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Q3 2019 Danone SA Corporate Sales Call

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PRESENTATION

Operator

Ladies and gentlemen, thank you for standing by, and welcome to the Danone Q3 2019 Sales Call.

Joining us on the call today, we have Cécile Cabanis, CFO; and Nadia Ben Salem-Nicolas, Head of IR.

(Operator Instructions) I must advise you all the call is being recorded today, Friday, the 18th of October 2019.

With that, I'd hand the call over to your first speaker today, Nadia Ben Salem-Nicolas. Please go ahead.

Nadia Ben Salem-Nicolas *Danone S.A. - Head of IR and Financial Communication*

Good morning to everyone. This is Nadia speaking. Welcome to the investor call for Danone's Q3 2019 sales.

I'm joined today by our CFO, Cécile Cabanis. We will begin with some prepared remarks by Cécile that we will keep to around 20 minutes, leaving plenty of time for Q&A.

Before I hand over to Cécile, I draw your attention, as usual, to the disclaimer on Page 2 about forward-looking statements and non-GAAP financial indicators.

Cécile Cabanis *Danone S.A. - Executive VP of IS/IT, Cycles & Procurement, CFO & Director*

Thank you, Nadia. And a warm welcome to all of you. As always, you know, we appreciate your interest in Danone.

If you recall, when we last speak in July, I guided towards an acceleration in revenue growth as the year progressed. And as you've seen by now, we have accelerated growth in Q3 with a 3% like-for-like sales growth that compares with the 2.5% in Q2. If we look across the businesses: We progress towards our long-term goals; and many of our initiatives aimed at quality of growth, product innovation, price/mix enhancement and discipline in revenue and portfolio management. These initiatives are gaining further traction with great outcomes from both consumers and customers. That said, it's also fair to say that we closed the quarter slightly below where we wanted to be, as some of the headwinds that we flagged at Q2 did not ease, and especially we do not control the weather.

Now going into details of the number in the next page, Page 4.

The total sales for the third quarter reached EUR 6.418 billion, which is an increase of 3.7% on a reported basis. If we look in more detail at the bridge: The like-for-like sales growth that I just mentioned was 3% in Q3, accelerating from 2.5% in Q2. The value growth continued to be the main driver of the like-for-like growth with a 4.6% positive impact. In all reporting line, it's positive. And with both some price and revenue management and product mix, country mix that all contribute positively. Volumes were down, minus 1.6%, driven by soft demand in Waters and a still negative volume in Russia for EDP.

In the next block, I think it's useful to remind that our like-for-like numbers exclude Argentina's performance given the way we've decided to treat the hyperinflationary situation in the country, not like some of our peers. So if we include Argentina, we would have posted a 3.4% growth in Q3. Scope effect linked to the divestment of Earthbound Farm last April is a negative impact of 1.3%. And finally, currencies had a positive impact, adding 1.6% of sales, mainly driven by U.S. dollar appreciation.

If I go to Slide 5, I will, of course, detail each entity performance, but I think it's worth to highlight the volume, value growth for each business.

Specialized Nutrition growth acceleration versus the second quarter was driven 1/3 by the volumes now back into positive territory for the first time since the beginning of the year and 2/3 by value reflecting both the positive country and product mix given value-enhancing innovation across our portfolio and performance of China. Essential Dairy and Plant-Based delivered a sustained 3.4% value growth, reflecting here again the delivery of the strategy of product premiumization, format adaptation and portfolio rationalization. The volumes were down, minus 2.7%, which is due to a negative development in our U.S. Greek yogurt segment and negative volumes in Russia, as I mentioned earlier. Waters volume were down 2.5%, coming primarily from Europe where we faced a tough comparison due especially to the weather in August.

If we move through the detail per business, and I'm jumping to Page 7 with Specialized Nutrition. So as you've seen, a spectacular quarter close to double digit, 9.8%. Exactly 1 year ago, I was outlining the new IMF category dynamics in China; and the expectation for our business to go through 4 volatile and difficult quarters before starting to grow strongly again, which has materialized. If we go through the number by segment in more details: Advanced Medical Nutrition delivered another very good quarter, with sales up mid-single digit led by the pediatric segment and growth that was again double digit in China and solid in Europe. Early Life Nutrition sales have grown more than 10% this quarter. The key region of accelerated growth was, as expected, China, which was up more than 20%. Rest of the world posted another solid quarter with Americas growing strongly; Europe that improved, driven in particular by the U.K. on a low base, if you remember, last year. The rest of Asia posted strong growth, including market share gain and further expansion in Southeast Asia.

