NESTLÉ S.A.

2019 NINE-MONTH SALES CONFERENCE CALL TRANSCRIPT

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Speaker:

Mark Schneider, Chief Executive Officer, Nestlé S.A.
François-Xavier Roger, Chief Financial Officer, Nestlé S.A.
Luca Borlini, Head of Investor Relations, Nestlé S.A.

Luca Borlini, Nestlé S.A, Head of Investor Relations:

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Good afternoon and good morning to everyone. Welcome to the Nestlé 9 Months Sales 2019 Investor Call. I am Luca Borlini, Head of Nestlé Investor Relations. Today, I am joined by our Chief Executive Officer, Mark Schneider; and our Chief Financial Officer, François Roger. We will begin the call with some prepared remarks by Mark. François will follow with a review of the 9-months sales figures. We will then open the lines for your questions.

Slide: Disclaimer

Before we begin, please take note of the disclaimer.

And now I hand over to Mark.

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

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Thank you, Luca, and a warm welcome to our conference call participants today. As always, we appreciate your interest in our company. François will take us through the details of our 9-month sales report in a moment.

Slide: Key messages

I think it is fair to say that we're making continued good progress towards our 2020 financial goals. We are seeing good momentum in our largest market, the United States, and strong growth in our global Purina PetCare business. Key rollout initiatives such as our *Starbucks* Coffee range and our plant-based burgers are performing extremely well.

While we are making very good progress on many fronts, I would like to reiterate what we said at our First Half Conference Call in late July. The strong year-end in 2018 creates a steeper hill for us in the second half of 2019 when it comes to organic growth. That view has not changed.

I would also like to use this call today to give you some background on the organizational changes we announced. Migration of the globally managed Nestlé Waters business to our three geographic zones is one further step towards harmonizing and simplifying our organizational structure. While we firmly believe that this is the right step for Nestlé Waters, we will continue to manage Nespresso and Nestlé Health Science globally. As you know, their key customer relationships are truly different from the rest of our business.

Our Nestlé Waters global structure was very helpful in bringing this business to its current size and stature. It also helped to establish leading global brands such as *San Pellegrino* and *Perrier.* Having said that, the business is now at a stage where local responsiveness and competitiveness are of increasing importance. This is where our three geographic zones come into play. They are the most proven and efficient implementation and execution structures inside Nestlé. I have every confidence that they will do an outstanding job in taking this business to the next level.

This move comes at a time when we have increasingly shifted from a worldwide approach in Waters to one that selectively focuses on the most promising segments and geographic markets. The structure change announced today is just one of several steps we're taking to improve the performance of our Waters business. We will pursue a growth strategy that will get us increasingly out of low-margin, undifferentiated business and focus on high-value premium brands, functional waters as well as flavored and carbonated products. Improved proximity to consumers coming from our new organizational structure, combined with the strategic focus on higher-growth, higher-margin segments, will help our Waters business to live up to our growth and earnings expectations in the midterm.

While it is clear that healthy hydration with Waters products is a very important and worthy endeavor, the Waters business also has to cope with a number of sustainability issues that are becoming increasingly important. We plan to address this with a strong innovation pipeline that covers several key initiatives.

First, the increasing use of recycled PET plastic in our bottles. We are aiming for 35% of recycled PET plastic in our water bottles by the year 2025, which will help to reduce the use of virgin PET plastics significantly. Some of our brands and bottle formats will be at 100% recycled PET plastic. It all depends on access to food-grade recycled material.

Second, the use of alternative container materials. This is where our recently founded Nestlé Institute of Packaging Sciences will come in, to explore and validate all available options. And third, the roll out of dispensing systems to fill reusable containers. These systems are high-tech devices that work from the normal water supply and make use of extensive filtration and remineralization for consistent water quality and taste. They allow you to pick your level of carbonation and flavoring and are equipped for cashless payment. We call this initiative Refill Plus because it truly offers more than just a refill from the tap. We are in beta testing right now; deployment in the field is scheduled to begin in 2020.

As you can see, we are doing our homework when it comes to innovation in the Waters business. Tight management by our geographic Zones will help us to implement these initiatives in the best possible way and make the most out of these opportunities.

We also announced today the appointment of Sanjay Bahadur to our company's executive board. Sanjay will lead our newly created group strategy and business development function. In a period of rapid change in our industry, it will be more important than ever to recognize key trends early and to act on them fast, including but not limited to portfolio adjustments. Sanjay brings deep operational and financial experience to his new role. He knows that only those strategies succeed that are implemented thoroughly and fast, and he has done a superb job overseeing our recent portfolio adjustments to position the company for higher growth.

I would also like to comment on our announcement in the 9-month press release regarding the return of cash to our shareholders. As part of our comprehensive value creation model, which we outlined in June 2017, we targeted more leverage on our balance sheet and initiated a share buyback program. This program will be completed in December 2019. In the meantime, we have seen significant cash inflows due to the strong development of our operating cash flows and several disposals.

As we have confirmed to you in early occasions, we have no intention to lever back down. With this in mind, we plan to kick off a new program to return cash to our shareholders beginning in January 2020. The program will stretch out over 3 years with a precise monthly volume of share buybacks and a split between buybacks and potential special dividend payments to be determined by market conditions. We want to do what is best for our shareholders, so leaving ourselves some flexibility to maximize value is clearly the most prudent thing to do.

As in the past, I would like to underline our preference for value-creating investments in our core Food, Beverage and Nutritional products business. So for good order, I need to point out that the amount of cash to be distributed to our shareholders will be adjusted should any sizable acquisitions take place during this 3-year period.

Slide: Our business as a force for good

Finally, let me turn to deforestation as a theme for this quarter's business as a force for good section. As you can see, we have made significant progress since 2010 in making our supply chain deforestation-free. We will reach more than 90% of what we set out to do a decade ago, which will put us at the top of the Food and Beverage industry. The remaining balance will be achieved over the coming three years and needs to be done with special care so that our zero-deforestation goal does not come at the expense of smallholder farmers. We have also pioneered new surveillance strategies, as evidenced by the use of satellite technology to verify supplier commitments.

