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DANONE 2005

the year in review

# DANONE

## 05

the year in review

HUMAN RESOURCES  
**Inside view of  
Danone management**

INTERVIEW WITH FRANCK RIBOUD  
**Health through  
food for all**

NEW HORIZONS  
**Research, industrial  
investment, affordability**



DANONE





**www.lu-cereales.com**



The cover photo was taken during a documentary in Soweto, South Africa, where, at the beginning of 2005, DANONE launched Danimal, a yoghurt enriched in vitamin A, zinc and iron, and sold for 15 euros-cents a pot.

Photos:  
Frédéric Atlan,  
December 2005.



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**Franck Riboud**, 50, Chairman and CEO since 1996. Shown here at the Salon de l'Agriculture in Paris in February 2006.

# INSIDE DANONE

Chairman and CEO **Franck Riboud** reviews 2005, highlighting nine key elements of DANONE's winning strategy for growth. Photos: Jérôme Galland/Aleph and Benoît Linero

**GROWTH** Organic growth is probably our most important strategic indicator. In any case, it's one I keep a very close eye on, because it best reflects the vitality and momentum within the business. In other words, it tells me whether we really have the capacity we need to offer consumers the right products, in the right place at the right time. Which means that it is naturally also the first criterion for judging the entrepreneurial performance of the people in charge of our local business units. On that count, 2005 was a very good year, with like-for-like sales growth reaching 6.7%, which is at the top end of the range we target over a period of several years. This performance is all the more

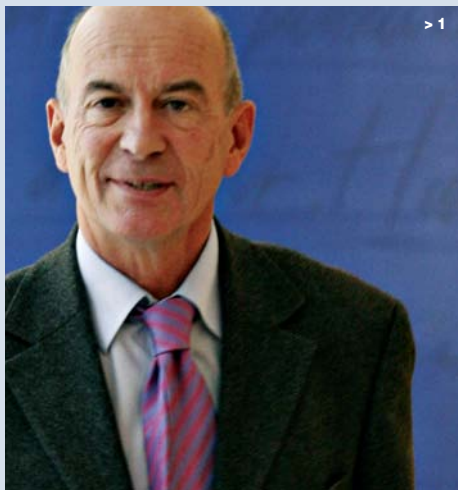
remarkable in that we faced difficult conditions in France, our biggest market. If you leave France out, this means that organic growth topped 10% in the other countries, that account for nearly 80% of our business. Which clearly shows that there has been no letup in the momentum developed over recent years.

**MARGINS** Obviously, a business exists to make a profit. You need profits to reward the shareholders whose investments made current growth possible, as well as to make new investments to underpin future growth. Which makes growth in operating margin another crucial indicator. In 2005, results remained in line with our medium-term objective,

with operating margin up 25 basis points to 13.35% despite the steep rises in packaging costs that resulted from higher prices for petroleum-based products. And we achieved this without compromising prospects for future growth. To put it another way, we are not going to sacrifice investment in the future—in our facilities, in expansion into new geographical markets, in advertising to build our brands—for the sake of temporary acceleration in our operating margin.

**NEW FRONTIERS** A few years ago, we identified five countries with significant potential for our products and selected these as the new frontiers in our drive for continued growth— ■■■





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■■■ China, Indonesia, Russia, Mexico and, for Dairy Products, the US. Today, we have a total of over 35,000 employees in these countries and they already account for 25% of our sales. And trends are very firm, with organic growth averaging an impressive 18% in 2005. Looking ahead, other frontiers are opening up, offering added potential for the future, among them markets in North Africa and the Middle East, where, with our partners, we are starting to post healthy sales volumes. We expect them to become additional drivers for growth in the near future.

**GEOGRAPHICAL BALANCE** Over recent years, investment in what we call our new frontiers and a few dozen acquisitions outside Europe have enabled us to achieve a broader geographical balance, which means we now have the advantage of being less dependent on our main market than most others. Clearly, we are not satisfied with the lack of growth in France last year, and of course we are taking targeted action to renew momentum. The results nonetheless have the merit of showing that we are less and less dependent on our original market. They also reward the efforts of recent years to spread resources, risk and opportunities more evenly. Today,

nearly 80% of our business is outside France and over 50% is outside Western Europe, on the markets where the potential for growth is greatest. The new balance we have achieved in barely ten years means that we are much less vulnerable to ups and downs here or there. And we are also better placed to take quick advantage of opportunities as they arise.

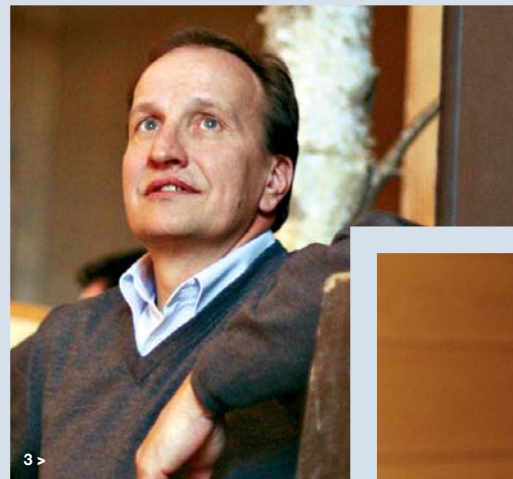
**CREATING VALUE** In 2005, I had the opportunity to express my belief that the DANONE business model in itself creates enough value to make any loss of independence both unnecessary and undesirable. At the end of 1996, our market capitalization stood at €8 billion. Over the next nine years that figure nearly tripled, reaching €23 billion at the end of 2005—even though our strategy of focusing on core businesses led us to shed operations accounting for around 20% of our sales. The gains are clearly attributable to the quality and consistency of our results. But I am also convinced that they reflect growing recognition for the value of other, less

tangible assets that include our focus on health, our research expertise and our capacity to build mutually beneficial partnerships. And, of course, our unique management culture.

**RESEARCH AND HEALTH** The central place of health in our product strategy makes research a special ■■■

**“Our five new frontiers—China, Indonesia, Russia, Mexico and the US—already account for 25% of our sales, with organic growth averaging 18%\* in 2005.”**

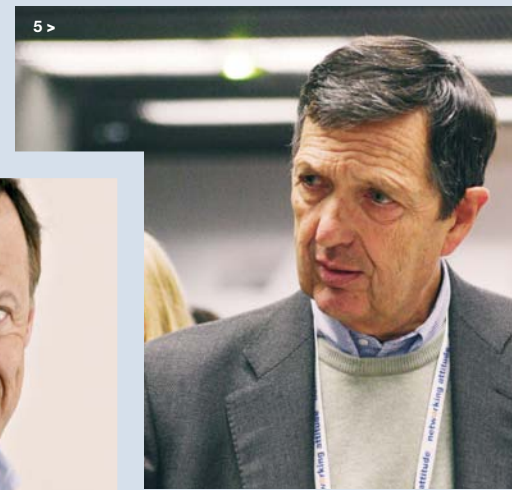
\* Like-for-like.



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**“Research does not have to be on a huge scale to be effective. But it needs to be open to outside developments, responsive and focused, with a clear set of priorities.”**

■■■ priority, as we confirmed by appointing the head of research to the Executive Committee in 2005. Research has two complementary roles for our business. One is to provide the scientific backup needed for the credibility of our arguments on health and nutrition, in particular as regards our more sophisticated products. The other is to contribute to product innovation, identifying and developing processes and ingredients that make a real difference for consumers, and setting our products apart in a way that is difficult for our rivals to replicate. To achieve those twin goals, we cannot rely exclusively on in-house research resources, since that would force us to try and cover too many different areas of expertise. Instead, we turn to cooperation, maintaining close relationships with international experts, specialized laboratories and leading scientific institutions such as the Pasteur Institute. Research doesn't have to be on a huge scale to be effective. On the contrary—it needs

to be open to outside developments, responsive and focused, with a clear set of priorities.

**GLOBAL CONCEPTS, LOCAL RANGES** A number of our brands, among them Activia, Actimel and Tallefine-Vitalinea, have the potential to generate annual sales topping the €1 billion mark within three years. They are not just names—each of them stands for a concept corresponding to a distinct health benefit, backed by research and clinical tests. These benefits make for appeal around the world, which means sales potential in many different countries, as illustrated by the example of Activia, currently on offer in over 30. In this, the general adoption of good practices developed in one or another of our businesses has played an important role, helping to speed deployment. But that isn't the whole story. Success also reflects our capacity to adapt products and reinterpret concepts for local markets, ■■■

**> 1 JACQUES VINCENT**  
60, Vice-Chairman and Chief Operating Officer. Joined DANONE in 1970 and has served as head of DANONE Germany and Dannon US.

**> 2 FRANCK MOUGIN**  
48, Executive Vice-President, Human Resources. Joined DANONE in 2001 after working several years in the United Kingdom.

**> 3 THOMAS KUNZ**  
48, Swiss, Executive Vice-President, Beverages. Joined DANONE in 1990 and has headed DANONE Mexico, Bagley (Argentina) and Dannon US.

**> 4 BERNARD HOURS**  
49, Executive Vice-President, Fresh Dairy Products. Since joining DANONE in 1985 has headed DANONE Hungary, DANONE Germany and LU France.

**> 5 GEORGES CASALA**  
64, Executive Vice-President, Biscuits and Cereal Products. Joined the group in 1973 and has headed DANONE Italy, Dannon US and DANONE France.





■■■ allowing for differences in tastes, nutritional needs and dietary habits. Activia, for example, is sold as “laban” in Saudi Arabia and “kefir” in Russia. That flexibility, that capacity to let local teams adapt global products to the specifics of their markets, is something I believe sets DANONE apart from its rivals and is a main reason for our success.

**PROXIMITY** Proximity is one of our core values. It means, first of all, a style of management that is simple and direct, centered on people rather than formal procedures or hierarchies. In keeping with the same principle, our organizations are structured to allow decisions to be taken at local level as often as possible, making local management teams responsible for their revenues and income and for their own business functions, including marketing, sales, logistics and production. More broadly, our approach to markets supposes local presence and close relationships with local people. Food is very much a matter of culture, so understanding different cultures is essential to our business. Which also means that partnerships and joint ventures with local businesses are often the best way to establish a presence on new markets. Similarly, in our distribution strategy, we are building increasingly close ties to traditional retailing to ensure that our products are accessible in all the places where people live, commute, work, and play.

“Our organizations are structured to allow decisions to be taken at local level as often as possible, making local management teams fully responsible for their revenues and income.”

**MISSION** DANONE’s mission embodies an ideal—the ambitious goal of bringing health through food to a majority of people. For the moment, of course, we are well short of that worldwide. We have industrial operations in around 40 countries, which means that only a minority of the world’s population has access to our products. And, as everyone knows, millions of people around the world have no access to healthy food at all. Helping to remedy that is clearly the great challenge facing today’s food industry. But we don’t necessarily have the right types of organization, the right ways of doing things, to deal with it. Making our products available in countries where people live on an average of two or three euros a day, where there are no organized

distribution networks, and where farming production is largely unstructured, requires the development of radically different business models. Obviously, you can’t use the same sales, marketing and production methods in a country like Bangladesh as you do in Europe, in Argentina or New Zealand. But whatever the model, we also have to remember that it is still business. We have to stop thinking in terms of charity, which inevitably runs out of resources sooner or later, and succeed in developing profitable businesses. While they should not aim for profit at any cost, they have to be able to create wealth locally and generate the resources they need to invest and grow. That is what we are trying to do in South African townships, and ■■■



“Millions of people around the world have no **access to healthy food at all**. Helping to remedy that deprivation is clearly the great challenge facing today’s food industry.”

■■■ the same thinking is behind the experiment we recently launched in Bangladesh, where we have teamed up with Grameen Bank, a world leader in microcredit, to set up a new sort of business to produce and market dairy products selling at under five eurocents apiece. That sort of groundbreaking reinvention of our business model, together with the resulting potential for social benefits, is to my mind a tremendous source of motivation for a business and its people. And I also believe that it is one of the most promising approaches for growth over the long term. ■

>1 **SVEN THORMAHLÉN**  
49, German. Joined DANONE in 2002 as head of R&D.

>2 **ANTOINE GISCARD D'ESTAING**  
45, Executive Vice-President, Finance, Strategy and Information Systems. Joined DANONE in 2005.

>3 **EMMANUEL FABER**  
42, joined DANONE in 1998 as Executive Vice-President, Business Development and Strategy. Currently serving as Executive Vice-President, Asia-Pacific.

>4 **PHILIPPE-LOÏC JACOB**  
41, Franco-Canadian. Joined DANONE in 1986 and was appointed Corporate Secretary in July 2004.

>5 **SIMON ISRAEL**  
53, New Zealand. Joined DANONE in 1996 and is currently non-executive president, Asia-Pacific.

