

FRANCK RIBOUD

A BUSINESS FOCUSED 100% ON HEALTH, WITH CLEAR PRIORITIES

DANONE TURNED IN A SOUND PERFORMANCE IN 2008, CONFIRMING THE POTENTIAL FOR PROFITABLE GROWTH OF A GROUP THAT IS 100% FOCUSED ON HEALTH AND WELL PREPARED TO STAND UP TO TESTING CONDITIONS.



Our sound results in 2008 show that our staff members have lost none of their agility and commitment—which is what really counts in the current context.

What do you have to say about 2008 for Danone?

Franck Riboud: Even before the end of the year, everyone, especially on the financial markets, had shifted their focus to 2009. But I think it's worth taking a closer look at 2008. There are some important lessons to be drawn for the near future, in particular at Danone.

The first point is that we achieved our targets once again, with organic sales growth reaching 8.4%*, margin up 53 basis points*, and earnings per share up 15.1%***. Of course that partly reflects our record 9.6%* sales growth for the first six months of the year, but I think we can learn more from developments in the second half.

The economic crisis took hold everywhere during the summer of 2008, but our key business indicators held on a firm track through to the end of the year. Growth in the fourth quarter, when the economic environment was very unsettled, was still a very sound 6%*. Which doesn't mean that Danone is immune from recession, but it does demonstrate the real solidity of our business. We have built that up over the years, drawing on our key resources: the strength of our brands, our consistent strategy, business lines and geographical balance. The results also show that our staff members have lost none of their agility and commitment—which is what really counts in the current context.

It looks like Numico also made an important contribution to the quality of results.

FR: That's the second lesson I want to draw: that the acquisition of Numico's baby nutrition and medical nutrition businesses was the right strategic choice for Danone. The results are there, in terms of sales growth, margin and synergies—cost synergies will be even higher than the €45 million we expected in 2008 and the €15 million forecast for 2009. Most importantly, the results are there in terms of the successful integration and high level of staff motivation, with teams on both sides doing an outstanding job. That's something we can be proud of. The results confirm the promise of our two new global businesses, but they also show that we've avoided getting in the way of growth, and have provided new momentum through the integration process. Integrating a new subsidiary is always risky, but in this case I think we can safely say it has gone very smoothly and efficiently.

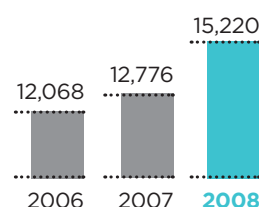
The new Danone has four business lines. How did they perform individually?

FR: The most impressive performance has come from the two new businesses I just mentioned, with organic growth reaching 17%* for Baby Nutrition and almost 13%* for Medical Nutrition. But at the heart of our group, Fresh Dairy Products turned in another robust performance with sales up nearly 8%*, to top €8 billion. This division is our real powerhouse, making an unmatched volume contribution of €400 million to growth. Water sales were up 1.9%*, an overall figure that combines results from two very different worlds. On the one hand we have four large and mature markets—France, Spain, the UK and Japan—where sales of bottled water have declined fairly markedly, but our own market shares are holding up well, even rising. Then there is the rest of the world, which already accounts for over half of our sales and where we are seeing double-digit growth. →

Key figures

Sales

(€ millions)



Organic growth

+8.4%*

(Volume up 2.8% and value up 5.6%*)

Positions

no. 1 worldwide
for fresh dairy products

no. 2 worldwide
for bottled water

no. 2 worldwide
for baby nutrition

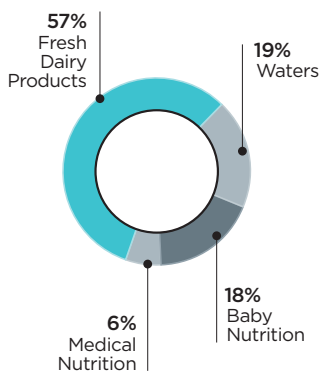
no. 1 in Europe
for medical nutrition

* At constant scope of consolidation and exchange rates.

** Based on diluted net earnings on ordinary business, pro forma.

The growing role of emerging countries is the consequence of the strategy we adopted a decade ago, going for growth where we could find it and extending our geographical reach.

4 businesses for health



Contributions to 2008 sales

Organic sales growth (like for like)

- +17%**
Baby Nutrition
- +12.7%**
Medical Nutrition
- +7.7%**
Fresh Dairy Products
- +1.9%**
Waters

* At constant scope of consolidation and exchange rates.