It is unfortunate that the consumer products industry overall will not reach similar levels in avoiding deforestation. Most of all, it is disappointing to see that many firms do not even disclose their results in this space. We are committed to full transparency and use every situation where we do not fully meet our initial objectives as a case study to learn and improve. We do not try to run from the facts; we try to learn from them.

This concludes my prepared remarks. Let me now turn it over to François, and I look forward to answering your questions later.

François-Xavier Roger, Nestlé SA, Chief Financial Officer:

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Thank you, Mark, and good morning, good afternoon, to all. Let me start with the highlights for the 9 months.

Slide: Nine-month sales growth

Organic growth was 3.7% or 3.5% excluding businesses under review. Real internal growth for the 9 months was strong at 3%. We reached 3.9% in the third quarter, which is the strongest RIG in a quarter over the last 8 years. The year-on-year growth acceleration was mostly driven by the United States and PetCare globally. EMENA contributed to the improved momentum in the third quarter.

Pricing was 0.7% for the 9 months with a temporary slowdown in the third quarter due to the phasing of pricing steps and decreasing coffee prices. We expect pricing to move steadily back into positive territory from the fourth quarter onwards.

Net acquisitions contributed 0.7% to growth. This mainly relates to the acquisition of the

Starbucks license and *Atrium Innovations* which more than offset divestments, including the *Gerber Life Insurance* business. Foreign exchange had a negative impact of 1.5% mainly as a result of the appreciation of the Swiss francs against the euro and some emerging market currencies. Sales for the 9 months were CHF 68.4 billion, a 2.9% increase on a reported basis.

Slide: Strong momentum in the Americas

This slide shows the development of our sales by geography. It includes both our Zones as well as our globally and regionally managed businesses. Organic growth and RIG were positive in all geographies. Pricing was positive in the Americas and AOA but negative in EMENA. In Europe, pricing was mainly impacted by decreasing coffee prices. This was more than compensated by strong real internal growth.

Slide: Positive growth in developed and emerging markets

Now looking at the growth dynamics between developed and emerging markets. Developed markets accelerated to 2.7% organic growth supported by strong real internal growth. There were positive contribution from all regions, North America was a standout. Emerging markets posted steady mid-single digit organic growth. The slowdown in China was offset by an acceleration in most of the other regions.

Slide: Zone AMS

Let's now look at the results of our five operating segments, starting with Zone AMS, where we continued to see strong organic growth momentum. Sales were CHF 24 billion. Organic growth increased to 4.1% supported by higher RIG of 2.7%. Pricing was positive at 1.4%.

North America accelerated further in the third quarter reaching a mid-single digit base. RIG was strong, reflecting a robust pipeline of new product launches. The largest contributor to growth was Purina PetCare which continued to see strong momentum in e-commerce and premium brands. Beverages had mid-single-digit growth, supported by strong demand for *Starbucks* and *Coffeemate*. The transition of the U.S. Pizza and Ice cream businesses from a DSD system to a warehouse distribution model is fully on track. Ice cream grew mid-single-digit, and Frozen food, including Pizza, grew low single-digit.

Latin America reported mid-single-digit growth with positive contributions in most markets and categories. Brazil was supported by strong performances in Dairy, Infant nutrition and *KitKat*. Mexico benefited from continued strong demand for *Nescafé*. Overall, Purina PetCare and Beverages, especially Coffee, were the largest contributors to zone growth.

Slide: Zone EMENA

Turning now to Zone EMENA. Sales were CHF 13.7 billion. Organic growth was 2.9% with good contributions from all sub regions and broad-based market share gains. There was an increased momentum in the third quarter resulting in a higher RIG of 4.6% for the Zone at the 9 months. Pricing declined by 1.7% mainly due to lower coffee prices. By category, Purina PetCare and Infant nutrition were the main growth contributors. In PetCare, *Felix, Purina ONE* and Tails.com were the key growth platform. In Infant nutrition, growth was strong in the Middle East, North Africa and Russia. In Confectionery, *KitKat* continued to grow at a double-digit pace. Vegetarian and plant-based food products posted double-digit growth, supported by the launch of the *Garden Gourmet* Incredible Burger, which is now available in 10 countries.

We also saw a second consecutive quarter of positive and accelerating growth in Coffee. Lower coffee prices were more than offset by the significant volume uplift. As an example, we decreased soluble coffee prices by a further 2.6% in the quarter -- in the third quarter versus the first half, which led to a RIG of 5% in the third quarter.

Slide: Zone AOA

Moving next to zone AOA with sales of CHF 15.9 billion. Organic growth was solid at 3.1% despite slower momentum in China and challenges in Pakistan. RIG was 2.5% and pricing increased slightly to 0.6%. China was flat due to softness in some categories where we are seeing different dynamics between price points. Super premium offerings such as *illuma* and *Purina* grew well while mainstream products like *Yinlu* peanut milk, congee and *S-26* were challenged. This polarization of consumption patterns between premium and mainstream is consistent with Nielsen and Kantar findings.

Japan and Oceania saw low single digit growth supported by strong demand for *Purina*, *KitKat* and the newly launched *Starbucks* range. The Zone's other geographic regions posted mid-single-digit growth with positive contribution by most markets. Overall and by product category, the largest contributions to growth came from Infant nutrition, Culinary, *Purina* PetCare, ready-to-drink *Milo* and *Nescafé*. Infant nutrition grew mid-single digit outside of China.

Slide: Nestlé Waters

Moving to our globally managed businesses starting with Nestlé Waters. Organic growth was subdued at 0.5%. Pricing increased to 3%, while RIG declined by 2.5%. Total sales for the 9 months were CHF 6.1 billion. In the third quarter, growth slowed as a result of high pricing comparables in North America and a disappointing summer in Europe.

