Chr. Hansen

Q3 2015/16
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Operator: Thank you for standing by and welcome to the presentation of Chr. Hansen's results for the first nine months of 2015-2016.

At this time, all participants are in a listen-only mode. There will be a presentation followed by a question and answer session, at which time, if you wish to ask a question, you will need to press star one on your telephone.

You are also welcome to submit questions via the web by clicking on the Q&A tab in the webcast at anytime during the call.

The questions submitted via the web will be answered after the call. I must advise you that this conference is being recorded. I would now like to hand the conference over to your speaker today, CEO, Cees de Jong.

Cees de Jong: Thank you, operator.

Good morning and welcome everybody, I'm Cees de Jong, CEO of Chr. Hansen and with me today, is CFO, Soren Lonning. Looking at the group result for the first nine months, we are quite satisfied with the overall performance. Food cultures and enzymes as well as natural color continue to show strong organic growth and both areas also delivered promising profitability improvement.

Health and nutrition on the other hand, did not deliver as expected, as we experienced deteriorating market conditions for our animal health business.

Our farmer customer base for animal health probiotics continued to be negatively impacted by the very low commodity prices for milk and meat and have both remained at extraordinarily low levels. That being said, bear in mind that this is at least, partly, offset by the strong performance in food cultures and enzymes where we have benefited from the high availability of milk for cheese production.

Before we go into details, I would like you to take a look at the disclaimer on the next page. Can we have slide 2 please?

I hope you all had a chance to read the statement or will do it afterwards, so we will move to slide number three.

Revenue for the first nine months reached EUR693m, and was 11 percent above last year. Now NPC is included from Q3 and contributed with around 2 percentage points to the growth year-to-date. Organic growth and that, of course, excludes NPC, reached 13 percent for the first nine months and 12 percent in Q3. The organic growth continues to be positively supported by price increases to protect us from depreciating currencies and from raw material prices in natural colors.

The impact from these price increases was around four percent both year-to-date as well as in Q3. Cultures and enzymes delivered organic growth of 13 percent, both year-to-date and in Q3 with growth supported by both volume and price. Health and nutrition delivered only three percent in Q3 and it was only slightly better than the first half and the organic growth for the first nine months was only two percent.

Natural colors delivered 20 percent organic growth for the first nine months, and volume and mix contributed around 12 percent and priced the remaining eight. The latter was driven by higher raw material prices, and from enforcing euro-based pricing to protect EBIT from depreciating currencies.

In Q3, the organic growth for natural colors reached 17 percent with volume growth of seven. The operating profit or EBIT increased by 18 percent to

EUR189 million, and it was driven primarily by the higher sales volume and the operational efficiencies. The EBIT margin before special items was 27.2 percent and as compared to 25.6 percent last year.

The increase in EBIT reflects, among others, the positive impact from operational efficiencies. After special items, the EBIT margin was 26.1 percent, up 0.5 percentage points compared to last year.

R&D expenditures in the first half increased by 22 percent, due to increased activity in food and food cultures and enzymes and in health and nutrition. Profit for the period was EUR128 million and that is up 15 percent from last year, and the profit for the period was negatively impacted by special items of around EUR8 million.

Finally, the free cash flow before acquisitions and special items decreased by 11 percent to EUR58 million for the first nine months, and that decrease was mainly due to a higher investment level driven by the Copenhagen capacity expansion. Now, let us move to the next slide, slide number four, for an update on the strategic highlights in the third quarter.

As most of you will know, we announced the (platform) of our strategy review in April this year, the review reaffirms our Nature's No 1 Strategy, and we have added bioprotection as a third strategic initiative.

Combined with our other two strategic initiatives, one in plant cells and the other in human microbiome, the bioprotection area will support the existing businesses in delivering on our ambition of sustainable long-term growth.

As a result of the review, we have extended our long-term ambitions another two years, and we have improved the organic growth guidance to eight to ten percent for the period.

Fiscal 2019-2020 reflects our current plan period, but let me just point out that we certainly see a lot of attractive growth also after this. During the quarter, we accelerated the expansion of the production capacity for cultures at our

Copenhagen factory and that project is running according to schedule and we expect to be able to inaugurate the new capacity already during the summer of next year.

This is not the only expansion project we will implement in the coming years, and therefore, we will see a high CapEx spend in the coming financial year and it is to both support our growth as well as to address opportunities for further production efficiencies.

As I mentioned earlier, animal health is not performing to our expectations, this is mainly due to the depressed agricultural sector which causes farmers to cut down on certain feed additives such as probiotics and silage inoculants.

Now despite the current challenging market conditions, the longer term outlook for this industry looks very promising, we will continue to expand our presence here. We will very shortly introduce new products for both the pork and the poultry segments as we referred to at the capital markets day. We do this to ensure that we can continue to differentiate our product offering from the producers of the more generic solutions.