Coming back to China. The Early Life Nutrition growth in China was favored by the base of comparison as we outlined earlier, of Q3 2018, but looking at the underlying performance, we are sequentially growing in absolute term. And Q3 was the highest quarter ever in net sales. The acceleration in growth in Early Life Nutrition China was supported mostly by 2 actions. The first one is an increased presence in physical stores in lower-tier cities, where we nearly doubled the number of MBS in which we directly distribute our product; and second, very strong growth in our direct e-commerce and including the rollout of some innovations in our cross-border channels such as Karicare sheep milk. Altogether, the direct channel has grown faster than the indirect. And it's now accounting in Q3 for 75% of total sales in China, which is a successful performance in a category growing in line with our estimates at mid-single digit.

Moving to Essential Dairy and Plant-Based, a growth of 0.7% like-for-like in Q3; with volumes down, minus 2.7%, and value up 3.4%. The slowdown versus the previous quarter is entirely coming from 2 things: first, the dynamic of the Greek segment in the U.S. Yogurt business; and second, the performance of CIS. Both of these segments and countries are facing some consumer and trading challenging environment.

The momentum outside of these regions continued to be positive. And if we look at our main regions: Europe confirmed and delivered slightly positive growth again, which is the key achievement of this quarter. We continued to make progress in the transformation of our dairy business to move our portfolio towards new generations through innovation such as organic, clean-label nutrition labeling; and on-the-go, with a positive mix impact. We are also making good progress in the execution of our plant-based expansion plan, which is the biggest pillar of the acceleration in the coming years. And overall, we are on top of that to accelerate launching, and we have launched now an Activia plant-based both in Spain and in Germany.

North America reported flat sales in Q3. Plant-based reported solid growth, if we exclude Vega which was still negative this quarter. Dairy Yogurt sales declined with a deteriorating price/mix, reflecting competitiveness in the category, which is not in the total category but, as I mentioned, penalized by the Greek and conventional segments, while more trendy segment like kids and newborn yogurt,



probiotic and plant-based continue to grow. Premium Dairy also posted declining sales given what we started to announce in terms of discontinuation of noncore SKUs, while the core business under the Horizon brand has grown and has increased its market share in the refrigerated organic milk market. Coffee Creamers continued to grow solidly driven notably by International Delight, iced coffee adjacency and good performance of Stok.

Looking at the rest of the world. As I alluded to, in CIS sales were down low single digit this quarter, with very strong negative volume as premium functional yogurts in Russia have been impacted by consumer trading down and by some distribution loss. Latam posted moderate growth driven by Mexico. And in Aspame, Morocco delivered double-digit growth as expected.

One extra comment which is on plant-based, which is really a key lever of EDP growth acceleration for the next year. It continued to deliver a consistent, strong growth in Q3, including double-digit growth of Alpro, accelerating its rollout in new geographies and also outside Europe.

Moving to Waters on Page 11. By now, it won't be a surprise because some other in the industry have commented on the weather, but our Waters posted negative growth, minus 0.9%, worse than expected. Back in July, I said that the entity would have to go through a very tough summer-based comparison in Q3. That was up last year 7%, in the quarter. This was due to exceptional hot and dry weather in Europe in August last year. The overall result came actually below expectation, as temperatures this year on average were 1 degree lower than Q3 2018. And you can have a look at the chart on the bottom left of this slide, and you can see the evolution over the last 3 summers and the correlation that we see between net sales and temperatures. And this is for our 4 biggest Europe water operations. So overall, this is not a Danone topic. It was a category short-term topic where in all this market we are not losing market share. It's around stable or gaining.

Europe accounts, as you know, approximately 40% of the entity, and the sales were down low single digit. All the decline was concentrated in August, and there was a return to growth in September.

In Asia the trends by country were confirmed, meaning continued strong growth in Indonesia and Turkey; declining sales for Mizone, where as you know we focus on a full rework of the brand to reconnect with younger Chinese consumers. Finally, Latam delivered a strong quarter, with all countries contributing positively.

Moving to the outlook on Page 12.