In North America, organic growth was flat. Positive growth for premium brands and *Ready Refresh,* our direct-to-consumer business, was offset by negative growth for the casepack format and for Nestlé *Pure Life*. We continued to focus on premiumization and innovation with a focus on flavored and functional offering. Europe saw negative growth following a disappointing summer season and unfavorable comparables for the third quarter. Emerging markets improved posting high single-digit organic growth. Nestlé *Pure Life* in Egypt, *Erikli* in Turkey and *La Vie* in Vietnam grew double-digit supported by expansion in the sparkling and flavored segments.

Slide: Other Businesses

Finishing with other businesses, which includes Nespresso, Nestlé Health Science and Nestlé Skin Health. Total sales for the other businesses were CHF 8.7 billion. Strong OG at 7.1% was driven almost entirely by RIG of 6.4%, while pricing improved to 0.7%.

Nespresso maintained mid-single digit organic growth with strong momentum in North America and emerging markets. Europe maintained positive growth in a competitive environment. Nespresso's global performance was supported by the continued progress of the Vertuo system rollout which is now sold in 21 markets.

Nestlé Health Science sustained mid-single-digit growth with an acceleration to high single-digit in the third quarter. Medical nutrition and *Atrium Innovations* were the largest contributors fueled by a strong innovation pipeline.

And finally, Nestlé Skin Health grew high single-digit for the 9 months. In the third quarter, the business grew broadly in line with the group, meaning that the group's organic growth without Skin Health in Q3 was also 3.7%.

Slide: Strong portfolio with standout performance by PetCare

Looking now at our growth by product categories where all segments sustained positive organic growth. Powdered and liquid beverages grew 2.8% for the 9 months. Coffee, which accounts for around 80% of the category sales, had the second consecutive quarter of mid-single-digit growth. This was supported by Nespresso, *Starbucks* and ready-to-drink coffee. We have also continued to roll out *Starbucks* launches, and products are now available in 34 countries.

Nutrition and Health Science saw mid-single-digit growth driven by RIG in all subcategories. Infant nutrition maintained solid momentum with 3.5% organic growth supported by emerging markets and a strong innovation pipeline. Milk products and Ice cream grew 3% with good contributions from the Southeast Asia and U.S. Ice cream. *Yinlu* peanut milk and congee put pressure on our overall growth.

PetCare saw outstanding growth globally based on e-commerce, super premium and strong demand for science-based offerings. *Purina ONE, Felix* and *Tidy Cats* grew strongly.

In Prepared dishes and cooking aid, growth was driven by ambient culinary in emerging markets, frozen pizza and vegetarian meal solutions. Confectionery growth was solid, based on strong RIG with some negative pricing particularly in Zone EMENA. Waters, we already discussed

Slide: 2019 guidance confirmed

We confirm our full year guidance for 2019. Organic sales growth is expected to land around 3.5% for the full year. As previously communicated, we are expecting softer growth in the fourth quarter. This is mainly due to three factors: First, the lapping of the highest comparables of the year, Q4 2018 organic growth was 3.7%; second, the disposal of the Skin Health business, which was accretive to growth in H1; and third, the DSD exit with some coming SKU rationalization. This will hit our organic growth in Q4 2019 and in 2020. Full year underlying trading operating profit margin is expected to be at or above 17.5% for 2019. Underlying earnings per share in constant currency and capital efficiencies - capital efficiency are expected to increase.

Let me now hand over to Luca for the Q&A session.

Q & A Session

Luca Borlini, Nestlé S.A. Head of Investor Relations:

Thank you, François. With that, we now move to the Q&A session. We open the lines for questions from financial analysts. (Operator Instructions)

The first question is from Warren Ackerman from Barclays.

Questions on:	**Zone AOA and China** **PetCare growth**

Warren Ackerman, Barclays Bank:

Two questions please. The first one is on Zone AOA, it's one for Mark. To get to your mid-single digit in 2020, Mark, you need Zone AOA growth to step up from the 3% level and China has been arguably disappointing for a while. Just wondering whether you can maybe walk through exactly how you see China, and how you're going further premiumize the portfolio? You talk about the bifurcation of growth. Just interested in your strategy about how you can accelerate, how quickly should we see that step up in the zone?

And then the second one is on pet food. I mean, if I back out of Q3, it looks like almost 10% organic growth and it's contributing almost 40% of your global growth. And it seems like every single region has accelerated which is hugely impressive. I just wonder whether you can maybe sort of walk through what's actually driving that. You mentioned a few things, but what is the single biggest driver? And maybe you can help us in terms of what you think the sustainable growth of pet food is. Because year-to-date it's up at 7%. I guess it must also be really helping your margins as well given the profitability of the division. So they're my two, thank you.

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

Thanks, Warren. Let me hit the first one and then hand it to François for the question on pet food. So clearly, we are aiming higher for the Zone AOA, no question. But it's also important to point out that this year was weighed down by a number of unusual circumstances. We've seen some pressure for example in markets like Pakistan where we expect improvement next year over this year. And clearly, the situation this year was somewhat extraordinary.

On China, it's also important that our Zone reporting does not paint a more negative picture than we're seeing on the ground. If you count in all globally managed businesses, the growth in China was about 1.5% and not flat. So again, while we're certainly aiming for higher than 1.5%, it's important to understand that the full scope of the portfolio is delivering more than flat growth in this important market.

Going forward, clearly, we are working hard to accelerate growth in AOA, no question. This applies to all markets. I think in China when it comes to Nutrition, a key aspect will be a deeper push into Tier 3 and Tier 4 cities. So a stronger presence in the market, a broader presence in the market can certainly offset some of the dampening effects that we've seen from the birth rates and also from stronger local competition. Then at the top end of the market in Nutrition, it's always important to offer the latest in innovation because the Chinese market is very eager to get top of the line products. I think we're leading in that regards.

Then as François mentioned, for *Yinlu*, we've seen a disappointing year when it comes to congee and peanut milk. And so we're working very hard to address that situation. Overall, I think it's been a subdued year for China not just for us but for many Food and Beverage companies. So an improvement there, together with some of the internal steps I outlined, I think over time will give us that Zone AOA uplift that we're looking for.

