

# NESTLÉ S.A.

## 2005 FULL YEAR RESULTS LONDON & NEW YORK ROADSHOW TRANSCRIPT

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Chairpersons: **Mr Peter Brabeck-Letmathe**  
**Chief Executive Officer, Nestlé S.A.**

**Mr Paul Polman**  
**Chief Financial Officer, Nestlé S.A.**

**Mr Roddy Child-Villiers**  
**Head of Investor Relations, Nestlé S.A.**

### **Disclaimer**

**This transcript might not reflect absolutely all exact words of the audio version.**

This speech 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.

## **Roddy Child-Villiers - Nestlé S.A. Head of Investor Relations**

### **Slide 1: 2005 full year results roadshow**

Good afternoon and welcome to the 2005 full-year results roadshow. I'm afraid that the morning presentation in Zurich helped us identify a mistake in one of the slides. When we get to slide 32 you'll see that there is a contrast between your slides and the screen slides. The screen slides have the right numbers; your slides don't have the right numbers. So if you're confused, the screen is the master.

### **Slide 2: Disclaimer**

As ever we'll take the disclaimer as read

### **Slide 3: Restatement of 2004 results**

Just to remind you that we have restated the 2004 numbers, firstly for the share based payments and secondly for the discontinued operations. We've also restated the organic growth, and as it says on the slide the impact is about 30 basis points, for those of you who are seeking clarity on that.

### **Slide 4: Agenda**

Our plan today is for Paul just to recap a couple of the slides from the conference call and then pick up on what we perceive to be the main issue that you were asking about on the call and after the call and try and address your issues on the EBITA margin evolution – the bridge, as I call it.

He's then going to talk a bit about the brand portfolio and how they form a foundation for growth, and also about the opportunities that we have through scale to drive performance through the business.

Then Peter will take over, do a bit of a strategic review both in terms of what we've achieved in 2005 in terms of our transformation but also what the outlook holds, and also importantly to talk to you about corporate governance. You will have seen in the press release that we a whole page on some changes that we're planning at the annual meeting. He wants to talk to you a bit about that as well, and also give an outlook for 2006.

So without further ado – well, just to remind you that we are broadcasting this event, so when we get to the Q & A please be patient and wait for the microphones before answering – before asking your questions. Thanks very much

**Paul Polman, Nestlé S.A. Chief Financial Officer**

### **Slide 5: 2005: Delivering The Nestlé Model: Improvement in key performance measures**

Thanks, Roddy. Good morning everybody – or good afternoon, sorry. In one day trying to hit Zurich, London and Paris you forget what time it is. But it's always a pleasure to be here in London. As you probably know I am Dutch, one of our previous prime ministers during the Second World War had to be in the UK, as a government in exile. But he unfortunately didn't speak English that well, and when he met Churchill he was a little nervous and he said "Goodbye, Mr Churchill", and Churchill said "Boy, that's the shortest meeting I've ever had." So we'll make it a little longer than that.

So I've had some time to practice my English. I apologise if you can't understand some of it, but let's go through it. Here are the charts. The first chart we put up during the conference and I just wanted to start with that. So just hit the highlights again and then go into it a little bit more in detail and show the strength of the underlying strategy. I thought that was more important, because what we will be focused on obviously is how can we maintain this wonderful momentum that we have in the company.

We've announced strong organic growth for both Food and Beverage as well as Pharma, and it's important to point out that the 6.2% is certainly above, slightly above the range of 5-6% that Peter had set out for the company. But what is especially pleasing is that it is achieved on both Food and Beverage and Pharma, both of them significantly outperforming the industry or the markets. So it's broad growth across all units.

If you look at the EBITA, again the Nestlé model, good progress on the EBITA from 12.7% to 12.9%. That's 20 basis points up, but more importantly that's another one billion if you look at it in absolute numbers in CHF. Improvement in the return on invested capital - you know that will continue to be a focus area. We are showing a 50 basis point improvement on that. Underlying EPS as a result up 12.9%. We're having a proposal to the shareholder meeting coming up to raise the dividends to nine CHF per share. That's another increase of 12.5%.

Strong cash flow allows us to complete the first buyback of one billion shares - one billion CHF in shares that we've just completed, and actually the second buyback programme of three billion CHF in shares is already one third on the way. With the strong buyback, with the increase in dividends that we've seen, dividend payout ratio that has gone up, there's actually an increase of about 59% in return to shareholders in 2005 alone and the projections for 2006 are that we will buy another 39%, so certainly a good return there.

All these results have been achieved whilst at the same time continuing to keep the company on track to its transformation to a nutritional, health and wellness company. I'll go in to that in a little bit more in detail, but it entails projects like GLOBE, like the European Chilled Dairy, changes that we've made that Peter will be talking about later, and some other ones. So being able to maintain these results, the consistencies of these results that I'm putting here in front of you, whilst at the same time continuing to transform an organisation of the size of Nestlé, obviously has to be seen together and in context, and certainly would be a good result to be able to do that.

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| <b>Slide 6: Positive evolution of EBITA margin</b> |
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Let me go to the next slide. This is what we showed to you on the call. I just want to go very briefly through it. As Roddy said, your restate for Lactalis which is now discontinued operations, our margins will be restated to 12.7% last year.

There is a 10 basis points currency pick-up for the first time in four years, actually for the second time I think in seven or eight years that the currencies are working for us. And that gave us 10, mainly by the way in Latin America and from the Far East currency effects.

The share base payments actually drags us down by 10 basis points, and if there's nothing else then accounting for that now for the three for years, versus last year two years, so it's another full year effect in there and that is 10 basis points.

And then we have a 10 basis points help again on the portfolio optimisation, which basically is this Eismann divestiture. So it's the continuous working of our mix, divesting here more commoditised businesses. That will bring us at the 12.8% margin, and then you add the market mix that helps us about 30 basis points and then operational activities 20 basis points down brings you to the 12.9% that we've talked about and you're familiar with.

And some of you, rightfully so, have asked the question "Well, these next two blocks on the right I don't fully understand that. Can you give a little bit more perspective on those and shed a little bit more light on what is actually happening there?"

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| <b>Slide 7: EBITA influencers: 12.7% to 12.9% = +20 bps</b> |
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We tried to do that on this slide by just simply looking again at the positives and the negatives that we had to deal with over 2005. Again I'd like to start with the EBITA from 12.7 to 12.9, which is a 20 basis points improvement.

