NESTLÉ S.A.

2017 HALF-YEAR RESULTS INVESTOR CALL TRANSCRIPT

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Speaker:

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Steffen Kindler, Nestlé S.A., Head of Investor Relations

Slide: Title slide

Good morning, good afternoon, everyone and welcome to Nestlé's Half-Year Conference Call. I'm Steffen Kindler, the Head of Investor Relations. Here with me is our CEO, Mark Schneider and our CFO, François Roger. As usual, we'll first present our numbers and business overview and afterwards we'll open up for Q&A for analysts. . [Operator Instructions] Please limit yourself to two questions.

Slide: Disclaimer

I will take the disclaimer slide as read and with that I handover to Mark.

Mark Schneider, Nestlé S.A., Chief Executive Officer

Slide: Title Slide – Mark Schneider

Thank you, Steffen and a warm welcome to our first half 2017 conference call. As always, we appreciate your interest in our company. François and I will be happy to take you through our first half results and answer your questions.

Before turning it over to François, a few comments from my side. First, I would like to ask for your understanding that we will limit our comments in this call to the results and specific actions of the first half of 2017. We would like to do the same in our Q&A session later on. While, I understand that there is considerable interest in our future strategic direction, the Investor Day in late September will give us ample opportunity to discuss this in greater detail and with a necessary amount of context.

Next, let me turn to sales for the second quarter and first half. As mentioned in our press release, organic sales growth was below our expectations, even though we are clearly inside our organic growth guidance range for the year 2017.

In this context, let me briefly explain why we said that our organic sales growth is likely to be in the lower half of the 2% to 4% range. We are committed to shareholder friendly communication and as such, it was important to give you our realistic view on where we will likely come out for the full year. While we expect improved organic growth in the second half, the weaker first half needs to be properly reflected.

While the muted sales performance in Q1 had some very simply and straight forward explanations, in particular of the challenging calendar, the situation is more nuanced in the second quarter. We saw a very encouraging picture in our Zone AOA, in particular of the fact that we return to positive organic sales growth in China in Q2, while the strong organic growth in Southeast Asia and in Africa continued.

Our Zone AMS accomplished a slight improvement in volume growth in North America as well as in Latin America. The solid growth in PetCare in the U.S. was encouraging and vindicates our interest in this category as one of the key future growth drivers for our group.

Zone EMENA saw a drop in volume in Q2, mainly due to Western Europe. We consider most of this temporary in nature, in particular the short-term reaction to our pricing action and the impact on some of our categories from the warm weather.

Among the globally managed businesses, Nestlé Nutrition continues to struggle in China and eked out only slightly positive growth in the U.S. market. We expect improvement in both markets later this year.

When it comes to margin, we saw a mixed picture. One the one hand, while our cost reduction efforts are clearly getting traction, combined with portfolio changes in pricing, we gained 100 basis points of profitability through these efforts, and this is early in the game. On the other hand, our commodity costs kept going up by a comparable amount, wiping out all of this potential margin upside. This is the first such commodity basket price increase in several years.

Regarding restructuring expenditure, we are already at CHF 166 million this year and confirm our CHF 500 million target at a minimum. We are in fact evaluating the acceleration of further restructuring projects, which might get us beyond our restructuring spend target in 2017. We plan to have an update for you on this by the time of our Q3 conference call.

In summary, while the first half results were soft, I am pleased with the overall progress we are making on our value creation agenda. This includes in particular: first, improving some of our underperforming assets like *Yinlu* and our *Gerber* baby food range in the United States; second, our cost reduction efforts; third, portfolio management such as the recently announced review of our U.S. Confectionery business; fourth, several small to mid-size acquisition projects that we're working on in high growth areas; and finally, the decision to increase balance sheet efficiency through higher leverage.

This is still early days and I realize that the P&L benefits of lot of what I just talked about are not showing up in the numbers yet, but things are definitely moving in the right direction. With that, let me hand it over to François.

François-Xavier Roger, Nestlé S.A., Chief Financial Officer

Slide: Title Slide – François-Xavier Roger

Thank you, Mark. Good afternoon to all.

Slide: Half-year performance highlights

We finished the first half, with sales of CHF 43 billion which represent a slight decline of 0.3% on a reported basis. Our organic growth was 2.3% with 1.4% contribution coming from RIG and 0.9% contribution from pricing. Foreign exchange was a mild headwind of negative 0.3%. Net divestments reduce reported sales by 2.3% for the most part attributed to the creation of the *Froneri* joint venture.