Organic growth in 2005 sales

6.7%

2005 operating margin

13.35%

Ranking worldwide

No. 1 for fresh dairy products and shared No. 1 position for bottled waters

No. 2 for biscuits and cereal products



# A YEAR WITH THE BOARD

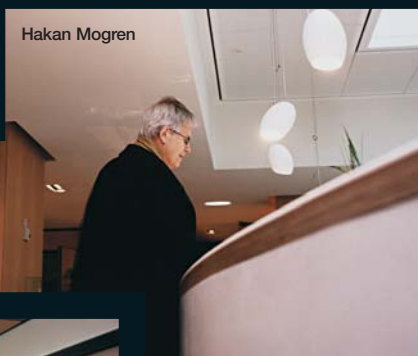
In 2005 the Board of Directors welcomed two new members and continued efforts to make **its own operations more efficient.**

Photos: Benoît Linero and Rafaël Trapet/Aleph

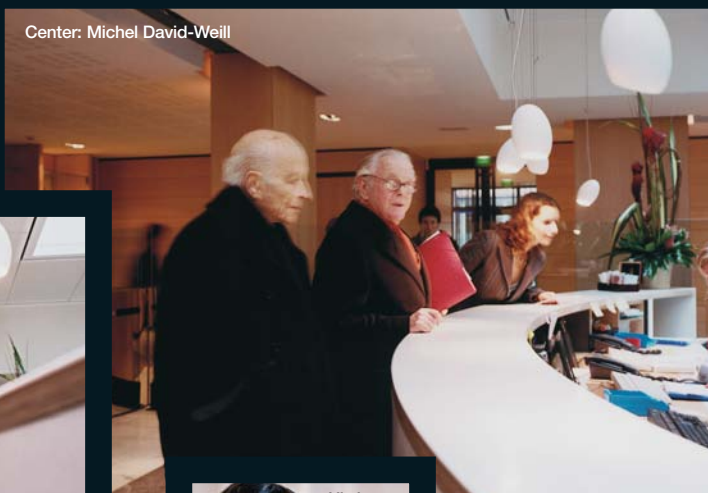
Daniel Carasso, Honorary Chairman



Hakan Mogren



Center: Michel David-Weill



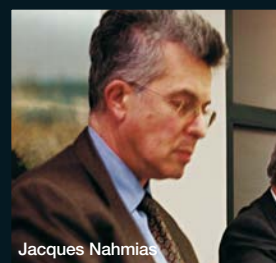
Hirokatsu Hirano



Richard Goblet d'Alviella



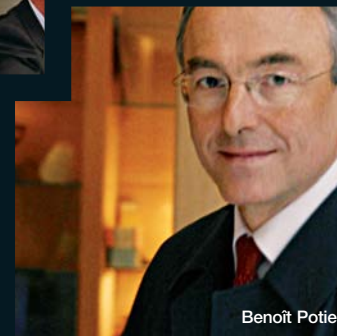
Jacques Nahmias



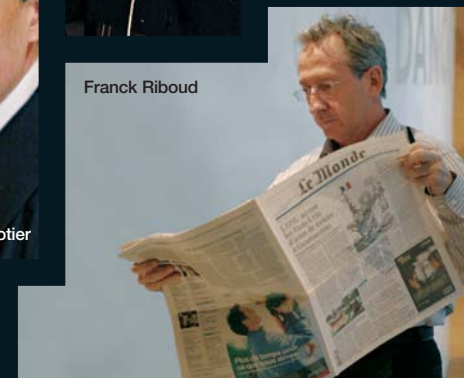
Left: Christian Laubie



Benoît Potier



Franck Riboud



Jean Laurent



Bruno Bonnell



Members of the Board of Directors

**Franck Riboud**, 50, Chairman and CEO, Groupe DANONE  
**Jacques Vincent**, 60, Vice-Chairman and Chief Operating Officer, Groupe DANONE  
**Bruno Bonnell**<sup>1</sup>, 47, Chairman, Infogrames Entertainment  
**Michel David-Weill**, 73, Chairman of the Supervisory Board, Eurazeo

**Emmanuel Faber**, 42, Executive Vice-President Asia-Pacific  
**Richard Goblet d'Alviella**<sup>\*</sup>, 57, Chief Executive Officer, Sofina SA  
**Hirokatsu Hirano**, 68, Adviser of the International Business Division, Yakult Honsha  
**Bernard Hours**<sup>1</sup>, 49, Executive Vice-President, Fresh Dairy Products  
**Christian Laubie**<sup>\*</sup>, 67, Member, Haut Conseil du Commissariat aux

comptes  
**Jean Laurent**<sup>1\*</sup>, 61, Chairman of the Board, Calyon SA  
**Hakan Mogren**<sup>\*</sup>, 61, Deputy Chairman, Astra Zeneca  
**Jacques Nahmias**<sup>\*</sup>, 58, Chairman, Pétrofrance Chimie SA  
**Benoît Potier**<sup>\*</sup>, 48, Chairman of the Management Board, Air Liquide SA

<sup>(1)</sup> Board member since April 22, 2005  
<sup>\*</sup> Independent director.

The Board of Directors met six times in 2005. Meetings averaged three hours in length, with attendance at 92%, up from 85% in 2004. Ongoing business regularly handled by the Board included market trends, the Group's finances, cash position, share buybacks and cancellations, and financial statements. In 2005, the Board also analyzed and debated significant acquisitions and divestments as negotiations progressed, focusing in particular on the resales of the Group's Sauces business—HP Foods in the United Kingdom, Lea & Perrins in the United States, and Amoy in Asia—and on completing its pullout from the Mahou brewery

a half-day with the Executive Vice-Presidents of the three business lines in December. In late 2004, the Board of Directors voted to assess its own procedures to improve efficiency and maximize its contribution to the Group. Following the arrival of two new directors in 2005, the Board decided to perform another self-assessment during fiscal 2006.

**AUDIT COMMITTEE** The Audit Committee, which met nine times in 2005, is charged with analyzing parent company and consolidated financial statements before they are approved by the Board of Directors (see interview with Benoît

signments entrusted to Group auditors. Finally, it makes recommendations on auditors' fees. In 2005, the Audit Committee focused in particular on the recently implemented International Financing Reporting Standards and their impact on the Group; procedures for monitoring and valuing long-term assets, especially Groupe DANONE's Home and Office Delivery business in the United States, Europe and Canada; progress on compliance with Sarbanes Oxley; and procedures for monitoring and assessing risks. The Committee also approved internal and external audit plans.

**COMPENSATION AND APPOINTMENTS COMMITTEE** By decision of the Board of Directors, the Compensation and Appointments committees were combined on April 22, 2005. The new Compensation and Appointments Committee serves the Board in an advisory capacity, making recommendations on Board operating procedures, appointment of new directors, and executive compensation and stock options. During the year two new directors joined Groupe DANONE. Independent director Jean Laurent, Chairman of Calyon SA, was co-opted by the Board, and Bernard Hours, Executive Vice-President, Fresh Dairy Products division, was appointed by the shareholders' meeting of April 22, 2005. The Compensation and Appointments Committee also recommended adoption of a medium-term variable compensation plan. Until now, members of Management Committees for the

"The Compensation and Appointments committees were combined on April 22, 2005. The new Compensation and Appointments Committee serves the Board of Directors in an advisory capacity."

in Spain and from DS Waters and LP, its Home and Office Delivery units in the United States. To learn more about Group operations and personnel, Board members took part in DANONE's Journées d'Évian, a seminar held in September each year the heads of all of the Group businesses around the world. Directors also spent

Potier, page 14). It ensures that Group accounting principles are appropriate and consistent, particularly where judgments and estimates are required, and checks the reliability of internal procedures for collecting and verifying data. The Audit Committee also examines the methods and results of internal and external audits, as well as special as-

Members of the Audit Committee\*

**Benoît Potier**, Chairman  
**Richard Goblet d'Alviella**  
**Christian Laubie**

\* made up entirely of independent directors

Members of the Compensation and Appointments Committee

**Michel David-Weill**, Chairman  
**Jean Laurent**  
**Hakan Mogren**

"To learn more about Groupe DANONE operations and personnel, Board members join managers for selected operational meetings."

Group's business units have received variable compensation consisting of a bonus based on achieving annual targets plus stock options that can be exercised over the long term. Under the new plan, Group Performance Units (GPUs) will replace a portion of the stock options, providing medium-term compensation linked to achieving the multi-year Group targets for sales growth, operating margin and net earnings per share announced to financial markets.

**EXECUTIVE COMPENSATION** Executive compensation at Groupe DANONE includes a fixed portion and a variable portion. Based on business and individual targets, the variable portion represents between 40% and 60% of total compensation. For Executive Committee members, variable compensation is based on quantitative business targets as well as a qualitative assessment of strategy during the year. For the Chairman/CEO and for the Vice-Chairman/Chief Operating Officer, the quantitative component is based on Group targets for sales, operating margin, free cashflow and net earnings per share as communicated to financial markets. For Executive Committee members in charge of a business line, the quantitative component is based on targets for sales,

operating income, free cashflow, and operating margin as defined in the budget for the business line. For the remaining members of the Executive Committee, the quantitative component is based on targets for operating income, net earnings per share and operating costs as defined in the Group's budget. In fiscal 2005, direct and indirect compensation paid to the members of the Board of Directors and Executive Committee—20 people in all—totaled €11.2 million. Of that, €10.9 million went to the members of the Executive Committee for performance of their duties, including €5.4 million for the variable portion. Supplemental retirement and other benefits paid by the Group to the same individuals in 2005 totaled €0.6 million. In 2005, the following amounts were paid to the four members of the Executive Committee who also sit on the Board of Directors: Franck Riboud, Chairman and CEO, €2,485,540; Jacques Vincent, Vice-Chairman and Chief Operating Officer, €1,544,620; Emmanuel Faber, Executive Vice-President Asia-Pacific, €966,058; Bernard Hours, Executive Vice-President, Fresh Dairy Products, €941,408.

**RETIREMENT LIABILITY** All Group executives who were enrolled in a retirement plan under French law at December 31, 2003 are covered by a defined-benefit retirement program. Participants who are still with the Group at retirement will receive a pension based on seniority and final salary levels. At December 31, 2005, total retirement liability for Group management was €39 million. ■



## The Internal audit team at DANONE

At DANONE, the Internal Audit Division ensures that all Group companies and structures comply with all applicable rules, both external—such as statutes and regulations—and internal—such as codes of conduct, policies and procedures. The Division also contributes to the Group's overall efficiency by helping management

and the Board of Directors to assess and continually improve internal controls, risk management procedures, and corporate governance in general.

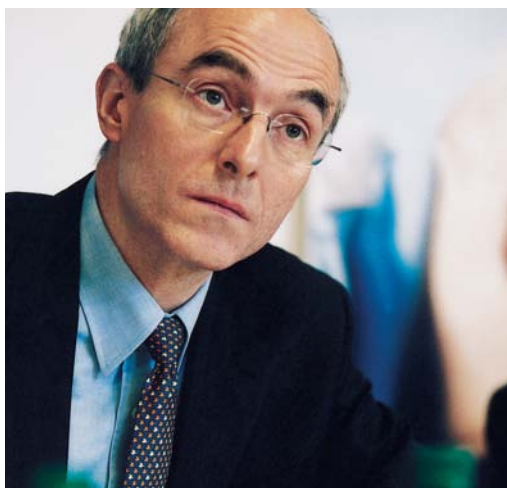
"What sets DANONE apart from other companies is that we rely largely on specialized auditing firms for field work," explains Jean-Claude Horen, Chief Risk Officer, and direct supervisor for the head of Internal Audit.

"As a result, we have a team of experienced auditors that can handle complex issues anywhere in the world, and the team's size and expertise can be adjusted as needed. Our Group head of audits keeps the work on track, overseeing these external auditors with the help of a small in-house team. This original and highly flexible approach means that we can always call in the right skills in the right place at the right time."

The Internal Audit Division reports directly to the General Secretary, and to prevent conflicts of interest internal auditors have no operational responsibilities. Under DANONE's Audit Charter, the Division has complete discretion to audit any organization within the Group. "They make sure everyone follows the rules," says Jean-Claude Horen. "Which gives them a protective role. But they

also create value through their ability to advise line managers and to encourage best practices within the Group."

# "IDENTIFYING WHAT'S BEHIND THE NUMBERS, STRIKING THE RIGHT BALANCE BETWEEN FINANCIAL PRIORITIES AND OPERATIONS AT EACH BUSINESS UNIT: THAT'S GOOD BUSINESS JUDGMENT."



Interview with Benoît Potier, Chairman of the Audit Committee

**C**hairman of the Audit Committee, Benoît Potier chairs the Management Board at Air Liquide and has been on DANONE's Board of Directors since April 2003. He was appointed Chairman of the Group's Audit Committee in 2005.

## How would you define your work on DANONE's Audit Committee?

**Benoît Potier:** The Audit Committee consists of three independent members, charged with analyzing the company's financial statements before they are approved by the Board of Directors. Which means three complementary tasks. First, we review the financial statements and check them for compliance with accounting standards—and in particular with IFRS\*. We then take a look at things from a business standpoint, analyzing what the numbers really say about our operations. Finally, we ensure that the Group is complying with risk management procedures and other standards of practice, and suggest improvements as needed for its business lines and operations.

## What is your role as Chairman of the Audit Committee?

**B. P.:** In addition to coordinating the Committee's own work, I try to offer insights through suggestions, advice and constructive comments. We make recommendations and guide management through the decision-making process, but without taking its place. It's always useful to have an outside view, and in this case it comes from long experience in an international manufacturing group.

Identifying what's behind the numbers, striking the right balance between financial priorities and operations at each business unit—that's what I call good business judgment.

## How did you close out the 2005 year?

**B. P.:** We ran a thorough review of the tests used to value our operations—accounting regulations, depreciation and amortization, and so on. And we analyzed the Group's business strategy in depth, requesting detailed explanations on some of our operations. We also studied risk management strategies and tools, particularly for security and information systems. It was a comprehensive annual review that looked at everything in detail.

## How would you rate the work of the Board of Directors?

**B. P.:** It examines substantive issues very thoroughly. We get detailed information on performance—organized by subject area and type of operation—as well as our competitors, risk management and the Group's overall status. We also get very good information on the Group's people and their skills, both through special presentations and during the Journées d'Évian seminar, which allows us to get acquainted with the Executives heading DANONE's business units. In general, DANONE's approach to corporate governance works very well. The rules are clear and transparent, and the shareholders know what they are. The range of nationalities and the wealth of experience represented on the Board are enormous assets for the company.

## Do you think the Board could operate even more effectively?

**B. P.:** Given the increasing complexity of the business we handle, it would surely be useful to broaden the Audit Committee to include new skill sets. More substantively, I think that we could take a closer look at Group policies on finance and acquisitions, this time from a risk management perspective. Given DANONE's current momentum, these strike me as key issues. ■

\* Since January 2005, all European companies listed on financial markets must comply with International Financial Reporting Standards.





sabor  
que se vive



At DANONE, combining business success with social responsibility has been a priority for 40 years. Nutrition, food safety and the environment are just some of the areas in which we have made a formal commitment to progress that we are backing up with concrete action\*.

Photos: Emmanuel Pierrot

\* For more information, see our  
2005 Social and Environmental Responsibility Report.