On the positive side we've had the efficiencies and the growth of the business. The efficiency projects are things that you might be familiar with like Operation Excellence and FitNes, and then simply the growth of the business itself. This has helped us about 160 basis points. We have the market mix including Alcon. We're talking here about the total that helps us 30 basis points. Portfolio optimisation and currencies I talked about, each 10 basis points. That gives you the 210 positive basis points.

On the other side what we had to deal with is an exceptional year, and it was an exceptional year, as reported by many of our competitive set as well, of rising input prices. We've been able to partly offset it on pricing, but as you can see part of it had to be offset with the savings programmes. If we would not have had these efficiencies and growth, we would not have come up with these 20 basis points improvement over all.

We had to deal with some one-offs. The China issue that you're familiar with on Nutrition, and we had Russia and the UK where we had issues on Confectionary. All of them fortunately being addressed, but they did drag us down and we estimate that effect to be about 25 basis points. But once again we decided to take that above EBITA in stride as part of the business, the running of the businesses, and for the businesses obviously to deal with and take the corrective actions. Then we have the share based payments I talked about.

That brings you to a total of 190 basis points down. 210 versus 190 is the 20 basis points improvement you see in the overall results. So I hope that is helpful to give you a little bit more of a detailed breakdown of these changes.

What is more important though next to these numbers is the quality of the numbers. I mentioned that briefly at the conference call. What is underlying this? Is this going in the right direction in terms of the strategy that we have as a company to win in the marketplace? Are we seeing the improvements around the businesses, the geographies that are strategic for us now and in the future? Are we on our way to the transformation of health, nutrition and wellness, so that we all get a sense of the underlying strength of these results as we look forward for the results in the years to come?

**Slide 8: Nestlé Brands**

The first thing I'd like to start with is to really look at the brands. Nestlé has its portfolio of strong brands, of course you know that, and these strong brands are the foundation of the value cross. If you simply look at the balance sheet of any company for that matter but certainly Nestlé as well you see a market cap of let's say about 140 billion CHF and you see an asset value of 40.

The difference, this 100 billion CHF is very simply you might call it intangibles but they're very tangible. That's the value of our brands. So the stronger we can have our brands, the more value we can create, not only for our consumers as a given but also for our shareholders

**Slide 9: 21 Brands with sales over 1bn Swiss Francs**

Nestlé is very blessed because we have about 21 brands that are over one billion CHF in turnover. Many brands that you are familiar with, brands in different parts of the world. Some brands have been around for a long time, I don't have to point them out to you, but there are also some relatively new brands. Brands like Nestlé Water or Nestlé Aquarel or the Nestea of this chart for example are relatively new brands. We all know how difficult it is to create a brand, and being able to create a billion Swiss Franc brand in turnover it goes without saying is even more difficult.

**Slide 10: 21 Brands with sales over 1bn Swiss Francs)**

Here you see – the next slide – again with some of the other brands that make up the stable of 21 brands. I'd like to especially point out Coffee-Mate. You might say "Why Coffee-Mate?" or might not even know this brand. I just was in the US to review the business with our US people and learn about it. A tremendously strong franchise. These are creamers to add to the coffee, and we're now launching another product called Teamaid, but that brand is over a billion dollars in itself. Again a great example of a strong brand, regional in this case, but important to the company

Then we also look at the next list of what is coming in, and it's pleasing to see that we have some other brands, like Nespresso or in the US a brand like Poland Springs, that are getting close to the one billion Swiss Franc barrier, so at least we'll have some pipeline fills to increase the number of brands on this chart

### **Slide 11: Bigger brands grow faster**

Now what is happening to these brands that are strategic for the company? Behind the results that we're putting out you actually see that those brands – Purina, Nescafe, Maggi, Stouffers, Dreyers or Nestlé – are actually growing faster than the company. So these brands are getting stronger. That's a good thing. Stronger brands getting stronger is what you want. Strategic brands growing faster is what you want.

Obviously the Americas, about one third of our business being there, is a very strong market and continues to be a very strong market, and that scale that we have there is turning into a competitive advantage for the company, without any doubt. But often there's talk about Europe – Europe this, Europe that. Well, here you see a very fine performance in Europe, as well around brands like Purina continuing to build share, but also Nescafé, for example, a mature category where we also continue to outgrow the market.

### **Slide 12: Share gains in key categories**

We've tried to recap that on this slide here. Just let me explain it very briefly. It's not overly complicated. But on the left side, so these dark brown columns are actually the market growth, and this reddish column, whatever colour you give that, is the growth of our brands in that category.

And what you see consistently for these core categories – I could have put some others on there, but for PetCare, Water, Ice Cream and Soluble Coffee – you see a consistency over a long period of time of outgrowing the market. Soluble Coffee, we have the data from '95 to '05, or water from '98 to '05. So not only are we growing those core brands, but more importantly we're actually growing faster than the market. And again that's a good thing.

### **Slide 13: The Transformation to Nutrition, Health and Wellness**

One of the key drivers that we've briefly touched upon is the transformation to a Nutrition, Health and Wellness company, that at many times has been eloquently and well explained by Peter. It really boils down to a very simple thing of adding this continuous unique benefits to our products around health and wellness, that allow us to obviously fulfil first and foremost the burning consumer needs but then also to differentiate our brands and capture more value.

### **Slide 14: BAB's: adding relevant nutrition, health & wellness to strong brands in a proprietary way**

And what you see here again as well an example of what some of these proprietary benefits are. We call them branded active benefits, and if you look at this slide we don't have to go through all of them, but they could be proprietary ingredients for heart health or for immunity protection, vitality, growth and development.

**Slide 15: BAB's on increasing number of products**

The way it would work is that they actually – and you can see that here – appear on a lot of our products, and you can see it here from the photo. LC1 is an example of pro-bio-whatever. It's a probably Calci-N the top, so you see actually how that gets translated into our products to differentiate from the competitive set.

**Slide 16: Accelerating sales of Branded Active Benefits**

Not surprisingly the goal is then to have as many brands as possible with these unique branded added benefits that give a point of differentiation for us to create value, and what we see here fairly pleasingly is that the brands that have the added active benefits - we call them 'Wellness in Action' – are actually growing at a rate of 20%, well ahead of the company growth, so again a broader portfolio where we applied it and a faster growth.

