which have been fueling this growth, page 17, with the launch of Nutrini Creamy Fruit in three countries, in Germany, in the Netherlands and the UK. And the division, as the others, keeps innovating. You see Pro-Stat Sugar Free in the US, which is adult nutrition and elderly nutrition, and you see a metabolic disorder product being launched on the right side, worldwide, which is Lophlex LQ Juicy.

So that's really what I wanted to tell you about the various divisions. I'll end this call with page 19, 20, and 21. On page 19, to tell you that we are using very much this roadmap as the guide of our action this year. The four priorities you see on page 19 have been, and remain, the four priorities against which we not only work but monitor our progress.

I guess what is shown on page 19 indicates that we are moving in the right direction. This is the case of the EU, where the minus 3% in fresh dairy allows us to continue targeting a return to a balanced growth by the end of the year.

In the CIS and NORAM, close to 8%, high single-digit growth, in line with our objective for the year. We have challenges, as you have seen, in different markets, but we have built strong brands which are definitely a strong help to go through these environments.

In ALMA, 12.5% like-for-like sales growth excluding the eight recall markets, so that remains a strong engine for growth with some situations, some very specific situations to handle.

And last, I'll just mention about China. The sales are moving up according to plan. We've made good progress, and now we need to continue working.

In terms of guidance, page 20, we therefore reiterate our guidance for the year, which is 4.5% to 5.5% in terms of top line growth, a margin which we see stable plus or minus 20 basis points, and a free cash flow in the region of EUR1.5b, excluding exceptional items.

I think Q1 is as well showing that the de-balancing is going to be a reality. I do reiterate what I said during the full-year conference call, i.e. that we see a de-balancing in terms of top line of 3 points between H1 -- sorry, around the 4.5 to 5.5 points, between H1 and H2. And we see as well a de-balancing of 150 to 200 bps on the margin side, but we feel comfortable in those numbers and those objectives.

And we feel, obviously, comfortable as well in reaching, page 21, what is our agenda for the year, which is coming back to a strong, sustainable, profitable growth, obviously from the second half of this year. And I believe what we have achieved this quarter, in particular with respect to the performance of some of our key brands and mix, is showing that we are progressively building a healthy top line and a healthy margin business.

That's what I wanted to tell you for this quarter, and we will now take some time to answer your questions.

QUESTIONS AND ANSWERS

Operator

(Operator instructions). Warren Ackerman, Societe Generale.

Warren Ackerman - SG Securities - Analyst

Good morning, Pierre-Andre, Regis, Marion. Hope you're all well. I've got two questions. The first one, maybe if you could dig down into Russia in a bit more detail. Can you remind us of the split of the portfolio between basic fermented milk and the modern dairy within the portfolio? You said volumes were up on the modern dairy, but how much were volumes down in basic and the fermented portfolio?

And I was hoping you could be precise and tell us what the overall Russian volumes were in total, in Q1, and pricing, so we can get a feel for that.

And then, secondly, just turning to the US, again a similar question. Can you tell us what your US dairy volumes were in the first quarter and how much did the market growth slow? I think you said it recovered in March, but in the first two months it was quite slow. Can you say whether you've taken any pricing in US dairy or whether you intend to take pricing in the near future? Thank you.

Pierre-Andre Terisse - Danone SA - CFO

You're welcome. And yes, we're doing very fine with the help, in addition, of the sky, which is completely blue in Paris.

Jokes aside, Russia, the split is about two-thirds/one-third, one-third low value added and two-thirds high value added. The magnitude of the volume evolution has been negative double digits on the low value-added products and low single digits on the brands which have performed well.

So that's clearly -- again, as I was saying, that's clearly shaping a performance where we see all key brands resisting pretty well, and not only resisting but expanding for some of them, which is obviously generating several points of mix in the equation. And to me it means that we are in a healthy model.

It does put pressure on the low value-added products and market entry brands, which is not new but has become, obviously, stronger given the volume contraction I'm talking about. And that, for us, is a call to switch a little bit the work we'll have to do in the coming few quarters on productivity and efficiency.

So to me, again, as I said during the call, it really shapes the agenda, which is on the one hand we need to work more on productivity and we need to draw the consequences from this volume pressure on the management of our cost base with respect to low value-added products, so basically to reduce costs and to be more competitive to protect the profitability of these products.