If we look at our trading operating margin before net other trading items, meaning before restructuring and others, it increased by 10 basis points in constant currency. Both restructuring expenditure on net other trading items, overall increased by 77% to CHF 166 million and CHF 349 million respectively. As a consequence, trading operating margin was down 20 basis points in constant currency to 15.1% or down 30 basis points as reported.

This largely reflects the acceleration of our saving program. I will go into more details on our margin in the upcoming slides.

Slide: Underlying trading operating profit

As I speak about the margin evolution for the six operating segments, I mean the Zones and the globally managed businesses as well as the product segments, I will focus my comments on the results before net other trading items. This is what we call the underlying trading operating profit and it is therefore before restructuring.

We believe that analysing the returns of our geographies and categories before one-offs provides a better view of the real underlying business performance particularly for the purpose of today's call. This is also consistent with the way we define underlying EPS, and therefore, should provide additional clarity on the calculation.

For transparency reasons, we have provided a reconciliation between trading operating profit and underlying trading operating profit, as well as definitions in the supporting slides of this presentation.

Slide: Resilient RIG in an environment of weak consumer demand

The next slide shows our organic growth over the last 10 quarters. Our results of 2.3% for the first half was below our expectations. In general, we continue to see weak consumer demand and a challenging retail environment particularly in Western Europe and North America. We have been facing specific challenges this quarter in Zone EMENA where price increases and weather conditions have affected volumes and this has been impactful at group level.

In addition softness in both Nestlé Skin Health and Nestlé Nutrition have impacted our performance this half. I will go into more details on the dynamics by geography and category shortly. Yet in spite of these specific challenges, we remain encouraged by our RIG development. The sustained contribution from RIG shows that we bring relevance to our consumers and that we optimize our product mix.

Pricing for the first half remained subdued at 0.9%. The volatility of commodity cost means that we take a pragmatic approach when raising prices. Price increases have to be sustainable relative to the commodity movements to secure price competitiveness.

Slide: Broad-based growth across geographies

Looking at the geographic breakdown now, this slide illustrates the combination of our sales for the zones and globally managed businesses combined. Our growth is broad based both in terms of organic growth and RIG with all geographies in positive territory. AOA continued to hold good volume-led growth, meanwhile RIG has been softer in AMS and EMENA mainly due to the challenging consumer environment as mentioned earlier.

Slide: Growth in Developed and Emerging markets

Looking now at the contribution for Developed and Emerging markets, both geographies contributed positively to RIG and OG. In the Developed markets, RIG was solid at 1.1% despite the specific challenges already mentioned, such as softness in EMENA and generally weak consumer confidence and deflationary pressures resulting in a challenging pricing environment.

In the Emerging markets, organic growth was 4.4% with RIG of 1.9% and pricing of 2.5%. Meanwhile, on pricing in the Developed markets, pricing remains negative, although on a generally improving trend versus the last 2 years. In the Emerging markets, we have exactly the opposite dynamic, where the contribution from pricing is progressively smaller.

Slide: Zone AMS

Moving to Zone AMS, sales were CHF 13.3 billion. Organic growth was 1.3% and this represents a meaningful improvement in RIG from Q1. Pricing of 1.4% came mainly from Latin America, but even North America finished the first half with positive pricing.

Looking in detail at the two sub regions, North America continued to face an environment of soft consumer demand and an overall difficult trading environment. In this context, we achieved broadly flat growth for our North American business. Coffee creamers continued to deliver good results and PetCare made a return to solid growth in the second quarter. Confectionery remained weak and Ice cream was impacted by unfavourable weather conditions.

In Latin America, RIG improved since the start of the year and pricing remained positive. Brazil was negative over the first six months of the year, but improved significantly helped by a recovery in RIG, which was actually positive in the second quarter. That said, as far as Brazil is concerned, we remain cautious on our outlook. Mexico had good growth, despite weak consumer confidence; PetCare remained a strong growth driver for the region.

Margin-wise for AMS, we actually improved our underlying TOP margin by 30 basis points, while we had higher commodity cost, these were more than offset by efficiency savings. We also saw some initial benefits from our restructuring projects.

Slide: Zone EMENA

Moving now to Zone EMENA with sales of CHF 7.8 billion. Organic growth was 1% comprised of 0.6% of RIG and 0.4% of pricing. We improved on pricing since Q1; however, this was offset by a meaningful deceleration in RIG. As mentioned before, EMENA's growth was below our expectation. Until this quarter, we had an average RIG north of 2% over the last five years and now we have fallen into negative RIG this quarter. We applied price increases in *Nescafé* across many markets in the Zone and this resulted in a contraction in volumes in recent months.

