

NESTLÉ S.A.

EUROPEAN DISCOUNT INITIATIVE
TRANSCRIPT

Event: Nestlé Investor Seminar 2005

Presentation Date: 8 June 2005

Presenter: Mr Hervé Cathelin
Responsible, Hard Discounter Strategy
Nestlé S.A.

Disclaimer

This is a transcript version which might not reflect all exact words of the live session.

This transcript contains forward looking statements which reflect Management's current views and estimates. The forward looking statements involve certain risks and uncertainties that could cause actual results to differ materially from those contained in the forward looking statements. Potential risks and uncertainties include such factors as general economic conditions, foreign exchange fluctuations, competitive product and pricing pressures and regulatory developments

Hervé Cathelin - Nestlé Responsible, Hard Discounter Strategy

Good morning to all of you. I have to wake you up and I have to wake up as well, it's still early for me you know as a salesman. And you know in this company I'm not the only one who started as a salesman but I'm very delighted to be able to talk to you about customers, about a key transformation which is taking place right now and how can we turn this transformation into an opportunity for our Group.

So hard discounters, the way I intend to address it is basically to review with you a little bit how we see all that, who does what, what is the situation right now. I intend to go rather fast through that, I intend to spend a bit more time on how we work with this particular retailer format and then provide you with a few examples because there's nothing like examples. Customer management is a lot about strategy but it's even more so about the good execution and I will go to it.

So first of all as I said how do we see discounters, what are they doing? We estimate that in 2004 they will reach probably about 18% share all over Europe; you see that historically discounting have been a German phenomena and a Spanish phenomenon that's where they grew the fastest, that's where they have reached the highest here in Europe and all that. So basically they are growing fast. It says also that for them, the next I would say land to conquer I would say is probably going to the centre of Europe which is France very likely, it's a battlefield for them and Italy that's where we see them taking a significant share and competing over the coming years.

Clearly the growth outpaces I would say the traditional retailer, it even outpaces their, how can I say, their owners for instance Dia as you know is a subsidiary of Carrefour growing much faster than Carrefour. The same applies to Penny (a hard discounter chain) and you see very impressive growth rates and definitely faster growth than the traditional retailers there.

So France, Portugal, Italy are clearly going to be the battlefield in the coming years and growth is what it's all about when we talk about discounters. Basically here a review of their shares, you know those, those are public knowledge as I said very important in Germany and Northern Europe and Spain and keep growing all over the years.

Now who does what in this business and how do we see them? We are not so much, when it comes to Nestlé in this hard discounters, soft discounters, these kind of very subtle differences. For us the key differences between those accounts, and I put a few names over here, is probably more the role that the brand has a need to play in the strategy. How do they display, if you will, brands in their stores and what is the role of international and national brands in their portfolio management. So clearly you see here from your left to your right the difference we make. Basically Aldi, Leader Price, Leader Price is a subsidiary of Casino of France, they are clearly the private worth. It's a 100% private label, it's a very limited assortment, I would say it's pure comfort. In the middle we gave some names to those accounts, it's clearly accounts where brands are playing a role to a lesser or larger extent but they are carrying brands, they are offering brands to consumers. There's a balanced I would say portfolio between what is under their product label and brand. The product variety is limited. You talk about a few hundred sales of SKUs, stock-keeping units, between 600 and 1,200 and clearly they are on everyday low price, I'll come later to what is everyday low price. On your right you have something which is a kind of hybrid, a bit closer I would say to classical supermarket or small upper market, let's say Mercadona is a good example out of

Spain where clearly you have a much larger assortment overall, close to 5,000 SKUs and they also work with some promotions you see they are a little bit of an in-between.

Now just go back a second on the heartland of hard discounters with Germany and to see how those big names, which I say many of them are coming from Germany are performing lately; the last number you have here is our first estimate from February 2005. Well you see that basically Aldi has lost share I would say over the last two years; and again at the beginning of this year. Lidl Plus are gaining shares, well we just look at that, notice it and it's clear if I link it to what I was explaining earlier on, it seems to us that the format or the banners which are carrying brands seems to have somehow a better performance on the marketplace which for us is good news.

Now this is Germany and it's fair to say that in Germany the market for hard discounter has probably reached close to some degree of saturation; this is Aldi, south and north as you can see there are not so many spots. There are still a few but really very limited so it's clear that the growth which as a result of store openings is going to slow down, that might explain a little bit the previous numbers that I shared with you. And somehow, what can I say, it's a kind of new 80/20 rules there because you know that it says that 80% of German consumers are 20 minutes from an Aldi.

So that's a new 80/20 and that's basically what this illustrates here but what it says is if it is saturation at home, the development for those retailers is clearly to be geographical expansion which they do, they actively do that. You have here you know the first of them which is the Germans Plus Dia. As I said it's also a Spanish phenomenon and very much driven by Dia a member of the Carrefour Group. So they have over the last years extended beyond their home country and for instance Lidl heading I would say the movement is now in 18 countries all over Europe from east to west and north to south. So geographical expansion is clearly for them inevitable.