And we need, absolutely, to continue what we are doing, which is great on the key brands, because what we are seeing this quarter and the reason why we are very proud of Q1, which on this side is good, is the pipe of innovation which has been built in the course of last year, which you can see on this presentation with Activia, with Activia Bilayer, for instance, which is clearly building a very healthy top line. And we need to keep strengthening that.

Prostokvashino has been growing 20% or more for the past at least two years, probably three years, and this is really helping to go through this period of very high inflation.



Then the last point is that, of course, we are probably coming to an end. We've seen a peak at 35%, 36% inflation in the cost of milk. We feel things are going a bit smoother now. We need to be careful, but I guess we have touched the extremes on the milk in this country.

So that's for Russia and the CIS overall, with only 1 point, 1-point-something point difference between Russia and the CIS, which is made by Ukraine, but it doesn't have a greater impact than the one I'm mentioning now.

In the US, volume are overall stable for the quarter, they're not growing. This reflects two things. The fact that, A, the shape of the growth of the market for the past few years has been high -- low single digit in volume and high single digit in value, because Greek is carrying a strong mix element, so that remains the case.

And as I said, we've had a specifically slow start of the year. This has been the case in January, a bit less so in February, and March has come back to normal. Difficult to attribute that to anything specific, certainly not to Easter, given we are talking of January, February. But basically March is showing a return to the previous element of equation, I mean the one of last year.

We've not passed yet any price increase, or rather we have not passed any price increase in Q1. We have been passing one price increase in the US at the beginning of Q2, and we'll need to monitor the effect. But I do not -- we are definitely not talking of the same context as the one we are discussing in Russia, of course. We are talking of low to mid-single-digit price increase, depending on whether you talk before or after promotion, so of the same magnitude as the one we have passing in some European countries, and we've seen volume reacting pretty well in these countries.

So definitely not the same context as Russia, but you're right; we have to monitor that in the coming few months [a bit on that].

Warren Ackerman - *SG Securities - Analyst*

Okay. Just to follow up, Pierre-Andre, obviously in the first quarter the consensus was looking for volumes to be flat, small up, and they're down 3.7%. Obviously the price mix is much higher. So just looking forward through the balance of the year, how do you expect the overall volume/value to shape up? Would you expect volumes overall this year in dairy to be up, given they're so down in Q1? Just in terms of modeling.

Pierre-Andre Terisse - *Danone SA - CFO*

We expected -- at the very end of last year, we expected the cost of milk to either -- to slow down, in reality. We didn't expect the inflation to be as strong as we have seen since the beginning of the year, so it's natural that this had led us to take pricing measures. This is something we've known for the past few weeks now.

So the volume decrease in this context is not surprising me. It's something I shared with some of you, most of you, in fact, in CAGE a few weeks ago. And what I do expect now, given the price increases we've passed in some of those markets, is volume to remain negative, at least for Q2. And we expect dairy to remain negative in the coming several quarters. And I would expect Q2 to be slightly more down, in fact, in terms of volume evolution versus what we have seen in Q1, before it probably does improve in Q3 and Q4.

Now, if you look at the Group, there is another contribution to the evolution of volume, and this is of course the base of comparison of Baby. Very clearly, this is going to progressively fade away, and in the second half it's going to be very different.

So dairy, the equation has changed. We had to adapt it, given the increase of cost of milk, and things are doing well. But of course, the consequence is that in some markets, and in particular in Russia, volumes are down and will remain down in the coming few quarters. For the Group, the Baby is obviously going to be a balancing element from H2.

Warren Ackerman - *SG Securities - Analyst*

Would you say volumes should be down in the US, given pricing's up at the beginning of Q2?



Pierre-Andre Terisse - *Danone SA - CFO*

Oh, sorry, just in the interest of the whole community, I'll stop here, we'll have other opportunities to answer your questions but we'll move to somebody else.

Warren Ackerman - *SG Securities - Analyst*

Okay. Thank you.

Pierre-Andre Terisse - *Danone SA - CFO*

Thanks. Bye.

Operator

Mitch Collett, Goldman Sachs.