We know that price increases usually impact volumes in the short-term. In addition, in Western Europe, the seasonality of our business has changed, following the spin-off of Ice cream to *Froneri*. The hot weather in recent months, and especially in June had affected performance in Confectionery, Coffee, Pizza and Culinary. We no longer have the benefit of Ice cream in our portfolio in a EMENA which used to offset such an effect.

Looking now at the dynamics by sub region in Western Europe, PetCare sustained its RIG driven growth. In Eastern Europe, organic growth accelerated since the start of the year, driven by strong RIG. PetCare remained a strong growth driver especially in Russia. In Middle East and North Africa, organic growth decelerated moderately, but remained positive. The region continued to be affected by political instability, and sustained deflation. Margin-wise, the zones underlying TOP margin increased by 50 basis points, higher commodity cost had been more than compensated by price increases, cost savings as well as portfolio management.

Slide: Zone AOA

Zone AOA, we had sales of CHF 7.9 billion. Organic growth was 4.8%, representing the fifth consecutive quarter of sequential growth. RIG of 3% and pricing of 1.8%, both represent an increase versus the previous year.

In China, we remain negative in terms of both RIG and pricing for the first six months; however, there has been a meaningful improvement since the start of the year for both components, and we even had a positive growth in Q2. The improvement was largely coming from *Yinlu,* Confectionery and Culinary.

In the other regions, sub-Saharan Africa and Southeast Asia performed well with healthy organic growth and RIG. India delivered good growth despite the uncertainty around the introduction of GST in June. And in the Developed markets, Japan sustained good growth, while Oceania remained affected by pricing pressure.

Margin for AOA: the underlying TOP margin decreased by 20 basis points. Input costs were up, and we made some marketing investments in order to turnaround *Yinlu*. And we're happy to see encouraging early results from these investments.

Slide: Nestlé Waters

Moving now to Nestlé Waters with sales of CHF 4 billion. Organic growth was at 4% driven by RIG of 3.5%. Pricing stayed in positive territory coming in at 0.5% for the half. Our growth was generally broad based. We had an acceleration in Q1 in the last three months helped by favourable weather conditions especially in Western Europe and North America, which delivered strong results in spite of pricing pressures.

Perrier continued to be a highlight sustaining double-digit RIG for the sixth consecutive quarter, and *S. Pellegrino* continued to do well. In Emerging markets, Latin America and China drove growth. On the margin front, the underlying TOP margin held stable, increased PET costs were basically fully offset by efficiencies on increased structural savings.

Slide: Nestlé Nutrition

Moving to Nestlé Nutrition, Sales were CHF 5.2 billion, organic growth was soft at 0.9%, also RIG improved slightly to minus 0.2%, pricing decelerated to 1.1%. In our largest market China, performance was mixed. Despite an encouraging start to the year, growth was slightly lower in recent months. We have seen growth from *Illuma* and *NAN* but it has been offset by a decline in *S-26 Gold*. Parallel imports continue to provide challenging competition and parallel imports are taking market share, but as you know, we limit our exposure in this area. We have recently launched the full organic *Illuma* range in Hong Kong, with plans to expand further into China.

In the Developed markets, growth was slightly negative overall with weak category dynamics. Although the U.S. remained soft, it was helped by the stabilization of the *Gerber* brand. We plan a comprehensive re-launch in the second half of this year, which incorporates organic products, new formulations, cleaner labelling, as well as new visuals on packaging.

In our Emerging markets, the Philippines and India were strong while price increases put pressure on volumes in Brazil and Mexico. Margin-wise for Nestlé Nutrition, the underlying TOP margin increased by 130 basis points. Our price increases and premiumization largely offset commodity headwinds from higher milk prices. But the large improvement in profitability was mainly driven by significant structural savings in non-consumer facing activities, mainly in the United States and in China.

Slide: Other Businesses

Finally, other businesses which covers *Nespresso*, Nestlé Health Science and Nestlé Skin Health. Sales were CHF 4.8 billion, organic growth slowed to 3.7% as RIG of 4.5% was offset by negative 0.8% pricing.

Starting with *Nespresso* which sustained good mid-single-digit growth, accelerating from the start of the year, as all geographies gain momentum. We continue to enjoy mid-single-digit growth 30 years after the creation of *Nespresso* and in spite of competition from compatibles. Growth in North America and Latin America continued at a double-digit base. We also had encouraging performances in the UK, in Spain and in the Netherlands.

Nestlé Heath Science decelerated slightly since Q1, but still maintain mid-single-digit growth. Medical Nutrition had good growth across all geographies, Consumer Care did very well in Asia and in Europe, but the performance was offset by the U.S. where growth was negative.