Overall, we have a strong underlying business fundamental to pursue our sales growth acceleration trajectory even if we continue to evolve in a context with uncertainty in term of geopolitics and macroeconomics. But if we focus on our activity fundamentals and plans: In Specialized Nutrition, our Asian platform will further expand geographically through innovation also, particularly in China where we have now a wide offer in premium alternative ingredient recipes through our direct international channel. Within EDP, Europe should continue to grow, and Yogurt in the U.S. will be a focus for us. We plan for, for example, our most successful innovation to be distributed nationwide. This is the case for our new low-sugar brand Two Good, which registered outstanding velocities and repeat rate. We also expect plant-based to further accelerate in Q4 with the new visual identity of Alpro; the recent launch of Activia plant-based in Spain and Germany; and overall a step-up of our oat offer, which is a buoyant ingredient in this category. Finally, Waters should improve, driven by new consumer trends such as no sugar and organic and also the overall strength of the category.

If I go to Page 13. Our priorities and trajectory remain unchanged. Q3 was the third consecutive quarter of top line growth acceleration. And looking at the 9 months year-to-date, we have delivered 2.1% sales growth. As a consequence, we can narrow our sales guidance for the full year 2019, and sales will be between 2.5% and 3% on a full year basis like-for-like; and of course, reiterate our guidance for recurring operating margin at above 15%. This should lead our recurring EPS to grow high single digit for the full year, another very strong year. That would bring the total growth of recurring EPS since 2014 to close to 50% over the period.

We remain very focused on disciplined capital allocation, including continued portfolio management and deleverage. And with this in mind, we continue to progress towards both our 2020 objectives and 2030 goals.

Maybe to conclude on Page 14. Also I appreciate that we are in a quarter communication, but I think it's important to keep the eye on the ball. And our ball is our compass. It's our 9 integrated goals and the business, the brands and the people model towards 2030. It defined also our midterm mandates, especially how we manage the tension between the short, the mid and the long term. And we are fully focused on this agenda in order to make sure that we are creating sustainable value for all.

Thank you very much, and I'm opening to your questions.

Nadia Ben Salem-Nicolas *Danone S.A. - Head of IR and Financial Communication*

So 20 minutes sharp. Thank you, Cécile.

Before going to Q&A, a reminder to kindly ask you to limit yourself during the session to a maximum of 2 questions, please.

QUESTIONS AND ANSWERS

Nadia Ben Salem-Nicolas *Danone S.A. - Head of IR and Financial Communication*

I think the first questions come from Alain Oberhuber at MainFirst.

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

Alain Oberhuber of MainFirst. I have 2 questions. The first is regarding the Specialized Nutrition. Congratulation for a very strong performance. However, if you look at value and volume mix, it looks like that the value mix is really high. My question is a little bit why was the pricing this high. And is this will sustainable going into 2020? And the second question I have is regarding EDP U.S.A. Could you elaborate a little bit on the brand Vega giving that it's almost 2% of group sales? When do you expect that to improve? And maybe what are you going to do in order to have this improvement?

Cécile Cabanis *Danone S.A. - Executive VP of IS/IT, Cycles & Procurement, CFO & Director*

Okay. So on Specialized Nutrition, yes, the value is an important element of the growth, but you have to remember that in this value we have 2 components. First, we have the country mix coming from the very high performance of China, which is above 20% of growth. And second, in Q3, we have launched a certain number of innovations through our direct international channel, which also have increased the overall mix. So this is overall what comes to this value part. On volume, however, we have now progressed and we are back into positive territory, and I think it's important to acknowledge it.

On EDP U.S., as I said, the overall performance has been good. Something I didn't say, but I think it's worth mentioning, is that on the year-to-date basis 85% of WhiteWave portfolio is growing more than 6%. Now we have some offenders, the rest, the 15%. And on Vega, as you know, it's the leader in plant-based nutrition in North America. You remember that we had an unfortunate, unsuccessful reformulation of Vega One of last year. And since that, the sales of Vega have been declining. We are working on different items. The first one was an ongoing reformulation of the Vega One Organic to improve the flavor, and it's expected to hit the shelves by the end of the year; and recent launch of a new Vega line, which is "Protein Made Simple". It's a powder targeting the new mainstream consumers to the brand alongside the core "sport addicts" original Vega consumer base. This action plan is supported by activation in order to revitalize the sport DNA of the brand with an official sponsorship of triathlon event IRONMAN World Championship in Hawaii. And overall you have to also know that the decline in performance is concentrated in one channel only, which is the club channel where we had a very limited assessment and very much dependent on Vega One which is the one part which is having problems. In modern trade, Vega is stable in sales since the beginning of the year.