**Slide 17: Driving growth and margin through BAB's**

A typical example is Nesvita. It's mainly towards the developing markets, but you see a benefit here for example of pro-heart, a proprietary ingredient of Acticol. Just behind that benefit we not only reduced the cholesterol which is a clear consumer need, but we were able to do that at a 17% premium versus the competitive set because of that benefit.

The same range of products has another benefit of active fibres which smooth digestion. Again a proprietary ingredient based on the technology developed in Nestlé, 19% price premium on average. Behind these two benefits, share growth from 33% to 37%, and more importantly we're able to roll it out faster to many more markets as we're now doing in 2006. It's one of the main reasons why we see the adult milk segment achieving a growth in this case of 23% organically. So you see the benefits if we can get that broader into the company of getting these unique benefits on all of our brands to drive our growth.

**Slide 18: Nutrition driving growth**

So the thought I want to leave you with here, is a very simple one. That our business obviously the growth is coming from the key brands that are strategic to us; more importantly it's coming from where we have the transformation to Health, Nutrition and Wellness. Our Nutritional sales – and I have to say it is restated for this once-off effect in China that we have – but our Nutritional business unit is growing at 7.6%, which is quite a decent growth compared to the market. Our products where we have the 60/40+ benefits actually grew 15% faster than the group as a whole. And as I've just shown you, where we have these branded active benefits we've increased those businesses by over 20%, so we get the growth where we want the growth to be.

**Slide 19: Portfolio mix improving**

The second element you want to look at is not only your brands but you want to look at your mix, your portfolio of where this growth is. I don't want to dwell too much on this chart, but what it basically says is the size of the bubble is the importance of the business. The bigger

the size, the more important the business is. On the horizontal axis you see organic growth and on the vertical axis you see the real internal growth. And whilst if you look at this chart you will actually see again very strong development of our business in China, Mexico, Brazil, so those are developing markets. They're growing fast; you want to grow with those markets. That's where the future is for a lot of our products.

Then you look at some other of the big bubbles like Dreyers, Water, and NPP, I have to apologise for that is Nestlé Pet Purina North America and then Nestlé Pet Purina Europe. So you see our PetCare business is up there as well. Not surprisingly a little bit slower growth in Europe, but still growth. But the growth is where you want to be, and that's again part of our strategy of strategically managing the portfolio and the mix of products and countries that we have, to drive the growth in this company. It's very much part of the Nestlé model.

#### **Slide 20: Scale becoming a competitive advantage**

Scale is the other element. You have to be sure that you stay close to the consumer but smartly stretch your scale. I always call it being locally relevant but globally efficient. There's probably a concept that you can put behind that. What the consumer doesn't see, you want to be as efficient as possible

In this transition and despite getting these wonderful results we've also been able to continue to evolve the organisation, and the organisational model to become even more agile. The first one is GLOBE. GLOBE is now rolled out to about 30% of the business and we plan to be, by the end of this year, early next year at 80% of the business, so it's going to be an important year for GLOBE. You can see the numbers that I've put down there.

At the same time we've started moving to shared service concepts. Recently we made an announcement to that extent in the UK as well. Some of these shared services might also be selectively outsourced where that makes sense.

At the same time we've been able to deliver on the efficiency programmes – Operation Excellence and FitNes – that alone was worth 1.2 billion CHF in 2005. And last but not least probably something that is slightly unnoticed but we've put organisational capabilities in place with an innovation / acceleration team or clustering countries to allow us to drive innovations faster into the market.

#### **Slide 21: Efficient operations driving down COGS**

Thanks to these efforts I think we've been able in this year of 2005 with tremendous input costs we've been able to keep that flat at 41.7. This is the cost of goods sold at 41.7 and you actually see more importantly the long-term trend of continuously trying to work your efficiencies as well as your mix to drive your costs down but then allow you to invest in your brands and capture more value. Very much a part of the model. There are very few companies I think in 2005, with the pressures in the market that have been able to show this.

**Slide 22: Bigger innovations, rolled out faster**

As a result of all this, a stronger mix, better brands, better cost structure, more optimally leveraging our scale, we also see that we're able to roll out our bigger innovations faster in the marketplace, and that obviously is the most important thing.

I'll just take you very briefly through four examples taken at random where you can see some of these elements. An example from Nutrition from our PetCare business, from Nescafé and Nestlé Ideal.

**Slide 23: Going global in Infant Nutrition**

I'll just quickly go into the first one. What you see here is a formula now going global, the speed of going global.

You've all heard about the new model of nutrition as a standalone business unit. Well, this is what you can do with that. Proprietary technologies, a premium brand on infant formula, in this case clinically proven allergy and/or diarrhoea prevention. The product is called Nan, or Nidina or Nidal or Beba in the different countries that we sell it in. Roll-out is well underway and we will complete that in most of the markets in the first half of 2006.

Never have we been able to roll out a product improvement of this magnitude so fast across so many markets. Obviously the consumer will benefit, but more importantly it's also generating double digit growth on our business in the markets that we have expanded it already. It's a clear example and a wonderful example of bigger innovations, faster.

**Slide 24: Going pan-European with Beneful**

Look at Beneful. Beneful is a wonderful benefit that was developed and launched in the US with success already in 2001, subsequently rolled across various products doing extremely well for us. The US sales grew 35%, market share continuously increased, as I was showing you before. As of 2004 we've been able to accelerate and roll that benefit out to Europe, more obviously hitting the market in 2005, and again being able to create a brand with over 400 million CHF in sales as a result.

**Slide 25: Nescafé mixes go global**

A brand obviously very close to our heart that you know very well – Nescafé. “Well, the shares are so big, you know, hard to grow this category.” That's not true at all. Again innovation drives this category, and what you see here is a wonderful example of both the developing as well as the developed markets. In the developing markets - here's the example of Turkey - we launched what you see on the right, the three-in-one products. They basically have milk, sugar and coffee in a little sachet, very much accessible to lower income consumers everywhere that we sell it. Purchased very individually, very affordable. The growth behind this, 32%, mixes 79%.

In the developed world – there's a Starbucks, I noticed one across the street, but you don't have to go that far, because you can just buy one of the Nescafé products on the bottom, the Frappaccinos or the Cappuccinos. These are the individual mixes for the developed world, again very quickly rolled out to many countries, from 15 to a 50% share in two and a half years in Australia alone. And again Nescafé as a global category more importantly had a 6.7% growth, mixes 17.6%. Again innovation is driving the fast roll-out behind that.