Nestlé Skin Health remained positive, but decelerated from the first quarter, pressure from generics in the prescription business weighed on growth as did China's soft performance. And additionally, we had difficult comps this year.

Margin for other businesses, overall the underlying TOP margin fell by 270 basis points as we invested in marketing and distribution behind these three businesses and this is especially true for *Nespresso*, where we have opened more than 40 new boutiques so far this year, but it is also true for Health Science where we are accelerating our investments behind our brands. Nestlé Skin Health's margin was marginally down.

Slide: Growth by products

Moving now to the growth by categories: we see the amount and composition of growth by product groups on this slide. It is worth mentioning that this year-to-date performance will still bear some impact from the leap year in Q1.

These charts illustrate our portfolio strengths and its consistency across growth categories excluding Confectionery which was impacted by the timing of Chinese New Year. We can see that the growth contribution by category range from 1.4% to 4.2% which are a level relatively close to the group average at 2.3%.

Important to note as well that Coffee, Water and PetCare delivered strong results this half confirming their role as growth engines for the Group.
Let's discuss in more details the evolution by product groups since Q1. For Powdered and Liquid Beverages, the softening was essentially due to a lower RIG coming from pricing taken in *Nescafé* EMENA. Waters, I've already covered, Milk products and Ice cream, it improved on all metrics: RIG, pricing and consequently OG. While Ice cream was negatively impacted by difficult comps in the U.S. Ambient Dairy accelerated with good growth and

Creamers continued on its strong trajectory. Nutrition and Health Science, we have discussed, Prepared dishes and Cooking aids was led by ambient Culinary, which did particularly well in the Emerging markets. Frozen was effected by difficult comps versus last year. Confectionery remained negative, but showed meaningful improvement especially in RIG, and as you know the timing of Easter and Chinese New Year impacted this category in Q1. Finally, PetCare we finished the half strong, thanks to a marked acceleration in the last three months. The U.S. business recovered from its slow start at the beginning of the year and the Emerging markets continued to deliver double-digit growth.

Slide: Underlying TOP margin by products

Moving now to the profit evolution by product category for the first half. As a reminder, this is before restructuring, which is a better indicator of the underlying performance. For your information, the reconciliation with the trading operating margin after restructuring can be found in the supporting slides of this presentation. Most categories have been affected by the increase in commodity cost, Powdered and Liquid Beverages, Nutrition and PetCare continued to deliver strong overall margins for the group.

Looking at the dynamics by category: the decline in Powdered and Liquid Beverages is mainly due to the investments made towards opening new *Nespresso* boutiques. Confectionery was impacted by higher input cost, namely sugar and dairy, which overrules any offset from lower prices for cocoa. PetCare's margin saw a slight contraction, mainly due to the investment made behind dry dog in the U.S., such as product reformulation and brand support.

On the positive side, the margins for Prepared dishes and Cooking aids grew very nicely, helped by good growth, particularly in ambient Culinary and due to some benefits coming from portfolio mix.

Slide: Gross margin impacted by higher input costs

Moving now to our gross margin, following four years of progressive improvement, our gross margin showed a marginal decline this year. We incurred around CHF 450 million of additional commodity cost in this half-year, which translated to about 100 basis points of additional headwind. We have been able to compensate for nearly half of it through efficiencies and pricing at gross margin level.

Slide: Underlying TOP margin in line with our expectations

If we take a look at our half-year margin before restructuring, it increased by 10 basis points in constant currency. The chart here shows the moving parts of our margin evolution.

Commodity cost were significantly higher coming in at nearly CHF 450 million more than last year, as I mentioned earlier. We expect the full year amount of the increased commodity prices to be around CHF 1 billion for 2017. This is a significant swing compared to the last few years, when we enjoyed regular decreases of input cost. At the same time, through pricing, efficiency projects, including the early benefits from restructuring, as well as portfolio management we generated 100 basis points of margin improvement.

Our cost reduction was not driven by cuts in brand investments as consumer facing marketing spend saw only a marginal decrease. Our R&D investment also remained stable. Rather the improvement was mainly due to efficiency and restructuring programs in operations, in procurement and in G&A. These savings are sustainable, they are material, and they illustrate well our commitment to cost discipline.

And we have another 20 basis points contribution from currency and other revenue, in total bringing the underlying TOP to 15.9% for the first half.

Slide: Underlying EPS increase

EPS, our reported EPS increased by 19% to CHF 1.58. Last year, we were impacted by one-off non-cash adjustments to defer tax, so if we look at our underlying EPS, it increased by 2.1% to CHF 1.68, that is a 3.4% increase in constant currency.