# Health

## Food or medicine?

Groupe DANONE places special emphasis on the development of products with distinctive health benefits. But we make food, not medicine.

Food delivering health benefits above and beyond nutritional value and taste appeal is a defining feature of new patterns of consumer demand, echoing the advice dispensed by Hippocrates more than 2000 years ago: "Let food be thy medicine." A daily source of the materials essential to health and well-being, food can also aid digestion, help improve cardiovascular functions and reduce cholesterol and other risk factors. Despite such benefits, food is never the same thing as medicine, which is used to treat specific pathologies over a defined period and should never be taken by people in good health.

### NUTRITIONAL VALUE AND TASTE APPEAL

At DANONE, we believe that food should contribute to health and well-being. And while nutritional value and taste appeal have naturally always been priorities for our products, over the past 20 years we have gone further, developing products such as Activia, Actimel, and Danacol with specific health benefits—but which we in no way consider medicines, since they are not intended to treat illness and have to meet the same standards for taste, texture and other perceived features as our other products. We refer to them as "functional" products because they offer one or more clearly identified health benefits in addition to their nutritional value. Actimel helps strengthen the body's natural defenses, while Activia helps regulate intestinal transit and Danacol helps reduce certain types of

high cholesterol. These benefits have been scientifically proven by the Group's researchers in cooperation with research teams around the world.

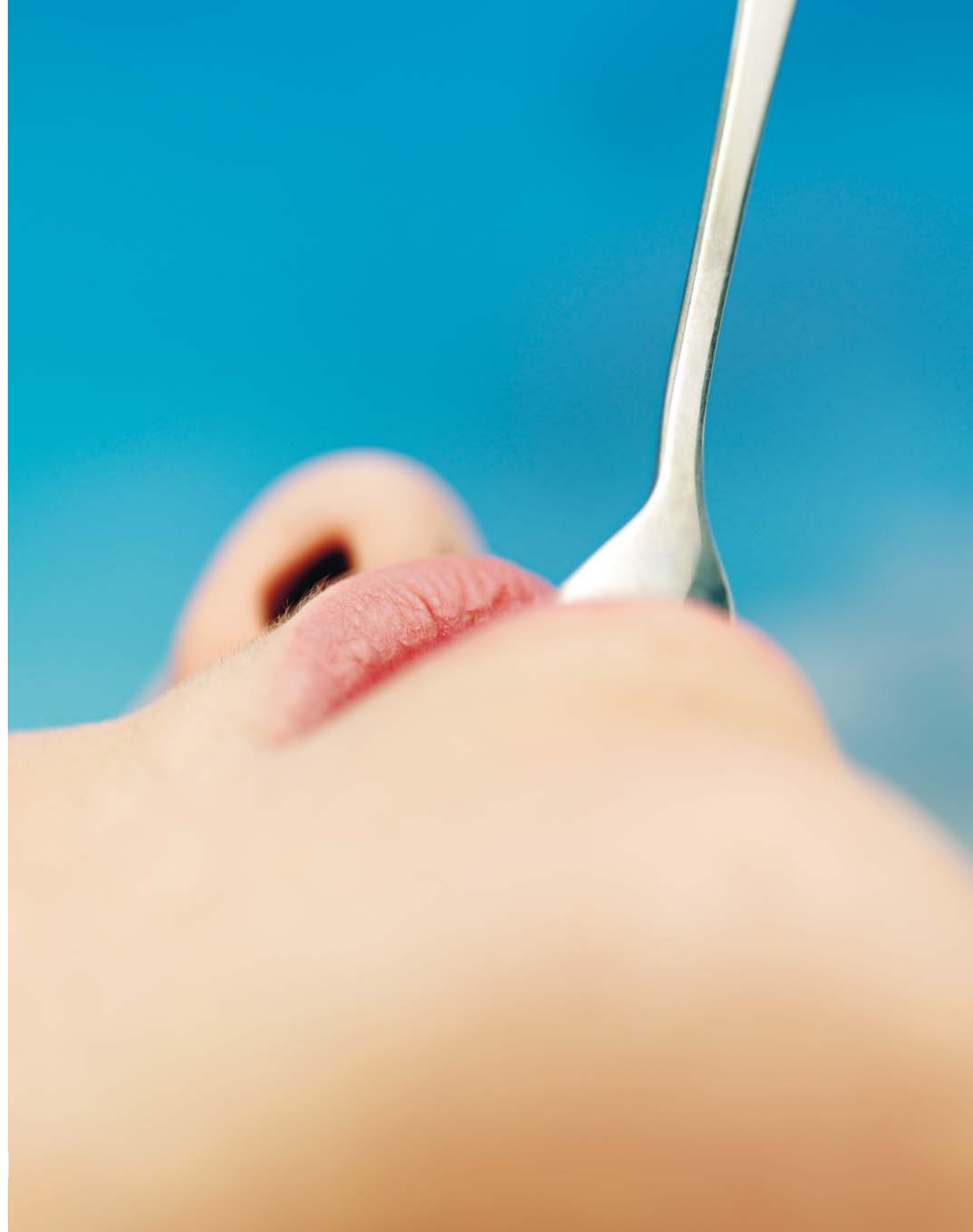
### NATURAL GOODNESS

While a wide variety of ingredients are used to develop functional products, our R&D teams rely first and foremost on the natural goodness of our raw materials—milk, cultures, grains and water. An important example of this is the lactic ferments referred to as probiotics, which can benefit health when consumed in sufficient quantities. DANONE now has a collection of more than 3,000 different strains that it uses to study interactions between cultures and the body. The probiotics present in Activia and Actimel were selected by DANONE researchers for their beneficial effects on the intestine. The *Bifidus essensis* culture in Activia thus stimulates lazy intestinal transit while the *L. casei defensis* in Actimel stimulates the defensive capabilities of the intestinal wall and flore.

### Prevention with Danacol

Danacol, sold in seven countries since 2005, stands out from other DANONE products. Fortified with plant sterols to help reduce bad cholesterol, it is intended for a distinct group of consumers—only those with high cholesterol—as part of a healthy, balanced diet with additional fruit and vegetables. But it is not medicine. High cholesterol is a risk factor for disease, not a disease in itself. And while their effectiveness has been scientifically proven and recognized by competent authorities, products containing phytosterols are not a complete solution for high cholesterol. Only a medical professional can determine the right option for each individual.

DANONE now has a collection of more than **3,000** probiotic strains that it uses to study interactions between cultures and the body.







# Crisis management

## Prevention or cure?

The confidence of consumers, authorities and shareholders increasingly depends on the capacity to anticipate risks and manage crises. DANONE thus makes continuing consolidation of that capacity a top priority.

DANONE identifies and manages around 180 potential crises annually, yet most of them go unnoticed—quite simply because they are successfully handled in a matter of hours. This reflects the first, simple principle of crisis management, which is to take everything seriously, or a minor incident can become a major crisis. That means that even the most routine issues must be addressed as soon as they arise, as is illustrated by a case in October 2005. A British consumer notified DANONE that her Volvic water tasted like camphor, which is common when water is stored with household products for too long, but owing to the company's failure to respond immediately, the situation nearly degenerated into a real crisis that could have threatened Volvic sales in other countries.

### RESPONDING ON THE SPOT

Poor handling of an incident can do lasting damage to a company's reputation and consumer confidence. Over the past 15 years, Groupe DANONE has thus made a special effort to develop an effective crisis management network. Since the impact of most incidents is local, this began with the appointment of a crisis manager for each business unit, with the result that 75% of all crises are now handled locally. The local teams are coordinated by crisis managers for the corresponding business lines and by a central crisis-management team that

reports directly to the General Secretary, whose department provides leadership and professional development for local crisis managers through kits, training and simulations.

### PREVENTION THROUGH DIALOG

Our crisis management network has one overriding goal—to identify potential crises and solve problems before they happen. An important tool for this is Vestalis, a risk-mapping method that allows each business unit to factor in its specific risk environment. The Group also monitors the Internet constantly and actively gathers information in the field. Above all, DANONE emphasizes dialog with consumers, paying special attention to the comments and questions directed to the customer service units for our various brands and providing tools for effective analysis of this invaluable information.

While the frequency of crises has leveled off since 2000, their nature has changed. The number of incidents directly related to products or quality defects thus dropped from two out of three crises in 2000 to one out of three in 2004, but new challenges have arisen. These include situations relating to social responsibility issues and public opinion campaigns led by consumer groups, which Groupe DANONE manages proactively through regular contact with consumer advocates. Another important concern is external risks such as SARS, anthrax and avian flu. The Group is preparing for these possible health crises in the knowledge that staying ahead of risks is half the battle.

### Quick reactions

**Christmas 2005: as DANONE distributed Evian water in a limited-edition Christmas bottle around the world, a customer in Japan reported the presence of foreign objects in one bottle. The information quickly reached Group headquarters, and crisis managers swung into action, isolating the warehouse that had shipped the bottle. Using the production date to identify the lots at risk, they recalled all bottles produced on that date and had other lots checked to ensure that no other bottles had been affected. In all, 180,000 bottles were inspected to eliminate any possible threat. Although the health of consumers was never in jeopardy, a rapid, systematic response was the only option.**



# Nutrition

## Reducing sugar and fat: mission impossible?

Concerns over obesity sometimes lead people to see sugar and fat as public enemies. But how can we reduce them without sacrificing flavor? DANONE has been striving to find the best solutions for over 40 years.

Over the past five decades, lifestyles have undergone radical and unprecedented change. Physical activity is less and less a part of daily life, which is increasingly sedentary. Diet has changed, too, and family groups have splintered. Together, these factors are behind the rise in obesity. Although the composition of process foods is just one part of the problem, businesses, public authorities and scientists work with other stakeholders to reduce ingredients such as sugar and fat.

### A LONGSTANDING COMMITMENT TO HEALTHY DIET

For DANONE, these concerns are nothing new. The link between diet and health inspired the creation of the brand in 1919, and in 1964 DANONE became one of the very first brands to offer low-fat product lines when Tallefine was launched in France. And JP Morgan study published

in January 2006 found that healthier products account for 75% of Groupe DANONE's portfolio.

### R&D FOR HEALTH

In their continuing drive to enhance the nutritional value of DANONE products, our R&D teams face a challenging task. Sugars and fats not only provide calories and other nutritional properties. They also have technical and organoleptic properties that are absolutely essential to taste appeal—and in many cases to production. If we reduce the fat in a biscuit, for example, the product may not be as tasty and it will also break and crumble more easily. To ensure that our products are both enjoyable and feasible to make, the Group's researchers cut fats and sugars by stages, creating innovative new recipes and using sensory analysis to check quality and acceptability every step of the way. Their expertise

is critical to the development of foods that offer the same pleasure even when a recipe has been completely reworked. R&D has enabled DANONE to offer reduced-sugar versions of many products, including LU breakfast biscuits and Actimel, as well as zero-calorie flavored drinks like Ser and Tallefine Fizz. It also enables us to limit fat content, cutting the saturated and trans fats that consumers are urged to limit and incorporating essential fatty acids whenever possible, especially in biscuits like our Tallefine / Vitalinea and Ourson lines. The Group's focus on healthy foods also means that we put special emphasis on products for children. Over the past 15 years, the recipes for Danonino—sold in France as Petit Gervais aux fruits—have thus been improved at regular intervals on a number of our markets, reducing fat by 50% in France and Germany. Overall progress has been measurable over the years. Between 1999 and 2005, added sugars in LU France biscuits fell by 9% and fat content by 7%. More recently, Fresh Dairy Products has developed a new Tallefine line called "double 0"—0% fat and 0% added sugars.

### A real alternative to soft drinks

The flavored water beverages sold by DANONE in several countries offer distinct advantages. Apart from their refreshing flavor, they contain as little as two to fifteen times less sugar than soft drinks, and are winning growing favor as a healthier alternative for those who prefer flavored drinks. These products include Volvic Thé in France, Bonafont's Levite line in Mexico, and Aqua's Splash of Fruits products in Indonesia. The Group's Beverages business line is working to develop new labeling that will make it easy for consumers to compare the sugar content of DANONE's flavored beverages with that of soft drinks.



# Packaging

## Both convenience and the environment: squaring the circle?

A major concern for consumers, packaging reduction is also a priority for DANONE. And we are well on our way to meeting a self-imposed goal—to reduce packaging by 10% between 2000 and 2010.

Consumers are increasingly conscious of the environmental impact of packaging. But even though a 2005 Europack survey found that 97% of respondents favor biodegradable or recyclable materials, everyone still wants products to come in attractive, convenient packages. To tackle this complex problem, DANONE has applied the principles of ecodesign since 2000. Which means factoring the environment into every stage of the product and packaging lifecycle, from design to recycling—all without compromising packaging's essential role in food safety, transportation and convenience.

### REDUCING VOLUME

We began by reducing the weight and volume of our packaging. In 2005, thirty-five of our Group's largest business units adopted this approach for their ten flagship products, and the results have been significant. The weight of Actimel bottles dropped from 11g (about four-tenths of an ounce) to 6.5g (less than a quarter of an ounce), while Evian bottles went from 43g (about an ounce and a half) to 30g (just over an ounce). From 2000 to 2004, all three business lines were well on track to meet their goals, reducing packaging weight by 27,000 metric tons—roughly equivalent to the waste generated by a city of 400,000 people in a year.

### A COMPREHENSIVE APPROACH

Clearly, though, packaging cannot be reduced indefinitely. As we reach the technical limits of this approach, DANONE is thus exploring other options. While some of the solutions are less visible to consumers, they are no less fundamental.

The Group factors in the overall environmental impact of packaging materials, from the energy required to manufacture and ship them to scope for recycling. Wherever possible, we avoid using petroleum-based plastics and other materials derived from non-renewable resources and choose recycled materials, although these are still in need of technological improvements. Finally, we contribute to packaging collection and recovery programs and are working to remove obstacles that complicate the recycling process, particularly during separation of different materials.