Nadia Ben Salem-Nicolas *Danone S.A. - Head of IR and Financial Communication*

Okay. Thank you, Cécile. Next question is from Warren Ackerman at Barclays.

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

Cécile, Nadia, I hope you can hear me okay.

Nadia Ben Salem-Nicolas Danone S.A. - Head of IR and Financial Communication

Yes.

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

So two for me. The first one is on the EDP bridge. At the Q2 stage, you said EDP grew just over 2%, and you were talking about 3% EDP growth in the second half. So in Q3, we got 0.7%, so that's, well, 2 points -- 200 basis points below what you were saying. I get Russia down low single digit on, say, 15% of EDP, but that's only 50, 60 basis points, so can you maybe kind of walk us through the bridge of the miss versus your previous expectations? And what do you expect specifically for EDP in Q4? Why should we have confidence that EDP on this very low Q3 comes back to something decent in Q4? I'm just struggling to understand where you were. I know Russia and the U.S. have got worse, but I don't see how the numbers work. And then secondly, on the guidance for the full year, if I take the low end of the guidance, 2.5%, it implies 3.7% for Q4. On the top end, it implies 5.7% for, i.e., the 3%. So it's a big range for Q4, 3.7% to 5.7%, a midpoint 4.7%. Can you maybe talk to us about what you need to do to get into the top end of the range and the bottom end of the range? And are you still confident that you will exit this year in line with your 2020 targets and that what we've seen in Q3 is a blip? And maybe you can talk to us specifically about Russia because that seems to be the thing that changed and what you're doing in Russia to try and improve the performance in the back -- in the fourth quarter and into 2020.

Cécile Cabanis Danone S.A. - Executive VP of IS/IT, Cycles & Procurement, CFO & Director

Thank you, Warren. So first on the bridge that you mentioned, it's 2 effects overall on the bridge versus Q2. It's U.S. going from moderate in Q2 to flat in Q3. And this is mainly due to what I mentioned on the Greek yogurt segment as well as Premium Dairy where, as you know, we are also doing a conscious portfolio pruning in order to make sure that we are not continuing to push the SKU that are not making sense. And the second one is Russia, which went from flat in Q2 into a low single-digit negative in Q3, as I mentioned, given the softer context leading consumers to trade down. And as you know, we had said for many years now and, I think, we all enjoyed very much for many years the very solid growth of Russia and margin improvement we've had on valorized. And today, the functional part of the value portfolio is getting less traction as the consumer is trading down. So we are reviewing the portfolio in order to make sure that we are back to consumer new environment. So this is one. And then in CIS you also have Ukraine, Kazakhstan and Belarus which are continuing to grow well. And then I think it was more than 2 questions, so I...

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

Yes, I get that, Cécile, but I don't get 200 basis. That doesn't account the 200 basis point shortfall from previous guidance, if I do the math on it. It's 50 bps on...

Cécile Cabanis Danone S.A. - Executive VP of IS/IT, Cycles & Procurement, CFO & Director

Yes because we thought Q3 would accelerate.

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

Okay.

Cécile Cabanis Danone S.A. - Executive VP of IS/IT, Cycles & Procurement, CFO & Director

So as I'm not predicting the weather, for Waters.

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

Okay. I'll take that one off-line. And then on the guidance for Q4, the range.

Cécile Cabanis Danone S.A. - Executive VP of IS/IT, Cycles & Procurement, CFO & Director

By -- you did your math, and I think your maths were well done. And then on the acceleration levers, it's what I mentioned. So Specialized Nutrition, it will continue to be the Asian platform that will further expand through both penetration and innovation. I mentioned that in Q3 we managed to double our presence in mom & baby stores in lower-tier cities. In EDP, Europe should continue to grow. And Yogurt in the U.S. should improve with both TDP gains and also national presence of some of our well-performing innovations. Plant-based continued to accelerate, and we expect it will continue to accelerate in Q4. And of course, Waters will improve, so looking forward, we are confident we have the right levels to accelerate the growth.



Nadia Ben Salem-Nicolas *Danone S.A. - Head of IR and Financial Communication*

Next question is from Richard Taylor at Morgan Stanley.