➔ Examples are Argentina, Indonesia, China and Mexico, which is set to become our largest single market for water within four or five years.

Geographically, emerging markets appear to be the main sources of growth.

FR: Yes, they are still the most vigorous. They already account for over 40% of group sales—and since they are growing faster than others, their weight can only increase. Sales in Asia were up 16%* and growth was in double digits in the rest of the world, which mainly means the Americas for Danone, reaching 13%*. But the overall result for Europe, which saw a rise of 5%*, was nothing to be ashamed of, even if conditions were already tough in some countries. What you have to be clear about is that the swing to emerging markets hasn't just happened. It's the consequence of the strategy we adopted a decade ago, going for growth where we could find it and extending our geographical reach.

Doesn't the growing weight of these new markets also mean risks, for example margin dilution and instability?

FR: Moving into a new country is an investment. And at the beginning, in the first few months, it costs more than it brings in. But that's the only way to build the future. And an important thing to note is that margin rates already equal our group average on many emerging markets—and that includes some where we've only recently arrived. Business in Asia even beat that average in 2008. As for instability, it's definitely a risk and we have to deal with it. To do that, we are careful to diversify our presence, which not only spreads risk, but also put us in a position to seize opportunities as they arise.

Will you be continuing investment in emerging markets despite the economic crisis?

FR: We will continue to take advantage of local opportunities, even if there is no reason to expect any massive or spectacular acquisition. We want to keep moving into new national markets each year, even if we are not going about it as aggressively as we might in calmer times. Because we have a duty to go on investing for the future. That is what we are doing in Kazakhstan and will soon be doing in South Korea.

Looking in the opposite direction, are you planning any divestments, to trim debt for example?

FR: We got into debt to buy Numico, but you have to remember a few things. Our debt ratio remains completely manageable, especially considering our capacity to consistently generate over €1 billion in free cash flow, year after year. Secondly, we made a bond issue to raise over €3.8 billion on attractive terms.

The next payment of €1.2 billion, due in December 2010, is covered, regardless of any divestments. Of course, divestments could speed up repayment, but purely financial considerations will never be our first reasons for that kind of decision. To take an example, we sold off Frucor, a beverage leader in New Zealand, because it focuses on flavored drinks and energy



Bringing health through food to as many people as possible also means a need for nutrition information and labels identifying the health benefits associated with Danone products. Above: infant formula in an Italian supermarket.

drinks whereas our strategy is now clearly centered on natural waters. We will never sell a strategic business just to speed up reduction of debts that are perfectly under control.

On the subject of China, how is your dispute with your associate in Wahaha beverages going and, more generally, what is Danone's current position there?

FR: Even without Wahaha, we are a leading player on the food market in China. We have very strong positions in baby nutrition with the country's top brand, Dumex, and in water with the Robust and Health brands. And we are now full owners of our new dairy-product business, which is launching Activia products—Bio in China—in Shanghai and Guangzhou. In 2008, our total sales in the country rose by nearly 30%, even though the business had not yet started up. As for our interest in Wahaha, it is no longer strategically important for Danone. It has been accounted for under the equity method in our financial statements since July 1, 2007. We are expecting the Arbitration Institute of the Stockholm Chamber of Commerce to hand down its decision in May or June, but our most likely option is in any case to sell the interest, although we are in no hurry. Our experience over the ten years from 1996 to 2006 was very worthwhile and rewarding for both Danone and Wahaha and its staff. But we've moved on now.

Danone is one of the world's top two bottled-water companies, but in developed countries the segment has been criticized for its price and environmental impact.

FR: There are a lot of uncritical assumptions bandied about on the subject. First of all, mineral water is not an ecological anomaly. On the contrary. Nothing could be more natural, in the most direct meaning of the word, than mineral water. There is nothing to filter, nothing to hide, nothing to add and nothing to subtract.



90 years' focus on health
2009 is the 90th anniversary of the Danone brand, launched in Barcelona in 1919. Its inventor, Isaac Carasso, used it for the yogurts he was the first to develop with the support of the research findings of the Pasteur Institute on lactic ferments. Carasso drew special inspiration from the work of Elie Metchnikoff, winner of the Nobel Prize for Medicine in 1908. In 1929, his son Daniel (photo above, left) brought Danone to France. Now over 100 years old, Daniel Carasso is Honorary Chairman of Danone's Board of Directors.

Nobody would deny that the year ahead will be challenging, but wringing our hands won't get us anywhere. In this kind of situation, what counts is attitude, courage, and commitment.