Mitch Collett - *Goldman Sachs - Analyst*

Hi there. Two questions, please. Staying on the subject of input costs, I guess you said that input costs were slightly worse than you had anticipated at the start of the year. Does that imply, perhaps, that the top end of the guidance range for margin is going to be a bit of a challenge?

And secondly, can you give us an indication for what the dairy organic volume and value growth would have looked like if we strip out CIS, where most of the input cost impact was?

And then secondly, on ALMA, obviously the growth rate ex the eight recall markets has trended down. I think you said Argentina was part of that. Is that the only market where we're seeing slowing, or are there other markets where conditions are becoming worse? Thanks.

Pierre-Andre Terisse - *Danone SA - CFO*

Okay. To talk about figures, CIS contributes around half of the negative volume evolution of the dairy division, so that's about 50% of it, the rest being made by Europe, which remains negative in volume, as you have seen, and by Argentina where the continuing and accelerating inflation in the course of the first quarter has led to a further price increase and to volume contraction, and really the situation in this market is very difficult.

In the rest of the markets, we've seen volume continuing to behave well. I'm thinking of the US, which I just commented. I'm thinking of Brazil. I'm thinking of Mexico. I'm thinking of South Africa, thinking of Egypt. There is one market in which we had a specific issue to handle in fresh dairy and in fresh dairy only and this was Indonesia, where the volatility has created some disruption in the activities, so this has gone negative. That I would qualify as a specific situation.

So, overall, volume is negative in CIS. I mentioned Argentina, for obvious reasons, and Europe continue to be negative, but the objective is, of course, to bring them back to -- or to bring back the overall equation to stable by the end of the year. And hopefully volumes are going to follow, given what we are seeing as a reaction to price increases. So that's for the dairy -- part of your question about dairy.

On the second question about ALMA, well, maybe I've answered for a part as well, since Argentina -- and in Indonesia a small impact. Fresh dairy has been contributing to a performance which is very low, at 12.5% top line growth, and putting a hyphen again with a very low. But still a bit down versus what's been showing the previous quarter, but which remains overall stronger at the 12.5%.



And in particular, I think this is extremely important to have in mind, our big growth drivers are working full speed. Aquadrinks; Aquadrinks China, Aquadrinks Indonesia. Aquadrinks Latin America have been a bit more under pressure for several quarters now. There is no difference at the moment, but these are contributing well.

Baby in Latin America is working well. Baby in Africa, Middle East is working well. Baby in Indonesia is working well. Medical outside Europe has been working well. What else? Dairy Brazil, dairy Mexico, keep working well.

So ALMA remains primarily, and by far, a very strong growth driver for the Group in all business lines, with some specific situations to handle, which are the ones I mentioned.

Mitch Collett - *Goldman Sachs - Analyst*

To come back on the input cost side of things, when you get guidance at the full-year results, it is predicated around a marginally better cost environment.

Pierre-Andre Terisse - *Danone SA - CFO*

Sorry, sorry, sorry. I missed this part of the question. Frankly, at this stage, given, A, the indeed higher than expected increase of input cost, but B, the reaction we have taken in terms of covering by productivity on the one hand and price increases on the other, and C, the positive reaction we are seeing on all key brands in terms of mix, I have absolutely no reason to change the guidance.

Mitch Collett - *Goldman Sachs - Analyst*

Okay. Thank you very much.

Pierre-Andre Terisse - *Danone SA - CFO*

You're welcome.

Operator

Celine Pannuti, JPMorgan.

Celine Pannuti - *JPMorgan - Analyst*

Yes. Good morning. Just to follow up firstly on dairy, can you talk about -- so I try to understand, you put some prices up in the first quarter in Russia, in Europe and now starting in the US. What kind of -- are we done in terms of price rise, or is there more to do in the coming quarters? If you could give us a bit of an indication of the ramp-up of pricing as we go into the next quarters in dairy.

And then my second question is on China. So, if I understand well, you are at 30% -- at the end of Q1, you are at a 30% level of what you were pre the recall in China, which is where we've been as well at the end of Q4, so where -- what has been -- haven't you seen any impact of the new range launch or is it because of the negative pricing that we are not seeing any improvement?

And then could you as well give us the price point range of the different offerings? What are the main ranges, please? Thank you.