Richard Taylor *Morgan Stanley, Research Division - Equity Analyst*

Just 2 questions from me. I was wondering if you could give us some color on the competitive dynamic in plant-based beverages both from a branded competitor perspective and from private label. Has the dynamic changed at all? So that's the first question. And then secondly, you've reaffirmed your objectives for 2020. I'm guessing that includes the guidance for 4% to 5% like-for-like growth. Of course, this quarter is something of a setback, so I think it would be really helpful if you could maybe talk through what gives you confidence the businesses will accelerate from here.

Cécile Cabanis *Danone S.A. - Executive VP of IS/IT, Cycles & Procurement, CFO & Director*

Thank you for your question. So overall we don't see any particular change in the competitive environment of plant-based beverage, so there is nothing specific to mention here. We continue to have a very, very good performance in Alpro. We continue to have good traction in the innovation we put on the market and overall a solid growth in the U.S. and here again good welcoming of the innovations.

On the objectives 2020, yes, they are confirmed. The main acceleration factors are really the one I mentioned on each of our entities. So it will be around making sure we are doing a great execution of the plans because the plans are there in order to make sure that we can accelerate around the levels that I mentioned answering to Warren question. And then we'll be vigilant in the overall uncertainty on the global context. Now I mean I've read many of your comments on the Q3. We are talking about 1 quarter, over a 5 years agenda, with very good performance. And I remind all of you of the performance in term of EPS growth. So I think we need to take the quarter for what it is. The weather in Europe was what it was. If I could predict the weather, I would probably be somewhere else. So we need also to make sure that we understand that we are talking about Q3; that the fundamental of the business, they continue to be there; that the plant-based, which is our main acceleration levers for EDP, is accelerating and the plans are executing, as we go, according to plan; and a Specialized Nutrition which is -- has been very dynamic in China. And as I mentioned, it's not only comparable base effect because on the absolute value we are sequentially improving, and it was the best quarter ever in term of absolute value. So let's not be caught on the quarter headline and make sure that we are all understanding the fundamental of the business and where we come from, where do we go and the plans that we have.

Nadia Ben Salem-Nicolas *Danone S.A. - Head of IR and Financial Communication*

Next question is from Celine Pannuti at JPMorgan.

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

I wanted to come back on China. So 2 things on China. So Specialized Nutrition, you said mid-single-digit growth in the market and you alluded to what you did in terms of increased penetration. Is it possible to understand, out of this 20% growth, what was the comp effect and what was the additional traction that you are getting in order to get a bit of an understanding what's the sustainability of growth as we look into 2020? And the second part of the China question is about Waters. And Mizone, you said, I think, was declining. And could you give us a bit more background of what's going on there and whether we should see a turnaround? And then if I may take a second question: In terms of U.S. Yogurt, you mentioned the rollout international of new innovation. Could you tell about the growth in dairy specifically? And are we now talking at a market that is declining? And what is the volume-versus-value component?

Cécile Cabanis *Danone S.A. - Executive VP of IS/IT, Cycles & Procurement, CFO & Director*

Thank you, Celine. So on China, overall and in order to help you understand the dynamic, what I could say is that, if we remove the base-of-comparison effect, we would be outperforming the markets in term of growth, which is what we guided in term even of midterm growth. We said, the overall category, we believe it will grow 3% to 5%, and we will outperform the category. So versus the mid-single digit, the underlying increasing performance is outperforming the market. On water, Mizone is declining. Maybe you'll recall, at the beginning of the year -- I'm not sure it was Emmanuel or myself, but we said that we were not counting on Mizone growth, that there has been some disruption in the category and we needed to review the attributes of the brand and the mix overall. The teams are doing that as we speak, and we would probably aim at launching a new version somewhere in the first part of next year. So that should help in order to rebound, but before that, we will continue to have negative growth on Mizone, acknowledging that Q4 will be a small quarter for



Mizone. You know that Q2, Q3 are really the big quarters.

On the Yogurt. And overall on Yogurt we really have 2 segments, as we started to comment from several quarters now. We have Greek and conventional. Greek had enjoyed many years of growth and was 43% of the category, and it's decreasing. It's decreasing on the back of unsuccessful innovations that are going across players in the industry and most importantly from loss of TDPs on the entire segment as well as an aggressive promotion pressure from competition. So that's overall what we see. Now we have, on the other hand, the rest of the segments. Remember that our Activia Dailies was the first SKU for a long time and growing. The kids segment continue to be dynamic, and the plant-based as well, in term of emerging yogurts. So you really have 2 realities. Greek, being 43% of the segment, of course, it's weighing on the overall growth.