### Taking the lead on environmental standards

"Our commitment to the environment is an integral part of our identity," says Gary Hirshberg, President and CEO of Stonyfield, the leading US producer of organic dairy products and a DANONE business unit. The brand has translated this principle into bold environmental initiatives that also make it more competitive, such as installing solar panels on the roof of its facility to save energy. Commitment to high standards in relationships with both consumers and suppliers has also helped Stonyfield to turn in strong business performances.

DANONE's packaging reduction initiative eliminated **27,000** metric tons of waste in four years—roughly equivalent to the waste generated by a city of 400,000 people in a year.





# Education

## How can the food industry can help?

Nutrition is everyone's concern today, and education plays a vital role. At DANONE, we are convinced that the food industry can help.

Because Groupe DANONE is in the business of designing and making food products, our responsibility for good nutrition is twofold: to offer products that meet our customers' needs in ways that serve public health, and to help educate consumers by promoting healthy eating habits and more active lifestyles. The food industry can communicate this important message through a wide range of powerful media, starting with the labels on its own packaging.

### BROADLY BASED ACTION

Since so many different interests are involved, the most effective education campaigns bring all stakeholders in from the beginning. With this in mind, DANONE places special emphasis on dialog with the scientific community and with healthcare and education professionals, creating partnerships and supporting the nutrition-oriented research

and education programs of local and international institutions. This approach provides a sound basis for initiatives that are truly relevant to local needs, which is especially important where children are concerned.

Since children acquire eating habits when they are five or six, it is essential to familiarize them with the concept of a balanced diet from the earliest age. DANONE Spain is thus working with Sant Joan de Deu Children's Hospital in Barcelona, forming a multidisciplinary team of experts dedicated to encouraging youngsters and their families to adopt good eating habits and be more active. In Belgium, DANONE has joined up with the Pediatric Society to create the "Healthy Appetite" program, which uses an educational card game to teach children basic rules for healthy eating—such as the importance of regular meals and eating five fruits and vegetables a day. The program has al-

ready yielded positive results, since participants consume around 12% more fruits and vegetables after playing the game. The same core purpose drives DANONE initiatives in other countries such as the Czech Republic, where young people are learning good eating habits with a video game.

### ENCOURAGING EXERCISE

As people become increasingly sedentary, being active is just as important as eating well. Which is why DANONE has broadened its educational efforts to include practical initiatives dedicated specifically to the promotion of exercise. While the most widely publicized of these is our Danone Nations Cup, a soccer tournament that has drawn the participation of more than 10 million children from all parts of the world since 1999, we are taking the same approach through local efforts. These include the Prince Trophy in Belgium, a hip-hop tournament in Canada, and the "Gotta Move" program in France. Sponsored by soccer star Zinedine Zidane, DANONE's goodwill ambassador, "Gotta Move!" is built around a variety of fun, educational tools for youngsters aged 8 to 14, including a web site and a traveling fitness circuit.

### Local impact through Danone Institutes

The 16 Danone Institutes around the world bring nutrition specialists into partnership with healthcare and education professionals to back nutrition research, keep healthcare professionals informed and raise public awareness of the importance of a healthy diet. Each Danone Institute promotes good nutrition in its home country through non-profit initiatives, often with a focus on young people. These include communications drives to help people develop more discerning tastes and encourage children to enjoy fruit, vegetables and other healthy food, as well as programs that encourage early screening to identify weight problems.





# Farmers

## Why get involved in lasting partnerships?

DANONE teams up with farmers in a shared commitment to impeccable quality and steady improvement in environmental standards.

Helping farmers to progress, meet more demanding quality requirements and improve environmental practices are the goals that drive DANONE's partnerships with these key suppliers. Farmers have a special place for us, primarily because they produce our most basic raw materials. Every year, the Group buys 4 billion liters of cow's milk—over 1 billion gallons, or around 0.8% of world output—in 21 countries, in addition to the cereal flours used in biscuits and the fruit added to our dairy products. More indirectly, farmers have an impact on the Group when their fields are in or near the catchment areas\* for the 78 springs operated by DANONE worldwide.

### RISING QUALITY

The equation is simple. Partnership means that the Group can count on regular supplies of top-quality raw materials as it continues to champion environmentally-friendly farming prac-

tices. In exchange, farmers can rely on DANONE's extensive expertise and support in the areas of quality assurance and sustainable development. For milk suppliers, the DANONE Quality, Safety and Environment program formalizes this relationship. The 15,000 dairy farmers who work directly for our Group have made a commitment to comply with the program's 42 criteria for quality, food safety and environmental protection. They are in regular contact with a technical adviser monitoring their farms and conducting annual audits of their operations. In return, Groupe DANONE provides varied support for farmers, among other things through technical meetings and action plans to improve the profitability of their farms. DANONE also offers practical tools, such as kits designed to archive veterinary prescriptions and store medications safely, and a storage unit that allows farmers to retain samples from each lot of feed used over the course of a year.

### SUSTAINABLE AGRICULTURE

In 2005, the Group stepped up efforts in support of sustainable agriculture, with the goal of showing farmers that commitment to the environment brings a new kind of value to their products and is not incompatible with profitable operation. To take an example, farmers can contribute to environmental protection and at the same time improve the image and profitability of their farms by reducing consumption of fertilizers, pesticides, water and energy, or by recycling waste. In France, where DANONE set up working groups on integrated farming in 2005, 53 farms have already begun the related certification process.

### Modernizing dairy farms in Turkey

Counting 15,000 small dairy farms with an average of only two to five cows, Turkey is representative of structures in many emerging countries. To compensate for this fragmentation, in 2000 DANONE began financing more than 300 collection centers, each managed by a controller, to ensure a reliable supply of high-quality, traceable milk. Since 2004, the Group has also offered training programs and innovative financing to encourage a trend toward farms with 20 to 50 cows, and is providing these larger operations with material assistance.

\* Areas where rainwater gathers after passing through several geological layers, before supplying springs.

All three business lines contributed to firm growth in 2005, each with its own strategy, but all with the same will to win.

Photos: Galith Sultan/Rapho

**Fresh Dairy Products 33**  
**Beverages 39**  
**Biscuits 45**





Disfruta  
de una sugerente  
mezcla de té,  
hierbas naturales  
y frutas con el  
Bífidus Activo  
de Danone.  
Nuevos Bio® Herbal:  
Té verde con lima  
y Poleo menta.

# ¡Descúbrelos!



# Vigorous health

DANONE's Fresh Dairy Products continued worldwide expansion backed by a focus on health.

**F**resh Dairy Product (FDP) sales showed an organic rise of 7% to stand at €7.2 billion, accounting for 55% of the consolidated total. Over the past five years, the business line's sales excluding baby food have grown by an annual of 9.3% on average, setting the rise from the beginning to the end of the period at €2.6 billion. At the same time, profitability has improved steadily, with operating

margin up from 12.2% in 2000 to 13.9% or 14.2% including baby food in 2005.

#### NEW REACH

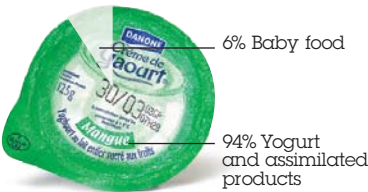
Rapid growth on a number of key markets drove gains in 2005. In Latin America, sales were up 40% in Argentina and 15% in Mexico, while in Eastern Europe overall performance benefited from rises reaching 20% in Turkey and a robust 30% ■■■

#### Ranking by country

**No. 1** in North Africa and the Middle East, Argentina, Belgium, Brazil, Canada, Spain, Eastern Europe, France, Italy, the US, Portugal and Turkey.



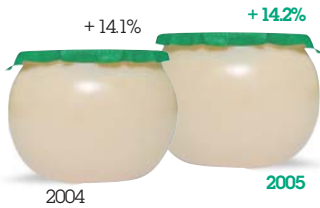
Sales by segment



Sales by region



Operating margin



FDPs around the world

- In April 2005, Danone and Yakult create a joint venture in India to develop the local probiotics market.
- Groupe DANONE increases its holding in Bright Dairy to 9.7% (China).
- The Danone brand enters Egypt by acquiring Olait in October.
- The first Danone products appear in Guatemala, Uruguay and Slovenia where they are exported from neighboring countries.

■■■ in Russia. Sales on the strategic Russian market have thus risen by an annual average of 50% over the past five years, lifting market share\* from 6% in 2000 to 25% in 2005. Growth was also robust in developed markets, at 11% in Germany, 25% in the UK and 12.4% in North America. DANONE's share of the US market topped 36% with sales up by an annual average of no less than 13% over the past five years. France was the only exception to these trends, but market share held high despite softer sales.

FOUR BRANDS WITH €1 BILLION POTENTIAL

The business line's strategic focus is on the continued development of four top brands, each representing a distinct concept based on a specific health benefit, in turn backed by dedicated research. In the case of Activia, the benefit is improved intestinal transit, for Actimel it is consolidation of natural defenses, and for Taillefine-Vitalinea it is weight control, while Danino favors healthy growth. In 2005 each of the brands continued to gain ground on world markets, with the two biggest sellers, Activia and Actimel, doing particularly well to post sales growth of 36% and 19%, respectively. This confirmed the potential for each of the four to generate annual sales of €1 billion in the near future. Activia and Actimel are already well on the way to achieving that goal, with sales already

past the €840 million mark. Promise for growth is backed by both expansion into new markets,—with Activia, for example, now on sale in China,—and innovation to extend ranges. Examples include the successful launch of “double 0” yogurts—zero fat and zero added sugar—in France under the Taillefine name and, in Spain, that of Vitalinea Saciactiv, a zero-fat product with a newly developed recipe inhibiting hunger.

PROXIMITY

Another lever for growth in Fresh Dairy Products is proximity through the extension of sales beyond the big retail stores where our Group has traditionally been well represented to outlets serving local neighborhoods. These may include, for example, traditional grocery shops, snack bars and even stands in the street. To achieve this, the business line is investing heavily in the development of specialized sales teams, delivery systems able to call on a large number of small outlets each day, and the supply of refrigerated displays for dairy products. Returns make the effort well worthwhile since the business line has found that regular visits from sales reps can raise business at grocery shops by around 50%, while the installation of refrigerators pays for itself in just a few months. In 2005, Danone thus established a presence at over 100,000 additional points of sale. ■■■

Activia en route to becoming the top-selling brand

Probiotics are today the fastest-moving segment in Fresh Dairy Products, benefiting from the progress of science and consumers' own health concerns. For Activia, a fermented milk product with bifidus, this was reflected in a 36% surge in 2005 sales to €845 million, a figure expected to rise to €1 billion in

2006, making it the top Danone brand in the near future. An extensive range with variations including fermented milk specialties such as laban and kefir means that Activia products match a wide variety of local tastes and they are now on sale in 30 countries, up from only ten in 2000. The brand is expanding its presence in China, with sales accelerating in the Shanghai and

Guangdong metropolitan areas, and in early 2006 it made its debut in the US, where it will be aiming for a lasting place on the still embryonic market for probiotics.

FDP



\* in value



Research powering success

■ At the 18th International Nutrition Conference in Durban, South Africa, the Danone International Institute awarded the fifth Danone International Nutrition Prize, worth

€120,000, to Professor David Baker for his decisive contribution to research into the fetal origins of diseases in adults. ■ In November, Danone's research center and the Pasteur Institute formed a partnership for research into

probiotics and the way they work. ■ On October 31, Danone inaugurated its first research center for Fresh Dairy Products in Asia. Based in Shanghai, this is dedicated to the development of products matching consumer expansion

in Asia. It comes in addition to existing research facilities in Asia including one for biscuits and two for beverages.



Close up—a breakthrough innovation

In 2005, Danone France innovated in the low-fat segment by launching of Taillefine “double zero”, the first yogurt with 0% fat and 0% added sugar.

Highlights at Blédina

■ 2005 results: Blédina continues to expend in 2005, and with a market share of 46.3% strengthens its lead in the baby food market in France.

Growth remains driven by the trust it has established with mothers. ■ 2005 success stories: – “Idées de maman” bowls—simple recipes in practical plastic bowls that can be heated up

directly in the microwave—was the main source of growth for Blédina in 2005 – for the first time, Gallia is leader in the powdered milk market – Blédilait Croissance takes the lead in milk for toddlers.

■ Noteworthy also was a step rise in exports, with double digit, growth in the majority most markets.

■ ■ ■ BREAKING FRESH GROUND

The Fresh Dairy Products business line is also branching out in new directions with innovative distribution services to reach consumers in emerging markets. For Danimal, a highly affordable yogurt enriched with iron, zinc and vitamin A to meet the needs of underprivileged children in poor townships in South Africa, this means a unique sales force made up of previously unemployed women selling door-to-door under the name Daniladies. This approach has enabled Danone Clover to overcome the problems that result from the lack of organized distribution systems and refrigerators. All told, sales through smaller outlets, referred to as proximity business, accounted for nearly 60% of growth for the

business line in 2005 and 25% of total sales, including 65% in Latin America. Potential remains enormous, since only around a quarter of the 4.4 million outlets that could sell dairy products around the world are at present regular Danone customers. ■

Focus on Asia

Markets for fresh dairy products are still in their infancy in many parts of Asia and consumption of milk is not traditional part of diets in countries such as China and Indonesia. Interest in the health benefits of dairy products is nonetheless on the rise and we are moving to make the most of the potential with a broad presence and new investments. This has involved in particular the creation in China of a new management division for Fresh Dairy Products in Asia and a new research center in Shanghai, as well as a new recipe for Milkkuat, the vitamin-enriched dairy drink sold in Indonesia, the acquisition of an additional interest in Shanghai Bright Dairy in China and new joint venture with Yakult in India. Asia is thus emerging as the new frontier for expansion on Fresh Dairy Product.

59% of the Division's growth in 2005 came from proximity business through traditional grocery stores, stalls, kiosks, etc.: DANONE has steadily built up its presence at all these sales points.

# Nachahmung ist ein Kompliment ...



## ... aber, es gibt trotzdem nur ein Original!

Einzigartig in Geschmack und Beliebtheit – **Volvic Frucht** und **Volvic Tee création**

Leichte Erfrischung ohne Farbstoffzusätze und Kohlensäure und mit wenig Kalorien, aber umso mehr Fruchtgeschmack. Auf Basis von Volvic naturelle.