The integration of NPC has been ongoing during the third quarter and we are progressing as planned with the insourcing of production, to securing of cross selling, and the internalization of NPC's product portfolio.

Now returning to our strategic initiatives, I'm very pleased with the strong growth we see in bioprotection and that is both across the existing areas in meat and dairy, but also in the adjacent food categories. As consumers continue to require higher standards for safe and fresh food through no chemical means, the amount for our bioprotective solutions will only increase in the coming years. To support our initiatives in bioprotection, we will increase our investments into this area, to build an even stronger product offering supported by dedicated resources in research and development in sales and in application.

Turning to plant health, in plant health, we had our first sales in the U.S. of our new VGR Biostimulant and that is sold in combination with one of FMC's existing chemical products.

This new combination product is used for corn plants and while farmers are still only testing the products, it has been encouraging to receive their feedback as they see the same yield improvements of around two percent as we experienced in our field trials.

And last but definitely not the least, human microbiome, we have completed a clinical study which did indeed show a positive physiological effect of the bacteria tested. Those results were so good that we have decided to move the clinical development to the next stage, and while it is still early days, it shows that we are on the road to bring our strengths towards a proof of concept level.

Now let us turn to the next page, please.

As part of the organizational change that we announced earlier this year, we have started to report on four regions as we have split the Americas region into North America and Latin America or LatAm, starting in our biggest region, EMEA, with almost 50 percent of revenue, here we saw ten percent organic growth for the first nine months, and nine percent in the third quarter. The growth was supported by both volume and price, and natural color, culture for fermented milk, cheese and meat, all delivered strong growth.

It was also very positive that the probiotic segment delivered solid growth, supported by strong performance in Q3. And as you all know, the probiotic segment has been depressed in Europe for some years now, that we see indications that we have (carried) the tide and that growth opportunities open up once again.

Enzymes and human health in EMEA were at the same levels in 2014-2015, while animal health was below due to the already mentioned markets conditions.

Turning to North America, in North America, we saw eight percent organic growth for the first nine months, and 14 percent in the third quarter. There was strong growth in human health in natural colors, cheese, and meat, while growth in fermented milk and enzymes was more modest.

Animal health and probiotic cultures were below last year, animal health was negatively impacted by insourcing at a major customer in Q3 of last year, and of course the general poor market conditions.

Latin American delivered 22 percent organic growth for the first nine months, and 15 percent in the third quarter, with growth supported both by volume and price. Growth was strong across all segments except for probiotic cultures and plant health.

And finally, APAC delivered 21 percent organic growth year-to-date in 2016 in the third quarter, we saw strong growth in fermented milk including probiotics, in natural colors and in cheese, and as in the previous quarters, growth was particularly strong in China.

With this, I will hand over to Soren to take us through the financial of each of our businesses. Soren, over to you.

Soren Lonning: Thank you very much, Cees.

As usual, we will start with our largest business unit, food cultures and enzymes, we are pleased -- very pleased that the strong growth momentum continues with food cultures and enzymes with 13 percent organic growth both in Q3 and year-to-date.

It is important to note that the impact on pricing continues to be substantial with four percent year-to-date and three percent in Q3, largely driven by the euro based pricing.

However, the substantial volume growth also continues. This is primarily driven by the usual suspects, so fermented milk, cheese, and meat, but also supported by probiotics and enzymes. And then I would like to emphasize that we had a very strong growth in bioprotection across the three subsegments, fermented milk, cheese, and meat, and this confirms the decision to make this a strategic focus area going forward.

For this Q3, we are on track to solidly exceed our long-term growth ambition of seven to eight percent this year. Changing to the EBIT development, we are pleased to see that we continue to deliver margin expansion in this business area, most importantly from operational efficiencies, but as expected, the margin expansion was also lower than in the first half of the year due to tougher comparable, as you may remember, the benefit from the Copenhagen expansion started to materialize in Q3 last year, and then also currencies had turned against us in Q3.

Year-to-date margin expansion up 3.4 percentage point is driven by production efficiencies which is roughly 2 percent, and secondly, full depreciation of the acids related to PAI's acquisition of Chr. Hansen back in 2005, roughly 0.7 percent and then a favorable product mix of roughly half a percentage point.

If you look to the Q3 margin expansion of 1.9 percent, drivers are more or less the same, production efficiencies contributing roughly one percentage point, again, the depreciation of the PAI assets continues to add 0.7 points, we continue to benefit from product mix but then on the other hand, currencies have turned against us and is impacting negatively.

And with these comments, I will be turning to the next page, and the health and nutrition business.