Let's look a minute on the size I would say are what we name the two giants, the Aldi and the Lidl and the effect of store openings. As you can see this is the number of stores that they have by the end of 2004 and the rhythm or the pace at which they are opening new stores which is clearly one of the very reasons for the growth of this format all over Europe. So Aldi opens five new stores a week, one a day. And how can I say, Lidl works on Saturday because they open six stores a week, so one more. Clearly you know how much store can you open, how long can you sustain I would say such a rhythm of store openings because clearly this, the pace at which they open stores, I repeat myself, is driving the growth that they achieve on the marketplace.

So let's take an example, as I said France and I will take several examples about France which is as I repeat probably one of the battlefields in the coming years. France for instance, discounters have grown by about 13% last year. You see that they clearly outpace growth from all other format of retailers for the time being.

But it is interesting to see what it does when you take what I refer to as a park effect which is, I'm back to the same point which is store opening. The more stores you open the more sales you drive but what is important also is to check on the internal growth I would say of those outlets. Here you know internal growth is still impressive, it's 7% but on the other hand you can see that close to half of the growth of hard discounters last year in the country of France has been driven by store openings. So it's kind of 50/50 the split between what is internal

growth and what is store opening. For information also I read last week a survey from T&F released in France lately, I think it was early this year, where they also looked at the average I would say spend by consumer per capita you know when you visit a store. And it seems that we have reached a kind of plateau over the last month and that the progression of sales per visit has flattened at about €1 per visit. If my memory is correct it is €1.3 when it was €1.7 a quarter ago. So it seems also that their internal growth in terms of satisfying customers, consumer needs and getting I would say increasing the transaction per visit has maybe, I say maybe, reached a little bit of a plateau.

It also depends and I will come to it now on what the other retailers are doing, the other retailers' activity.

So basically, sorry the other retailers' activity, and I'm not going to enter into that, you know it for sure; they have modified their offering, product labels, value line, all these kind of things which is a fact of life. Basically a lot of what they've done with value lines goes against their product label but it's what they do in terms of offering assortment I would say. What we are interested in is two other things that they have developed lately, extensively I would say, which we believe goes in the right direction for them. And of course for us our brands are quite active in those formats.

So first of all promotion. They really grew very actively their promotional activities and they do it especially on regular format. In other words they are moving a bit away from very special specific formats which are only geared or dedicated for a given period of time. Regular format is good news for us because it is regular production and regular inventory. Second of all we have noticed together with Nielsen the lower consumer interest for large sized packaging which was a trend for many years. We are back to regular formats and to probably more interest in regular I would say packs, regular pack sizes, regular servings I would say proposal from our side. Again it might be driven by the out of pocket, it's clear that larger pack size costs more but that's what we noticed and it's again for us you know satisfying news.

Second, the impact of price cut must be significant and visible. It is very clear that they love to use on pack, flash on pack information such as reduced price, minus whatever and all that to clearly advertise or signal I would say strongly to consumers that those products, those brands are on promotion. Clearly, and we have measured this, they're a promotional impact on high value added manufactured brands, our brands are clearly attractive and perform well in promotion and are for them a very interesting promotional tool.

And the last point and sorry for the translation which is not perfect, the idea was to say that they have, all of them have developed some kind of loyalty card programme and they have run some kind of promotion through this new electronic support and this is gaining speed, getting up to speed.

So it leads me to the other very significant reaction from the traditional retailers promotion was 1) you have seen it and clearly hypermarkets are as usual much more active than supermarkets, so really back fighting. And back fighting with some results.

And back to France, you can see that over the last period because last year they are early into the year, hypermarkets have regained momentum, regained share. The pink part is supermarkets the yellow one is hypermarkets and the blue is a combination of both, sorry I missed the colour code. So hypermarkets clearly have regained I would say some momentum. Promotion is definitely something which has helped them to back fight I would

say this hard discounter wave. Hypermarkets are yellow, pink is supermarkets, blue is a combination of both.

The second activity to develop as I said is electronic based consumer loyalty programmes. Why are they so interested in loyalty programmes? Well that's clearly one of the weaknesses I would say for the time being of the fast growing, fast developing hard discounter format. As it developed very fast a lot of their activities are geared towards generating traffic, traffic building, getting new consumers into their store, they run a lot of promotions on non-food items which are promotions to attract people into their stores. And one of their difficulties I would say has been at least beyond Germany where the phenomenon is different, one of the difficulties is to secure loyalty so the repeat visit if you will is critical to them. That's clearly an avenue for I would say the other retailers and they have developed it extensively so they have all invested into a loyalty programme which are based on cards. They have between 1 million to 7 million cardholders which in some countries can be highly significant when you have let's say in the UK or in France 7 million households. Remember this is a family who have cards from retailers that's quite some and clearly they run more and more activities based on that which are clearly customer related activities and individual related activities as they are customised to consumer profile. This better knowledge of consumer behaviour seems to be a competitive advantage for traditional retailers.