## **Slide 26: Nestlé Ideal rolling out across emerging markets**

Last but not least Nestlé Ideal, for the emerging markets. It's very unfortunate that we have seen significant input cost increases in milk and dairy products, especially in zone AOA, which partly explains the slight decline in margins that you see in that zone. What is more unfortunate is, that these basic staples, important products are becoming progressively more difficult for consumers to be accessible to. Nestlé Ideal found an answer on that, so we formulated a product obviously at a pricing far more attractively. It was able to give the consumer the enhanced benefits that they were looking for – iron, calcium, vitamins A, C and D. Not surprisingly the consumer had a need, and you can see that in the 25% growth that we have in affordable milks in Latin America and the expansion obviously as a result, that we now do in AOA as well. Another wonderful example of improving the lives of the world's consumers and making our product innovations more accessible, faster.

## **Slide 27: The Nestlé Model**

So I hope you've got a little bit of an idea that not only have you put in these numbers that I've talked to you about in the front which once more confirm the Nestlé model of solid top-line and bottom-line growth, but more importantly that the quality of that growth is where you want it to be – behind stronger brands, behind a better mix, behind a company that is well on its way to leveraging its scale and being able to roll out its innovations, bigger and faster. That's really what the Nestlé model boils down to.

With that just let me hand it over to Peter, before we get on the Q & As.

**Peter Brabeck-Letmathe, Nestlé S.A. Chief Executive officer**

## **Slide 28: Strategic overview**

Well, also a warm welcome from my side. This is now the third time that I come with a new co-pilot and I'm sure you are as much impressed as I was impressed, how fast and within a short period Paul really got a good grip of our business, understood the culture for our company. And I'm sure that his background will bring a lot to us. I have already asked him to personally take care to help us in all with our Nestlé Service Centres over the world, and we will work very heavily on those sites in order to leverage the size, as he was saying before. And again I think the experience he brings will be very helpful in this sense. So it's nice to have Paul now with me.

I also would like to take the opportunity to give a warm welcome and introduce our UK team. I think Alastair Sykes who most of you know. Alastair, I don't know if you want to get up so that everybody can see you. He is our Chairman and CEO of Nestlé in the UK. Steven Barbourer who is our Chief Financial Officer and Fiona MacKendrick who is responsible for the outstanding success we had in Nescafé in 2005.

Before I go into the strategic aspects perhaps one short remark. I was of course very carefully reading whatever has been said after the press conference, and there was one line, in one of the newspapers which I didn't appreciate too much. It was saying that all of the top-line growth of Nestlé basically comes down to that we have been delisting the Chilled Dairy business and that Alcon was growing very well.

Now, let me get this straight away, straight. The Food and Beverage business had an organic growth of 6%, full stop, okay. That's what the truth is. The Food and Beverage business was growing organically 6% and that's still on the highest side of our target.

So to say that only because Alcon was growing faster than the 6% that the whole growth of the Nestlé group is due to the Alcon growth is of course a misunderstanding, to be nice to those who write those things.

Now, I am supposed to talk more about the strategic aspect, and basically what I want to do is to take you very shortly, the Nestlé Nutrition, the European Chilled Dairy, Nestlé Food Services, Corporate Governance and then a short outlook.

### **Slide 29: The transformational opportunity**

As you know very well, we are in the middle of a transformational process at Nestlé, both on the strategic side and I have explained this to you over my last couple of appearances here. We are transforming basically an agro industry into a Research and Development based Nutrition and Wellness company, and this is a major, major strategic challenge.

But as challenging, is the operational challenge, and on the operational side what we're doing is basically we are breaking up the super tanker, and the biggest tanker that there is in the world and the fast moving consumer goods company. Even after the recent acquisition of P & G and Gillette we are still bigger in this size, and we break this now up in to an agile fleet of independent boats. Of course we will keep a strategic direction, we will have a strategic boat which will ensure that all those fleets are going in the right direction, attack where they have to attack, and we also ensure in order to leverage the size of the scale of our operations through shared supply boats. And I think this is a major aspect which is enabled of course now by the implementation of GLOBE which you have seen. Basically we have now more than 30%, 34% of our business under GLOBE, and at the end of this year we should have close to 80%. These will be the enablers on which - and afterwards Paul - is going to accelerate this establishment of shared services, outsourcing, etc, etc.

And the other thing which we are doing is we are constantly looking at those businesses which are the underperforming businesses. Today Paul was talking about the 21 brands in our stable that have sales of more than one billion CHF. Now this is quite a proud stable to have, but we also are quite aware that we still have some underperformers and we have to take care of them.

### **Slide 30: Nestlé Nutrition & steps towards a wellness future**

Now, talking about the strategic transformation a very important point of course was the creation of a globally run Nutrition business which is now standing alone, which is reporting separately. We had the first trial run in 2005 which went very well with the exception of the small incident - small in quotes - incident we had in China, but which I think has more to do with compliance and some other issues than really with the performance of the business.

This business is based on infant healthcare and performance nutrition, and basically we have now agreed with global management that we will raise of course now their targets for growth and profitability. And what I would like to see in the future is a 10/20 rule being accomplished. And this is 10% organic growth, 20% will be the margin. That would be my middle to long-term goal for this type of business

## **Slide 31: European Chilled Dairy**

Talking about the underperformers, you were rightly complaining and shareholders were mentioning that we had a lot of patience with our European Chilled Dairy business. Well, we have tried and tried, both internally – you'll remember we created even a European organisation because we thought that perhaps our market driven organisation was one of the obstacles in order to be more successful.

Finally the outcome was that no, that the loan was not good enough. Our products have performed quite well, but we were just too small. We didn't have the critical mass vis-à-vis a very strong competitor and above all vis-à-vis the private label which were eroding the branded volumes more and more. And you must have seen that even the leader in the European Chilled Dairy lost quite a lot of market share in the area to the private label businesses.

Therefore we still want and we still say this is a very important business for Nestlé, but we want it also to be important and profitable for the shareholders. And therefore we look for what I call creative solutions in order to get this business, in the market but very profitable in the market. And what we did, we basically lined up very strong local or regional players. We lined up with Müller in Germany, we lined up with Emmi in Switzerland, and we lined up with Lactalis Group in Europe. So the idea was that to make the Chilled Dairy business a good business for our shareholders as well as for our consumers.