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“Evian will be our first carbon-neutral product by 2011”

Evian, the world's number-one mineral water brand, is backed by unrivalled experience in the conservation of water resources, with care of the catchment area for its own spring a priority. Evian is also looking at the broader picture with a drive to reduce its environmental impact through optimization of energy consumption, packaging and transport. The target is to halve its carbon footprint from 2000 to 2011, and Evian is backing initiatives to offset the remainder. This includes the support it will be providing from 2009 on for the rehabilitation of wetlands, which act as natural carbon traps, in association with the Ramsar Convention and IUCN (International Union for Conservation of Nature). See page 85.
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↳ It comes from the depths of the earth, where it is protected against all forms of pollution, and it undergoes no treatment, especially no chemical treatment. It's even better than organic. And that means that mineral-water producers are also the most determined defenders of the environment in the regions where they operate, for the simple reason that no other business has such strong incentives to protect its immediate environment. When I say that, I am not trying to dodge the issues relating to the environmental impact of mineral-water packaging and transport. But there again you need to look at the facts. To take an example, two-thirds of the deliveries made by Danone Water France—which covers our Volvic, Evian and Badoit brands—are by rail or barge. How many businesses do you think have such an environment-friendly record on transport? As for the bottles, they are 100% recyclable—which is much more than can be said of most other packaging—and the unit weight is declining from one year to the next. And for the past few months we have finally been allowed to use up to 25% of recycled materials. Lastly, Evian, the world's number-one mineral water, will be our first carbon-neutral product by 2011 (see sidebar this page and page 85).

What would you reply to people who say that it's irrational to choose bottled water since tap water serves the same purpose?

FR: There are several points worth making. First of all, developed countries have the enormous good fortune to have near-universal access to drinking water, which is far from being the case in all parts of the world. In a number of countries, the natural water Danone provides is the only affordable option. Secondly, we're talking about two different things. If what you mean by bottled water is mineral water or spring water, then it is a rational choice for people who refuse to compromise on water, the one absolutely indispensable "food" for life. Mineral water offers reliable quality, consistently pleasant taste, and content that is set out in clear detail on the bottle. It's the right choice for vulnerable populations that can't afford risks, like babies, the sick and the aged. Don't misunderstand me: we have nothing against tap water. But when you're walking through a supermarket, sitting in a café, or standing in front of a vending machine, mineral water isn't competing against tap water: it's competing against other beverages. Those other drinks are usually sweet and always less natural than mineral water. They're also more expensive, and they have a much bigger environmental impact than bottled water. In a country like the UK, for example, when consumers cut back on mineral water it is generally in favor of sweet beverages. What we need to do first is revive their taste for water.

To return to Danone, how do you see prospects for 2009?

FR: Nobody would deny that the year ahead will be challenging, with difficulties ranging from high exchange-rate volatility and rising unemployment to softening consumer demand on emerging markets. We have no more certainties about how things will shape up in different contexts than anyone else. And we don't have any magic solutions, either. But wringing our hands won't get us anywhere. In this kind of situation, what counts is attitude, courage, and commitment. ↳



Two and a half million children from all over the world have taken part in the Danone Nations Cup every year since 2000.

This international soccer tournament for children aged 10 to 12 embodies the values of openness, humanism, proximity and enthusiasm that are fundamental to Danone. And we are proud to offer children and their families this opportunity to make their dreams come true.

"Believe in your dreams"

Zidane
10
Zinedine Zidane





Developing countries are making a growing contribution to Danone's business, accounting for no less than 52% of water sales, for example. In 2008, capital expenditure totaling €706 million was in large part used to back geographical expansion and growth on emerging markets such as Brazil, Argentina, China and Indonesia.

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52%

of sales are outside Western Europe.
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3rd place

Danone headquarters placed 3rd for the quality of working conditions in the "Great Place to Work" survey of businesses with more than 500 employees.
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(Great Place to Work® survey, France 2009).
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↳ And your ability to steer your way on a slippery surface. You need to have quicker reflexes, be more attentive and ready to take the initiative. So we are approaching the year with realism, keeping a very close eye on the ball. With very clear priorities. The first of these is to ensure the highest possible level of efficiency in every area. In a downturn, there's even less room for the "almost right". Secondly, we are going to continue improving our margins, aiming for a 10% like-for-like increase in diluted earnings per share. Because that is how we can generate investment capacities and potential for future growth.

And growth?