It is fair to say that health and nutrition did not deliver as expected with three percent organic growth in Q3, and two percent year-to-date. On one hand, human health did grow strongly, both year-to-date and in Q3, although the timing of orders affected positively in Q3.

On the other end, animal health was more negative than expected in Q3, due to the challenging market condition which is likely to prevail for some time.

On a smaller scale, plant health delivered the first sales of VGR which contributed positively. The impact from NPC on the year growth was eight percent year-to-date and 21 percent in Q3, of course the organic growth was unaffected. For the full year, organic growth is expected to be well below last year as we expect growth in Q4 to be very modest due to the challenging market condition in animal health and the timing of orders in human health.

Turning to the EBIT development, year-to-date, the margin is reduced by almost 4 percentage points and that is driven by first of all, the lower sales of animal health, around two percentage points, the highest ever tariff cost of certain human health products in the U.S., around one percent, this is something we discussed back in Q2, and then the inclusion of NPC which is also impacting negatively to the tune of minus one percentage point.

In addition, we have continued to invest in (life houses) which is also impacting negatively but that is offset by a favorable currency effect year-to-date. If you look to the margin development in Q3, specifically, margin reduced by 5.6 percentage point and that was driven by first of all, the inclusion of NPC, which is between minus 2 to minus 3 percentage point, the lower sales of animal health to the tune of minus two percent, the higher tariff cost in the U.S., minus one percent and then currency have now turned against us.

Let us turn to the next page and the natural color business, we did have another good quarter in natural colors with growth of 17 percent in Q3 and 20 percent year-to-date. It is important to note that the impact from raw material is significant both yesterday and in Q3, although the impact is expected to be less in Q4.

We continue to see strong growth across industries and we do that despite some lost volume from margin improvement initiatives, most importantly within the Carmine business.

Moving to the EBIT margin, here we continue to see progression especially from the higher sales volume and optimization initiatives, although this is partly offset by currencies.

Year-to-date, the margin expansion is 2.5 percentage point and that is driven by optimization initiatives ranging from logistics, production, sourcing, and product portfolio optimization contributing with almost four percentage point higher volume combined with prudent cost management adding two percentage point but that is being offset by currencies which is impacting negatively by minus 3 percentage points. And also a negative effect from Carmine which is diluting margin due to the higher topline.

In Q3, specifically, the margin expansion is 2.4 percent, and here, the drivers are very similar, optimization initiatives, combined with higher volumes and prudent cost management as to build the margin expansion, but we are also here, having a positive effect of the reorganization of the color division last year in Q3 and that also adds almost two percentage point margin expansion.

These positive benefits are then being negatively impacted by currencies and Carmine dilution so we end up with 2.4 percent margin expansion. Let us turn to the next page.

Moving to the cash flow on and balance sheet, when you look at the cash flow from operating activities, it has increased by EUR4 million year-to-date, that is driven by the improved operating profit, but is partly offset by higher net working capital, primarily due to increasing raw material prices, especially within the color area, but also a very high sales in the month of May.

However, we should also note that when you look to the net working capital as a percent of net sales, then this remains on par with last year. Moving on to the cash flow for investing activities, here, we have spent almost EUR50 million more compared to last year, that is largely driven by the expansion of the culture production in Copenhagen, and also the laboratory facilities for the human microbiome initiatives.

There is some timing in this, last year was quite back-end loaded and we have the opposite situation this year and so we expect this difference to last year to tighten substantially in Q4.

So based on this, free operating cash flow is down slightly due to primarily the high investment level but when we look to how we will end the year, we expect to be back on track and deliver as we are guiding improvement compared to last year.

I'm also pleased to note the improvement in the return on invested capital increasing from 33.8 percent last year to 36 percent this year.

Let us turn to the next page, we have added a small comment here regarding our currency exposure given the recent turmoil in the financial markets driven by the Brexit.

And we would like to share two facts about Chr. Hansen's currency exposure. On the top left corner, you will see the breakdown of our revenue, roughly 55 percent is in euro, all covered by euro price list, 25 percent is in U.S. dollar, and the remaining 20 percent is in various currencies such as the Chinese renminbi and the Brazilian real.

If you look to the benefit of our euro based pricing, this has had roughly a positive effect of roughly three percent so far in this financial year. And speaks to the strength of us hedging for these tide of depreciating currencies.

On the right hand side, you will see a few comments regarding the consequence of the Brexit for Chr. Hansen and as you will see here, we are expecting a very modest impact, if you look to our revenue exposure, we are roughly two to three percent of our revenue is happening in the UK but here, we have hitched more or less half of that based -- with the euro based pricing.

It means that the net exposure to the British pound is just around one percent of our net sales. I can also confirm that although our balance sheet exposure has been covered through hedging. So when you look at this, the impact from Brexit in the short term will be very limited.