Eine Marktführerschaft, die so schnell niemand nachmacht. Mit 168,7% Wachstum für Volvic Frucht und 75,2% Wachstum\* für Volvic Tee création!



**DANONE WATERS**  
DEUTSCHLAND GMBH

# Beverages Fresh vitality

Beverages outpaced other Group businesses, with organic growth reaching 10% in 2005. The goal is now to further reinforce leading positions on high-growth market segments.



**B**everages, which accounted for 27% of consolidated sales, showed continued pace in 2005, with organic growth for the past five years averaging close to 8% a year. Sales for the year came to €3.5 billion, showing a rise of 10% at constant exchange rates and scope of consolidation. Operating margin reached a vigorous 13.7% despite the steep rise in prices for the PET used to make bottles—the business line's main raw material.

In 2005, main sources of impetus for the business line, which generates over half of its sales revenues and some 70% of business volumes on emerging markets, were in Latin America, where sales were up 34% overall, benefiting from a 42% surge in Mexico. Trends were also very firm in Asia, where growth remained vigorous, reaching 15% in the year. The region accounts for nearly half of all our Group's beverage sales. With the exception of France, where sales ■■■

**Shares top place worldwide for bottled water**

**Ranking by country**

**No. 1** in China, Argentina, Indonesia, Turkey, Spain and the Canary Islands, Germany and Mexico.

**No. 2** in France



BEVERAGES

Asia, a key market for beverages

Asia now accounts for 48% of beverage revenues, contributing €1.6 billion to the total, and nearly 60% of volumes. This strength is also apparent in competitive rankings, with DANONE well in front for bottled waters in China, Indonesia and Japan, posting sales three times those of its nearest rival. Group brands on offer in the region include Aqua, the world's top-selling bottled water and number one in Indonesia with annual sales of close to 3 billion liters.

Volumes on this scale naturally make cost-effective logistics critical, all the more when rising fuel prices put costs under pressure. In 2005, Aqua responded with a program to optimize logistics, accelerating turnaround and rolling back costs. Environmental impact has also been limited with the reduction of emissions and risks associated with the saturation of truck fleets. The Asia-Pacific area is also a special focus of product innovation as illustrated by functional drinks such as Mizone, sold under the name

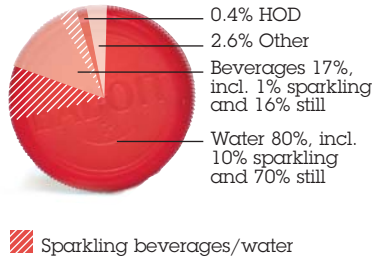
Maidong in China, which has got off to a strong start in Indonesia following its launch on the local market in November 2005. Other new product are Nutri-Express in China, and V Energy in Australia and New Zealand. In New Zealand, subsidiary Fructor launched a nationwide information campaign to promote low-sugar alternatives to soft drinks—with good results, since there has been a clear shift in preferences at New Zealand schools.

Close up—Nutri-Express

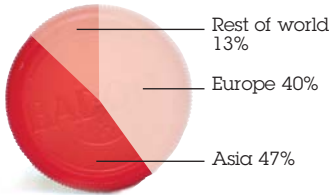
Nutri-Express was undoubtedly Wahaha's greatest success in 2005. 300 million bottles of this milk and fruit-juice based drink, enriched with 15 vitamins and minerals, were sold during the year.



Sales by business segment



Sales by region



Operating margin



■■■ were down a little, European business was also on the rise, putting on 10% overall thanks to healthy rises of 13% in the UK, 19% in Turkey and 27% in Poland. Finally, North America, where conditions have been difficult and sales sliding for several years, showed signs of the first benefits of sales partnerships in the US.

STRENGTHENING POSITIONS ON STRATEGIC SEGMENTS

The sales momentum built up within the business line bears witness to the effectiveness of a strategy focused on the three fastest growing segments of the market for non-alcoholic beverages—natural waters, flavored waters and functional drinks. Together, the three are expected to account for 85% of market growth over the coming five years, probably at the expense of soft drinks (source: business line will be working to bolster competitive positions with the quickest growth on the market, building on two key strengths—powerful brands with leading local positions in three-quarters of our markets, and the capacity to develop innovative products and concepts that match consumer health concerns. In all parts of the world, there is growing favor for low-sugar beverages and functional drinks that help with weight control or provide added energy and vitality. In the natural waters segment, DANONE is thus working to raise awareness of

related health benefits, as illustrated by initiatives in the UK and, more especially, Mexico, where advertising messages place new emphasis on the role of spring water in the elimination of toxins. Other moves to boost sales focus on the creation of additional opportunities to consume, in particular through the introduction of new formats such as the half-liter bottles of Evian launched on the French market in 2005. Turning to flavored waters, DANONE builds on the natural quality and health benefits of its top brands like Aqua and Volvic, backing this up with the launch of low-sugar products to set them clearly apart from soft drinks. A number of successes illustrate DANONE's approach to this segment, where innovation holds the key to growth. These include Levite, a flavored water sold under the ■■■■

**85%** of market growth in beverages over the coming five years will be in natural waters, flavored waters and functional drinks (source: Zenith).



Highlights

- In April 2005, DANONE and Coca-Cola sign a new distribution agreement for DANONE bottled waters in the US.
- In May 2005, DANONE announces the last stage in its divestment of Spanish brewer Mahou, in which it had retained a minority interest, for €600 million. This marks the end of the group involvement in brewing.
- In November 2005, DANONE finalizes the sale of DS Waters to investment fund Kelso. Founded in 2003, DS Waters includes all group HOD operations in the US and reported 2005 sales of \$800 million. DANONE's decision to pull out of the HOD market in North America will have

no impact on business development projects in water sold in large jugs, notably in emerging countries like China, Indonesia and Mexico (see box p. 43).

Volvic and Unicef join forces

In 2005 Volvic Germany teamed up with Unicef to launch operation "One liter for ten liters", under which Volvic undertakes to provide ten liters of drinking water to Ethiopian villages for each liter of mineral water sold in Germany. The only program of its kind at DANONE, this ran from June to August 2005 and will lead to the drilling of 25 wells supplying 900 million liters of water to villages previously without access to a source of drinking water. "One liter for ten liters" exemplifies DANONE's dual commitment to business and social success, and has strengthened links between Volvic and German consumers. It was rolled out in France in an operation benefiting Niger in early 2006 and is set for wider deployment yet.

■■■ Bonafont label in Mexico, which has seen market share rise by some ten percentage points in five years, and Volvic Fruit and Volvic Thé in Germany, which have helped to double Volvic sales volumes in this country in two years. Finally, flavored versions of the Zywiec offering in Poland have won over 60% of the market in just a few months.

STEPPING UP INNOVATION

The pace of innovation is fastest of all in functional drinks, a high-growth market where the key to success is the development of pioneering concepts that mark a new departure and offer scope for worldwide deployment. Examples include Ser, a sparkling, zero-calorie water with added calcium and magnesium that was first launched in Argentina, where it is now market leader for low-cal beverages ahead of the world leader for low-cal soft drinks. The French version, Taillefine Fiz, made its debut in 2005 and is already number two on the market for low-cal drinks, while in the Province of Quebec in Canada it is number one for flavored waters under the name Silhouette. The same strategy has also been rewarded in the Asia-Pacific area, where DANONE produces and markets 11 billion liters of beverages a year. Among the most recent successes in the region, Nutri-Express—developed by Wahaha, number one on the Chinese beverage market—has

already sold several dozen million bottles in just a few months, demonstrating the effectiveness of Wahaha's distribution circuits. This follows on the lead of New Zealand subsidiary Fructor, a prime mover with products such as V Energy, which now has 67% of the market in Australia and New Zealand, as well as Just Juice Bubbles, the latest addition to its range. New products of this kind are building momentum for DANONE's strategy of extending its scope beyond mineral waters to cover a broad range of healthy beverages. Today, they represent 29% of the business line's total sales and 71% of sales of bottled water. They also account for nearly 60% of its growth. ■

BEVERAGES

Latin American sales surge 34%

Beverage sales in Latin America were up a vigorous 34%, reflecting the strength of local brands such as Salus, which has 75% of the market in Uruguay, and Ser Lime Limon in Argentina, which has won the top place on the market for low-cal soft drinks. The strongest growth for the Beverages Worldwide business line was in Mexico, where sales were up no less than 42% as the Bonafont brand went from strength to strength, raising its market share by over 12 points to around 36% in just three years. Bonafont has won a place among Mexico's favorite brands with a strategy emphasizing

the health benefits of its products, in particular in the elimination of toxins, and has backed this up with development of new bottle formats and the promotion of its flavored water Levite. In 2005, Levite already accounted for 18% of sales volumes and 28% of sales revenues generated by the Bonafont brand. In addition to its place in bottled waters, DANONE is number one in Mexico for home and office deliveries, a market representing 12 billion liters a year, with brands that include Bonafont, Aga, Ultrapura and Aquapura.

Success for Ser in Argentina

Ser Lime Limon, a sparkling flavored beverage with zero calories, was launched in 2003. Health-conscious consumers who still enjoy the taste of soda gave it the thumbs up. Today Ser is No. 1 in low-cal soft drinks.





UUTUUS TÄYNNÄ MAKUA.



*Jyväset Yrttimaustettu Cracker, suolainen Jyväshyvä-uutuus, on leivottu käyttäen hyvätekevää oliiviöljyä, runsaasti viljaa ja herkullisia yrttejä. Se on maistuva suupala vaikka sellaisenaan. Kätevissä annospakauksessa ne kulkevat helposti myös mukana.*

[www.jyvashyva.fi](http://www.jyvashyva.fi)



# Innovation makes the difference

Quality-driven innovation, enhanced nutritional value and affordability set DANONE biscuits apart.

In 2005, Groupe DANONE's Biscuits line solidified the comeback that began in 2004. Higher margins and growth in both volume and sales\* rewarded a strategy of ongoing innovation, enhancement of nutritional value, and affordable prices for emerging markets. With sales of €2.4 billion, biscuits account for 18% of the Group total, and in 2005 showed organic growth of 1.5%, reversing a slight downturn to post positive numbers for the second year in a

row. The rebound was driven primarily by emerging markets—with Indonesia up 30%, and Russia and China showing 20% and 9% growth respectively—but several European markets were also particularly vigorous, among them Spain, where sales rose 7%. Outside France, biscuit sales were up more than 3%. Although LU France, the line's number one business unit, saw sales level off slightly in a slackening market, it made gains ■■■

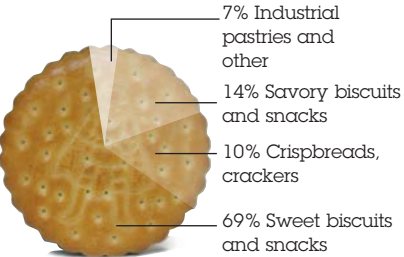
## Leading positions worldwide

**No. 1:** in Belgium, Eastern Europe, China, India, France, Morocco, Russia and Tunisia

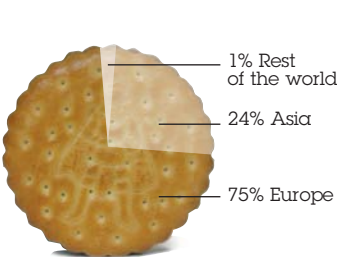
\* Like-for-like.



Sales by segment



Sales by region



Operating margin



Russia, a new frontier

With growth of 20% in 2005, Russia is a new frontier for our Biscuits line. Market leader Bolshhevik has stepped up the pace of sales by overhauling its logistics in this enormous country, establishing a route to market to distribute products well beyond the Moscow-St. Petersburg corridor. At the same time wholesalers and local vendors have been organized into regional networks, with the goal of expanding our current 60% coverage of Russian territory to 90% by the end of 2006.

■■■ in both volume and market share, shoring up its leading position with over 30% of the French market. At the same time, Biscuits operations became significantly more profitable. Although operating margins have lagged behind the Group average in the past, in 2005 Biscuits posted an above-average margin of 14.5%, an increase of 3.5 points over last year. Gains are a direct result of improving plant efficiency and investing in innovation over the past two years.

STEPPING UP THE PACE OF INNOVATION

Innovation is the primary driver for growth in the world biscuit market, which edged up in 2005, spurred largely by market growth of around 5% in Asia. For DANONE, innovation is grounded in two simple ideas: renewing our commitment to quality, and positioning our products well away from retailer brands and deep-discount offerings. Over the past two years, some of our business units have revisited more than half of their recipes, and all Group companies have played a leadership role in re-energizing the biscuit market through innovation. On the French market, for example, around 90% of all new products came from LU France, where innovation accounted for 11% of sales. New offerings included lemon Paille d'Or wafers (see Highlights), flavored Mikado cookies and Petit LU with Fruit, all designed to pique French consumers' curiosity and satisfy their demand for quality. Elsewhere

in Europe we've taken the same fresh approach, rolling out new crackers under the TUC brand and broadening the breakfast biscuit range to include whole grains.

ENHANCING NUTRITIONAL VALUE

Backed by extensive research and development, all of these innovations are directed towards the same goals: continually improving the nutritional value of our products and deriving maximum benefit from the energy and fiber naturally found in grains. In markets where consumers are increasingly health-conscious, the ability to improve nutritional value without sacrificing taste appeal is key to competing and succeeding. With this in mind, DANONE researchers are using their expertise to design recipes with the best possible balance—less sugar and fat, and more grain, fiber, fruit and other nutrition-packed ingredients. Between 1999 and 2005, grain content of LU Biscuits in France rose 14% on average, while added sugar and fat fell by 9% and 7% respectively. We have also developed whole-grain versions of our biscuits, positioning these as healthier products and using packaging to underscore the value and benefit of cereals.