FR: With consumer demand squeezed, we will be looking for growth wherever we can find it and accelerating it when we do. At the same time, we are not going to wear ourselves out trying to achieve growth in situations where it's unreliable or simply impossible. You have to choose your battles, and for us that clearly means going for higher market share. Now is the time to widen our lead on competitors and I'm convinced that Danone is well equipped to do that. We have the right culture for it, and our lean, decentralized organization gives the managers of our subsidiaries full responsibility—the most effective motivation. That agility, that freedom from unnecessary constraints, is an even more decisive competitive strength in our current environment.

What about product innovation? Will the strict new European regulations on health claims mean new obstacles or risks?

FR: We are obviously going to keep innovating. Setting the pace is part of what market leadership is all about, and I would be tempted to say that innovation comes naturally to us. Our R&D teams very certainly make it a key goal. But we'll be a little more focused and we'll pay more attention to prioritizing new product launches. As regards the new regulations on health claims coming into force in Europe, we believe that they are, on the contrary, a step in the right direction. Of course, there will be a need for some fine tuning to start with, as people in the industry learn exactly what authorities expect in the way of scientific documentation and what criteria they use to take decisions. There is likely to be quite a lot of to and fro over the first few months, but a mutual learning curve is inevitable in a new field like this. The ground rules will in any case become clearer, which will enable businesses that are genuinely investing in science and research to stand out from the crowd with clearly defined claims. In this area, Danone has more than a head start with our 1,200 R&D staff and 80 clinical studies published over recent years.

You recently announced plans for a fund to finance the development of what you call Danone's eco-system. Could you tell us what the plan involves and where the idea came from?

FR: The idea started with a simple observation—the fact that businesses and their immediate economic environment are increasingly interdependent. That has become painfully obvious with the current downturn, which has shown how even prosperous businesses can suddenly become vulnerable if their economic and social environment deteriorates. Which should remind us that it is in the interest of businesses themselves to look after that environment, what I have called by analogy their “eco-system”. So that's the idea behind the fund.

We have already set up a number of structures to back local economic development in different parts of the world, but we believe that there is now a need to broaden that approach and place it on a more systematic, more lasting basis.

Entirely financed by Danone, the fund will be set up with an initial allocation of €100 million and topped up with the contribution of 1% of our net earnings each year. It will provide financing for worthwhile projects identified by our subsidiaries in the regions where we do business—for example, programs to develop the know-how of local suppliers, to help create related businesses such as micro-enterprises for food distribution, or to improve employability in communities near our factories. It won't be an emergency fund or a recapitalization fund, since its aim is instead to prevent crises before they happen. Nor will it be used to finance any plans to enhance the competitiveness of our sites. And of course it's not a solution to every problem. It is simply meant to reinforce the economic fabric that we are part of, which is founded on mutual dependence.

At Danone, we believe that is part of the purpose of a business. And something we can do to back our own development over time.

So, the final question—what do you expect Danone to be like five years from now?

FR: Before we do anything else, we need to focus on the present and steer our way safely through the rough waters ahead. But that also means that we have to be clear about where we want to go and look to the medium term. I don't think that Danone in 2012 or 2015 will necessarily be very different from what it is today. But I hope that it will be even better attuned to the aspirations of people everywhere, to their concerns for nature and health, and to the need for more attention to human beings. That's the hope that gets us out of bed in the morning. ●

Executive Committee

Franck Riboud

53, French,
Chairman and CEO

Emmanuel Faber (see p. 93)

45, French,
Co-Chief Operating Officer

Bernard Hours (see p. 72)

52, French,
Co-Chief Operating Officer

Jordi Constans (see p. 20)

44, Spanish,
Executive Vice President
Fresh Dairy Products
Western Europe

Thomas Kunz (see p. 24)

51, Swiss,
Executive Vice President
Waters

Felix Martin Garcia

(see p. 20)
48, Spanish,
Executive Vice President
Fresh Dairy Products, Central
and Eastern Europe, Africa/
Middle East, Asia and Oceania

Flemming Morgan

(see p. 29)
53, British,
Executive Vice President
Medical Nutrition

Christian Neu (see p. 27)

52, German,
Executive Vice President
Baby Nutrition

Muriel Pénicaud (see p. 60)

53, French,
Executive Vice President
Human Resources

Pierre-André Térésse

(see p. 98)
42, French,
Executive Vice President
Finance

Sven Thormahlen

(see p. 43)
52, German,
Executive Vice President
Danone Research

Dirk Van de Put (see p. 20)

48, Belgian,
Executive Vice President
Fresh Dairy Products and
Waters, Americas