If you look to the currency impact, on the corner -- bottom corner, left corner on the page, you will see that the currency impact in Q3 increased to three percentage point is covered by price increases and this is also a reflection that we no longer have tailwind from the U.S. dollar. Let us move to the final slides which is our outlook, EMEA, our group outlook remains unchanged compared to the guidance given on the 7th of April 2016 for the organic growth, it reflects that the food colors and enzymes, natural colors business are doing slightly better, whereas the health and nutrition is below our initial expectations.

R&D expenditures continues to be expected around seven percent with an increasing impact on the P&L, R&D expenses in the P&L amounted to 6.5 percent of revenue year-to-date, compared to 6.2 percentage point last year. In Q3, this impact was negative 0.5 percentage point.

Also the guidance for EBIT margin and free cash flow remains unchanged. And with this, I will hand over to the operator to open up for questions.

Operator: Thank you, as a reminder, if you wish to ask a question, please press star one on your telephone and wait for your name to be announced.

If you wish to cancel your request, please press the pound key.

And now, our first question comes from the line of Fulvio Cazzol.

Fulvio Cazzol: Yes, good morning, gentlemen, so a couple of questions from me, firstly on the animal health; I was just wondering, when did you start to notice that conditions were turning more challenging? I'm just trying to understand how much visibility you have in this business.

Some of these commodity prices, such as milk, have been under pressure for a few years now.

And then my second question is on the probiotics within food cultures and enzymes. What's behind the growth in probiotics? And what makes you confident that the market has turned a corner and we are now back to growth in Europe, please? Thank you.

Cees de Jong: Fulvio, let me take your questions. We have indeed been surprised by the severity and the duration of the market conditions both for dairy farming as well as for pork. We have been surprised during the quarter, if you would look at the statistics, you will see that those prices are now at prolonged and at a very low level and the situation that hasn't occurred in this severity before and indeed, we were caught by surprise in the quarter in all fairness, we would have expected the market to recover.

We have now also become a little bit more cautious going in to the fourth quarter.

That said, the overall numbers stayed and then will have also been impacted by the distributors destocking given the tough market situation that they face, and what we of course, need to take into consideration is that on the positive side, the more milk that is available, basically, there is much more milk available, gives us positive effect in food cultures and enzymes.

And there is more milk being converted into cheese.

Now the outlook over allotted for companies and changed this as a result of those two effects, and the long-term outlook for probiotics in animal health, we would say, of course, is still very positive. I mean, in this quarter, we have seen a group of 50 institutional investors launch an engagement campaign towards the ten biggest restaurant chains, both in the U.S. and the U.K., to have them work on curbing the use of antibiotics. So antibiotics come under increased scrutiny, I'm pretty sure you have picked up the article in The Economist, where also the general awareness of the (misuse then to antibiotics in feeds) being now brought to light.

So long-term, animal health, we are not concerned but we were indeed surprised in this quarter.

And maybe the last thing, I should say about this at the capital markets day, we announced that we will be introducing new products for both pork and poultry and there, we are nicely on schedule so we will introduce a product next year.

Now with regards to probiotics, and why we see growth, we have seen some positive effects with certain customers that drive that growth and obviously, we can never comment on the individual customers, so it's a little bit tough to answer that question in more detail. We can see us turn the tide in Europe.

Fulvio Cazzol: Sorry, just as a follow up on that, so you've seen a higher rate of innovation activity by customers generally across the board in Europe, particularly within probiotic yogurts. Is that basically the summary there?

Cees de Jong: I'm not sure whether we should call it innovation or whether we should call it increased focus and marketing. It's more towards the latter.

Fulvio Cazzol: OK, got that. Thank you.

Cees de Jong: You're welcome.

Operator: Our next question comes from the line of Lars Topholm.

Lars Topholm: Yes, my question's on HND and how you evaluate your market position here. This weakness you're seeing is a trend to extend our sort of increased competition. And maybe you can comment a bit on how you have seen the competitive landscape changing in each of the segments over the past couple of quarters? Thank you.

Cees de Jong: Thanks, Lars. It's a great question.

We would consider ourselves to continue to be the leader in the niche market of bacterial probiotics for animal health. I think our position is unchallenged when it comes to dairy cattle silage, when it comes to pork, in all fairness, there, the impact is really due to end-market considerations or end-market pressure, what we have seen and there, we need to introduce more than ever, new products, what we have seen is that in poultry, there is increased competition and they are not fully satisfied with our ability to differentiate or distinguish ourselves based on that product offering, so we are, as you know, introducing new products for both poultry and pork.