AFFORDABILITY DRIVES GROWTH

Because emerging Asian markets account for 21% of DANONE Biscuit sales, growing the market means combining ■■■

BISCUITS

Challenging old ideas

A recent study by leading lifestyle researchers in France questions conventional wisdom on eating biscuits. The study\*, which surveyed 1,500 adults and 1,000 children, found that biscuit consumption in France is moderate, averaging 17 g per day for children and 10 g for adults. Although biscuits are often accused of encouraging unhealthy snacking and interfering with regular meals, 89% of biscuits are actually eaten during regularly scheduled meals, especially as part of breakfast and

children's after-school snack. On average, biscuits accounted for only 4.5% of total sugar ingested by youngsters each day. Finally, researchers found no difference in body mass index between participants who ate biscuits and those who did not, showing that moderate biscuit consumption as practiced in France cannot be viewed as a causal factor in the rise of obesity.

\* by Credoc (Centre de recherche pour l'étude et l'observation des conditions de vie)

Close-up—Mikado

On the heels of its successful milk-chocolate Mikado and chocolate-caramel Mikado, LU Biscuits has launched a "revolutionary" new offering—hazelnut crunch Mikado. Tasty hazelnut pieces were added to a biscuit previously known for its smooth texture—a radical departure in keeping with DANONE's broader strategy of innovation.



# BISCUITS

### Asian biscuit boom

The Asia-Pacific region represents 25% of total Group biscuit sales, and DANONE leads the market in India, Malaysia, Indonesia, and northern and eastern China, where our brands averaged

7% growth in 2005. Indonesia offers an excellent example of the Group's strategy for local growth. As a result of the affordability strategy launched in 2001 with our Biskuat range, DANONE's market share has doubled,

topping 14.4% in late 2005. Volumes have exploded, with annual growth averaging more than 30% over the past five years. Between 2000 and 2005, local output increased fivefold, and our Karawang plant stepped up production

to meet the challenge. This benchmark facility, which will soon add a fourth line raising capacity to 50,000 metric tons, is well on its way to becoming DANONE's largest biscuit plant.

### Close-up—Jia Gai

The launch of Jia Gai, a financially affordable and a nutritionally enriched (particularly in calcium) product for low-income Chinese consumers, proved a great success for Danone Biscuits China.



### Highlights

■ In September 2005 DANONE begins selling biscuits in Croatia, Slovenia and Romania, exporting products from plants in neighboring countries. More broadly, exports are on the rise in several regions, including

the United States and the Middle East.

■ 2005 marks the 100th birthday of France's famous Paille d'Or biscuits and LU, maker of this delicious raspberry-filled wafer, celebrates by launching a new lemon-flavored version. Around 2,500 metric

tons—some 14.3 million packages—of Paille d'Or are sold annually.

■ In October 2005, Groupe DANONE and Tunisia-based Sotubi announce the creation of a joint venture aimed at growing the Algerian biscuit market and funding construction of a plant

in Algeria. Partners since 1997, DANONE and Sotubi will hold 51% and 49%, respectively. Under the new agreement, the Group will strengthen its presence in Africa and the Middle East through holdings in local companies with leading market positions.

■■■ affordability with nutritional value. In Asia, biscuits are viewed as a nutritious staple rather than an indulgence. In countries where many—and in some cases most—people live on less than two dollars a day, consumers demand biscuits that are both healthy and affordable. DANONE began meeting this demand five years ago in Indonesia with our Biskuat range. Fortified with essential nutrients, Biskuat is sold in packages priced at 500 rupiah (about

€0.05) in nearly a million retail outlets. Success in Indonesia inspired the launch by DANONE Biscuits China, which offers budget-conscious Chinese consumers a biscuit fortified with calcium and other nutrients for €0.15. In only a few months, DANONE Niu Nai Jia Gai has become a winning product— all the more so in that the range has encroached only marginally on our higher-end offerings. ■

### Low-sugar biscuits

LU now offers low or reduced-sugar versions of Petit Déjeuner, Pépito, Prince, Barquette and other European flagship biscuits. Grain, fiber, fruit and other nutrition-packed ingredients are added to replace the missing sugar.

**21%** of biscuit sales are in emerging markets in Asia, where biscuits are viewed as a nutritious staple rather than an indulgence.



#### WESTERN EUROPE

20,985 employees  
**No. 1** in fresh dairy products  
**No. 1** in bottled water  
**No. 1** in biscuits and cereal products  
**Sales:** €6.8 billion,  
54% of the consolidated total

#### EASTERN EUROPE

11,243 employees  
**No. 1** in fresh dairy products  
**No. 1** in bottled water  
**No. 1** in biscuits and cereal products  
**Sales:** €1.2 billion,  
10% of the consolidated total

#### AFRICA AND MIDDLE EAST

2,648 employees  
**No. 1** in fresh dairy products in South Africa  
Groupe DANONE has significant interests in companies with strong positions in Saudi Arabia, Morocco, Tunisia, Algeria and Israel.

#### ASIA-PACIFIC

41,137 employees  
**No. 1** in bottled water  
**No. 1** in biscuits and cereal products  
**Sales:** €2.2 billion,  
17% of the consolidated total

#### LATIN AMERICA

9,311 employees  
**No. 1** in fresh dairy products  
**No. 1** in bottled water  
**No. 2** in biscuits and cereal products  
**Sales:** €1.1 billion,  
8.5% of the consolidated total

#### NORTH AMERICA

2,860 employees  
**No. 1** in fresh dairy products  
**Sales:** €1.1 billion,  
8.5% of the consolidated total

# DANONE WORLDWIDE

In under a decade, DANONE's scope of operation has been completely transformed, with markets driving growth—once European—now on all continents.



الصافي فروتي... صحي ولذيذ، بلا جدال.

الصافي  
ALAFI

جديد

فروتي



زبادي بالفواكه الطبيعية

Insideview



DANONE is also—perhaps above all—a distinctive management style built on firm convictions. Employees tell us what it means for them.

Photos: S. Camboulive, É. Flogny and J. Galland/Aleph, L. Benevello, R. Valleros

**P**roviding opportunities for personal development is the first responsibility of a business to its employees. And it is also one of the most effective ways of improving performance.

As DANONE has insisted for over thirty years, there can be no lasting business development without personal development. Which in turn assumes respect for and defense of basic principles, starting with workplace safety. Enter WISE, a program introducing more stringent safety procedures at all levels of the business (see p. 56). Equally important is compliance with the social practices recommended by the International Labour Organization, which are now an integral part of DANONE's agreements with union representatives worldwide and an obligation

for DANONE suppliers as well (see p. 57, RESPECT). Personal development also means enhancing professional skills—those needed for both current and future jobs. Skills that will enable employees to advance along a promising career path, taking on new functions with more responsibilities or positions in other fields, other professions and even other countries. Which is where policies on training, organization and functional or geographical mobility, and employability enhancement through diploma courses come in (see p. 54, 58 and 59). By the same token, these initiatives bolster the personal commitment of the men and women at Groupe DANONE, as borne out by our internal research and surveys (p. 55 and 61).



From left to right: Christine Gaze, Virginie-Colette Beauval, Colette Tisserand, Franck Dosière, Marie-Thérèse Rodriguez, Aude Gilbert.

Class of 2005 from the Blédina plant in Villefranche-sur-Saône, France.



## EMPLOYABILITY

When they started at DANONE, they never thought they would earn a diploma. But by the end of 2006, 750 of the Group's employees in France will have earned a credential from the education system through Evoluance, the French component of the Group's Evolution program. Although Evolution takes different forms in other countries, the philosophy of this international initiative is always the same: to help employees adapt to a changing job market through professional development.

Launched in 2003, Evoluance offers all DANONE plant workers, office staff and front-line supervisors a choice of two credentials:

- the General Training Certificate program, taught by instructors from the French education system and designed primarily for DANONE plant and warehouse employees who do not yet have a diploma; and
- the Recognition of Prior Learning program that allows employees who already have a diploma to translate workplace experience into academic credit, earning one of nearly 40 creden-

tials over a period of up to three years. In 2005 Evoluance won the Management and Skills Trophy jointly awarded by Cegos, Europe's leading provider of professional training, and the French business monthly *Enjeux-Les Échos*. Groupe DANONE recently signed a new agreement with the French Ministry of Education to put the program—which takes different forms in different countries, while building on the same general philosophy—on a lasting basis.

## COMMITMENT

Every two years since 1999, Groupe DANONE has polled its 9,000 managers on their commitment to the Group. In only a few years, this survey—now rounded out with a survey of General Managers and another of all business unit employees regardless of position—has gone far beyond providing a snapshot of employee opinion, becoming a highly effective tool to shape and consolidate employee commitment. The surveys have shown that communicating results and taking corresponding action makes managers more committed, revealing a close correlation between effective dissemination of survey results within a business unit and its overall economic performance. But most importantly of all the surveys have demonstrated that corporate culture remains the single most powerful driver of employee commitment. The experience of Danone UK is particularly telling. As it worked to translate Group values into everyday practice—with initiatives sometimes as simple as providing fresh fruit for employees to express our commitment to health—the business unit has seen a significant and unmistakable rise in employee commitment, which in turn has had a direct impact on performance. And recognition has also come from outside the business, with the BBC naming Danone UK the Healthy Workplace 2005.

"Most companies fail to make the connection between employee commitment and business performance. Groupe DANONE stands out from the crowd in the way it uses internal surveys to drive commitment—which in turn drives growth."

Liz Ellis, Human Resources Director, Danone UK.



## SAFETY

While DANONE has achieved continuous improvement in workplace safety in the past, in recent years we have been less satisfied with our performance in this critical area.

Dealing with this calls for ambitious moves to shift from a largely local approach to a more demanding, cross-functional mentality, making safety everyone's business, not just a job for experts. Our Biscuits line took up the challenge in 2004, launching the WISE safety improvement program with the goal of continuous reduction in workplace accidents. Now deployed in Fresh Dairy Products and Beverages, the Group's other business lines, the WISE program has already achieved significant improvements in the Biscuits business line, which has seen accidents drop by 37% in one year.

Designed with the help of DuPont, a world-class specialist in safety management, the program is based on one simple observation: 90% of all accidents are caused by people, not technical problems. Which puts management at the heart of workplace safety. Of the 12 core principles underpinning the WISE program, the most important is Visible Management Commitment. That means, for example, that whenever managers see a safety hazard, they will immediately talk with those involved and take steps to eliminate the hazard. Managers are also called on to support the program by communicating effectively, conducting internal audits, setting ambitious goals and providing the necessary resources—in short, making safety an integral part of everything we do.

**"WISE makes safety an integral part of performance, reflecting its place as a non-negotiable corporate value. For shop-floor employees, it is also a clear step ahead in terms of quality of life at the workplace."**

**Romilbert Guastalli**, plant manager, Saiwa biscuits in Capriata d'Orba (Italy).



## RESPECT

For over 20 years, DANONE has built its human resource policy on the conviction that sustainable economic success is impossible without personal and professional growth for individuals. For us, the seven fundamental social principles recommended by the International Labour Organization are non-negotiable—a given. To formalize this commitment, all agreements signed with the Inter-

national Union of Food Workers' Associations in 2005 explicitly included the seven principles, which address the critical issues of child labor, forced labor, discrimination, freedom of association and the right to collective bargaining, workplace safety, wage conditions and working hours.

The Group will apply this initiative, known as RESPECT, even more broadly beginning in January 2006, encouraging all business units to ensure that their

suppliers comply with the fundamental social principles. Grounded in specific procedures that include social audits and other rigorous assessment tools, RESPECT has a direct impact on the way our people work. To cite one important example, buyers no longer focus exclusively on getting the best product for the best price, but pay close attention to supplier working conditions. By 2008, all of the Group's suppliers will be implementing RESPECT.



**"At DANONE our management style is built on relationships. People do not interact as superior and subordinate, but as one human being to another. We always treat each person as an individual, not just a member of a group."**

**Joam Sintes**,  
Human Resources  
Director, Danone  
Argentina

**"Our RESPECT initiative ensures that DANONE's values are applied across the board—from suppliers through to customers. And it is also a promise of sustainable growth for our Group."**

**Pablo Colombo**, Purchasing  
manager, Danone Argentina.



## CAREERS ON THE MOVE

One of Groupe DANONE's core human resource challenges is developing internal resources and offering varied career paths geared to mobility wherever possible. While geographic mobility provides the international experience and familiarity with different management cultures essential to a multinational group, cross-functional mobility is just as important, offering opportunities for versatile, satisfying career paths and building bridges between functions that all too often remain isolated from each another. At DANONE it is not uncommon to find a former buyer in marketing, or to see a human resource manager running a production plant. Although this approach can clash with ingrained habits, it is central to our drive to develop the human resources needed for continued success. Three of many examples tell the story.

"DANONE has given me a fantastic opportunity to develop my professional skills by encouraging and supporting my move from Operations into Sales. It was a gamble, but HR helped me succeed by developing an on-the-job coaching program with my co-workers in sales."

**Filippo della Torre**, "Italian", Key Account Manager, Danone Waters UK.

"You have to keep moving internationally. And not just in France or the US—in Slovakia and Uruguay. The biggest ideas come from small countries. You have to take risks, learn to think differently. That's what DANONE looks for in an expat."

**Mariano Lozano**, "Argentinian", General Manager, Danone Clover, South Africa.





## CAREERS ON THE MOVE

"I came to France to learn about new sales methodologies, extend my business network and better understand the DANONE culture. Now, I'm going back to China where I will use what I learned in the Fresh Dairy Products division. This energy opens up opportunities for personal and professional development."

**Rosine Pu**, "Chinese", Transportation buyer at Danone France and, from April 2006, buyer for China Fresh Dairy Products.

## PERFORMANCE

At DANONE we know that human resources are a primary driver for growth. A look at the performance of the Group's business units around the world shows that the most successful companies are those that invest the most in managing their people. Closer analysis reveals that some management styles are better than others at motivating employees and inspiring commitment. Building on this insight, DANONE has identified specific steps that give people and organizations maximum impact on performance and growth. These center on a close-knit management team that communicates goals to everyone in the business unit, cultivating a strong corporate culture and values. And by the same token reinforcing our position as an employer of choice to attract effective, committed people.

To help our business units work toward these goals, the Group encourages them to share best practices from country to country and from one business line to the next—not to impose a one-size-fits-all solution, but to cultivate new attitudes.