Let me take just one example, well-known which is Tesco and you know also that the hard discounter has not so far been very successful in the UK. Why is it to exist there? About 400 Lidl stores for instance but still Tesco is about 7 million households with a card. They have tripled this number over the last eight years. Those customers are spending twice that what they used to spend on it so clearly those loyalty programmes are adding value to those stores and as I said this goes through a promotional programme, promotional activities which are supported with France and here we are and that's good news for us.

Now if I would sum up this kind of overall review of discounters I would say that clearly the best in class is Lidl in Europe and you see over the last years that their growth has outpaced their park effect as I said so clearly they are growing. We mentioned Dia Carrefour which again has a very significant growth and supported also by healthy store openings and of course Aldi. You have seen what I shared with you about Germany but Aldi is way beyond Germany and you have seen their geographical expansion which explains some of those numbers. So that was about who does what and a little bit of the panorama.

The success factor, why is it working so far? First of all, and I insist on that, it is a shopper proposition, a consumer proposition which is based about convenience, the proximity, when I referred earlier on to this 80/20 rule, clearly they have rediscovered to some extent the convenience. Also the convenience of choice, it's a limited choice and for some consumers it means easier shopping, faster shopping and that for them, this easy to shop if you will is an interesting dimension to shopper and consumer. Simplicity, so there are simple products, the quality is OK I would say the value for money is there and with the euro in Europe the value for money has been a little bit disturbed over the last years so they have addressed that issue. Price of course is an important characteristic of those stores by definition.

Now as I said smart buy, this is smart buy. What is it? It's that penniless people need low price you know that but you also know that affluent people, rich people love low price, it's a classical one, I have heard many retailers saying that.

Clearly from probably what was the start of those stores which were high discount, low price for I would say a less affluent part of the population has really reached now another cluster of the population and let's take Germany where they have the most developed, just a few items here in terms of what is the consumer perception of those stores and yes social barriers have gone down. As you said in the past I never entered the discounter but now I do it and buying a discounter is accepted socially. And you can see in Germany a lot of people driving big German cars going to an Aldi or a Lidl and carrying in the street some Aldi or Lidl bag, it's OK. And the fact that it's OK is clearly a change in consumer mentality. So that's one, consumer. A shopper if you will insight.

The second one is an efficient operating model. Clearly they work on very high rotation SKU (stock keeping units), there are few SKUs as I say, limited assortment, those SKUs are very high term. They are a very low cost operator, that's what allows them to sell at a lower price and it protects their margins, they are high unit margin operators.

Their model overall, what is it? It's limited range, high rotation SKU, I said it. These are very efficient logistics and before anything else logistic is a critical element of success for those retailers and low cost to serve to their consumers with the relationship with their suppliers. Simple stores, quite simple, no frills, very simple price. It's a store where you buy, that's it. And very lean management, not too many people, not too many labour costs, their cost structure is very low on that. By the way they have been in some countries under attack on that through the public opinion on the unions. And that leads them to this policy of so called everyday low price, which you are familiar with I'm sure, for all of those who are from North America. My colleague who is going to talk about Wal*Mart later on, might enter into that as well.

The very low prices you know, is very different from the traditional European model which we refer as high low, which was sell in the shelf I would say at a relatively higher price and out of the shelf in promotion at a promotional price with quite a spread between what is on shelf and what is promotional prices, low price just fits in between and let me take an example of France, you know on a few SKUs. They have here a few Nestlé SKUs as much as product labels. What you see here is that you know, and it depends on SKUs but more or less the hard discounters are selling at a price which is just a bit higher for brands, higher than hypermarkets, lower than supermarkets, slightly, in between everyday low price. And the price for hyper and super are the average price which is a result of purchases made on shelf and on promotion, so that's the price consumer base. And then when it comes to private label you see this is probably where they are the most competitive and clearly their price of activity is openly very much expressed on private label. And when it comes to brands, because they carry brands, most of them as you have seen, they try to be attractive but be reasonable I would say, everyday low price doesn't mean everyday lowest price.

So with that what I would like to do now is probably spend just a bit more time and go probably slower there on how can we add value to this model. I describe that model as being very dear to the consumers; in other words they are probably great sellers as much as they are great buyers, but they are great sellers and also give internally which adds efficiency. So we at Nestlé, we bring to them an attractive and unique consumer franchise I would say; our brands and our products carry the franchise and our consumer proposition is clearly a point of attraction for them. Many of them are missing for the time being. Second of all I said loyalty is clearly a deficit in their development as for now, and to have national, international, well known, well appreciated brands is clearly an advantage to them. So an opportunity to