Pierre-Andre Terisse - *Danone SA - CFO*

Yes. So pricing on product.

Pricing on dairy first. We've done most of what we had to do, but still there are some specific countries and some specific situations where we probably will have to take some further pricing. So if you're going to quantify that, I would say that we are probably down by two-thirds to 75% and we remain to be down about 25% to one-third.

Most of what we had to do, given what we know and the reading we have of the input cost evolution has been taken, again, there remain a minority, some several cases which need to be covered but that's a minority. This is assuming an evolution of the cost of milk which is stabilized, as we have been seeing for about two weeks or three weeks now. And we just think this is going to continue and possibly revert a little bit, but it's obviously something we cannot be sure of.

So we keep monitoring the situation extremely closely and carefully. A lot has been discussed during this call about the price increase, but I can tell you internally at least as much is being done and discussed about the way we can reduce costs to make sure that we absorb as much as possible from the cost inflation. I guess the result of that has been the good receipt of the pricing taken in most areas, and I have in mind Europe in particular but also Brazil, Mexico and a few others, and we'll continue to work on that.

That's for the dairy (multiple speakers).

Celine Pannuti - *JPMorgan - Analyst*

Can I just follow up on the dairy pricing? What is your expectation of milk price in Europe, and also how -- in Europe, how your pricing positions versus competition? What (multiple speakers).

Pierre-Andre Terisse - *Danone SA - CFO*

(Multiple speakers). The difference versus -- sorry, with respect to the cost of dairy in Europe, we basically expect now a sequentially stable price. And we'll see what happens, but that's what we assume.

In terms of competitive position, I think what you read with the evolution of market shares shows that we have no particular concern. The inflation of the cost of milk has been touching everyone. We have probably, as others, been trying to generate productivity to face that.

We have decided in some instances, not all of them but in some instances, to pass a price increase because we thought that was a reasonable thing to do. We've been followed in some markets by our competitors in markets in which -- which are very visible. Russia, we have clearly been followed by competition, just because this is putting everyone -- everybody under the same pressure.

And again, one of the ways to have a look at the problem is to have a look at the evolution of our market share, which has been pretty stable or positive. So that's for pricing.

China. When I say we are back to about 30%, about that, of where sales were pre the Fonterra crisis, I was referring to our sales. I was not referring to the take-off. The take-off, to my knowledge, has been progressing slightly.

So we obviously see the effect from the launches of products, although you probably will have in mind that we have been launching the renovated launch -- the renovated Dumex version at the beginning of March and the renovation of Dumex International at the beginning of April. So this is coming progressively, and this is why I'm trying to be careful in the way we look at the numbers.

Still, the welcome of our initiatives of these two launches by the trade, and the welcome of these launches by the consumer, and the fact that we are indeed seeing some sequential improvement in the take-off is reassuring, so it shows that we are working in the right direction and we just need to continue. So, no worry to have about that.

In terms of pricing, I hope you have understood and seen well what we have done, which is, yes, on the Dumex mainstream to sell it at a discount to the previous Dumex, but at the same time to have Dumex International which is being sold at a premium, and therefore to try and segment the market. This has been very much the approach we have since the beginning of the year, to be segmenting the market. So that's one of the ways to do it, to create two brands around one old brand previously.

The launch of Nutrilon, although this is very premium and therefore not very high in terms of volume, is expected to gradually occupy the space in the range of the ultra-premium. And we'll have, of course, further innovation coming as we move into the year.

Celine Pannuti - JPMorgan - Analyst

Thank you.

Pierre-Andre Terisse - Danone SA - CFO

Welcome. Next question.

Operator

Eileen Khoo, Morgan Stanley.

Eileen Khoo - Morgan Stanley - Analyst

Morning, Pierre-Andre. Eileen Khoo here from Morgan Stanley. I hope you're well. I just have a quick question, actually, on your acquisitions running. You made a number of acquisitions last year. Would you be able to give us a bit of color of this and how they're performing so far, and what if anything has surprised you?

And then could you also give us an update on your joint venture in fresh dairy with Mengniu? When do you expect operations to be up and running for this one? Thanks.