## **Slide 32: A base for renewed growth and profitability**

We feel that these joint ventures will give us a base for renewed growth and profitability, a basis by the way the chart that I think Roddy was mentioning before that you have something different here than what is on the picture here. You see now in Euro, it's expressed in Euro before we had the mix-up between the CHF and the Euro. What you see very clearly is that Nestlé is bringing into this business is its brands, its established businesses, marketing expertise, research and development, very important. Our research and development centre, the product technology centre will work especially for these joint ventures.

Now what does Lactalis bring? Lactalis brings an enormous supply chain expertise. They have 62 factories in France, which means that they have an incredibly strong also political relationship with milk farmers which is very important, so that our five factories which we were able to bring into this joint venture are being absorbed in a much bigger mass of products. And if restructuring is necessary it's a big difference because the milk farmers wouldn't lose their market because they can go to one of the other of the factories, which we wouldn't have been able to do. They bring in it about 300 million Euros, so together we will be a business of 1.5 billion Euros, and they are very profitable and have quite accelerated growth.

You can see that the total business of Lactalis is about six billion Euros, so it is a substantial player; I would say the number two player now who will be the number two player in Europe. And therefore we feel that we have a strong base now, created a very efficient, very close to the raw materials part, and very well positioned politically which also has a value in France as you all know. And therefore we will establish - very aggressive now – a launch plan for this business.

For the shareholders as I said first of all we will have 40%, Lactalis will have 60%. But as the business, the existing business and the future business is going to be built on Nestlé brands, you have to add to this the constant and instant cash flow that comes from the licensing. So it is now the only the 60/40. Don't forget that on all of those products we have licensing fees agreed with the joint venture which the joint venture will pay to us. So for the shareholders we are transforming basically a business that had EBITA margin between 1.5 to 3%, we're transforming this into a business which becomes immediately very attractive from a cash flow perspective.

### **Slide 33: The attractiveness of Food Service**

Now the next business that we will look into is the area of Food Services. This is a big, growing opportunity. The market is growing by 5 to 7% whereas the retail market worldwide is growing almost 1.5 to 2%, so this is a market which has a substantially higher growth than the retail market. It is a huge market - it's about two trillion of CHF are being spent by consumers all over the world. The relevant market for us which we are looking into is about 400 billion CHF. 80% is in food; 20% today is about the beverages.

You'll see that Nestlé is already today - it's not something that we have to discover - Nestlé is the worldwide leader in food services, with turnover of 6.6 billion which makes quite a big difference to number two which is Kraft and number three which is Unilever, and then Sara Lee as you see there. But interesting also is to see the latest figure where you see that all of us, all the big players of the world still only make 3% of the global manufacture market. So there is a huge opportunity for consolidation and for further driving this business.

### **Slide 34: Five Strategic Business Pillars of FoodServices**

That's why we looked at it very, very carefully, and we have decided to concentrate ourselves on five strategic pillars in this business. One is on a global base - global beverages. Beverages per se are being managed much more globally; there are more global brands on the beverage side. You see here we have identified two different pillars. The first one is the standard where we have been today, which is basically vending machines and those things. This is about a 30 billion market. Relatively low growth for this - it depends on the countries, zero to 3%, but it is a very good high EBITA margin. Beverages normally have higher EBITA margins than food.

The second one is a proprietary solution. That's the one that is really starting to grow very strongly. This is when you're talking about the McDonalds and you find the system, proprietary system which you only develop for one customer, one of the big customers. This segment is growing by 5-10% and delivers very high EBITA margin, and we have of course a unique opportunity by being, clearly the leader in the coffee segment and the leader in the chocolate beverages and also the leader, or co-leader at least in the tea area. Now on the food side where we have three pillars - we have the standard food which is the hugest market, 230 billion of CHF, but the market that is really not growing more than I would say the retail market and where the EBITA is relatively average. This is a market that was basically created by taking retail products and putting them into bigger packaging. Basically that's very staple items, but it is a very huge market.

The other one is the ready-to-serve. It is still relatively small - 15 billion, if you want to call this small. Growth is quite interesting, 4-6% growth, and products like the newly acquired

Hot Pockets of course are in this segment a very important tool in order to participate. And then you have the high growth area in the food which is 5-7% and this has to do with customised food like for example for Kentucky Fried Chicken or for Burger King etc where you really develop products which again are exclusive, specialised for one customer. This is today already an 80 billion business and as I said high growth, 5-7%.

### **Slide 35: FoodServices Strategy**

So those will be the five strategic business pillars that we are going to develop, and basically we have decided that this opportunity that there is with this high growth potential demands perhaps an even more focused approach and this is the reason why we have decided to create a strategic business division which will report directly to me. A little bit like I did about 10 years ago with the nutrition business, as I also started with the nutrition business division, and we have had I would say the advantage that we were able to attract Mr Marc Caira. Marc is today the Chairman and CEO of Parmalat North America. He did an outstanding job during this very, very difficult time of our competitor to keep Parmalat North America profitable. And I think through being this one at least profitable helped the whole business of Parmalat could survive.

Marc was before for 20-some years our Food Service manager in Canada, so he knows us of course very, very well, has now achieved an incredible experience, additional experience for many years as Chairman and CEO, and I am very pleased to say that on the 15th of May he will join us and he will take over this new job, being part of the executive management team and being appointed deputy executive vice president. So this will be a new priority setting for our organisation, a new sales channel that could grow substantially faster than the retail one. And this always forms part of why we can commit to our shareholders that we will continue to have a 5-6% organic growth, combined with an improvement of the EBITA margin. This continuous improvement of the EBITA margin can only come by the combination on the one hand to continuously strive in order to improve the efficiency, and on the other hand to adapt and to change our product portfolio.

### **Slide 36: Corporate Governance**

Let me come to the question about Corporate Governance, a question which I know is at the heart of many of you. You might know the situation of our articles of association which are articles which have been approved by the shareholders in 1989. At that time basically we had proposed to the shareholders to introduce a one share base in our corporate structure. Up to this point of time you had to be a Swiss citizen in order to be able to acquire and to register shares. Therefore we had two thirds of all of our shareholders were Swiss by definition.