increase the loyalty rate of the hard discounter shoppers. Third of all, and allow me to say that, you know it's our brands, it's our business, we believe that our brands are going to bring in-store a bit more excitement. It's clear that their stores as I said are quite lean, simple, and you know buying, shopping I would say is not only purchasing, filling I would say the fridge or the closet, it's also you know a kind of pleasure. And we believe that this pleasure, the excitement through buying should be brought through more branded product into their store and we bring that. The other point and I referred to it earlier on is to increase the average transaction per visit. A lot of the monies they invest is geared towards generating traffic, bringing people into their store. You have seen, I said it, you know that France, the late numbers, they show a trend or a snapshot, we'll see, but the late numbers are a kind of flat or no evolution of the average transaction spend. We believe that bringing brands which carries definitely another price point would be a way for them to increase that. We have multi category coverage, we are a very large company, we have a very scope of activity from chilled to dry, very chilled to mid based products and so far and so forth; water; cereals; pet care, you name it. So they have a very centralised negotiation process; they don't work as you know like other retailers. This centralised negotiation process can be made more simple when you deal with the very large supplier as we are which speaks with their model definitely. And very critical point, as I said, logistics is very key in their business models, the efficiencies in logistics. And here we are. Put it that way in very simple terms, we Nestlé with the scope of activity we've got, with the number of categories we are in, we can still attract and ship a truck to the warehouse relatively easy; it's easier I would say for us than for many other suppliers. It's clear that on a truck we can combine if you will shipments of different types of products and then you know get much more effective and efficient in the way we supply and deliver to the customer. More truck, more frequent delivery and then you know clearly lower inventory which for them it's clearly you know the KPIs of their activity, low inventory, here we are. So to sum up I would say what we can bring to their model is growth because we can attract more consumers and increase the loyalty rate of those consumers and efficiencies because clearly you know what we do fits very well with their model.

Conversely how can they add value to our business? First of all it's an opportunity for us to reach all type of shoppers, there is no exclusivity. We are you know a mass seller I would say, we sell to everybody, we do, so it's important for us that we reach all types of shoppers, all types of consumers. And as I said now you know in those type of outlets you've got I would say less affluent, affluent people, all type of categories, all types of shoppers, and we are interested in reaching all of them and make our brands available to all of them anywhere they shop. Which leads me to the full channel coverage, to cover the retail and the self service channel, we have to be in hard discounters it's critical to us, it's important and it's very linked clearly to the overall Nestlé strategy which is whenever, however and wherever. Wherever it is, our brand has to be present and sold into those stores because you have consumers there, and consumers are valuable to us. Second, or third sorry, lower cost to serve. Those, the way they work, the model of hard discounters, the lowest to have lower cost to serve. How? Sales activities as I said, it's more simple, it's a simpler negotiation process, it's easier for us. In-store activities, no in-store activities, no promotions, no end case, no displays, no merchandising, it's handled by the retailers, so for us it's clearly a lower cost. Administration is in most cases a central invoice, one invoice to a central place, much more simple. Logistics, I'm back to it, you know, a full truck is clearly an advantage to them as much as it is an advantage to us. And last but not least is production efficiency. As I said they have very few SKUs, so those SKUs, the volume is, if you observe, concentrated on a very limited number of SKUs which for us is concentration of volume; concentration of

production which is again an advantage for us in terms of production cost. No promotion, as I said, they work on everyday low price which is no promotion and the way I refer to it with my teams is no peaks and packs which is what we have with other retailers which are promotional peaks. So you have to build inventory for those peaks, you have to manage the way out I would say and the sell out of those inventories, still you know very often that we're asked to produce special packs for promotions, the bonus packs, the bundling products, buy two, buy three, buy four, whatever, all those complicates I would say our supply chain performance. Peaks and packs here, we don't have that, it's clear flat sale, to sell everyday and everyday low price means everyday sales and we just, I would say, fill the pipe as we go, which for us is a potential advantage. So back to it, what do they bring to us. Well the same I would say, they bring growth because they bring the access to a larger scope of shoppers, one. And second of all efficiencies as I would say their model which is lean, fast and concentrated is going to be effective and efficient for us in cost to serve and in production. So that's I would say the way we see the mutual benefits that we have in building business together.

Now how we intend to work with them and we'll see later that we are working with them, so clearly those are real examples and I will come to fact, which is what we do with them, but just how we have historically I would say looked at discounters.

First we said we should offer discounters the same brands and the same variants as any other retailers; as I said same shoppers, same consumers, price after all, OK if we did low price which is promotional price, that's why we should do, why? It's clearly you know very attractive for discounters because they are you know comparable and competitive term to terms I would say with other formats, and it's clearly the best way to optimise the efficiencies in terms of logistics, production, packaging for them, for us. We are clearly in what we do at best which is mass production, mass delivery, mass merchandising. The risk clearly it's about pricing but as I said, it's up to us to manage through promotional prices, the difference between every day low price and promotional price. But that's clearly a pure model and a model which in fact, and I will show you an example that has been the one we have followed the most, because that's a model which is clear to consumers because those are comparable things, and effective and efficient for the two players, hard discounters and us.