François-Xavier Roger, Nestlé SA, Chief Financial Officer:

Warren, I will cover the question on PetCare. So indeed we did very well. Especially in Q3, you mentioned a figure, which is actually close to where we were. It's happening across the Zones. So it's happening in Western countries but it's happening in emerging markets as well and more specifically Russia, China, LATAM.

It's largely the consequence of innovation and strong execution, jointly with a strong push that we did in e-commerce as well which is really giving very good results. We are also premiumizing the range, and the entry into super premium and science-based product is certainly helping. We are clearly moving further than the mere supply of pet food, moving into solutions and bringing relevant solutions to pet owners, I would mention some: Aging, obesity, the need for natural and organic products for example, which are doing very well.

Finally, there is a little bit of tailwind coming from pricing and this is more specific to the U.S. but it was very good to see that it came without any negative elasticity or negative impact on volume because when we see the quality of the growth in the U.S. and elsewhere, it's a good combination of volume, pricing and mix. And mix is largely the consequence of premiumization.

Luca Borlini, Nestlé S.A, Head of Investor Relations:

Next question comes from Céline Pannuti from JPMorgan.

Questions on:	**Pricing** **Innovation iniatives**

Céline Pannuti, JP Morgan:

My first question is on pricing. So you mentioned that pricing should return to positive in the fourth quarter. Could you explain where we should see that? Because I presume the lapping of the high pricing in Waters will continue. And what has that done in Coffee specifically that we saw, the step down in EMENA in the third quarter compared to the previous 2 quarters?

And then my second question is on innovation and some of the initiative there. Could you please tell us a bit more about the size of plant-based that you have reached in the third quarter? And as well, the size of the *Starbucks* rollout.

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

Céline, if I can start on the second one, innovation. So clearly, the *Starbucks* rollout and the plant-based rollout are giving us a whole lot of positive momentum. So we're absolutely excited about that. We would not highlight those two initiatives time and time again if we weren't really excited about how they're doing. But I think also for competitive reasons, it would not be prudent at this point to disclose the exact numbers. We're seeing very solid double-digit growth here, very strong customer acceptance, very good velocity. So all the good things you're looking for in retail that really point to continued success, I couldn't be more excited. But again, I don't think it's in the best interest of our shareholders to toss around these numbers.

François-Xavier Roger, Nestlé SA, Chief Financial Officer:

As far as pricing is concerned, we see this softness that we had in Q3 as totally temporary. This is largely linked to the phasing of pricing step that we took. And to high comparables, you mentioned water, I could mention as well Dairy in Brazil for example. There is another factor as well which is coffee prices that went down significantly, which is partly the link to the coffee bean prices by itself. But as far as Coffee is concerned, the good news is that it has been largely offset by a positive RIG. When you look at our RIG in its totality for Nestlé in Q3, this is the highest level that we experienced in a given quarter over the last 8 years.

We are very confident in the fact that we will be back into positive pricing in Q4 as well as next year. We will be helped as well probably by some commodity pressure because we know that this year we had some commodity headwind. Even next year, we will get more and probably at a higher level as well. So once again, we are confident in the fact that we will be back into positive pricing from Q4 onwards.

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

Let me build on that and just say obviously this is a one quarter situation. As François said, we're expecting positive pricing from Q4. Overall, when you look at the 9-month period, it is true that we're not quite as happy with pricing as we could be. So this is an area that will deserve our continued focus for the rest of the year and certainly into 2020.

Luca Borlini, Nestlé S.A, Head of Investor Relations:

Next question is from Jon Cox at Kepler.

Questions on:	**Returning cash to shareholders** **Long-term strategy in Waters**

Jon Cox, Kepler Cheuvreux:

A couple of questions. One just on the returning cash to shareholders, the CHF 20 billion. And you've mentioned a mix of buybacks and special dividends. Just wondered what the thoughts are behind that. Of course special dividends are all very well, but obviously there's tax implications in Switzerland for example with dividends. Just wondering what your thoughts are. Would you be prepared to pay this sort of CHF 20 billion earlier or would you start slow and wait for M&A? Just anything in terms of granularity would be much appreciated.

Second question, just on how you describe Water and maybe now looking more to specific geographies and segmentations and the fact that Nestlé typically is saying that we want to be #1 or a very strong #2 in pretty much all of the markets, are we seeing a slight adjustment there in the strategy going forward? And actually you may dispose of parts of a business, even if it is factored to be a growth business, because it's not growing in a particular region or you feel uncompetitive and you'll focus your attention on other regions. So it's more of a sort of a longer-term strategy question. Traditionally, Nestlé has been #1 or #2 in everywhere.

Now you seem to be talking about Water slightly differently. Should we expect that also with other businesses going forward?

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

Thanks, Jon. And let me address both of these. So first, when it comes to the return of cash to shareholders, it's important for me to point out this is not about, as you worded, a mix of these two. As we were saying in the press releases, we leave ourselves the option open to also consider a special dividend. But there's a clear preference for share buybacks. But I do think, in this very volatile day and age when it comes to financial markets and given that we're talking about a 3-year period, having maximum flexibility to use both tools in the toolshed, if you will, is important. But I think as you look at the precise wording of the press release, there's a clear preference here for the share buybacks. So that flexibility I think is a good idea and a prudent way to go about it. So it should be seen as a positive sign.

When it comes to that potential tax disadvantage, we are fully aware of that and hence that's something that will be part of our considerations. But let's not underestimate the sheer volatility we're facing. As I said in my prepared remarks, it's all about doing the right thing for our shareholders.

When it comes to the Waters business, I'm glad you're reminding us of this ambition level that I'm very proud of at Nestlé. And that is true, yes, we want to be a #1 or #2 and preferably #1, and we are in Waters. This is what we have built up since 1992. The lead is such that frankly we can afford to be selective. It is good to be selective because if you're trying to roll out the Waters business in a non-discriminate way all over the globe, you run into issues where it's either an excessive exposure to the low value part of the business where there's not enough differentiation or you might turn into regions where clearly the Waters issue is raising a whole lot of sustainability and access issues that frankly we don't want to be exposed to.