Pierre-Andre Terisse - Danone SA - CFO

You're welcome, Eileen. So, on Mengniu, well the operations are up and running, i.e. the businesses we had and businesses they had has been running since we signed the agreement. We're in the process of closing. And as you can imagine, we have -- given the high certainty we have about the closing of our transaction, we have already started working together.

So the joint team is currently managing the two businesses and they're doing it successfully, again, with some good success and good performance on the key brands of the JV. And forgive me if I don't know them by heart yet; I will. But Bio in particular has been progressing well. So from an operational standpoint, even though we have not closed yet, this is progressing well and moving in the right direction.

With respect to the other acquisitions we've been doing last year, Centrale Laitiere du Maroc, we are progressively making the integration, stepping up, as we have done in Russia with Unimilk, the level of productivity and the level of efficiency in front of inflation which is, as in many other markets, strong, trying as well to invest in marketing to build the brands.



And it will be, if I am not mistaken, and integrated in the perimeter starting from Q2. And you will have a reading of the performance, but it's basically after a 2013 which has been a bit more difficult from a margin standpoint. In particular, in the first half it's basically delivering on track on this revised basis.

Happy Family, good performance, in baby; that's developing fast and well.

YoCrunch, in the US we've decided to revisit the formulation of some of the products which we thought was not at the level we wanted in terms of quality. So we are reshaping the portfolio with extremely and even amazingly high successes of the new ranges. We just need to fine tune the balance between the previous range and the new range and integrate it into Danone. But there's definitely -- it's definitely a positive -- no surprise, but a positive news.

And the last one is Sirma in Turkey, which is to my knowledge doing well. Again, we are not developing too much on the acquisitions because they are not part of the like-for-like evolution of the performance, but they're all doing well and we are doing the job to make them come in the Danone environment.

Eileen Khoo - *Morgan Stanley - Analyst*

Okay. Thanks very much.

Pierre-Andre Terisse - *Danone SA - CFO*

That was all? Yes. You're welcome.

Operator

Jeff Stent, Exane.

Jeff Stent - *Exane BNP Paribas - Analyst*

Good morning. Just two quick questions, the first of which is do you have any plans to move to hyperinflation accounting for Argentina? And if you had been hyperinflation accounting in Argentina this quarter, what would the like-for-like growth have been? Thanks.

Pierre-Andre Terisse - *Danone SA - CFO*

We've studied that and there is no individual behavior on this matter. Hyperinflation is a matter which is governed by IAS 29. It is governed by the IASB, which every now and then meets and says this country is in hyperinflation or this country is not in hyperinflation.

So our understanding is that there is no room for interpretation. We are therefore following the standard. For the moment Argentina is not in hyperinflation. If it were to be in hyperinflation one day, I've not made, obviously, this test, but that would be deducting about 1 point to our top-line growth on a regular basis.

Jeff Stent - *Exane BNP Paribas - Analyst*

Okay. Thank you.

Pierre-Andre Terisse - *Danone SA - CFO*

You're welcome. Next question.

Operator

Jon Cox, Kepler.

Pierre-Andre Terisse - *Danone SA - CFO*

Hi, Jon.

Jon Cox - *Kepler Cheuvreux - Analyst*

Yes. Good morning. I have a couple of questions for you. To start with Russia, I'm just wondering if you've done any sort of analysis in terms of if sanctions get a lot worse in terms of milk flows. I think you basically source all of your milk in Russia, but is there some overlap into Eastern Europe? And maybe you can just give us any thoughts on that, if sanctions are really tight and what the impact could be on that business there.

And then, just on the non-Russian part of CIS, I think one of your competitors yesterday said that they'd seen signs of a slowdown, given what's happening in that region, and I'm wondering if you're seeing any signs of that. That's the first question.

Just a second question on Germany; you're talking about headwinds there, just wondering if you can just elaborate a little bit on that.

And then just the last question. EPS consensus is around EUR2.75 for this year. Do you think that's realistic, or do you think maybe currencies, I think consensus is minus 7 at the moment, actually needs to be a little bit worse, just given the deterioration in the ruble; i.e. I'm asking a bit of a currency question there? Thanks very much.

Pierre-Andre Terisse - *Danone SA - CFO*

You're welcome. Let's take them one by one, CIS first. You're right to say that we are sourcing all of our milk in the CIS region. The biggest part of it is in Russia and there is some milk coming from Belarus. So, no milk coming from the rest of Eastern Europe and no real interactions on this point between Eastern Europe and Russia, at least for us.