Management at that time thought that this was not any more modern, and therefore proposed to the Swiss shareholders to give up this privilege and to open the company up to all shareholders of the world. And the Swiss shareholders at that time before voting in favour of this demanded from management quite stiff articles, and changes in the articles, and they have to do with that nobody can have more than 3% of the shares with voting rights. This has to do that any changes of the articles have to have a presence at the shareholder meeting of two thirds of all shares, and that then afterwards any resolution would have to be taken by three quarters of the presence in the shareholder meeting.

Now you might ask yourself why two thirds and three quarters. Well, if you make the calculation you arrive at 51%. The idea was that nobody should be able to take over the company, if not at least 51% of the shareholders would vote in favour of that. That was the reason why these articles were being established. At that time there was no Swiss legislation which obliged anybody who was acquiring more than 5%, 10% or 30%, 33% to declare this to the public. There was a completely different legal setup.

So we were trying and we made the shareholder survey which many of you participated in. As a matter of fact we had 25% of the shareholders responding which was quite high. We were pleased with that, because we saw that this was really an issue shareholders were worried about. And the outcome was I would say enlightening. It didn't make our lives much easier, but it was enlightening in the sense that what you could feel is that everybody wanted to change the articles. Everybody understood that you have to modernise the articles, but there were two different currents. There were I would say mainly you, the institutional investors, who in the meantime make about two thirds of our investment is now institutional investors who wanted to have a complete opening, opening up limited article three, limited super-majorities and things like this. And then you had about one third - and those were mainly individual shareholders – who insisted that we should maintain the articles where we have the 3%; we should maintain the super-majority, because they are still very much afraid that something could happen to the company.

Now, the board looked at that very carefully. One thing that we realised was that as we are today we are basically blocked, we cannot move as a board, because we will never get two thirds of all shares, shareholders into one room. Because we have today more than one third of our shares as so-called "dispo" shares, which are shares which have not been registered and therefore they don't have any right to vote. So it is impossible to have even if you get everybody who has been registered into the room, which is almost impossible, but even if we did that, we still wouldn't have sufficiently people present in order to change any of the articles of the association. Now, you see very clearly that this is a blocked situation.

We have therefore worked over the last couple of months very carefully with our lawyers in Switzerland, corporate governance lawyers especially, in order to see how we can find a way out, how we can find a breakthrough into this situation. And what we are going to do is we are going to propose in the forthcoming shareholder meeting a new article, a transitional article, article 37 where we are asking that the shareholders mandate the board for a full revision of its articles of association, and that this revision whenever it will be brought to the shareholders for approval, would then be approved with a two third majority vote but not with the limitation of who is in the room. So if we have 40% then it is two thirds of the 40%. It depends how many people will be in the room. This would allow us a breakthrough.

Now let me also say quite frankly there is a legal risk to this, there is no doubt. If any shareholder wants to put a question mark, he can go to the judge and say that this is against the articles of association because we are basically violating the articles of association, okay. But it's the only way that we find a way out, and the stronger the support is that we will get from our shareholders for this motion, the higher the probability that in a legal case afterwards we are able to move forward and that the judge would say "Yes, but the broad majority of shareholders want to have a change. Therefore although

legally you can discuss about it, it was the will of the shareholders and therefore the company has the right to start with the renovation of the articles.”

I mention that because I think it is also in your interest to understand what we are doing, why we are doing it, and frankly also to ask you for your support. If you want, please ensure that you participate and that you express your opinion, whether you want to change these articles or whether you want to live with those that we have. But from all that I have heard, from all that I have seen and all the discussions I have had, especially you, more the institutional shareholders, are interested in order to open up those shares, and this would give us the possibility to do so.

### **Slide 37: The Four Factors of Group Sales 1996 - 2005**

That's about Corporate Governance. Now let me finish with this by putting the 2005 results into perspective. I think it is always important that one looks at how a model works over the longer run. You see here our 10 years now performance. You will see that first of all our organic growth over the 10 years was 5.7%, and what you also will see is that the acquisition growth was exactly 1%. So I always have to smile when I have to read in the newspapers that Nestlé can only grow by acquisition, and mostly very expensive acquisition.

The fact is that over a 10 year period 5.7% of our growth came from organic growth, came from our own innovation, renovation, from creating new businesses, and only 1% even though in this period we had huge acquisitions like Ralston Purina, Chef America, Dreyer, Schoëller Yet if you look at it over a 10 year period they make exactly 1% of our growth, okay. So Nestlé is growing like we have always said by concentrating on our organic growth, and we are using acquisition as additional growth but it's not external acquisition which is driving our growth.

The other thing which might be interesting in this chart is the question about the exchange fluctuations. You see that the exchange fluctuations are extremely high and have a huge impact on our business. I mean over the last four years we lost about 25% of our turnover was lost, only due to exchange fluctuation. This was enormous. But if you look at it on a 10 year period it's minus 1.4%. And I think again if you take this one into account you will understand why I don't believe there is any reason that we should be changing just because of exchange fluctuations to any other currency in the consolidation. We feel that the Swiss Franc over the long run is quite a stable currency which flattens most of those fluctuations out, but you have to have a longer term perspective.

### **Slide 30: Group EBITA Margin over last 10 years**

And then finally about the EBITA margin over the last 10 years. When I started I promised that we would have 5-6% organic growth combined with an ever-improving EBITA margin, and you can look at the chart by now and you will see that with the exception of 2001 where we had accounting changes if you remember, there's one line in one direction. Every single year, Nestlé delivers improved EBITA margins.

Now you can say they are not spectacular. No, but they are sustainable and fixed. We have not gone back once. This company has delivered every single year a high EBITA margin, and if you look at the combining effect now between the top line growth combined

with this improvement, the improvement of EBITA in the year 2005 was more than one billion CHF. We created an additional one billion CHF by improving 20 basis points our EBITA margin last year. And I think what is important at least for me is how much EBITA we are really creating, and not whether I have 13.5 and have then less sales.