So at the end of the day, focusing on higher-growth, higher-margin segments inside Water and at the same time having a broader leadership ambition I think is not a contradiction. The Waters business worldwide is one of the strongest-growing categories. Depending on the year, typical growth is between 5% and 7%. So as you can see, with our current numbers, we're quite a bit away from that. By moving and shifting the business over time to the premium offerings, to functional offerings and flavored and carbonated offerings, I think that we can sort of tilt the business mix towards that more attractive side of the Waters business and benefit from higher growth.

But do not underestimate our ambition. I think with that change today, it's important that people don't see it as a lack of commitment to this business that we have built up so patiently. It's also not a lack of complete transparency. Because as you know we'll continue to report Waters as a category so you'll be able to track very nicely our organic growth and our profitability. So we're as committed to this as ever. And when it comes to the precise strategies and sustainability issues, I think I hinted in my prepared remarks at some of the things we're pursuing. So it's not only about a new organizational structure, it's also about a new direction in the Waters business.

Luca Borlini, Nestlé S.A, Head of Investor Relations:

Thanks, Jon. Next question is from Alain Oberhuber from MainFirst.

Questions on:	**US performance details** **M&A**

Alain Oberhuer, MainFirst:

Two questions also from my side. First, regarding the U.S. Could you give a little bit more granularity of the good performance with Ice cream, maybe you could give us also some hints regarding the other brands, how they performed? Within that question also in the U.S., the Frozen dish business. *Lean Cuisine* was weak, but obviously the other three brands and in particular *Stouffer's* improved. If you could help us there a little bit.

The second question is just to come back to Jon's question regarding M&A. Do I understand the cash given back to shareholders will depend on potential investments? If I do the math, obviously you could buy these CHF 20 billion back in the next 3 years and still do acquisitions. Is that a hint that you focus on a large acquisition in the near term?

François-Xavier Roger, Nestlé SA, Chief Financial Officer:

Alain, François speaking. I will answer the question on Ice cream. So we are doing well on Ice cream. Clearly our strategy is to have a differentiated strategy, which is focused, on profitability and especially as far as the U.S. is concerned. That being said, we are very happy with the level of growth that we have achieved. We are at mid-single-digit growth. The U.S., which accounts for two-thirds of our business, is really doing well with mid-single-digit growth which is driven by super premium *Häagen-Dazs* and *Outshine* and particularly with non-dairy offerings, so we are happy with it. We are gaining market share, which is good.

And it's even better in the context of the DSD move that we are doing. So it's very good. AOA is also growing at high single-digit growth driven by China, Malaysia, and Thailand. We have a robust growth as well in Canada and Chile.

So we still have opportunities going forward to improve our operational competitiveness and especially in the U.S. value chain. We can push further as well in premium and innovation, and we have proven in the recent past that it's working well. So once again, happy with the market share gains.

In Frozen, in the context as well, in the U.S., we are doing well. We are growing with low single-digit organic growth, which is essentially RIG-led. And we are doing well in Pizza, *Hot Pocket, Stouffer's*. You said it is more complicated for *Lean Cuisine,* which is something we are addressing. We went through ups and down in that category. The idea is really to focus on innovation and much more on the core offering and we are working actively on it.

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

Yes, and let me build on that. So I think what you're seeing here in U.S. Frozen in one after another range of products and brands, when we focused on it, we found a solution. So don't underestimate our ability to succeed in this area.

When it comes to the return on cash, thank you for the clarifying question. The wording that we used that potentially we would reserve the right to deduct the amount spent on large acquisitions from the overall envelope, that's exactly the same wording that we also used in the summer of 2017. So this is not meant to signal that either something is happening or not happening. It's just simply in the interest of maximizing flexibility, something that we mentioned for good order.

When you look back over the last 2.5 years, think about the *Starbucks* license acquisitions, which was basically around CHF 7 billion. We did not modify the envelope of the current buyback program as a result of that. In fact, the current buyback program, as you know, has been accelerated from what it used to be. It used to be laid out as a 3-year program and now we had shortened it to roughly 2.5 years.

So again, this is more of a comment for good order in case something very large and extraordinary were to happen over the next 3 years. I think overall, spacing out these programs over several years is a good idea to take advantage of changing market conditions. But then as you're talking about longer periods of time, it's important to have these cautionary statements for good order.

Luca Borlini, Nestlé S.A, Head of Investor Relations:

Thanks, Alain. Next question is from David Hayes at Société Générale.

Questions on:	**Business reviews** **DSD Impact on organic growth**

David Hayes, Société Générale:

I have two questions. Firstly just on review of the business, we kind of got used to, almost it feels like every quarter, a business gets thrown into a review state and then generally gets sold. We haven't seen it this quarter. I guess two questions related to that.

Is there still an overriding review of all the businesses ongoing? Or do you feel like the portfolio now is kind of broadly where you want it to be? I guess related to that, was Waters part of a significant review where the decision was to integrate it into the Zones? That was the outcome rather than some other options that you may have looked at.

And the second question is maybe a little bit detailed, but just to pick up on the point that was made earlier about organic growth impact in the fourth quarter and 2020. You mentioned the DSD initiative and that having an effect. Just wanted to make sure -- my understanding was that, that DSD sales impact was going to be below organic growth, if you like. But you seemed to mention that it would have an effect on organic numbers moving forward. So just trying to clarify whether that was the right understanding and what sort of an impact that might be.

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

Thanks, David. Let me start with the review. I think when you look at 2019; this has been a very busy and also very productive year when it comes to portfolio review. So I think overall, there's good reason here, on behalf of the company and the shareholders, to be happy. I think even in prior years, it was not like every quarter something was coming out new. But having said that, I think we did mention very clearly in the summer, we're not done. This is an ongoing process and we are committed here to portfolio transformation. So again, we won't be able to, and it would not be wise to, dish up something every quarter. But we will continue to work on this, no question.