In poultry, we really need to differentiate ourselves. Then in addition there, too, and maybe that is also what you aimed to, we have seen a number of acquisitions and I think there is even announcements coming up this week or maybe even today, that reconfirms for us that this is an important and interesting field going forward. Remember, that is 70 percent, seven-zero percent of all antibiotics in the U.S. are being used in the animal feed chain, and that is just irresponsible.

700,000 people die every year because they get infected by resistant bacteria and of course not all of that is due to resistance on meat and poultry, but you can imagine what is happening there.

So the long-term outlook for antibiotics, for probiotics in the feed chain is just very positive and we continue to be the leader.

Lars Topholm: And if you should give an indication of the momentum in the animal side of that business for the quarter, is it fair to assume that human health has grown double digit, which means everything else equal, animal health declined around 10 percent or a little bit more. Or is that completely far off?

Cees de Jong: No, I don’t think you are far off. Human health continues to do very well. Especially in the U.S., and also in the coming quarter, we are more cautious with regards to where our animal health business can go.

Lars Topholm: Thank you very much, Cees.

Cees de Jong: You're welcome.

Operator: And our next question comes from Soren Samsoe.

Soren Samsoe: First question on natural colors, you have very strong organic growth, 17 percent in Q3. But it seems like that momentum may fade a bit in Q4. Is that due to lower impact from raw material pricing? Or is it volumes going down? Or is it a combination?

And second question also on natural colors, some of this new customers that has talked about using more natural colors in the U.S., if you give us an update on if that's on track. And then finally on free cash flow, you continue to grow free cash flow below both top line and earnings growth; you've done it for quite a long time now. When could we expect to see that reverse, where you increase cash flow more than earnings growth? Thank you.

Soren Lonning: Let me take those, Soren. Addressing your first question on natural color and the momentum, I think when you look, I was looking at Q3 where we are reporting seven percent volume growth. Here, we are actually growing well outside in the Carmine category and growing double digit here. However, we have taken a quite firm stand on our pricing in the Carmine category to improve margins, and that is spilling into the overall numbers on this, when we look forward, in Q4 we also continued to perform well on the volume, it will also be driven by the non-Carmine colors, and we will only have limited growth in the Carmine due to these initiatives to increase margin.

But overall, we remain positive on the growth outlook of the business.

That also leads into the next question which was relating to the U.S. customers, we are continue to working with the large U.S. customers, we have converted the first of the major ones and are starting to see some positive benefit from that, but it is also fair to say that there is still a lot of the large customers that we are still working with and where they haven't really clicked over to the natural solution just yet.

But we remain optimistic, we are working with a lot of them over there and -- but it is -- it takes a longer time than you would expect to making this change both due to the technical solution that needs to be in place and the consumer acceptances that needs to be run.

If you look to the free -- the cash flow, then you are right that we are currently -- the free cash flow is currently below last year and t is driven a lot by the investments and to a large extent, also timing, as we alluded to, we expect to -- as we said, deliver free cash flow above last year for the year still, and so we will improve our cash flow in Q4. We have also said that when we look to next year, this is a year where we will -- make -- have the majority of the investments in the new capacity expansion and (others) and that will influence the investment level next year.

And it means also that the growth of free cash flow will be modest next year.

That is in line with our previous guidance but then we expect to after that year, to come back in a normal mode with strong growth in free cash flow again in the financial year 2018.

Soren Samsoe: Thanks for that.

Operator: And our next question comes from the line of Tobias Bjorklund.

Tobias Bjorklund: So good morning to you, so I have a few questions. So, first of all, you still guide 10 percent to 12 percent organic growth, and I wonder what that would equal in euro growth. I would assume the acquisition that you made in the U.S. might not contribute as much for the full year as you might have initially expected, as there are some market issues in animal health.

And also, FX for the full year, if you could shed some light on that. And then, you talked about capacity coming online summer 2017 in Avedoere and we also saw some additional CapEx in other areas. I wonder if you could shed some light on that. That would be interesting.

And the last question is regarding the VGR corn inoculant. I wonder what's the shelf life stability on that product if you know it. Thank you.

Soren Lonning: Yes, let me address your first question, Tobias.

If we include the numbers, then we expect the euro growth to be roughly one percent less than the organic growth for the year. So that is in terms of translating into euro growth with -- if we correct for the NPC, exclude that, then we see a two to three percent lower Europe growth compared to our organic growth for the full year.

So we have a currency effect which is to the tune of two percent to three percent negative for the year.

That, I think, answered the two first questions…

Cees de Jong: I will take the next ones. And maybe I was a bit confusing Tobias, when I talked about additional investments, I think I also said that those were in research and development, sales and applications, so you should not expect those to be hardware but it s more on our cost base where we continue to grow and that is in line with the guidance that we gave, and on the captured VGR, I'm really (over arched) and my guess is that it is anywhere between six and 12 months but we will have to take that one offline.