Slide: Continued focus on working capital

Moving to our working capital: the chart illustrates our commitment and focus on reducing working capital. The 130 basis points decline shows that over the last 12 months, we continued to make improvements on our working capital as a percentage of sales on a five quarter average calculation.
Following several years of significant progress in working capital reduction, we continued to see opportunities for further improvement in the future, but we believe that it will come at a more moderate pace going forward.

Slide: Free cash flow evolution

On free cash flow, we declined free cash flow generation by CHF 2 billion on a year-on-year basis from CHF 3.3 billion to CHF 1.3 billion. The largest contributor to this decline was coming from working capital, resulting in a negative effect of CHF 1.3 billion. It represents a lower level of working capital improvement versus the same period of last year, and this was mainly coming from commodity price inflation and the phasing of payables for both marketing and CapEx.

In addition, in half-year 2016, we benefited from the one-off tax refund of CHF 300 million, which by nature did not occur this year. Despite this negative cash impact from working capital, continued progress was made to structurally reduce net working capital on our balance sheet as I mentioned earlier, resulting in further reduction of close to CHF 600 million as of June 2017 for our working capital compared to June 2016.

Slide: Outlook 2017 confirmed

That brings me to my last slide. We confirm our full year guidance for 2017, but organic growth is likely to be in the lower half of the 2% to 4% range. We confirm as well our target of CHF 500 million of restructuring investment in order to drive future profitability. We are reviewing the feasibility of accelerating our restructuring program in 2017 and we will share further information in September or October.

On the bottom-line, we expect to reach a stable trading operating profit margin in 2017 in constant currency. As a reminder, this trading operating profit is after restructuring and we expect to achieve underlying constant currency EPS growth and improved capital efficiency.

With that, I'm now handing over to Steffen to manage the Q&A session. Thank you.

Q & A Session

Steffen Kindler:
Thank you, François. Next we start our Q&A session for analysts. [Operator Instructions] We go ahead; the first question comes from Céline Pannuti from JPMorgan.

Questions on: Soft Pricing and Market Share performance
Margin – Benefit from structural savings programme

Céline Pannuti, JPMorgan:
Yes, good morning, good afternoon, rather. My first question is relating to organic growth which you said didn't really meet your expectation and clearly there was a maybe softer pricing than expected. Am I right in believing that that soft pricing recurs in the second half despite you having as much commodity cost in the second half? And beyond just pricing,

could you as well comment on how you feel you fared competitively in terms of market share performance?

My second question is on margin, in the 100 basis points that you mentioned in terms of savings, was there any benefit from the 200 basis points total savings program already in the half, and when you say you're accelerating the margin improvement initiative, do you mean that this will come faster than the 2019, 2020, you said? Or are you seeing more opportunity above and beyond the 200? Thank you.

François-Xavier Roger:
Céline, good morning. On the market share, our market share is slightly down, but I would say if we exclude Water, U.S. on which we voluntarily refrain from grabbing market share at the lower end of the market, if we exclude that our market share is basically flat.

You talked about the margin improvement of 100 basis points, if I understand your question, which was about the component coming from our structural cost initiatives, you have during the first half of the year, we had a little bit less than CHF 200 million of saving, which was coming from our structural initiative. So it is starting to gain traction, so we are probably at a place of about CHF 0.5 billion already for this full year 2017, so you remember that this program is a three-year program, so I think that it showed that we are getting traction on that front.

On pricing, so you saw that our pricing remained at 0.9%. We remain a little cautious on pricing, especially the part of pricing, which is linked to commodity pricing. We have seen, and you saw it in our P&L, a significant increase of commodity pricing which is something that became obvious already nine months ago. And you know that there is a time delay anyway until it reaches our P&L, so we did take some price increase as a consequence.

But over the last two to three months, we started to see an inflection point and commodity pricing moving down again. So, but the reason why I said that we need to be careful with pricing going forward, given that we want to make sure that any pricing action we're taking is sustainable versus both commodity pricing and competitive forces in market. I remind you as well that pricing is a local decision, so it's a very much linked to very specific competitive situation in a given market.

Steffen Kindler:

Okay, that gets us to the next question, Jean-Philippe Bertschy from Vontobel. Hello, Jean-Philippe. Please go ahead, two questions.