François-Xavier Roger, Nestlé SA, Chief Financial Officer:

So David, as far as the DSD impact and OG is concerned. So this move from DSD model to warehouse model will impact globally -- or we'll have a reduction of sales of about CHF 500 million overall. About 60% of it, which is roughly speaking CHF 300 million, will not impact OG because it will be classified as a change of business model and it will be included in scope, in the M&A line, in line with our alternative performance measure. This 60%, this CHF 300 million that will not impact OG, corresponds to the transfer of activities to the retailers. So we have to compensate them for whatever they are taking over. The other part, which is about 40% or about CHF 200 million of the reduction, will negatively impact organic growth, this corresponds to an expected SKU rationalization that retailers will probably do as a consequence.

All of these numbers are fully in line with what we communicated in May during our Capital Market Day, so both the CHF 500 million impact and the distribution between what will hit OG and what will not. Our guidance, just to clarify, for both 2019 and 2020 do take into account the negative impact on OG from the DSD exit. For the time being, we have assumed that the larger part of the impact will be recorded in 2020 but there is still some uncertainty. Some of it could fall possibly in 2019 which is the reason why I mentioned it as one of the items that could possibly impact our fourth quarter of 2019.

Luca Borlini, Nestlé S.A, Head of Investor Relations:

Next question is from John Ennis at Goldman Sachs.

Questions on:	**Nestlé Waters move to Zones** **PetCare in the US**

John Ennis, Goldman Sachs:

Two for me as well please. The first is on the Nestlé Waters migration. I wondered if you could run through some of the learnings you found from implementing a similar migration with the Nutrition business and how that helped support your decision to do this with Waters. And then maybe comment on why the other businesses will remain separate.

Then my second question is on PetCare RIG in the U.S. How much of this growth do you think has been driven by Purina catching up in the e-commerce channel? And I wondered if you could maybe give us a bit of color around the growth by channel and where you see your current market shares by channel for that business.

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

Yes. Thanks, John. Let me start on Waters and then hand it to François for the PetCare question. In all modesty, the two previous migrations, Nestlé Nutrition in particular but also Professional were a real success. I think Nutrition, as you look at 2018, 2019, even in that first year as we implemented that change, 2018, you saw a new bigger and new local connectedness really driving growth in that business. So that's why I do believe that this structure change will also benefit the Waters business a lot.

When it comes to key retailer relationships, whether it's the Waters business or the rest of our Food and Beverage business, there's a lot of overlap here. Hence there's a lot of opportunity to harmonize structures and simplify processes and speed up everything and make our retailer relationships a little less complicated. So on that front, I'm very bullish. I think we practiced these migrations now twice. As you know the Nutrition business was a CHF 10 billion business that we migrated. Waters is about CHF 9 billion. So I think we can handle that size and we can handle and land those migrations without too much impact on the business. Professional was a little smaller, but here again, I think lots of good learnings that will help us now.

It is going to be important to have a strong strategic business unit going forward. You may have seen that we made the necessary appointments right away with this announcement today. So overall, to have strong strategic guidance from the center and where we want to play in the Waters business and to have an aligned strategy is paramount. So I think with all of that, there's good reason here to be quite bullish on this new structure.

As I said in my prepared remarks on Nespresso and Nestlé Health Science, these key customer and retailer relationships are different for these two businesses. And we looked at this extensively and I believe for these businesses, the global setup is clearly what works best. But let's not forget the fact that if you add up the Waters business, the Nutrition business and Nestlé Professional, then there is CHF 20 billion to CHF 25 billion of business that has been harmonized and migrated, once the Waters migration is done, into these geographic zones that are clearly the backbone of the company when it comes to execution.

François-Xavier Roger, Nestlé SA, Chief Financial Officer:

John, on PetCare. I mentioned indeed earlier in my comments the fact that e-commerce was a driver of the acceleration of our growth. Just to give you some further perspective, e-commerce sales in the total sales of PetCare are now in the high single-digit. So it's important to understand that. E-commerce sales grew with a strong double-digit rate across all regions. Actually it's even north of 40%, so it's a very, very strong rate. If you talk more specifically about the U.S., the growth rate is even higher than that. So it's clearly a key factor of the acceleration of our growth. This is not the only one though.

Our market share on the e-commerce side are slightly below our off-line market share but the gap continues to reduce which is good news. We continue to focus very significantly on e-commerce. As you are aware as well, we are pushing very hard as well on the development of personalization with this acquisition that we did in the U.K. and that we are rolling out in some European countries. I'm talking of Tails.com, which has a strong performance, and which is obviously recorded as well in the e-commerce figures I mentioned earlier.

Luca Borlini, Nestlé S.A, Head of Investor Relations:

Next question is from Jean-Philippe Bertschy at Vontobel.

Questions on:	**Infant nutrition performance in AOA** **Coffee performance in US**

Jean-Philippe Bertschy, Vontobel:

I have two questions as well. The first one is on Infant nutrition. I think François, you were mentioning kind of a good level of growth where some of your competitors were reporting some slowdown. But you were mentioning as well a slowdown in AOA. So if you can give some colors in the different geographies and business segments.

And the second one would be on the Americas. You are mentioning or describing a slowdown in *Nescafé*, Coffee creamers and *Starbucks* in North America. If you can give the reason of these slowdowns, especially if *Starbucks* was impacted or if you saw a slowdown in *Starbucks.*

François-Xavier Roger, Nestlé SA, Chief Financial Officer:

Jean-Philippe, on Infant formula, so as I mentioned, we are growing mid-single digits, 3.5%, which is led by RIG. Most geographies have good performance. Emerging market have actually a good performance. In China, we see a little bit of a slowdown but with a clear polarization in Infant nutrition as with other ranges as well, between super premium. Actually with *illuma*, we continue enjoying a very, very attractive level of growth while we are actually facing some pressure with *S-26*. So we see this polarization putting some pressure on the overall growth.