We have been, and we will keep, investing time and some money in trying to -- in helping Russia to step up its production of milk. It's not by coincidence that you have an inflation which is 30%. It's because that's one of the parts of the world where the lack of availability of milk is the biggest, with strong cycles, so there is a need to step up the production of milk. We are involved in that with other Russian fellow companies.

And from that standpoint, as well as for the identity of some of our brands, we are completely a local company. Prostokvashino does not sound particularly European, neither Tëma, neither Letniy Den', neither (inaudible), neither -- well, Nio Balans a little bit more.

But all that's to say that I believe we are very much a local food company with some know-how and management skills brought by Danone, management of the fresh dairy category, but essentially a local company which is sourcing locally, producing locally and selling locally, and as such I would tend to see us a bit far from any political tensions.

Again, the biggest thing we have to manage in the CIS is clearly the inflation of the cost of milk and what it does to the overall equation, and in particular to the volumes of the low -- the market entry brands and the low value-added products. The rest seems to be more anecdotal for us at the moment.



Germany, no, I did not mention any weakness other than the fact that we have been negative in fresh dairy for the past few years now in this market. We have seen some progress at the beginning of the year and we continue to see some progress, but this is slow; this is too slow. It does show to some extent, in the evolution of the market share, but in a category which then remains negative for the moment.

So there is no sequential news, if you wish, apart from the fact that we get positive signals of the evolution. But this needs to be confirmed because they are not at the level we would like them to be for the moment, and nothing else than that. In the rest of the businesses, we are performing well in Germany.

Your last question was about the EPS here, and I'm not going to start guiding on the foreign exchange. You know the elements of the driver of the evolution of the EPS this year. It's a top line which is 4.5% to 5.5%. It's margins which we see stable plus or minus 20 bps, a financing which I expect to remain slightly positive overall, a tax which should be stable.

And yes, you're right, a negative impact from the currencies, and you see how much it is in Q1. Clearly, the bases of comparison are going to improve as we move in the year, since the movement of the devaluation started at the end of Q2 last year, so it will be slightly easier in H2. But yes, difficult to expect that it's going to reverse and to become positive in this year.

To what extent is it going to be, well, I'm sure you have specialists which have a far better knowledge of the evolution of currencies than I have myself.

Jon Cox - *Kepler Cheuvreux - Analyst*

Thank you.

Pierre-Andre Terisse - *Danone SA - CFO*

Thanks.

Operator

Pierre Tegner, Natixis.

Pierre Tegner - *Natixis Securities - Analyst*

Good morning. I have -- bonjour. I have some questions basically on Russia. First of all, are you closer to low single-digit volume decline or closer to mid to high single digits there in Russia, because it's not quite clear according to the positive on two-thirds of your portfolio and double digit decline on one-third? That's the first question.

And the second question is, following all what you said on productivity, positive mix effect, excluding the pricing, are you still comfortable and committed to make progress the margin in Russia CIS this year?

Pierre-Andre Terisse - *Danone SA - CFO*

Okay. Without entering too much into details, yes, we are negative mid to high volumes in the CIS, with double digit indeed in -- volume-wise in the market-entry, and slightly positive but it's really low single digit in the rest of the category, and in particular in value-added products, and within these value-added products a solidly positive performance in volumes for some of our brands, the key ones.

With respect to the margin, I think that's the right question for the CIS. Our objective remains to grow margin this year. Clearly, the mix is something which is going to help us; the pricing as well. The last element will be the speed at which we have the ability to reduce our costs, though it's unlikely to be a year --

When we talk about Russia, we give a range of growth of margin. It's unlikely we'll be a year where we grow margin very significantly in this country. But still I believe with the mix, the evolution of the brands as well as the actions of cost reduction we have started and we will continue taking, we can have reasonably as a target to grow margin in this part of the world.

Pierre Tegner - *Natixis Securities - Analyst*

Okay. So --

Pierre-Andre Terisse - *Danone SA - CFO*

At least that's what I have in my compass.

Pierre Tegner - *Natixis Securities - Analyst*

Okay. Does that mean that as a worst case this margin improvement in the CIS is only a question of timing, through the potential lag effect in terms of pricing?