The second model we have done a bit, and you have seen some probably in shelves, is to offer our brand, and I'm still very keen on that, it's all about brands. But with differentiated approach, basically different variants, different pack size, essentially in different labelling, you know instead of being in 100g you are in 125g. Instead of getting yoghurt by six you have yogurt by eight, all this kind of thing. It's still very high attractivity for discounters because for them it's still a way to have brands and to have them in, I would say in a way and in a format which satisfies consumers. It creates some kind of differentiation and can limit a bit the price comparison somehow. Clearly for us it's an increase within the supply chain. We have done it, I'm not sure it is the solution that we favour the best.

Third is to offer a dedicated brand, some of Nestlé brands or sub-brands that are owned by us and we dedicate to some of those accounts. That's a possibility and that's a possibility that so far we have not explored, to be very clear with you, but it's a possibility that we still keep open in our minds. It can well be that we have sub-brands or brands that we are not you know marketing strongly any more that we dedicate to them; we have not done it but it's a possibility. But for us winning with discounters, I would sum it up, it clearly goes through brand, bringing them brands, brands which are going to satisfy consumers which are going to increase their franchise loyalty effectiveness.

Now you may think that all that is new news to us, that suddenly we woke up and we say, oh my God discounters are here, we need to do something. That's wrong, discounters we have done business with them in many countries and I have here picked a few examples. We have already taken advantage of the very significant growth that they bring to us and I have indicated a few accounts. This is 2004 sales, you read or heard that this is about 5% of our retail sales in Europe. You see some very impressive numbers, Lidl plus 5%, knowing that the bulk of the business was Lidl in Germany. You see Mercadona, Mercadona is probably late 2004, something like 16% to 17% of the Spanish market, a very big customer in Spain, plus 26%. ED which is the Dia name in France, plus 21%, flat with Dia in Spain and Portugal. And I mention Migros because we are in Switzerland and Migros has been historically I would say a kind of hard discounters and they have discovered I would say the brands lately and of course a few of our good brands which have brought us some additional sales. So 10%, that's the growth we had with this format last year, so I want you to have that very clear. What I explained to you in term of what we bring to them, what they bring to us, the kind of strategic framework we think about when we work with them has been applied and has delivered I would say those numbers.

Now what's next? What's next and here I'm going to go fast, so a few examples. Lidl to begin with; Lidl for instance and let me backup one second on Lidl. Those are late 2004/2005 examples, clearly you know in Lidl late 2004 we entered with Vittel in Lidl Germany and we are going to answer with Aquarel now in other Lidl outlets outside of Germany being Spain and Portugal, that should happen in the coming week.

Back to Germany, nutrition then, we entered early this year with a full range of nutrition 63 SKUs which really to some extent goes against their model. Very powerful entry, so far very successful for us of course, for them because you know this category is clearly a category of destination and a category which is attractive to consumers and which is loyalty building.

Confectionery, we have entered additional confectionery brands and confectionery item, you can see those, Choco Crossies, the multi packs of Kit Kat, Lion and Nuts, and some mini bags in Germany and in most of Lidl stores all over Europe. Just a side comment over here, something that we do more and more for them is assorted packs which is one pack with three different brands into it. Back to the logistic model. For them what is important is that it is one carton. To some extent it is one stock keeping unit because they keep those units in their warehouses; that's what's important to them. We list one logistic SKU I would say with three brands, very successful.

Spain you may not be familiar with some of those sub-brands, those are Spanish brands, we have good hopes, it's not yet done, we are in negotiation on those to enter in Spain.

Cappuccino is in Germany, family cappuccino, larger size cappuccino, again an assorted pack that is now available in Lidl Germany.

Beyond ED which as I said is the French name for Dia, is very much a South Europe chain; France; Spain, Portugal and Greece.

So here you have Nescafé which is available beyond ED. Just one minute on this because again it's all the learnings we have had, I showed you nutrition, the 63 SKU in one go but you know that when you create a shelf you sell better. I showed you the assorted pack which again a way to sell into those outlets, that's good execution, this is already also a very good

execution, for you it may be the same. One is a 12 pack which is three by four, and the other one is a 12 pack which is two by six, no difference, yet you know we change our pack from the three by four to two by six for Dia and ED. Why? Because when you look at their shelf it was for a way to fill their shelf better. In other words to put in the shelf more products in one go which means that we have sold a lot of other stocks position in doing that because the three shelf only on four, did not fit well into their shelves; the sales went up and the market share of Dia grew in Spain. As I said it's a lot about execution, it's a lot about detail, those small things is how you learn to work with a new format with the new retailers, we are learning.

Today in France you see some Kit Kat, you see some Nesquik, incidentally you will see on the Nesquik it is under ready to shelf, ready to sell carton, it's a new thing we do to save on label cost, clearly you know this goes directly in the shelf, take off the cap, ready to sell. By the way we found it so easy after all that now we supply all retailers with this kind of carton, it's easy for everybody and it is for us, and it's a service to retailers and to consumers. Small thing as well. The barcode on those products we have printed in several places on the pack now, so that when you go to the cash, it goes faster at the cash, so you speed up if you will the wait time at the cash position. We learned a lot of small things like that in working with them.

Mercadona, nutrition again, has been entered, has been listed and again you see with a selection of items early this year.