In the developed markets, we have a little bit of pressure with some negative growth. Baby food in the U.S. returned positive in Q3, which is good news. The growth is supported overall by innovation and premiumization, and I'm mainly referring there to HMO, which is quite amazing, what we did. You remember that we did more than CHF 600 million of sales with HMOs in the first year of marketing last year. The development and the moving to organic and natural is also contributing to it. We are also enjoying a strong mid-single-digit growth for Infant cereals, which is helping. We are actually gaining share in that space for Infant cereals.

Your other question was about Coffee. I think in the U.S., as you know, we are growing very nicely with *Starbucks*. It's a big opportunity in the U.S. to start with. And outside of U.S., we launched 24 new premium coffee products in late February. We launched creamers in the U.S. in mid-July as well. All of these products have been developed jointly by Nestlé and *Starbucks*. Very happy with the performance which has been very strong. We are growing in the U.S. for *Starbucks*, strong double-digit with market share gains. We are obviously doing a lot of work for the international expansion.

You were referring to *Nescafé* I think, but I was not sure exactly of what you mentioned because I don't think that I mentioned that we were declining in the U.S. with *Nescafé*. So this is not part of what we shared earlier.

Luca Borlini, Nestlé S.A, Head of Investor Relations:

Okay, well, Jean-Philippe, thanks for the question. I can follow up with you in more detail later on.

The next question is from Jeremy Fialko.

Questions on:	**Q3 EMENA RIG** **Mix vs Volume in Q3 RIG**

Jeremy Fialko, HSBC:
A couple of questions. So the first one is on the EMENA RIG, so a very strong number in Q3, the likes of which I can't remember for some time. So just going to a little bit more detail behind that in the third quarter and whether there are any sort of phasing or unusual factors to be aware of.

Then the second thing that's linked to that is clearly RIG is the kind of the composite of the volume and the mix. I know this is not something you disclose, but is there any way that you can give some sort of a directional indicator of the contribution of mix versus pure volume growth to the RIG number in the third quarter given this is now such a huge part of your organic growth?

François-Xavier Roger, Nestlé SA, Chief Financial Officer:

Okay. For EMENA, indeed we have enjoyed a very nice level of RIG in the third quarter with a clear acceleration. There is no specific phasing there. It improved in the third quarter mainly as a consequence of our strategy as far as Coffee is concerned. As I indicated in my prepared comments earlier, we decreased further the price of coffee during the third quarter and it has been more than offset by an acceleration of volume as far as Coffee is concerned. This has been a key driver of the acceleration of our RIG.

We don't indeed provide the detail between mix and volume because it would have to be looked at by category. I'm not sure that it's relevant anyway by market because it's a mixed bag of very different activities. And it's -- for example, Water would probably frustrate the entire analysis because of its volume. Be aware of the fact that in volume, we are growing overall and across categories as well. But we see a very strong contribution of the mix as well which is positive, which is largely the consequence of our premiumization efforts. This is valid for EMENA, this is valid for the group and this is valid for basically each and every single category that we have.

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

So Jeremy, just to build on that. In a day and age when innovation drives so much of the pricing opportunity and when we have such a successful effort underway on premiumization, it is true that this mix effect in RIG is becoming stronger. And that's why it is important, while we can't disclose here that precise breakdown between volume and mix, it is important to keep the different reporting system in mind when you compare our pricing to the pricing of competitors.

Luca Borlini, Nestlé S.A, Head of Investor Relations:

Next question is from Andreas Von Arx from Baader.

Questions on:	**Water business strategy**

Confectionery performance

Andreas von Arx, Baader:

Thank you for taking my questions, I have two. First one is on the Water business. Just maybe to get some additional color because it's not clear to me. So this is a CHF 7.5 billion business. How should that look in the medium term? Will there be significant changes or will it just basically continue like we have seen the last few years that you are exiting single markets where you don't have critical mass? Maybe to stress it a bit clearer, more than 1/2 of the business is in the U.S. There, you have *Pure Life* and the regional brands. So does that announcement today now mean that you're also looking into reviews of some of your U.S. regional brands or not?

Second question is on Confectionery. Here, you had only I think below 2% organic growth in the third quarter. It's a slowdown compared to before. I think you mentioned you had a good European growth in the quarter, so that means the other regions must have been quite weak. Could you provide some additional details, which regions are affected? And how long will you look at that low growth before you might take similar strategic action as you did in the Waters business?

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

Andreas, let me start on the Waters business. So when looking at the U.S., it is true, the U.S. is the single-biggest country market for Nestlé Waters. But -- while a while ago, it used to be largely Nestlé *Pure Life* and the regional spring water brands. I think by now, it's important to fully factor in the success that we have had with the international premium brands such as *Perrier, San Pellegrino* and *Acqua Panna*. So I think it's a much more balanced business presence that we have built up over the years in the U.S. And we'll continue to push that because clearly in premium, there's a lot of opportunity in the U.S. market.

We will continue to do very surgical adjustments around the globe. As I said, the intention and the general direction is to get us out of the more competitive low-value-added, low-margin side of the business and to get us into the higher-growth, higher-margin aspects of the business. But we will do that step-by-step. And again, those processes will look very different country by country.

Then there are some countries overall that we also will consider exiting entirely. Think about, for example, the local Waters business that we exited last year in Brazil. So when it comes to local sources, where we don't see competitive advantage in the long term, we will reserve that right. But again, the whole thing will happen in a step-by-step way. In the meantime, you will also see organic growth. So I don't see the business shrinking overall as a result of what we're doing. It's just going to be changed in that portfolio transformation.

François-Xavier Roger, Nestlé SA, Chief Financial Officer:

Andreas, as far as Confectionery is concerned, we had positive organic growth of 2.3%, which is, as you said, essentially led by RIG. Actually, even the RIG we saw sequential acceleration of the RIG during the year. The OG is driven by *KitKat*, EMENA and Southeast Asia. *KitKat*, we continue to have attractive level of growth with high single-digit growth, which is based on innovation. What we did with new product, Senses, Ruby, Matcha, very good execution as well. EMENA has a good momentum with a very good contribution from Russia and the U.K. Southeast Asia -- South Asia is doing very well with *KitKat* and *MUNCH*. Japan had a strong third quarter especially with the launch of the paper package in *KitKat*.