Tobias Bjorklund: OK. Thank you very much.

Operator: Once again, if you wish to ask a question over the phone lines, please press star one on our telephone and wait for your name to be announced.

Our next question comes from the line of Hans Gregersen.

Hans Gregersen: Good morning, if we look on your growth guidance of 10 percent to 12 percent for the full year, you have done 13 percent for the first nine months.

Can you explain to me the growth, the acceleration, where's that coming from in Q4, and why? That's the first question.

Secondly, if we look on natural colors, how much has the U.S. conversion contributed if anything in the quarter?

Then on the human bionome, you mentioned a positive clinical result. In which application is this culture for?

And then finally, if you could just shed a little bit of light on bio-protection? You mentioned salads and fish. What has happened commercially since the CMD? Thank you.

Soren Lonning: Let me start by addressing your first question. So it is true that we have delivered the 13 percent organic growth year-to-date, the reason why we expect a lower growth in Q4 and therefore, also maintain our guidance of 10 percent to 12 percent is really driven by two things. It is lower growth than health and nutrition and this is to the already discussed effect of the animal health, but it is also reflecting the fact that human health had a strong quarter in Q3 and there were some timing of orders that we expected to have in Q4 but which came in in Q3.

And it means that the human health will also have somewhat softer Q4. So that is the health and nutrition, that is one key thing.

The other part is that we have benefited throughout the year from pricing, and that is primarily been the pricing effect from applying a euro based pricelist and is from the effect of the passing on increasing raw materials prices in the color.

Those two effects, we also expect to be lower in the Q4 and that combined makes us -- maintain the guidance of ten percent to 12 percent.

And then I didn’t quite get your second question regarding the U.S. dollar.

Cees de Jong: It wasn’t regarding the dollar, I think it was how much the conversion in the U.S. contributed to natural product sales. If that is your question, Hans, then I am about to answer that one.

In all fairness, the contribution of the U.S. in the third quarter was still limited, we have converted, some players, we have even a very important product in there, where we need the full conversion to really make a major impact on the number.

Like Soren said before, that is a slow process and it is not because our color solutions lack in ability to their work, but it has to be mentioned that our customers not only take out the artificial color, they also take out the artificial flavorings if it is in any other artificial ingredient that is in the matrix so it just takes them time to get this done and I think our position is excellent when it comes to taking our product of this conversion but it is the process that we will take, and I think that is what we have always set. We will see more impact next year, but the good thing is we will continue to see impact in the years to come.

Some of our customers and obviously I won’t mentioned names but some of them have mentioned that they will take five years to fully convert. I think the good news is I don’t expect any of them to backtrack from this initiative as there is so much consumer awareness on it.

On the microbiome..

Hans Gregersen: Cees, if I could just interrupt here.

Cees de Jong: Sure.

Hans Gregersen: If you look on this reformulation, which obviously is quite a challenge for a lot of the food and beverage manufacturers, compared to what you've said previously, is there any risk of this being a little bit more prolonged or delayed slightly due to these very tough reformulation projects?

Cees de Jong: No, not really, I think this is what we have learned, Hans, already over the last sort of three or four years, and in all fairness, a very good product has been converted in the U.S. and we have been working with the customer for more than three years so we were not surprised when it happened and we have learned a lot in the process.

So our assumptions with regards to U.S. conversion for natural colors has not changed in our strategic outlook.

And turning to microbiome, you asked the application area, and I decided last week to take it out for competitive reasons. It was in our deck, but I don't want competition to know what we are doing. Let me put a few words around it, we have created a clinical model in humans where we tested two of our strains for a very specific effect.

We do something to this group, to these humans that enables us to then test the probiotics, the probiotic are being given in capsule and the two strains that we test separately and the results have been very encouraging.

And that is why we go to the next phase. Remember what we do here, Chr. Hansen is not a pharma company, it's not going to be a pharma company, so the only thing we want to do is come to a strong proof of concept and in all likelihood, we will enter into partners to further scale this up.

But then, at least, we will be the ones that own the IP and for that particular reason of wanting to own the IP and having exclusivity, I need to be a bit secretive here.

Then on biome protection…

Hans Gregersen: That's fine, but, Cees, can you -

Cees de Jong: You have four more question asked, right?

Hans Gregersen: Could you at least indicate is this a niche application or a broader application?

Cees de Jong: The way we tested is in a (small group) of the population and we feel that it's highly relevant for a significant group. Otherwise, we wouldn’t do it.

Hans Gregersen: OK, thank you.