My conclusion would be I want to save time for some questions which you probably. That for us how hard discounters is a growth opportunity beyond what we already do. And you have seen it, we have already taken advantage of this growth opportunity. But we want to capitalise on that. It's additional sales and it's a way to which all types of shoppers wherever, whenever, however. Well we notice with pleasure that the winning model is the one where shoppers can shop brands, fine. We have demonstrated over the time and as we learn more and more the petty details on how to work with them that Nestlé fits with their operating model, our brands are attractive for their shoppers. We offer definitely high rotation potential. Our brands can reinforce the shopper loyalty as I explained previous and last but not least operating efficiencies in terms of logistics, sales, in-store activities and so on and so forth. Which leads us to the interesting economics to us because lower cost to serve and controlled production costs is of value to us. So clearly our objective is to accelerate our development in this channel. We start from a good base, we have seen it and we are accelerating. I shared with you a few examples which as you know are the last activities with them which go from water to chocolate to coffee to culinary, to all categories of product, nutrition of course. And we are developing our business at a fast track with them taking advantage of this growth opportunity and this great opportunity offered to us to really reach all types of shoppers, it's very important to us, wherever. It's a transformation, it's a change but it's a transformation that we have already addressed and are definitely going to turn into an opportunity. That was my message.

Questions & Answers

Question #1

Private label production & Soluble coffee quality

Two questions. First of all your CPW unit that you own in percentage makes private label cereal in the UK, it's a meaningful part of their market share. Do you have customers that point this out to you and try to encourage you to make private label for other products?

And second of all how good is that soluble coffee that sells, how can they sell it so cheaply?

Hervé Cathelin - Nestlé Responsible, Hard Discounter Strategy

Well two questions private label production. It is not overall a Nestlé strategy to produce private labels, you know it. But it happens that in some categories for a particular reason which pertains to our production schedule or to opportunity we see for developing our business that we do it. We are not the only ones; it is a fact of life I would say for manufacturers and as far as I know we haven't had many objections from other retailers, that's a fact. Your second question is the instant coffee we sell you find it very cheap, my push back to you is do you find it very good?

Participant

(Unable to hear).

Hervé Cathelin - Nestlé Responsible, Hard Discounter Strategy

OK thank you by the way. Don't. And clearly you know here the question is to sell some sophisticated product and believe me instant coffee is a sophisticated product, it's technology intensive, it's raw material driven, it's process engineered, you can make some products but you cannot reach the quality level. And we have by the way, we check on it, we are not complacent about it, we check about it all the time, we measure ourselves against those kind of products and so far I would say the price difference is worth it. So keep loyal to Nescafé thank you.

Roddy Child-Villiers - Nestlé Head of Investor Relations

We actually have Ian Friendly who is the CEO of CPW here already. Ian do you want to comment on the private label thing?

Ian Friendly - Cereal Partners Worldwide (CPW) President & CEO

Sure. Good morning everyone. The private label business that we have in the UK was one that came about as we acquired a company at the very beginning of the joint venture from RHM, and it was a very important and significant part of the business in the UK. But outside of the UK we have a consistent policy that is consistent with both Nestlé and General Mills that we do not supply private label anywhere else. And our customers seem to understand that that's very specific to both the situation in the UK from our history as well as the different commercial nature of private label in the UK.

Question #2**Negotiations, logistics and production for Lidl**

Could you explain who exactly negotiates with Lidl. And then how do you co-ordinate within Nestlé in regards to logistics and production and so on in the various businesses?

Hervé Cathelin - Nestlé Responsible, Hard Discounter Strategy

Right as I said those accounts are more centralised than many of our usual retailers. So we have adopted the different way of working internally. So clearly we negotiate with the headquarters of Lidl out of Germany; we have one point of contact I would say with them and the role of this point of contact within Nestlé is clearly to represent, I would say, the interest of all our markets and to negotiate with Lidl on that basis. Now Lidl or others by the way, I'm not just picking on Lidl. I still want to insist that if we have one point of contact with those retailers we are doing business locally which is that we discuss with them on local terms, local price, local condition that we intend to do business one market at a time. Because by the way our product line is not equivalent eventually from one country to another and we also want to stick I would say to the local pricing structure and term structure of the given market. But the relationship I would say with the customer is certainly more centralised and with a stronger handed co-ordination if you will, than with many others. So that's how they operate.

Question #3**Net margin implications of hard discounters and category variations in margins**

Would you talk a little bit about the margin implications net net of the hard discounters? After you've done all of these things like repackaging the product or created a sub brand, whatever strategy you choose what is the net margin implication? And secondly does that vary by category? Have you achieved the same level of success in terms of protecting margins in some categories more than others?