Questions on:	**Nestlé Skin Health** **Nespresso**

Jean-Philippe Bertschy, Vontobel:

Thanks. Good afternoon, gentlemen. The first one would be on Nestlé Skin Health and you are not surprised, I am asking the question, how high is the level of your patience and I would ask as well, if you can give us some more colour on what's happening exactly in Nestlé Skin Health, underperforming for a couple of quarters. Especially if you can give us maybe a timeline about the patent expiry, you still have in your portfolio?

And the second one would be on *Nespresso*, a significant margin drop in H1 and if you can give us, as well, some indication on how you see the profit margin going forward, and if the margin drop was mainly linked to the store opening or if you are seeing some pricing pressure as well? Thank you.

Mark Schneider :

Jean-Philippe, let me take the first one, this is Mark. So on Skin Health, I just don't want to leave you with the impression that we're just watching there and doing nothing. We are not happy about the results for sure, but I think over the winter and spring now, we've started to take a fairly decisive action under the new leadership team. And so there is no specific timeline, I could share with you about patience or not having patience any more. I think it is about putting in place those changes that are needed to succeed in the future. I have confidence that the new team is doing that and we are also looking at a better second half compared with the first half.

François-Xavier Roger:

As far as *Nespresso* is concerned Jean-Philippe, so the pressure on the margin for *Nespresso* is mainly coming from the opening of the 40 new boutiques, to a lesser extent you have little bit commodity pricing as well, but it is not coming from a price pressure. We keep on having very, very consistent price on the *Nespresso* capsules, so there is no pricing pressure there.

Steffen Kindler:

Okay. This gets us to the next question, that's Jon Cox from Kepler Cheuvreux. Good afternoon, Jon, your two questions please.

Questions on:	Impact of healthier snacking and on-line purchasing on Confectionery. Frozen performance in US

Jon Cox, Kepler Cheuvreux:

Thanks, Steffen and thanks guys. Just two questions, one on Confectionery. Obviously, North America remains pretty fragile as we've seen with other people reporting. I know there're some one-offs Easter, Chinese New Year, but you confirmed that some of those trends in North America, namely the move to healthier snacks and maybe move online in terms of shopping is having an impact now in Confectionery in the rest of the world, that's the first question.

Second question, just on Prepared dishes and Cooking aids. Prepared dishes, you mentioned Frozen, it looks like the slowest growth figure we've seen for a couple of years, now since the reboot we saw in North America. Are you concerned there is more to it than just the fact, you're lapping difficult comps, do you think there's a structural issue with that market as well? Thank you.

Mark Schneider :

Jon, let me take the first one and also latch on to the announcement of early June when it comes to the review of the U.S. Confectionery business. So we look at very strong local brands here in the U.S. market, they do have an iconic standing in the U.S. but they are mostly limited to the U.S. market. And, so, we're not seeing a particular spill over effect here from what's happening in the U.S. market into other markets. In fact, with our announcement we made it very clear that we'll remain strongly committed to the Confectionery business in other parts of the world, because we're benefiting from one very strong global brand, as you know, *KitKat* and then of course also many, many strong and iconic local brands with meaningful market shares.

When it comes to the U.S. situation, I just wanted to confirm that we have seen significant interest in our business both from strategic and financial buyers and of course while we would like to retain flexibility when it comes to the ultimate solution and while we're open towards creative deal proposals, I also wanted to confirm that our clear priority is a straight sale of the business. The process is on track, as we announced it in early June and we hope to complete the process by the end of this year.

François-Xavier Roger:

Jon, as far as Frozen food is concerned for the U.S., the main reason for the softness during the quarter is the comps, so we remain with positive growth for *Stouffer's* and Pizza for the example in the U.S. It was more on the *Lean Cuisine* side that we have been impacted by tough comps. But, no, so there is no real underlying issue there. It's a timing issue on comps.

Steffen Kindler:
That gets us to the next person that's David Hayes from Bank of America. Good afternoon, David. Please go ahead.

Question on:	**Pricing in EMENA** **Pricing in Coffee**

David Hayes, BoA Merrill Lynch:
Good afternoon, all. Thank you. Just to come back on the pricing you talked about, I guess, specifically in the EMENA region and you said that you saw the reaction to taking pricing up. I wondered can you talk whether that was more retail, whether that was delisting in certain cases of product lines or whether that was a consumer reaction?

And I guess and related to that, thinking about the Coffee pricing you talked about, can you talk about where the competitors weren't following you, where you were leading pricing up and you weren't followed? And I guess related to that, would you say that the increasing online element of the business means that taking pricing becomes more problematic because the consumers see those deltas quite quickly, perhaps quicker than before? Thanks so much.