"The best brands and the most innovative ideas in the world won't get you anywhere if you don't have the human resources you need to develop them."

**Javier Robles Gonzales**, Executive Vice-President for Southern Europe, Fresh Dairy Products.



代謝のいいカラダづくりをサポート。



あなたをご存知でしょうか。  
evianが、代謝のいいカラダづくりをサポートすることを。  
Ca (カルシウム) と Mg (マグネシウム) のバランスに  
すぐれた水であることを。  
カラダを考える人に evian。



あなたの知らない evian.

Newhorizons

Groupe DANONE targets  
the future with investments  
in research, production  
facilities and new develop-  
ment strategies centered  
on affordability.





Year after year, R&D puts breakthroughs in technology to work to combine tasty eating with enhanced nutrition and health benefits.



# RESEARCH

In a business that makes healthy food the priority, research naturally has a central place—preparing for the products of the future with a focus on nutrition and active health.

**A**s in other areas of operation at DANONE, new product development always has an eye on customers and consumers. This is reflected in our four priorities for research: nutrition, active health, familiarity with consumers, and product affordability and accessibility, particularly in developing countries. The overriding goal is to reinforce market positioning

with expanded ranges offering new benefits in areas such as digestion, weight control, growth, and natural defenses. There are three stages in the research process. The first begins well upstream from business operation and production, with major cross-functional projects concerning research into subjects such as probiotics. These aim to open the way for products

that may only come out much later. This first stage is a search for fundamental knowledge through scientific testing of hypotheses, generally together with outside partners and leading international research authorities. Findings may concern, for example, the human immune system or the role of probiotics in tactile and visual perception, innate preferences for sweet ■■■

## Partnership with the Pasteur Institute

In November 2005 Groupe DANONE and the Pasteur Institute teamed up for a program of joint research to identify

the precise mechanisms of probiotics\* and gain a clearer understanding of their health effects, forming a partnership to make the most of complementary expertise. Groupe DANONE's research teams offer highly

specialized knowledge in fermentation biotechnology, where resources include a unique collection of some 3,000 different lactic ferments, and human nutrition, while the Pasteur Institute, internationally recognized for its

achievements in microbiology and immunology, has developed new *in vitro* and *in vivo* test methods with special relevance for probiotics. The tie-up renews a long tradition of association—the first Danone

yogurts brought out in Barcelona in 1919 were made with ferments that came directly from the Pasteur Institute.

\* Probiotics are living microorganisms which, when ingested in sufficient quantity, provide positive health effects.



## Marketing and research: building bridges

Since September 2005, DANONE's Daniel Carasso Research Center outside Paris has also been home to several dozen marketing specialists from the Fresh Dairy Products business line. These experts have moved in among the white coats and laboratory equipment to ensure a daily link between research and marketing. For Sven Thormahlen, head of Research, and Bernard Hours, head of Fresh Dairy Products, this is only logical: since Group strategy aims for continued reinforcement of the health positioning of top lines such as Activia, Actimel, Vitalinea and children's specialties, it is essential for marketing and research teams to share the same vision of brands and products. Which means that they must interact constantly rather than step in one after the other in traditional sequential mode—and for that there is no substitute for day-to-day contact. Clearly, Danone stands to win an added edge as researchers become more aware of consumers and markets more aware of what goes into scientific evidence.

**800** people world-wide are employed by DANONE research units, including 450 researchers and engineers specializing in product and process development at the Daniel Carasso Center south of Paris.





Roll-out of slow energy release biscuits came after 40,000 hours of R&D.

■■■ tastes, or possible cereal substitutes for sugar in biscuits.

The second stage in our research process is more directly related to business operation, aiming to determine whether laboratory results still apply in real production conditions. An example is testing the preservation of the health benefits of a given molecule once it is worked into a complex recipe.

Finally, in the third stage, the research gets to grips with the product itself to give it the right texture and aroma, backing this up with consumer tests to verify organoleptic properties and industrial tests to ensure the feasibility of new processes.

Importantly, too, research provides scope for new functional synergies between our three core business lines. An example is the way recent work on nutrition

has opened up new possibilities for both Biscuits and Fresh Dairy Products. This includes the development of slow energy release biscuits with a special baking process to make the most of specific nutritional features. A key benefit is that when they are part of a full breakfast, they help discourage snacking between meals, keeping hunger at bay for around four hours. A new Vitalinea-brand dairy drink developed in Spain offers similar benefits. ■

# 80%

of DANONE research resources are dedicated to health and nutrition.

# INDUSTRIAL INVESTMENT

In 2005, Groupe DANONE invested €607 million to raise production capacity and improve logistics, readying for steep growth in selected markets. A close-up on three cases in Fresh Dairy Products.





RUSSIA

**In 2005 monthly output** at the Chekov plant, 25 miles from Moscow, rose from 7,000 to 12,000 tons and surface area more than doubled. Today the unit has the space it needs to install new production lines in the years ahead.

**Headcount rose 35% over five months**, with 120 employees recruited and trained in a matter of weeks.



TURKEY

**With sales rising steeply**—up 20% in 2005—Danone Turkey revamped its Lüleburgaz plant over an 18-month period and tripled output at the facility, 90 miles from Istanbul, to 150,000 tons a year.

**The renovated plant** employs 320 and was officially opened in November 2005 in a ceremony attended by Turkey's prime minister.





SAUDI ARABIA

The Al Kharj plant, equipped with leading-edge technology from DANONE, lies in the heart of the Saudi desert, immediately adjacent to a dairy farm with 34,000 head of Holsteins.

With a total surface area of 15,000 sq. m—1.6 million sq. ft.—the plant counts 21 production lines and turns out 250,000 tons a year.



AFFORDABILITY

Groupe DANONE is working to make the benefits of healthy food accessible to ever more people, formulating and testing innovative business models focused on affordability.



**Milkual**, an Indonesian dairy specialty enriched with essential nutrients, sells for 1,000 rupiah or 10 eurocents a serve.

In keeping with our mission of bringing health through food to as many people as possible, we are refining our strategy to develop more affordable products that match the nutritional needs and purchasing power of the

majority of people. Today, DANONE is a worldwide group generating over 30% of sales in developing countries, but our core consumer markets are still mainly among better-off city dwellers. Yet in many of these countries a lot of people ■■■



■■■ cannot afford to spend more than a dollar a day on food. They nonetheless aspire to the safe, healthy diets that have so far been denied to them.

**A NEW MODEL FOR GROWTH**  
Responding to those aspirations is a challenging task in many ways, first of all where prices are concerned. Offering products that meet DANONE quality standards at less than 10 or 15 eurocents a serve demands a complete overhaul of every link in the value chain to reinvent production, packaging, distribution and sales. Another challenge is to develop products that match local health needs and nutritional deficiencies, and are at the same time attuned to local tastes. Finally, there is the challenge of developing new distribution methods in an environment dominated by small outlets offering only the barest necessities, which means taking the time to work in close cooperation with local people, authorities, scientists and associations. The first experiments with affordability strategies began with calcium-enriched biscuits launched on the Indonesian market under the Biskuat name in 2000, and

since then followed up with four new recipes plus a dairy beverage, Milkkuat. Moves have also got under way in other countries including Morocco, where highly affordable Moufid yogurts have been on sale since 2004, and, perhaps most remarkably, in South Africa, where Danimal, a yogurt especially designed for sale in poor townships, was put on the market in May 2005. Enriched with iron, zinc and vitamin A to remedy common deficiencies in these areas, Danimal sells at just one rand or a little under 15 eurocents apiece. But innovation is most apparent in distribution, as explained on the page opposite. Following the resounding success of first tests in Soweto, sales will be extended by stages to other townships in the Johannesburg area and in turn to the country as a whole. This achievement shows the promise of a strategy that is set to take new shape in other parts of the world. ■



After Soweto, which counts three million people, and Orange Farm with two million, Danimal is set to go on sale in other parts of South Africa.



**Danimal**  
is a dairy product with added iron, zinc and vitamin A that meets the special nutritional needs of South African children. It sells for just one rand per serving—less than 15 eurocents—in Soweto and Orange Farm townships.

A fresh take on sales

In developing countries, affordability is meaningless without availability — not only must the price be right but the product must be available where people live and shop, which generally means in small outlets serving local neighborhoods. These can be extremely scattered as in Indonesia, which counts no fewer than 1.8 million shops and kiosks. In response, our Group has developed new expertise to ensure that our products are widely available and that outlets receive regular deliveries, a challenge that calls for imagination and innovation in distribution and logistics. In Jakarta, for example, we financed the purchase and equipment of several hundred romboks—licensed pushcarts for street sales—in a mutually beneficial arrangement that makes our products available to local consumers and provides the pushcart owners, generally women, with a livelihood. In South African townships, too, benefits have been mutual, although the methods are very different. In these areas, there are no structured networks of neighborhood outlets and truck deliveries are not an option. The response, which went into operation in 2005, is a new type of door-to-door sales by formerly unemployed local women, dubbed Daniladies, who bring Danimal, a yogurt especially designed for local children, to the people living in their neighborhood. The results have been very positive for everyone, ensuring the success of Danimal and providing the Daniladies with a regular source of income for themselves and their families. Local employment is also a key feature of a new joint venture launched alongside micro-credit specialist Grameen Bank in Bangladesh this year.

At home in Indonesia

Affordability strategies demand first-hand knowledge and familiarity with real needs and the way people live—what goes into meals, how they are prepared, what people like

and what might be lacking in their diets—to develop products fully suited to the local environment. Reflecting this, DANONE development teams in Indonesia set up an immersion

program, spending ten days in the homes of local families and drawing on the assistance of ethnologists, sociologists and nutritionists from the University of Jakarta.



# Dormir es crecer



¿Sabías que... Es durante el sueño cuando se segrega la hormona del crecimiento Gh?

BRILLA en la oscuridad



## A YEAR OF GROWTH

Sales rose 6.7% in 2005, setting consolidated net sales at €13,024 million—on target for the sixth year running.

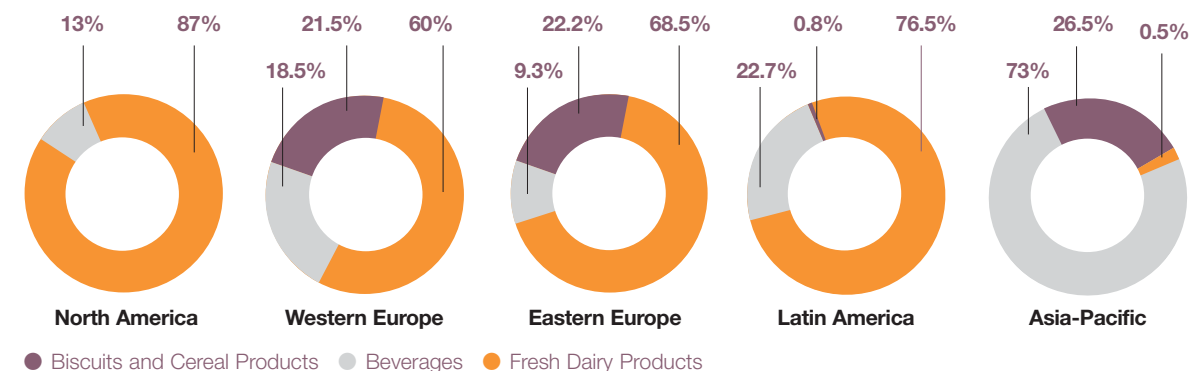
# +6.7%

organic growth  
for Groupe DANONE  
in 2005

→ LIKE-FOR-LIKE SALES GROWTH OF 6.7%

Organic growth of 6.7% and a further rise in operating margin against a backdrop of sluggish consumer demand in France and pressure on some raw materials bore out our choice of strategic priorities in 2005. These called for reinforcement of our positioning in healthy eating, growth in markets identified as new frontiers, a major drive in innovation, and world-wide deployment of key brands with sales potential of €1 billion. Consolidated net sales thus reached €13,024 million full year, up 6.1% on the reported figure for 2004.

→ NET SALES BY BUSINESS LINE AND BY REGION





## → KEY FINANCIAL HIGHLIGHTS

€ millions

## Income statement data

	2004	2005	CHANGES
Net sales	12,273	<b>13,024</b>	+ 6.1%
Organic growth	–	<b>+ 6.7%</b>	
Trading operating income	1,608	<b>1,738</b>	
Trading operating margin	13.1%	<b>13.35%</b>	25 bp
Net income (excl. non current items)	910	<b>1,031</b>	+ 13.3%
Net income (attributable to the Group)	449	<b>1,464</b>	

## Cash flow data

Cash flow provided by operations	1,574	<b>1,716</b>	
Capital expenditures	520	<b>607</b>	
Purchase of businesses and other investments	98	<b>636</b>	
Free cash-flow <sup>1</sup>	1,204	<b>1,303</b>	

## Financial position

Net debt	4,538	<b>3,572</b>	
Stockholder's equity's (including minority interests)	4,506	<b>5,621</b>	
Debt/equity ratio	100.7%	<b>63.5%</b>	

## Current per share data (€)

EPS (fully diluted)	3.57	<b>4.14</b>	+ 15.9%
Dividend per share	1.35	<b>1.72</b>	+ 26.0%

## Market

No. of shares at Dec. 31 ('000)	268,095	<b>264,235</b>	
Share price at Dec. 31 (€)	68	<b>88</b>	
Market capitalization at Dec. 31	18,230	<b>23,252</b>	

## Personnel

Total employees	89,449	<b>88,184</b>	
Western Europe	22,492	<b>20,985</b>	
Outside Western Europe	66,957	<b>67,199</b>	

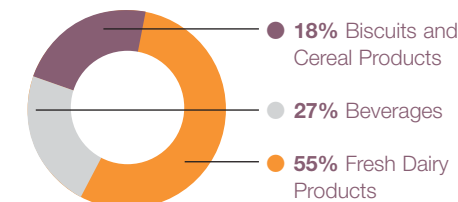
(1) Cash flow from operations less capital expenditures (net of disposals) and change in working capital.