Cees de Jong: And then your last question, Hans, was on bio protection and I think you asked how about salads and fish and what we have been reporting for Q3 is that the key driver for growth in bioprotection, obviously still was our activities in fresh dairy, cheese and meat, however, we continue to see players in salads and fish to go for bioprotective solutions and the way this works is that retailers who have become aware of this technological solution basically asking their suppliers to test out these solutions.

And the mode of action, obviously is similar to what we see in fresh dairy and cheese and that is that the good bacteria, basically outcompetes the ones that potentially could spoil the food.

Hans Gregersen: Thank you.

Operator: And our next question comes from the line of Heidi Vesterinen.

Heidi Vesterinen: Hi, I have a few questions. Maybe starting with natural colors; you were very positive on the outlook on conversion, but we're also increasingly seeing that many companies, they are restructuring; they're also reducing SKUs.

Could this not have any impact on launch rates, timing, maybe even reduce the addressable market in any way?

Second question; in the past quarters you were saying that maybe cheese volumes could slow a bit because of the high stocks. This time on the call you sounded quite positive; did I interpret that correctly? Do you think that, as long as dairy prices remain very depressed, cheese volumes will be strong?

And then the last question on the euro pricelist; if we were to freeze exchange rates now, do you expect any impact on organic growth from the euro price effect in full-year 2017 please? Thank you.

Cees de Jong: I'm sure Soren will take the last question, Heidi. Let me take the first one. On natural colors and the outlook of conversion, for some customers, it is a big task, I think on one of these calls before, I said that there is a customer that needs to convert 400 SKUs in their confectionary line.

But I don't see any changes with regards to the commitment to change out the artificial colors, and the driver for that is that consumers have become much more aware. And as I said before, I think this is, Chr. Hansen benefiting from information technology and total transparency.

Nowadays, consumers know what is it their food or in their beverage, and they have become more and more critical. So I don't think that there is a way back, we are indeed, positive on how we see this conversion and the positivism is also based on the interactions that today, we have with those customers.

Remember that two years ago, we said U.S. conversion will come, we don't know exactly when it will happen, and now we have seen all these major announcements already two years ago, maybe even three years ago, we were working with these companies.

So it is a process that is ongoing and we have no doubt that the conversion is happening. When it comes to cheese and cheese volumes, in Q3, we still see a good growth in cheese, for instance in the U.S. cheese production, was in line with previous years, of course the abundance of milk has become available due to the evaluation of the quota system, that now starts normalizing.

So going forward, we think we are going to go back to, let's say, normal levels of cheese production, there, of course, one of the key drivers for our growth is conversion. Remember that in the cheese market, still only 50 percent of the players are converted and one of the things that we continue saying is that for instance in Northwest Europe, there is significant opportunity for us to convert big players and that is exactly what we are working towards doing.

Soren, you want to take the euro price?

Soren Lonning: Yes, and to answer your question, we -- at this point, based on the currency rates that exist now, we see very limited euro prices effects in 2017.

And as you may recall, some of our key currencies with euro based pricing, the position in real, the ruble, et cetera. Actually the key changes happened back in our financial year 2015 but is impacting of course also this year.

So for 2017, we expect very limited effect from euro prices at this point in time.

Heidi Vesterinen: Thank you.

Operator: And our next question comes from James Targett.

James Targett: Hello there, it's James Targett from Berenberg; a couple of questions, both on margins. Firstly, just on natural colors, we've had a couple of quarters now where the margins have been 11 percent/12-plus- percent. I just wondered if you're getting more confident in being able to achieve your -- I think you still have a low-teen midterm expectation perhaps as early as next year now, as in 2017.

And then secondly, just on health and nutrition margins. The impacts you highlighted in the third quarter, the large ones, I guess those are all going to impact for the next few quarters going forward. Am I right in thinking that, and is the magnitude of the impact going to be as great over the next two or three quarters? Thanks.

Cees de Jong: Let me take the first one on natural colors because I think I have talked most about wanting to bring natural colors back to mid-teen margins and mid-teen for me is around 15 percent.

And James, you have to trust me, I'm pushing that part of the organization, very hard to get there, but we said we would achieve that level, sort of mid-planning period so I would not expect us to be there next year, I would be extremely pleased however, in fiscal 2018, going to be there, that said, when I look at the progress that natural colors is making, I can only give them a very big compliment for the activities that they are undertaking. But they are also taking some very structural actions in a sizable project and my expectation is that we will really see the full effect sort of still in the midst of our planning period.

Soren Lonning: And then James, let me address your questions on the health and nutrition margin. So to your question regarding the drivers that we see right now, if they are going to prevail for some time, I would say you are largely right about that. If you look to the Q3, the lower sales of animal health, we expect that to continue, we can of course, adjust investments to some extent, economy, but it will affect also going forward, the higher tariff cost in U.S. of around minus one percentage point and that will also impact in Q4, bear in mind that we took our year-to-date correction in Q2 so you will also have it in Q1 but then you will catch up in Q2 next year on that part.