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

I may have missed it, but did you give the number for plant-based growth in the quarter?

Cécile Cabanis *Danone S.A. - Executive VP of IS/IT, Cycles & Procurement, CFO & Director*

Yes. It was a consistent strong growth.

Nadia Ben Salem-Nicolas *Danone S.A. - Head of IR and Financial Communication*

Okay. Next question is from James Edwardes Jones at RBC.

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

Danone has got a bit of a reputation for missing guidance, certainly more so than most of the companies that I follow. Do you feel that overoptimistic forecasting at the group level is detrimental to operational management over the long term as people try to cut corners to make overoptimistic guidance? And do you feel there's a need to take a more conservative approach to setting group guidance? And secondly, you confirmed that the 2020 targets, but you didn't mention the 2022 target for ROIC. Can you please confirm that that's still valid?

Cécile Cabanis *Danone S.A. - Executive VP of IS/IT, Cycles & Procurement, CFO & Director*

Thank you for your question. First, I would like to remind everyone that, since 2014, we've been delivering what we said. And I think it's important because that's what we are really focused on, making sure that we execute our plan. Now you also have to realize, and I think we had that discussion in the previous years, that we need to manage the tension between the short, the medium and the long term. We need to make sure that what we do is creating value and not just hitting the numbers of a quarter, which would be absolutely meaningless. So overall I don't think your comment is fair in term of assessing, but I hear it. We -- you can say -- I mean you can use the term you want on guidance. We have 2.1% 9 months year-to-date. We had guidance around 3%, which was not precise. We are giving a precision of 2.5% to 3%, and this is what we've done so far. And we have confirmed the margin guidance, more than 15%. And I have also added that this would lead to strong EPS growth.

On the ROIC, we have continue to improve. And the target is confirmed, yes.

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

Got it. I suppose I'll just come back on that and say I look at the share price. People are clearly, clearly are concerned about this. Judging by the tone of the questions there have been, people are concerned about how realistic it is that you're going to see that revenue growth in Q4, that you're going to see 4% to 6% revenue growth after 2020. I'm just, I suppose, asking. Does everything in the business need to operate its full potential in order to hit those numbers? Or is there a bit of slack built into your guidance and your expectations?

Cécile Cabanis *Danone S.A. - Executive VP of IS/IT, Cycles & Procurement, CFO & Director*

Well, on what we control, the plans are there and they are set up in order to deliver. On what we don't know, I cannot answer.

Nadia Ben Salem-Nicolas *Danone S.A. - Head of IR and Financial Communication*

Thank you. Next question, I think we'll have time for maybe 3 next questions, from David Hayes at Societe Generale.

David Hayes *Societe Generale Cross Asset Research - Equity Analyst*

Just two from me. Just on Russia. And I'm sorry if I've missed this, but I think you mentioned in the prepared remarks you mentioned something about distribution disruption impact. I just wonder whether you could just touch on that, whether there was a little bit of one-off miss that impacted or whether that was just a reference to shelf space generally in the category. And then the second question is the quarterly budget process. You outlined strongly a couple of years ago or so that we're using this quarterly budget review and that you were then reallocating focus in terms of investment and plans. I just wonder. As you've gone through this year and perhaps in the last round of that quarterly budget review, what has changed? What specifically have you moved resources into, focused on more; and where maybe you've been a little bit less focused?

Cécile Cabanis *Danone S.A. - Executive VP of IS/IT, Cycles & Procurement, CFO & Director*

Thank you, David. So on Russia, I don't think we can say there was a specific one-off impact. And there are some new competitive environment with local players and regional players. And on some of our distributors, it is changing a bit the dynamic, but mostly it's around the portfolio and the consumers trading down on a strategy that has really delivered for so many years. So we need to address that. Then on the quarterly performance, yes, we continue to be very active in the way we allocate or reallocate resources. If I take an example: Over the Q3, we have put more resources behind our Chinese ELN platform in order to support the innovation and overall the success that we were getting in term of traction on penetration.

Nadia Ben Salem-Nicolas *Danone S.A. - Head of IR and Financial Communication*

Next question is from Katy Hutchinson at Davy.