Mark Schneider :
David, this is Mark. You're right. A lot it was centred on Coffee. Our take is that most of this came from the trade, the classic short-term reaction following a pricing action. And as you look at some other regions, so take for example, Latin America coming out of last year now into this year, these items tend to be transitory. So overall this more abstract theme, like, how does the consumer react to pricing in a more online driven age, I don't think that had a meaningful impact yet on this second quarter situation.
Steffen Kindler:
Good. That gets us to the next question that's James Edwardes Jones from RBC. Good afternoon.

Question on:	**Margin guidance**

James Edwardes Jones, RBC:

Afternoon. I see you reiterated the guidance of flat margins for 2017, but at the same time you are talking about the possibility of increasing restructuring cost, can we take it that the guidance of flat margins will be sustained whatever you decide to do to restructuring costs?

Mark Schneider :

James, this is Mark. It really depends on how much in addition we find. And hence, let's reserve judgment on that, give you our take, either as François said, by the time of the Investor Day or by the time of our Q3 conference call. But of course these two items are connected. And so, if we find a lot, we may not be able to hold it up, if we find a little and we overshoot at the same time on some of our savings initiatives, we may be able to cushion it.

Steffen Kindler:

Okay. Next person in line is Mitch Collett from Goldman Sachs. Good afternoon, Mitch. Your two questions, please, or one.

Questions on:	**Pricing deceleration in Nutrition** **Savings in non-consumer facing activities**

Mitch Collett, Goldman Sachs:

Hi there. A couple of questions on Nutrition. I think you said that input costs are going up, I noticed the pricing in Nutrition has decelerated perhaps you could give us a bit of colour on why those two are moving in different directions.

And then secondly, I think you also said that non-consumer-facing activities in the U.S. and China had seen savings and I just wondered specifically what those were?

François-Xavier Roger:

Mitch. So on Nutrition, pricing has improved somewhat for Nutrition, especially as the commodity pricing has put some pressure on the entire industry and category, because the price of milk is actually higher. But we have been able to increase our margin more by finding savings on G&A. So what we said is that we did not cut marketing spend neither in the U.S., nor in China. But we focused really on being more efficient in our G&A cost which is exactly what we have done. And the margin improvement as a consequence is quite significant, because we improved it by 130 basis points.

Steffen Kindler:

Okay. That makes us move on to Jeremy Fialko from Redburn. Good afternoon, Jeremy, your question, please.

Question on:	US PetCare

Jeremy Fialko, Redburn:

Yes, hi. Just one question from me, so on the U.S. PetCare business, obviously it was quite gratifying to see that that did improve a bit in the second quarter versus the first quarter. Could you talk a bit about what you did to engineer that improvement, and also in particular your online growth in PetCare, if that is a category in which you're seeing very, very fast growth in online? And whether you think that your, sort of, online market shares are now getting close to your offline market shares, so you're not sort of structurally losing out as the trade moves? Thanks.

Mark Schneider :

Jeremy, this is Mark. It didn't have so much to do with the online versus not online. I think most of it simply was the timing on some of our planned renovation rollouts and so it was – it would have occurred at any moment in time when you're basically switching over from an older product to a newer one.

Steffen Kindler:

Next person is Pinar Ergun from UBS. Hi Pinar, please go ahead.

Questions on:	Marketing spend Nestlé Skin Health

Pinar Ergun, UBS:

Hi, thanks for taking my questions. First one is on marketing spend, you mentioned in your press release that it was down slightly as a percentage of sales, any chance you could quantify that?

And my second question is on Skin Health, this division has been challenged for a while, just wondering, what's the level of your strategic commitment to this business, is long-term gain worth the short-term pain and why? Thank you.

François-Xavier Roger:

Good morning, Pinar. The marketing spend in absolute value has declined by 1.8% in Swiss francs.

Mark Schneider:

And Pinar, on the Skin Health, as we discussed earlier at the moment, it's really our full focus on improving the operating situation and that is again reviving organic growth and also working on the structural cost of the business, so we'll put that in place and then see what that's getting us.

Steffen Kindler:
Good. Next person in line is Patrik Schwendimann from Zürcher Kantonalbank. Patrick, please go ahead.

Questions on:	**Input Cost 2018** **Regions and products expected to contribute to trading operating margin in H2**

Patrik Schwendimann, Zurcher Kantonalbank:

Good afternoon, Mark, François and Steffen. What is your best guess guide estimate for the input cost for 2018, I know it's early days, but you mentioned that in the last two or three months an inflection point, so I wonder what you're expecting here?

And second question, you are expecting an improvement in the trading operating margin in H2 of roughly 20 basis points in local currencies, which product categories and regions are the main drivers behind that improvement? Thank you.

