

Second Quarter & Half Year 2009 Results

Paul Polman, CEO

Results and performance

Q: What should we take out from these half year results? What were the highlights for you?

A: We're pretty pleased with the progress we're making, although we still recognise we have a lot to do. But if you look at the quarter two results, you see that the volume is starting to grow - 2%; and it's quality growth. It's the first time that we've seen consistent growth across all regions, including Western Europe. We have about 60% of our categories improving their growth trends. If we look at the top countries, 19 out of 24 countries are growing. So it's a widespread growth. And if you look at the quality of the growth, driven as you've seen in the results, by an increase in A&P spend and a step-up in innovations, I think we can broadly be satisfied, recognising obviously that there's a lot more to do and that we have a moving competitive set and economic environment out there.

Q: Positive underlying volume growth, but what's the story on pricing?

A: The story on pricing is equally good. Obviously you've seen in the numbers that pricing has come off. In the second quarter we have about 2.1% of incremental pricing. That is lower than previous quarters, but you should not forget that we came from an exceptional pricing year in 2008, and obviously a lot of the pricing is coming off.

And then we've made a deliberate commitment, as I've mentioned before, to get our European volume to grow again. And what we've seen is that we were really ahead of ourselves on pricing last year and we've had some price corrections in Europe that you see reflected in positive volume growth, but also obviously in a slight compromise on the margins at this point in time.

Q: As you say, you're going for volume growth through increased innovation and A&P spend. How would you say that's all going?

A: I think we can be pleased but, again, recognising that we have some way to go. We have some very good innovations that have now hit the marketplace; we're spending behind that and we're seeing some results. And it really runs across all of our categories. In our savoury brands we have the jelly bouillon, Knorr Stock Pot, we call it. Rolling out in deodorants, we have the hair minimisers. We have upgrades on our toothpaste brands. We have a new Dove variant, that's better for your skin. We've adjusted our detergent formulas.

What I've seen is that we've reacted fairly quickly with quality innovations that are increasingly being rolled out in more countries. And that is driving our growth. Otherwise you would not get that consistency.

Having said that, although 60% are improving, we still, in my opinion, have too many "cells" where we're not where we want to be. We need to strengthen our [brand] equities, continue to improve our formulas. So there's work to be done. But what you see in this industry is that if you do the right innovations close to the consumer, work well with your customer and spend behind it, you can get results.

Q: But there is a view, in a sense, that you're buying volume at the expense of margin?

A: I understand that and, obviously, the numbers have to speak for themselves. But if you look at the second quarter, we're reporting a slightly lower margin - 60 basis points - over the quarter but it was driven by 50 basis points more in A&P and 30 basis points from dilution from last year, which would suggest that our gross margin actually is up. Our gross margin has continuously improved over the last three quarters now.

And we've also warned the market that the input cost easing will occur more over the second half than over the first half. So we had to deal with that as well.

So, all in all, I'm pleased with the quality of our progress. If you also look at the details of the results and where the volume growth is, in two of the significantly sizeable regions, the Americas and the Rest of the World, we're actually improving our volumes and also improving our margins.

Strategy

Q: The 30-day action plans that you talk about, are they just a quick fix or is it more strategic?

A: No, I think it's more strategic than perhaps we get credit for. Obviously the first thing is this is fast moving consumer goods and with the 30-day action plans, I probably regret that we didn't call them 15-day. But what I really meant by that was we need to make quick decisions in areas where we have opportunities to do better.

But I think it's more strategic than short term because it really creates a culture again, a winning culture, a bias for action culture, and a culture that is increasingly externally focused. It will take time to evolve and strengthen a culture from a very solid base, and this is one of the areas where we can.

Clearly behind the 30-day action plans in many places we've seen improvements. Our shares in laundry in South Africa, for example, frankly had gone down to levels that were not acceptable. We've made quick decisions, put stronger plans in place, better segmentation of our portfolio, and we see the shares responding. And that story holds for many places in the world. So it is working for us and is obviously more than tactical in our industry.