Let me say also another thing just for between ourselves. I have read there is disappointment because we didn't get to 13%. Ladies and gentlemen if we wanted to get to 13% we could have done that very easily. We could have given you 13.1%. Because we took all our one-offs and put them before EBITA. Now, not all companies are doing that, and you have seen that the one-offs that we had last year which we could have justified perfectly well as below the line were 25 basis points. So if it was really just in order to show that we are getting to 13% or 13.1% just with one decision, we would have done that. But I think it is honest and it is much more transparent to our shareholders to show you what it is. We had some one-offs last year. We assumed them; we put them in the operational part of this business. That's the way I believe it should be, and not trying to get just to 13-13.1%. So if we wanted, we could have the 13 or 13.1% but I feel much more safe on this side, and we have been able in spite of this to improve again our margins. And I hope that for this year again we will be able to deliver that.

**Slide 39: Nestlé Nutrition & steps towards a Wellness future**

And the last subject perhaps is about this management of capital structures which is also a subject that I hear very often. Well, I think we are managing our capital structure very responsibly. If you look now at what we have been giving back to shareholders, where it was always said "Nestlé has such a conservative approach to these things", well, I think we are giving back quite a lot to our shareholders. In 2004 it was 2.8 billion, in the year 2005 it was 4.5 billion, and this year it's going to be 6.2 billion CHF which we are giving back to shareholders. So I don't think that anybody can say that Nestlé does not return cash to its shareholders when we feel we have the possibility to do so, and we have been doing that and we will do that also in the future.

**Slide 40: Outlook**

And with this I stop my part with a clear outlook that I expect that in 2006 for whatever can happen we should be able once more to deliver the Nestlé model of 5-6% organic growth combined with a further improvement of our EBITA margins. Thank you very much.

**Slide 41: Q& A Session**

**Questions from London Roadshow, February 28<sup>th</sup> 2006**

**Questions on: Input costs for 06, Food & Beverage margin target, Increased savings from GLOBE**

**Alex Molloy, Credit Suisse**

I've got three questions, quite short though. The first one is on input costs. Input costs net of the pricing minus 50 basis points or so in '05. How do you see that in '06? The second question is why do you not have a target of increasing Food and Beverage margin or a Food and Beverage margin target, given that this is where the efficiency initiatives are?

And the third question is, 80% of the business will be on GLOBE by the end of the year. Will this help you to make savings, give an increased visibility on your business in areas such as procurement?

### **Paul Polman**

The input costs net of pricing, let's just start with that for a second. Obviously in 2005 we've seen a tremendous increase over the year in most of our input costs, and you're familiar with the costs of energy. Who would have thought it would go from the 20s to the 60s? You've seen that translated in coffee prices; you've seen it in sugar prices. You've seen it in many of these materials.

Now what has happened very simply is that these costs have increased during the year. We do expect them to level off in 2006, but I do want to point out that you'll get the full year effect of a year to year increase that you'll be seeing. We think that it's less inflation that we have in these materials as we've seen in 2005. And we also think that our savings programmes that we fortunately have - because as you know Operation Excellence and FitNes will run through 2007 and then become part of the normal operations, partly driven by GLOBE that is obviously there. But once we get with these savings programmes it'll be more than enough to offset the cost increases that we see.

Your second brief question is on 80% of the business in GLOBE at the end of the year, are there more savings coming. Obviously when 80% of the business is on GLOBE one of the main elements of GLOBE as you well know is to get first and foremost best practices in the company, and that's already a benefit and a key enabler for some of these savings of Operation Excellence and FitNes that you're seeing. Another one is a common database and then obviously a common infrastructure that we put behind that.

When we have 80% of the company on GLOBE it will be, as Peter has alluded to, a key enabler for us to move faster to what we call Nestlé Business Services, grouping and aggregating some back room services, selectively outsourcing, and we would not be able to get to some of that without GLOBE. That brings you to the procurement part as well. If you look at the main savings that we have there, it's probably in aggregating or buying at higher levels and getting that skill. Continuously when we look at Operation Excellence, savings, and for some of the office parts and the FitNes savings we see that a lot of that, more than half of those savings continue to be in area of procurement. We've made some progress there, there's absolutely no doubt about that, but there are certainly tremendous opportunities still.

A little example of that: as you can see there's an efficiency increase in our total marketing spend', the PFME as we call it, and one of the wonderful examples there is global media buying. The company has moved from a fairly individual by-country media buyer to a scaling-up, only working with two big media buying houses. So that is a wonderful example of procurement leveraging scale, and as a result the cost of media goes down. We can get more efficiencies in our PFME spend. That's what you see in the results that are being published, but far more effective use of our money and we continue to do that.

On no target this year - your third question - on no targets for Food and Beverages etc. We're one company that's called Nestlé that has the target out there, and everything is part of Nestlé and the Nestlé strategy. So to start breaking up individual targets.... Peter

has a challenge that he just gave to Nutrition, that is well understood. Each individual business unit within Nestlé being run by the responsible people like Alastair in the UK or Richard Laube for Nutrition, they will have their targets. But for the company to start communicating externally each of these individual targets I think would not be a good idea, that would be micromanaging it.

We have a total model which is called the Nestlé model that we're trying to year-on-year improve on. Does that mean that Food and Beverage performance is fine? No, we can continue to improve that. I think over time when you see all Alcon who has had a stellar performance, perhaps become less of a contributor to some of the growth, and Food and Beverage to carry even more of that weight. There is no reason why that cannot happen. So internally yes, externally I'm not so sure, but obviously I'll see if Peter wants to add to that.

### **Peter Brabeck-Letmathe:**

No. I think first of all very clearly we have targets and we have internally of course targets as it was said for all the businesses. But secondly I mean we are very clear, we have always talked about the group and it is a group performance that we are looking for, and this is I think what we have, what we are delivering.

If you talk about improvements, you cannot do this improvement without improving the targets for Food and Beverage. It's like the growth as I said before. Yes, we have 6.2% organic growth with Alcon, but this doesn't mean that the Food and Beverage business is not growing. It is growing by 6%, otherwise you cannot get an organic growth of 6.2 if only Alcon would be growing by 10%, okay. And the same is with the margins. If you look from 10.2% to 12.9% we would not have been able to do that if the Food and Beverage would not have improved those margins.

Now in 2005 it is true that if you look like-for-like, basically our food margins were stable. They did not grow in 2005, this is true, you can see that and we have shown this as transparently as we can. Now, you can say this is good or bad. I think in a year of the pressure that there was in the area of raw material costs, and taking into consideration the one-off cost which I have told you if I had been, if I want to manipulate I put this 25 basis points into the food because the whole thing was in the food, okay, and you would have a 25 basis point improvement which is exactly what we have been doing in the past. And we didn't do that, and that's why I explained to you. Why? Because I feel much more comfortable by putting it into above the line instead of putting it under the line, frankly speaking.