Pierre-Andre Terisse - *Danone SA - CFO*

Yes, absolutely.

Pierre Tegner - *Natixis Securities - Analyst*

Okay. Thanks, Pierre-Andre.

Pierre-Andre Terisse - *Danone SA - CFO*

You're welcome.

Operator

James Targett, Berenberg.

James Targett - *Berenberg - Analyst*

Hello. Good morning, everyone. A couple of questions. Just on those productivity savings and the cost savings you're targeting, I wonder if you could just put them in context of the EURO.5b underlying cost savings that you normally achieve.

And then, just apologies if I missed it, but what is now your input cost growth expectations for the current year?



And just finally, in terms of the promotional environment in dairy in the US and Europe, I just wondered if there's been any particular changes during the quarter. Thank you.

Pierre-Andre Terisse - *Danone SA - CFO*

Sorry, can you repeat the last one? I missed it.

James Targett - *Berenberg - Analyst*

Sure. Just in terms of the promotional environment in dairy in Europe and the US, have there been any changes during the quarter?

Pierre-Andre Terisse - *Danone SA - CFO*

So, on this one, it's going to be easy. No real change, either in US or in Europe.

On the expectation we have for the evolution of the cost of milk in particular, we are no -- we're at the moment above 10%. We expect for the year to be at levels which likely are going to be high single digit, with a strong de-balancing and a growth in first half which is going to be 10% or more and which is going to progressively go down in the second half. Of course, this is our assumption at the moment. It remains to be proven.

On productivity, frankly, I would not comment on the EUR500m plus or minus and its level for the first half and for the full year in a call which is essentially about Q1 sales. But what I can tell you is that there's a number of places in which we are working and progressing well on productivity, but it's not time for me to quantify that.

James Targett - *Berenberg - Analyst*

Okay. Thanks a lot.

Pierre-Andre Terisse - *Danone SA - CFO*

Thanks. We'll take a last question.

Operator

Liam Rowley, Barclays.

Liam Rowley - *Barclays - Analyst*

Good morning, everyone. Just briefly on margins again and the de-balancing on first half versus second half, clearly the big swing factor is in baby, but just getting some color on the dairy margin. Given dairy inflation, given you've got negative volumes, do you expect a significant recovery in dairy margins in the second half?

And then secondly, on the US, how is the margin evolution there, given you haven't taken pricing and volumes have been more stable, given there is some input inflation there? That'd be great. Thanks.



Pierre-Andre Terisse - *Danone SA - CFO*

Yes. In the US, as in many other markets, sorry, the evolution of the cost of milk at the beginning of the year has been putting margins under pressure. So, margins have been under pressure at the beginning of the year in most of our dairy markets. And that's been including the case of the US, where we have since taken a price increase, as I mentioned during the call, as we have in many other markets, as well as trying to use the mix as well as a mitigating factor.

So margin in the US, yes, has been under pressure, but given the actions we have taken I see no reason to -- for that to be very different from what we had in mind at the beginning of the year, and therefore to have a negative impact versus what we expect for the Group and fresh dairy overall.

In terms of de-balancing, you're right. The biggest de-balancing factor is going to be China, in baby, baby Asia and baby China in particular. But as I said already during the call of the full year, the speed at which we pass the price increases and the speed of the implementation of the price increases, plus the speed at which the cost of milk continues to increase, will have an impact on the phasing of the margin for the year.

Again, if I look at both factors and I combine them, I keep seeing on the same margin de-balancing for the year, i.e. minus 150 to minus 200 in the first half and then still a reversal and a plus in the second half. Again, for the majority attributable to baby, but with some elements coming on the dairy side as well.

Liam Rowley - *Barclays - Analyst*

Thanks very much.

Pierre-Andre Terisse - *Danone SA - CFO*

You're welcome. We'll stop the call here. I just want to thank you all for this call, your participation. We'll take further questions you may have during the day with Regis and Marion. And I wish you a very good Easter. Thank you. Bye, bye.

Regis Massuyeau - *Danone SA - IR Director*

Thank you. Bye.

Operator

That will conclude today's conference call. Thank you for your participation, ladies and gentlemen. You may now disconnect.

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