The currency which is impacting by roughly minus half a point in Q3, is we also expect to continue, it's the latest knowledge we have on this. And then there is the NPC which was quite substantial in Q3.

And here, we are actually expecting some changes because first of all, we are still not fully decided on what O.T. do with the trader business which is part of NPC and where -- which is impacting margins negatively, it is quite low margin business, so that is up in the air, and then secondly, we are expecting to realize production synergies in our financial year 2017 so we will not get an impact in Q4 of this but in 2017, there will be a positive effect from these production synergies from us insourcing the production of the NPC products.

So some of the drivers will prevail for some time, others will likely change a bit over the coming quarters.

James Targett: Great, that's helpful. Thank you.

Operator: And we have another question from the line of Fulvio Cazzol.

Fulvio Cazzol: Yes, good morning again, gentlemen. Sorry, I had a follow-up. Could you comment a bit on China? I remember the message from the last release that growth was at a very high level and you expected it to somewhat slow in the next few quarters.

And in Q3 your reported growth continued to be very strong. Could you sort of comment on the drivers behind this development and what's your latest outlook for growth in China, please. Thank you.

Cees de Jong: I don’t think we guide specifically on China going forward, but we are extremely pleased with both the progress that we make and also confident about the outlook. We are recently presenting to our board, one of the introductions I made is that of course, it's every entrepreneurs' dream to supply products to each and every Chinese, well, we are in one of the products in China with 3 billion bags are being produces every year.

And remember what we did there. First and foremost, we setup our go direct model so that we could interact and translate the needs of the Chinese into what we needed to supply. Then it became quite clear that we needed to strengthen ambient solutions, you and I, we probably keep our yoghurts in the fridge, in China, the fermented milk drinks are being produced and kept and stored and ultimately consumes at room temperature.

We have come up with a solution for that and that has been a magnificent driver for growth. There is about four or five key leading companies in China with whom we have excellent relations like we said before, these companies have made it to the top ten, and will probably make it to the top five. One for sure, maybe even to. So we have done all the right things and the market in China continues to be good and so our outlook is favorable.

I hope that helps. Again, we don't give specific numbers on China nor specific items.

Fulvio Cazzol: No I understand that. Thanks, that's help.

Operator: And our next question comes from the line of Tobias Bjorklund.

Tobias Bjorklund: I have one follow up question on the next generation probiotics, the microbio, and if now, we have a great product that no one is ready to take through clinical studies. Would you be ready to share such an approach, share the preclinical first phase studies or how do you think about that or is there a clean cut for you in the -- and if you could shed some lights on that.

Cees de Jong: I'm not sure whether I fully understand your question, Tobias. Well, let me start answering and then I would be pleased to give you the chance for a follow up question.

We have done let's say, a pre-concept or concepts clinical trial with a number of individuals and that number of individuals -- and that trial has been extremely meaningful for us because one it proves that we could develop a model that follows, for instance, the current new (EFRA) guidelines as to how you need to come up with good science, and we will -- we are in the process of creating intellectual property on this, we will do more studies to make the results more robust, think larger proof of concept study, and then when we have this outcome, I cannot imagine that there is not going to be a player that either in the food or in the pharma field that doesn't want to take this further because the results are so powerful and so promising.

And yes, we will be working with partners and we shared -- obviously we will share the outcome once we feel that we have sufficiently protected our position.

I hope that answers your question, if it doesn't, I will be happy to answer a follow up question.

Tobias Bjorklund: No, no, it's great. That's what I was looking for. Thank you so much.

Cees de Jong: Operator, I think we have time for one last question.

Operator: All right, our last question comes from the line of Hans Gregersen.

Hans Gregersen: Cees, just to check with you, if I heard it correctly, was it right that 70 percent of all penicillin used in agriculture, human use, industrial use, that was used in the farming of animals.

Cees de Jong: The 70 percent is right, it is not penicillin, it's antibiotics.

Hans Gregersen: Antibiotics, sorry.

Cees de Jong: And I'm quoting here an article of The Economist that appeared in May, so there, there are some quite interesting data on the use of antibiotics, there is actually apart from the consortium of investors that we talked about, there is also a study done on behalf of, I think of the U.K. government but if you Google the Economist, antibiotic resistance, I'm pretty sure you will find that article.

Hans Gregersen: Thank you very much.

Cees de Jong: You're welcome.

Operator, I think that concludes the call for today. Thank you for your help and thanks everybody for listening in and asking questions.

Operator: This does conclude our conference for today, thank you for participating, you may all disconnect.

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