Katy Hutchinson *Davy, Research Division - Food Analyst*

Two questions from my side, please. So firstly, in terms of price/mix by region. So we've seen 3 quarters of positive price/mix growth in North America and Europe combined. Can we infer from that, that gross margin is continuing to expand in that region in line with your midterm objectives? And then secondly, on plant-based and your strategy for Asia, what is your strategy for that region? And also how alternative substrates and plants, outside of almond and soy, are progressing? And some numbers behind that will be helpful.

Cécile Cabanis *Danone S.A. - Executive VP of IS/IT, Cycles & Procurement, CFO & Director*

Thank you, Katy. So overall, to your first part of the question, meaning that the gross margin, given the price/mix, is expanding. Also, for EDP, for example, we were hit by quite an inflation in term of milk, but we also have productivities. So we are vigilant to make sure that we have the right dynamic in terms of overall gross margin. And if you remember, we had also set a rule in term of innovation that they should be accretive to the gross margin. So we are following that closely. In term of Asian plant-based, today, for us it's very, very small. And it's built in our plan for the next years in term of acceleration, but we will come back in due time to discuss that with you.

Katy Hutchinson *Davy, Research Division - Food Analyst*

Okay. And on the alternative substrates...

Cécile Cabanis *Danone S.A. - Executive VP of IS/IT, Cycles & Procurement, CFO & Director*

So on the alternative substrates, we continue to be strong in soy, yes, overall. And almond, of course, which is quite a good segment. And as I think I mention, oat is getting very buoyant. So we are now present in oat and, especially with Alpro, expecting to accelerate on that part.

Nadia Ben Salem-Nicolas *Danone S.A. - Head of IR and Financial Communication*

Okay. I think we are going to take a last question, from Guillaume Delmas at Bank of America Merrill Lynch.

Guillaume Gerard Vincent Delmas *BofA Merrill Lynch, Research Division - Director*

So a couple of questions for me. The first one is on Latin America. You mentioned the region posted moderate growth in the quarter. It sounds like a sequential slowdown relative to the first half, when you were talking about solid growth in the region, so wondering if you could shed more light on Latin America and particularly on Brazil, whether you're seeing some continued improvement there. And my



second question is on ELN China. So going back on ELN China, wondering if you saw any one-offs in your Q3 performance. I mean, particularly given the high number of innovations, are you aware of any trade loading in the quarter? And conversely, have you seen any negative impacts from the Hong Kong protests? Because I think Hong Kong accounts for around 10% of ELN China sales.

Cécile Cabanis Danone S.A. - Executive VP of IS/IT, Cycles & Procurement, CFO & Director

Okay. So on your first question, yes. And overall in Latam it's worth to maybe say a few words on Brazil, especially on EDP Brazil which was this quarter impacted by a steep decrease in the milk part of the portfolio because, as part of our revenue management initiative given the very low milk price in Brazil today, we are managing this part. On the other hand, in Brazil, Yogurt keep growing with good performance of innovations such as YoPRO. And also, distributors reshuffle is now completed. So we will continue to improve versus the crisis that we had 2 years back. And then on your question: So on Hong Kong there were some temporary disruption, but it has been compensated and mitigated through the direct international performance.

And one-offs. Overall we need to really make sure that, when it comes to Early Life Nutrition China, it can be volatile from 1 quarter to another. And we don't control everything, so it's really important to look at it over a longer period and which is what we gave, I think, last quarter in term of the last 2 years performance where we grew 25%. So we need to really be careful on the quarterly performance overall, but we have not made a specific one-off, as far as we are concerned.

Nadia Ben Salem-Nicolas Danone S.A. - Head of IR and Financial Communication

This closes this Q&A session. Thanks, everyone, for your interest. The IR team remains available all day long to answer any follow-up questions.

With that, thank you, Cécile.

Cécile Cabanis Danone S.A. - Executive VP of IS/IT, Cycles & Procurement, CFO & Director

Thank you very much.

Nadia Ben Salem-Nicolas Danone S.A. - Head of IR and Financial Communication

Thank you all, and let's catch up later.

Cécile Cabanis Danone S.A. - Executive VP of IS/IT, Cycles & Procurement, CFO & Director

Bye.

Operator

Thank you very much. That does conclude the conference for today. Thank you for participating. You may all disconnect.

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