Hervé Cathelin - Nestlé Responsible, Hard Discounter Strategy

Alright I don't want to enter into too many internal numbers and I'm sure you appreciate that. What I can share with you and you understood it between the lines I'm sure is that for us to develop business with this format I would say it's an interesting business proposition, because when you take away from the P&L let's say a lot of sales costs, let's say sales force, some of your negotiators because it's more centralised. When you also take into account logistic efficiencies and leave me to deliver on food trucks versus less than a truckload makes a big difference, longer production runs and all that, we have acquired, how can I say, we have proven to ourselves that it is an interesting business proposition because the cost to serve is really lower. Second is the pricing. As I said the way to support EDLP investments, basically it is required to support EDLP, versus investment required to support the promotional activity, after all, in mass, in total in average, I would say, is not significantly different for us and we can demonstrate it and prove it. There are many accounts which are running like that, we are not the only manufacturer in this situation. But basically on the internal income, we protect our income line and we grow it because we take advantage of the

opportunity and in terms of cost we reduce our cost base. All in all this is an interesting format. The second question was whether there are differences by category, yes there is a bit. It's clear that in categories where the market is more open, where the offer on the market is wider, where the market is more commoditised and where then private labels are priced strong it is probably harder first of all for us to justify a branch franchise let's face it. And second of all to protect our economics. You have seen that the progress we have made with hard discounters are mostly in nutrition, coffee, chocolate; those are categories where clearly they are out of what I describe as being commodity driven relatively ordinary products. So as I say process intensive high technology and high knowledge and master of production and product formulation.

Question #4

Consumer acceptance of hard discounters in non-German markets & Managing the model 1 method of working with hard discounters to minimise risks

There were two contradictory things in your presentation. You talked about the relatively low consumer loyalty with hard discounters yet you were pointing out the high acceptance in Germany. And Germany I think is really very different and I remember living there 25 years ago and you'd get ABC1 economic groups happily going to hard discounters so that's quite different. Do you have numbers or surveys of consumer acceptance in non-German markets? That would be my first question. And the second one is how you actually manage Model 1 without the risks that you point out in that?

Hervé Cathelin - Nestlé Responsible, Hard Discounter Strategy

You're right to point out that there is a difference of course between Germany and the rest of Europe. In Germany discounters have been here for so long you know more than 25 years as a matter of fact, it's an historical model and clearly we have been able to reach all types, all layers I would say, of the society. Now I can't provide you like that you know detail numbers but I do remember that in France for instance which as I say is clearly a land where a lot of things are going on, the hard discounters are recruiting, getting new consumers beyond the first and very natural consumer group that everybody would expect; which is what I referred to as the least affluent if you will. They do. And for instance they also, the survey which refers to discounter attitude which is the kind of attitude from a relatively more educated more affluent consumer group versus discounters which is a kind of positive attitude versus it considering that as a smart consumer you do the right arbitration between your spendings. And if you want to spend more telephone and on the internet you have somehow to arbitrate and be smart, and arbitrate versus other things. So this attitude if you will that we referred to for Germany, they need low price, love low price seems to get more and more adapted to other markets, but it will take more time. And clearly the way to start for discounters it's a start with the heart of their proposition which is not low prices by the way, it's a low cost visit. Overall you know when you visit a hard discounter you get out of the shop with a lower basket if you know what I mean, or you feel that you get a lower basket than at the other retailers. Consumers do not go line by line by line; they don't have the clear idea of price one at a time, even more so when they are in euros. But what they know is when they go to the cashier what is the out of pocket. Your second question was how to manage the overall retailer landscape I would say. So first of all my first answer would be that we have done it. As I said it's a significant portion of our business currently; we have taken advantage of that growth. It's not something we will just scratch our head and say how we are going to

do it, we are already at those outlets. To say that it pleased necessarily all the other retailers, no. No surprise there. Again pricing is of the issue. We have to make sure through our promotional activities that we place all those formats and I refer to formats, they are in the same channel which is retail, but we place all the formats in fair terms and in competitive terms one to one. Back to it it's important that EDLP and high-low somehow matches up if you will over the time. So the managed pricing is for us a critical issue. I see the results: we have done it well in most cases, most of them in all ways, and we have had some difficulties it's fair to say.

Question #5

Expected evolution of market share of hard discounters in medium term & Level of sales to hard discounters compared to market share of hard discounters

Two questions, there's a really big jump in the market share of hard discounters in Europe from 16% to I think it was 17.6%; there seemed to have been an acceleration from the previous years. Do you have a view of where that goes to medium term and is there a level where hard discounters starts limiting consumer choice? I think in Germany and Norway you get to 40% and it seems stop maturing. And the second question is if I look at your European sales 5% of them are into hard discounters and that compares with 18% the hard discounters have of the European markets, so you're still hugely underweight in the hard discounters. Do you see that moving more in line with the hard discounter weighting over time?

Hervé Cathelin - Nestlé Responsible, Hard Discounter Strategy

OK several things quick. The last numbers you have here is an internal estimate OK, the 17.6%. It can be by the way contradicted by Nielsen or GFK or GNF when the official numbers would come. We came up with this internal estimate based on the progression we have seen in some countries beyond Germany and that's our best guess I would say for the time being. When official numbers would be available I am sure you will be aware of it. We still believe that last year has been very active years for discounters, they have opened a lot of stores when you look at the number of store openings, and their internal dynamic is still here. That was one question.