(2) Subject to the approval of the General Meeting of shareholders.

## → NET SALES BY BUSINESS LINE

€ millions

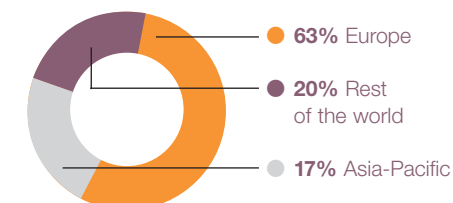
	2004	2005
Fresh Dairy Products	6,510	<b>7,184</b>
Beverages	3,201	<b>3,473</b>
Biscuits and Cereal Products	2,562	<b>2,367</b>
<b>GROUP TOTAL</b>	<b>12,273</b>	<b>13,024</b>



## → NET SALES BY REGION

€ millions

	2004	2005
Europe	8,096	<b>8,179</b>
Asia-Pacific	1,965	<b>2,235</b>
Rest of the world	2,212	<b>2,610</b>
<b>GROUP TOTAL</b>	<b>12,273</b>	<b>13,024</b>

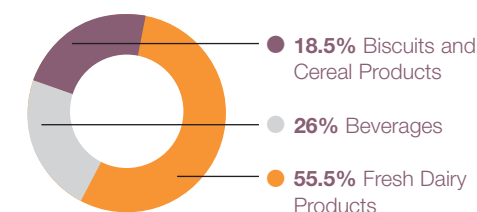


**+18%** DANONE's "new frontiers" continued to drive growth, with sales up 18% (25% of total sales).

## → TRADING OPERATING INCOME BY BUSINESS LINE

€ millions

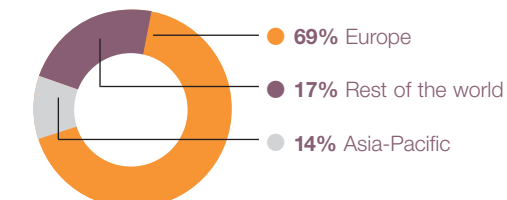
	2004	2005
Fresh Dairy Products	917	<b>1,019</b>
Beverages	493	<b>474</b>
Biscuits and Cereal Products	278	<b>343</b>
Unallocated expenses	– 80	<b>– 98</b>
<b>GROUP TOTAL</b>	<b>1,608</b>	<b>1,738</b>



## → TRADING OPERATING INCOME BY REGION

€ millions

	2004	2005
Europe	1,209	<b>1,266</b>
Asia-Pacific	259	<b>256</b>
Rest of the world	220	<b>314</b>
Unallocated expenses	– 80	<b>– 98</b>
<b>GROUP TOTAL</b>	<b>1,608</b>	<b>1,738</b>





13.35% Trading operating margin rose for the 11th year in a row despite an increase in raw material prices linked to oil.

→ TRADING OPERATING MARGIN BY BUSINESS LINE	2004	2005
Fresh Dairy Products	14.1%	14.2%
Beverages	15.4%	13.7%
Biscuits and Cereal Products	10.9%	14.5%
GROUP TOTAL	13.1%	13.35%

→ TRADING OPERATING MARGIN BY REGION	2004	2005
Europe	14.9%	15.5%
Asia-Pacific	13.2%	11.5%
Rest of the world	10.0%	12.0%
GROUP TOTAL	13.1%	13.35%

→ WORKFORCE AT DEC. 31, 2005

32,228 people in Europe

41,137 people in Asia-Pacific

14,819 people in the rest of the world

For a total of 88,184 employees worldwide

→ CAPITAL EXPENDITURES

Capital expenditures reached €607 million in 2005 (4.7% of sales) up from €520 million in 2004 (4.2% of sales), reflecting expansion of production and logistics capacity in high-growth countries. Net financial debt was down from €4,538 million at the end of 2004 to €3,572 million on December 31, 2005.

CAPITAL EXPENDITURES (€ millions)



target

Groupe DANONE is on target to meet projections. For 2006, these call for net sales growth to reach 5 to 7% once again.

→ CURRENT EARNINGS PER SHARE (DILUTED)

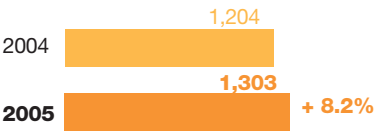
+15.9%

Current earnings per share (diluted) rose 15.9%, from €3.57 in 2004 to €4.14 in 2005.

Current income, excluding minority interests, totalled €1,031 million compared with €910 million in 2004, a rise of 13.3%. Groupe DANONE bought back own shares for a total of €685 million during the year.

→ FREE CASH-FLOW (€ millions)

Free cash-flow showed a further improvement, rising 8.2% on 2004, reflecting the combined impact of increased cash flow provided by operations and optimization of working capital.



→ PRESENCE WORLDWIDE

Sales teams in 120 countries. 201 plants around the world.

→ NET SALES IN TOP TEN COUNTRIES:

→ France: €2,883 million → Spain and Canary Islands: €1,463 million → China: €1,186 million → US: €893 million → Mexico: €613 million → Germany: €543 million → Benelux: €537 million → United Kingdom and Ireland: €476 million → Italy: €433 million → Argentina: €374 million.

→ ANNUAL PER CAPITA CONSUMPTION

BISCUITS (KG/YEAR)

→ 2.4: world average  
→ 9: Western Europe  
→ 2.9: Eastern Europe  
→ 9.1: North America  
→ 4.8: Latin America  
→ 1.1: Asia-Pacific  
→ 0.4: North Africa & Middle East

BOTTLED WATER (LITERS/YEAR)

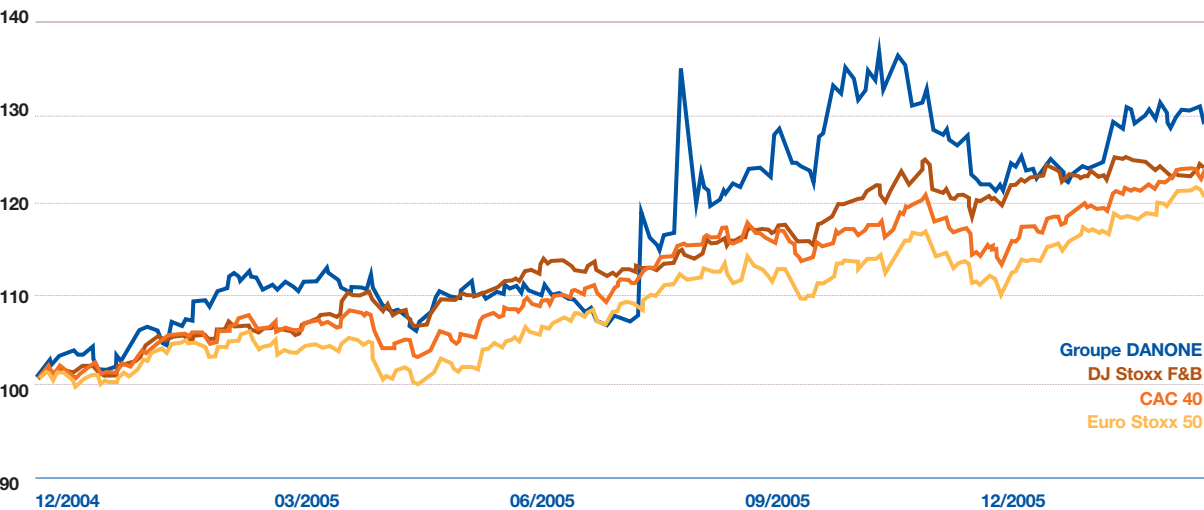
→ 26: world average  
→ 107: Western Europe  
→ 26: Eastern Europe  
→ 79: North America  
→ 51: Latin America  
→ 11: Asia-Pacific  
→ 12: North Africa & Middle East

FRESH DAIRY PRODUCTS (KG/YEAR)

→ 4.3: world average  
→ 24.8: Western Europe  
→ 4.8: Eastern Europe  
→ 14.7: North America  
→ 4.4: Latin America  
→ 1.5: Asia-Pacific  
→ 1.3: North Africa & Middle East



→ MAJOR STOCKMARKET INDEXES FROM JAN. 1, 2000 TO DEC. 31, 2005



→ KEY MARKET DATA

	2001	2002	2003	2004	2005
€ thousands					
Market capitalization at Dec. 31	19,322	17,606	17,466	18,230	23,252
€					
Closing price for the year	69	64	65	68	88
High for the year	82	75	69	73	96
Low for the year	62	55	52	62	68
€ thousands					
Average number of shares traded daily	1,180	1,574	1,599	1,271	1,427

→ PER SHARE DATA

	2001	2002	2003	2004	2005
in thousands of shares					
Number of shares representing capital stock	282,066	274,670	269,950	268,095	264,235
€					
Net dividend per share (excluding tax credit) <sup>2</sup>	1.03	1.15	1.22	1.35	1.70 <sup>1</sup>

(1) Subject to the approval of the annual General Meeting – (2) Depending on legislation applicable to beneficiary; calculation based on 50% rate.

→ DIVIDEND AND SHARE BUYBACK PROGRAM

**Stock prices picked up sharply in 2005.** Danone shares rose 29.9%, outperforming major stockmarket indexes including the CAC 40 (+ 23.4%), the Euro Stoxx 50 (21.3%) and the DJ Stoxx Food & Beverage (+ 24.8%).

**The Board of Directors will propose to the General Meeting of shareholders** held on April 27, 2006, a dividend of €1.70 per share for 2005, up 26% on the payment for 2004. This dividend will be payable from May 10, 2006. The Board's recommendation reflects our confidence that the Danone model will continue to

deliver one of the best financial performances in its sector. In view of sound finances, the company plans to buy back shares for an amount of between €600 and 800 million.

For more information  
[www.danone.com](http://www.danone.com)

17, bd Haussmann, 75009 Paris

Toll-free information number for investors calling in France: 0800 320 323

E-mail: [finance@danone.com](mailto:finance@danone.com)

**Share buybacks and cancellations**  
4.6 million shares canceled in April 2005

9.1 million shares bought back in 2005

19,715,829 own shares held at Dec. 31, 2005

An 18 million share buyback program has been authorized by the Ordinary and Extraordinary Annual General Meeting.

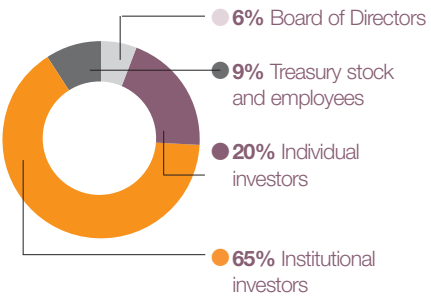
A company may not hold more than 10% of its own shares at any time.

No more than 10% of shares may be canceled in any period of 24 months; cancellation is subject to approval of the Ordinary and Extraordinary Annual General Meetings.

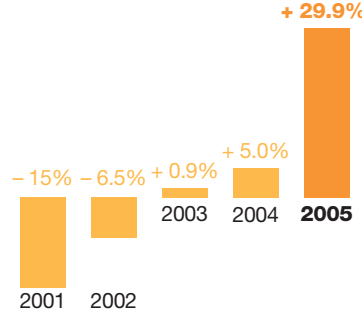
→ SHARE OWNERSHIP AT DEC. 31, 2005

Groupe DANONE share ownership:

Institutional investors:	65%
- France	28%
- US	11%
- UK	9%
- Other	17%
Individual investors	20%
Board of Directors	6%
Treasury stock and employees	9%



→ SHARE PRICE 2001-2005



→ GROUPE DANONE SHARE DATA

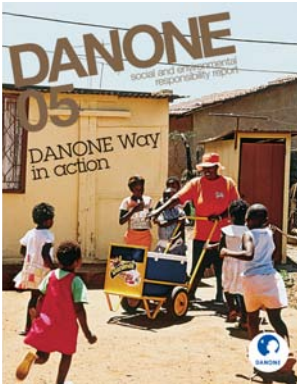
**Nominal value:** €0,50 per share at Dec. 31, 2005  
**Number of shares listed:** 264,235,190 at Dec. 31, 2005  
**Listings:** Euronext Paris, SWX SWISS Exchange and the New York Stock Exchange in the form of American Depositary Shares (ADS)

→ MAIN SHAREHOLDERS

at Dec. 31, 2005	% of capital	% of voting rights
Eurazeo	3.7%	7.3%
Caisse des dépôts et consignations	3.5%	3.4%
Sofina and Glaces de Moustier	2.0%	2.9%
Predica	1.7%	1.7%



For more information...



Social and Environmental  
Responsibility Report  
DANONE 05



20-F DANONE 05



www.danone.com



GROUPE DANONE – 15, RUE DU HELDER – 75439 PARIS CEDEX 09 – VISITORS: 17, BD HAUSSMANN – 75009 PARIS – TEL.: +33 1 44 35 20 20 – CORPORATE COMMUNICATIONS TEL.: +33 1 44 35 20 71 – INVESTOR RELATIONS TEL.: +33 1 44 35 20 76 – TOLL-FREE NUMBER FOR SHAREHOLDERS: 0800 320 323 (FREE FROM LANDLINES IN CONTINENTAL FRANCE) – FINANCIAL INFORMATION: WWW.FINANCE.DANONE.COM – WWW.DANONE.COM

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CE N'EST PAS DANS LE LAIT DE VACHE  
QUE LES BÉBÉS TROUVERONT  
TOUT CE DONT ILS ONT BESOIN.

Le lait de vache ne contient ni la qualité ni les quantités de matières grasses, de protéines et de minéraux adaptées aux besoins des bébés.

La suggestion de Blédina: **BLÉDILAIT Croissance** (dès 10 mois)

Blédilait Croissance est un lait de vache écrémé adapté pour les bébés entre 10 mois et 3 ans avec :

- 25 fois plus de fer, pour aider bébé à mieux se protéger
- 4 fois plus d'Acides gras essentiels, pour son développement cérébral
- De la vitamine D, pour aider à fixer le calcium
- 11 vitamines, pour sa vitalité
- Un taux de protéines réduit

3240 dites « Blédina » ou [www.bledina.com](http://www.bledina.com)