Brazil was actually positive. It's an important market for us. Positive growth for the 9 months, supported there again by *KitKat*. We are suffering a little bit in biscuits because in Brazil also, we reported as part of Confectionery but we have a biscuit business there.

And we feel a bit of pressure as well in China with *Hsu Fu Chi*, but it's too early to draw conclusion for the year because it's a very seasonal activity that we have. So we need to wait for Chinese New year to have more visibility there. On *Hsu Fu Chi*, the *Hsu Fu Chi* is, again, largely in the mainstream offering which is traditionally a category that is suffering a little bit more.

Overall, in terms of market share, that's important, we see a favorable trend and especially in EMENA and AOA.

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

Yes. Let me build on that. There's some isolated areas that deserve attention as François pointed out. But overall, I couldn't be more energized about the good things that have been happening to our Confectionery category here over the last year or two. So we're very bullish about the progress we're seeing and I think we're heading in the right direction.

Luca Borlini, Nestlé S.A, Head of Investor Relations:

We're getting towards the end of the call. There's still one question from Alan Erskine at Credit Suisse.

Questions on:	Movement of Water business into Zone Management Peanut milk and Congee in China

Alan Erskine, Credit Suisse:
Yes, two questions for me. One, apologies, I'm going to go back to the Water announcement. I know in the past, the consideration when thinking about putting it into the Zones was that it's a high fixed cost, relatively low gross margin business where cost discipline is critical. I guess my question is, are you sure that as you integrate it, that you might not lose some of that tight focus on cost? Or is part of your thinking that within the Zones, an opportunity will be to try to take out some fixed cost and make it more of a gross margin story? That's my first question.

And my second question is just peanut milk and congee have obviously been challenged categories for some time now. I just wonder, to help us sort of triangulate our modeling, what percent roughly of your China sales are congee and peanut milk?

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

Alan, so let me focus on the Waters business first. So you are right. The Waters business locally needs to be managed with extreme care and cost consciousness. And it's a high fixed cost business. So that aspect and the local responsibility and local execution ideally will not change. The customer interface as I described is the same. So we need to be careful here to selectively take over the good things that the globally managed waters business has given us but then also harmonize where it makes sense. So this is not a one-size-fits-all kind of migration. We will do this with extreme care. We looked at this very carefully in the preparation for this move.

Overall, it's important to note that about 60% of our Waters business by volume is really local brands in various countries. So these need to be managed with local relevance in mind. And so that's where we believe that a management structure that goes by market or by region probably has a closer connectiveness when it comes to consumer understanding, consumer insight than a globally managed structure. So try guessing from here how a local water brand would resonate with a consumer in Southeast Asia or South America. I think that's hard work to do, and hence I think that's best left to the local teams. But the distribution side and managing the stream of products and the logistics, those structures we would certainly maintain to the largest extent possible.

François-Xavier Roger, Nestlé SA, Chief Financial Officer:

Alan, to answer your question on *Yinlu*. So *Yinlu* is about CHF 1 billion in value. And out of the CHF 1 billion, you have about two-thirds of it which is made of local products. What I mean by local products is product that were there when we acquired that business originally, which is essentially congee and peanut milk. The rest of it is obviously this ready-to-drink coffee, which is a business that we have developed and that is doing very well.

Luca Borlini, Nestlé S.A, Head of Investor Relations:

We have the last question, you have the honor to ask the last question, Patrik Schwendimann at Zürcher Kantonalbank.

Questions on:	**Pricing**

Patrik Schwendimann, Zürcher Kantonalbank:

Thank you for this honor. I have two questions regarding the price effect. Pricing was 0.7% after 9 months. As a best guess for 2020, would you expect a similar price effect after 9 months or lower price effect? That's my first question.

Second question, to what extent is the current price effect related to a deflationary environment and to what extent to a more aggressive Nestlé policy?

François-Xavier Roger, Nestlé SA, Chief Financial Officer:

Patrick, we are not providing any guidance at this stage for 2020 and even especially so for the detail of pricing. It's too early to get there, we might come to that point during our next conference. What I can tell you though is that pricing, the level of pricing that we have experienced in Q3 is not linked to increased competitive pressure. So this is more once again linked to the phasing of our pricing activities and to the comps. We see that as a temporary softness and we expect to be back into positive territories.

It is linked to deflationary environment? Yes, it has contributed to it. There is nothing new there. This is something that we have experienced over the last couple of years, actually, because we used to have inflation in Europe and in the U.S. and in China and so forth, so we have less or none in most of these countries. So this is certainly something that has contributed to the fact that we have less pricing. We have had less pricing last year as well and this year again.

I just want to mention one thing though, to put things in perspective, because beyond the phasing of pricing, as far as Q3 is concerned or Q3 year-to-date, we have more pricing this year than last year. So that's something that needs to be taken into consideration as well.

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

Patrick, let me build on what François said. So first of all, hope you understand that we can't be helpful here on 2020 expectations yet. I think it's too early for that. And when it comes to the pricing overall, I think both in the press release and also with our statements here on the call, you see that we very much characterized this as a temporary Q3 phasing-related situation. We wouldn't do that if we didn’t feel a strong amount of confidence here that the situation will correct itself in Q4.

Overall again, especially when comparing to companies that have a different organic growth reporting system, do keep in mind our RIG composition, with volume and mix being in there, and mix these days being such an important part of potential pricing upside. So when you look at the combined total, the organic growth, I think it adds up to something that is pretty much industry-leading in large Food and Beverage. That is what counts at the end of the day. And especially when you try, but with RIG of course, it also means usually pretty good underlying market share news.

So again, while we're not happy about the Q3 and certainly expect better pricing in Q4, it's also important not to overplay that situation. There was very much a phasing-driven as we responded to some pricing opportunities last summer, which have lapped now.

End of Q&A session

Luca Borlini, Nestlé S.A, Head of Investor Relations:

Well, this concludes our call. Thank you, again for participating to it, and we wish you all the best.

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

Thank you. Talk to you in February.

End of Transcript