Participant

Sales into hard discounters versus the discounter share of the market.

Hervé Cathelin - Nestlé Responsible, Hard Discounter Strategy

OK first of all the 18%, if it is 18%, it's all discounters. I remind you that unfortunately some of them are carrying no brands at all. But for us it's anyway the market where we are excluded. For how long a time? That's a good question. And as I said we have seen with pleasure that Migros is pushing into or getting into some brand activity. Aldi might consider it one day and maybe their last performance might push them to also consider it, but no indication there. But that's clearly you know already part of the market which gets out of our hands. Then clearly also those accounts that anyway, they have a higher rate of sales of private label. The concept of fair share if you will does not apply so well there because clearly private label is still the dominant share of what they sell. So you can't compare it like that. 5% is still not enough and you understood it; we want to accelerate this and sell more.

How much would represent a reasonable share into those outlets, because we believe that we have some to gain but don't enter into the fair share, there are some opportunities for us, no doubt about it and if some of them would go even further you know in making brands available, we'll be there.

Question #6

Negative impact of hard discounters image on brand image

When you go around the hard discounters they are rather cheap and nasty places; I have been seen in the odd one. And I was just wondering have you seen any negative impact in terms of your brand image given the positioning in those types of stores?

Hervé Cathelin - Nestlé Responsible, Hard Discounter Strategy

No, the answer is very simply no. And back to it, the shoppers who buy in hard discounters are not ashamed of their buying. Now maybe at the very beginning, the very few, the beginning, when store opens you know they are in less affluent areas, into suburbs and stuff which is probably what you see in the UK right now. I don't how many of you have seen a Lidl store in the UK but I advise you to go and there are already close to 400 stores in the UK. They are located in very particular surroundings which probably most of you will not go and that's a start. Here, yes, brands are probably not at their best but as they grow and as they develop I would say they are sociological bays I would say back to my comments on the fact that the buy into those outlets is more and more socially acceptable. Then brands are a perfect fit and there is not at all any image damage overall. And I would even add something. Firstly for people who are, how can I say, who have a harder time in terms of managing their budget and so far and so forth I would say that they even favour those brands. For them it's, they see it as a sign to them, you know what I mean? And for this part of the population as well it speaks well about our brand.

Question #7

European price gap between brands and private label

A follow up actually. One of the interesting slides I think was the price gap between the brands and the private label which is 50%, it's really a pretty big gap. The growth in discount as you seem to be saying is going to continue and that's saying something about a growth and the value shopping constituency. Have you got a strategy to deal with that in terms of the price gap? What is Nestlé's view in terms of its European price gap with private label given that growth, given the lack of growth of Nestlé's business in Europe over the last few years?

Hervé Cathelin - Nestlé Responsible, Hard Discounter Strategy

Well first of all the price of private label we are not defining it, that's a given to us. But let's try to learn from history I would say because hypermarkets other accounts have turned to product label historically. And you have seen that there is a gap of course, price between brands and product label but that gap has been monitored if you will and maintained over the years in those accounts. We believe that hard discounters will gradually follow the same path which is that they would increase slightly the price of their product labels once they have established their pricing image. And their pricing image is, how can I say, of a given right

now, even in geographies where they are very new. So once they have established this image of lower price and lower price back to it, it's not item by item SKU by SKU it's much more you know, when I go and shop at Dia or Lidl I've got the full trolley and for the cost or an out of pocket which seems reasonable to me. Once they have established that image we have to believe that they will probably increase a little bit their price. Our intention for our brands is not to discount our brands, we are not a discounting company. Our brands are worth it and as I said our issue is to manage pricing between EDLP and promotional activity there. And we believe that as we go, in fact, the gap we'll reduce that from the bottom.

Question #8

Negotiating conditions for different fomats within the same group

If we take the example of Carrefour which has several formats when you are negotiating with Dia I would like to understand what's happening to the other formats. Do you have to give the same conditions to the hypermarkets or not?

Hervé Cathelin - Nestlé Responsible, Hard Discounter Strategy

You may understand that I'm not going to enter into the detail of our negotiations. You will respect that I'm sure. Now the process is that Dia is Carrefour which means that our point of entry in Dia is through Carrefour to begin with. But then we have specific deals or contracts when it comes to Dia, why? Because they have fewer SKUs, because they are not running extensive promotion as I said, so you know they cannot have the same activity as a Carrefour store and hypermarket by definition. So we need to adapt our programmes I would say to Dia. So if I would make it simple and probably over simplify it let's say in Carrefour we have a relationship with the group and then we have specific programmes which are designed for hypermarkets, for supermarkets and for discounters outlets. Because they don't carry the same assortment, they don't work the same over the time mostly with promotions and they don't I would say, they don't address the consumers the same way. So we adapt, we customise our programmes to those formats.

Roddy Child-Villiers - Nestlé Head of Investor Relations

Hervé thank you very much indeed.

END OF CONFERENCE