Mark Schneider :

Patrik, let me take the first one and as you suspected, I think it is pretty hard at this point to give you a concise estimate here for 2018. So, it's the old notion they may go up, they may go down, they may stay flat, but not necessarily in that order. It's just, as you see even in the first half, there were some surprise moves where some upward movements were not continued and trended down again. So, this is a fairly volatile age and I think we have to take it with a fairly short time horizon.

François-Xavier Roger:
Patrik I prefer not to give any guidance on the distribution of the trading operating margin improvement for the second half of the year, so we are working on it. We know what we have to do overall, and we are confident about maintaining this trading operating profit flat, but the distribution between the regions and the categories, we keep it for ourselves as a task for time being.

Steffen Kindler:

Okay. And next in line is Alex Smith from Barclays. Good afternoon, Alex. Please go ahead.

Questions on:	**Speed and agility of Nestlé** **Nutrition as a key growth engine**

Alex Smith, Barclays:

Hi. Good afternoon. Couple of questions for Mark please. Mark, when you first spoke to us in February, you talked about wanting to make Nestlé a more agile and consumer responsive organization. So, I'm just wondering how your thoughts on that might have evolved over the last five or six months and what changes you might be looking to implement to affect that change on the speed of the organization?

And then a second question on the role of Nutrition in the growth equation. I think you spoke again today about the key growth engines being Coffee, PetCare and Water, but, I think, I noticed on your press release announcing the buyback, you spoke of Nutrition being within that group. I'm just wondering if there's been a reassessment there given the historic contribution of that category to your growth or is it still missing on the list? Thanks.

Mark Schneider:

Yes, Alex thanks for both questions. With regards to the first one, I can confirm that this whole notion of being agile and speed in everything we do is very important and very high on my agenda. In line with what we said earlier in the conference call, I'd like to leave the forward-looking thoughts to our Investor Day in September, but my assessment on that and the need of being more agile and faster that has certainly not changed from the February conference call.

When it comes to Nutrition, you're absolutely right and very observant on your part. So we added that to the list. And the reason we added it was that we really talk about slightly different context between February and the June announcement. In February, when I listed these three areas, Coffee, PetCare and Water, it was under the organic growth header, and I was trying to explain that if we accelerate our growth plans in those three above par areas that this will help our organic growth overall. And as you know, our organic growth in 2016 of Nutrition was not that impressive and hence, if I'd added it to the list at that point, it simply would not have made sense.

The statement in June was different in nature. This was sort of strategic growth areas, where we also think about additional capital deployment. And yes, long-term Nutrition is absolutely one of our core businesses. I mean, this is the business that the company was founded on, and we believe that going forward there are very attractive fundamentals that continue to apply into the future. And it's as you know our business where we're also the leading company in terms of market share. So, yes, from a strategic point of view, the fact that this is core, it certainly had to be on that list. But in February, I was talking about organic growth only and since they were going through a bit of a difficult patch. I felt at that moment to add Nutrition didn't make sense. I hope that explains the difference.

Steffen Kindler:
All right. Then we go to Toby McCullagh from Macquarie. Toby, good afternoon. Your two questions, please.

Question on:	**Nespresso margin pressure**

Toby McCullagh, Macquarie Capital:
Hi. Good afternoon. Just one actually. You flagged *Nespresso* as being a big cause of the margin pressure. Is it fair to back into *Nespresso* margins being down around 300 to 400 basis points for the period and apologies if I missed it somewhere? What's your plan for further store openings this year? Is *Nespresso* going to be a similar drag on margins in 2H as it was in the 1H or is that drag going to drop which would help us make the bridge for, to expect better margins in the second half of the year, given that the input costs look as if they're going to continue at about the same level? Thanks.

Mark Schneider:
Hey, Toby, I'm glad you're bringing this us, so that we can have a chance to clarify. I wouldn't call this margin pressure. I mean, we had significant additional store openings in the first half and as you know, they take a bit of time before they become accretive and obviously, we would not have increased the number of store openings by that much, if we didn't see substantial positive growth prospects for this business going forward, so this from my end, while it's OpEx, it's clearly investment into the future and when it comes to the fundamentals of the *Nespresso* business, our assessment has not changed, it continues to be very, very positive, we're huge fans.

End of Q&A session

Steffen Kindler:
Okay. With that we come to the end of our session today and the end of the Q&A. Thank you very much for joining us today and we talk to you again at the occasion of our nine-month earnings call in October. If you have questions in the meantime, you know how to reach IR per telephone or per email. Take care and have a good rest of the day. Bye-bye.

End of Transcript