Q: And are there competitive gaps that need to be filled?

A: Well, there always are, because it's a moving thing that we're dealing with. I do think that we want more of our cells, our strategic positions in countries, to grow than we currently have. I still think that our brand equities in some places need to be strengthened. In some cases our formulas could be better.

In terms of the categories, we'd like to see more performance out of hair care. Our spreads business could do better. But that will always be the case. The good thing is that I see an improvement, but I'm certainly not satisfied yet with where we are.

Q: But, given today's market, there are M&A opportunities here. Might they be infill or transformational?

A: There are always opportunities, obviously, and we will look at things and decide very carefully. We've looked at things that we let go because we did not think it was worth paying the price that others expected. And we've looked at some acquisitions that we got; very strategic ones, like TIGI. We've just concluded the Baltimor acquisition in Russia, which gives us the leading positions in sauces. Inmarko ice cream, I've talked about before, and we've just bought another ice cream company in Romania.

So the first thing for us, and a priority again, is to strengthen our portfolios, especially in this economic situation where consumers trade up or down. You want to be sure that they stay in your franchise. And I think in some places we had weakened our portfolio by focusing on too few brands. So we look at those acquisitions as a priority, next to strengthening our core brands. But for now no other plans beyond that.

Culture and sustainability

Q: You've made a number of new appointments, including some from outside. Do you now have the right team in place or are there going to be more changes to come?

A: We've made some appointments from outside, but obviously the bulk of the appointments have been from inside where we've been skill-matching, putting the right people in the right job. We've changed about one-third of the people. I still think we'll have one other round of changes in September, and then we'll broadly be fine with the organisation that we have, bar the continuous occasional positional changes that we have to do. But I want to say I'm happy with the organisation. You cannot get the results that we've just talked about without a good organisation.

Q: Now, you've said that you're still committed to sustainability, in spite of the current economic environment. What does that all mean in practice, especially in the run-up to the Copenhagen Summit?

A: Yes. I wouldn't even say despite the economic environment, I would say the economic environment drives home the urgency even more.

First of all, it makes good economic sense. We've found out that if we really reduce our packaging, if we reduce our CO2 imprint, if we reduce our water usage, we would actually be more efficient. And part of that efficiency we can price on to the consumer.

The second thing is it makes good consumer sense. When we did the Rainforest Alliance on Lipton, as an example, we really saw our business respond. So the consumers are asking for it.

And, thirdly, it drives innovation. It drives different solutions from what we've been doing and that's obviously the game we like to play. And companies like ours, who invest in innovation, should benefit from that.

We take this responsibility very, very seriously. I'm personally very interested in looking at the climate change. We as a company have a fairly limited impact on the CO2 emission, in fact 3 million tonnes, but in our total supply chain it's 300 million tonnes. So I'm preaching quite actively a total value chain approach.

We are honoured to be part of the Copenhagen Summit. We were there a month or two ago with Ban Ki-moon and others and we've been invited back for the end of the year. So hopefully we can make our contribution and that's obviously an important role that we have as a business in society.

Outlook

Q: Now you're still not giving any formal guidance for the rest of the year, for the second half. Aren't you being a little bit coy in managing expectations?

A: I don't think so, and I'm not sure if we should give guidance or when we would give guidance. I'd rather have the results talking. You can see that again with full transparency in the results of the second quarter, which I think are good, and which I think are even better if you compare them to the competitors that I've seen.

But I also recognise that the markets out there are still tough. The competitors obviously will be stepping up their innovations. This is a good thing for the consumer, but we just need to continue to stay focused on what we do well and deliver.

I don't see any need to put targets out there. We've been very clear that our priority is to re-ignite volume growth, whilst protecting operating margins and cash flow. I think in the numbers that we've published where you see the volume growth, where you see responsible margin progress, the gross margin progress we talked about, and where you see our cash flow, in this case our working capital, making a significant step change you can see that we do deliver on what we say. And I think that's better.

I come from a part of Holland where my parents always said it's better to deliver than to talk. And I think that's true for business as well.