But you cannot improve; you cannot deliver what I have shown you we have delivered, if you're not constantly improving the food and beverage margin. This is where 93% of our business is, and you cannot with 7% of the business improve the 93%. It's impossible.

### **Alex Molloy, Credit Suisse**

Just one slight clarification on the input cost question. On the pricing side of that equation with the pricing programmes you've already implemented to recover pricing from '05 do you expect pricing to be 1-2% positive in '06 similar to '05?

## **Paul Polman**

There will be a positive effect on pricing. If it's 1-2% that might be a little bit less than what we've seen in 2005 for exactly these input costs reasons that we talked about. So obviously there will be a difference between organic and RIG. I'm not sure it will be as high.

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| <b>Question on:            Outsourcing of manufacturing base, Innovation partners</b> |
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## **Victoria Buxton, Lehman Brothers**

Good afternoon. Paul, both in the full year conference call and again today you've touched on the potential to outsource both to the manufacturing base but also mentioned outsourcing innovation ideas. Could you give us a sense what percent of your manufacturing base is already outsourced and where you believe the potential to be going forward. And on innovation what do you see the potential to derive innovation partners to be going forward and is this a change in direction from the Nestlé that you've joined?

## **Paul Polman**

Nestlé has a very long history actually and a fairly extensive use of third parties in manufacturing, especially when you get to food and food service. You'll actually see that – Peter probably has the numbers - better, but we probably have more external partners than internal ones.

## **Peter Brabeck-Letmathe:**

I was just thinking, don't quote me now on the exact figures, but it is somewhere around 1200 factories which are outsourced basically, and we have about 470 factories which are ours. So it is a substantial amount which is being outsourced and which we are bringing products in from outside but those are normally small runs, especially as you are were saying in food services where you have to tailor-make things, small runs and things like this. So co-manufacturers it's about 1200 all over the world.

## **Victoria Buxton, Lehman Brothers**

What about on innovation?

## **Paul Polman**

Innovation, because everybody answered on how much do you spend on R & D and is it going up or is it going down, and I've been saying that for a long time these are meaningless figures. Because really innovation can come from anywhere and anybody could work for you on innovation. We have wonderful suppliers, or partners as we call them in Nestlé that we work with that bring innovation, be it the perfume houses or be it some of our suppliers for packing materials or some co-developments we have with universities on certain technologies and that goes on.

It is very clear that in the world that we're living in with the fast change that we have that innovation can come from anywhere. Any company can figure out that there are more engineers or PhDs in chemistry or whatever you have outside of the company than inside

of the company, and we always ought to worry about the garage next door that might obsolete any of our products. At least that keeps me awake at night.

Just as a small anecdote - I took my children to the Nobel Prize Museum in Stockholm not long ago and I used to know all the Nobel Prize winners. When I was at school these people were in the A & T labs or in the Bell labs, and now it's all the Chinese or the Indians that you've never heard of, and usually they've worked by themselves on some wonderful technologies. So companies that are going to succeed in the future are companies that have an open innovation system and are able to tap into that and extend their network way beyond what we can do internally. That's true R & D in that sense. Then obviously the strength of a company becomes its ability to commercialise it, and innovation is only as good as you commercialise it.

So where is Nestlé on this scale? It's a little bit pretentious to say we are on this scale because it's difficult to measure. We certainly have many examples where technologies come in from the outside. The company also is a very open company in working successfully with a lot of partners, be it with the BPWs or CPWs and others. There are a lot of examples of a capability to work with outside partners, and we certainly have some innovations that we've brought to the market that have big inputs from other partners. But these are areas that we will continue to drive, and have to.

### **Peter Brabeck-Letmathe**

Perhaps two remarks additionally. First of all there is always this question mark whether a big company like Nestlé can really create I would say breakthrough innovations, and of course you don't have breakthrough innovations every single day and we always refer back and say "Well, Nescafé was a breakthrough innovation. Today 26% of the total coffee market, roast and ground and soluble included is Nescafé." I mean this was the breakthrough innovation.

But let me take another one which we are very proud about, Nespresso. Nespresso was a breakthrough innovation because what we did, we made the roast and ground coffee individually accessible, the individual cup. Today of course now that we have this success, now everybody comes from roast and ground into the same direction, but this was a breakthrough innovation and where we still have today and outstanding position. We are growing this year. We're going to be hopefully a one billion CHF business which we created from zero. There was nobody around, not even retailers, so we don't sell them through retailers. We only sell them directly to you, to the consumers. Now that was a concept developed 13 years ago, 14 years ago.

Another breakthrough for me, a breakthrough innovation which is today not highly on your radar screen, Laboratoires Innéov. Laboratoires Innéov is a joint venture with L'Oréal. It's a completely revolutionary way of how you can get cosmetic impact from a nutritional point of view and we can strengthen your skin by having a nutrition product. We can make the density of your hair stronger by a nutrition product; we can get your dry skin better by a nutrition product. Those are breakthrough innovations that we have been putting in. Now, for the time being there are not yet so much on your radar screen which they shouldn't be, they don't have to be. But believe me one thing – in 10 years from now we are going to have another billion business created from zero from just an idea.

So I think Nestlé is quite strong now. Add to that the two things we have been doing. One is a venture capital fund and the second one is on the growth fund. On the venture capital

fund what we are doing, this is an R & D tool, this is not a finance tool. The venture capital fund is basically screening the radar of the R & D activities outside of the food area in this territory between food, pharma, personal cosmetics, what's happening there. And the growth fund is enough to take those initial ideas and make them, put them in the market until they get to a certain size of about 100 million and then we can absorb them in. So here we are working again with the outside world very strongly, and Paul is on the board of both of them - venture capital and on the growth fund.

So I think you see a company where renovation, innovation is extremely high on our priority list and it's one reason why we are able to have I mean this 140 year company running like a relatively young company I would say.

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| <b>Question on:</b> | <b>Impairment test for North American Ice cream, European Petcare margins</b> |
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**Mark Lynch, Goldman Sachs.**

In the accounts you talk about the impairment charge or test rather for North American ice cream where you're projecting that your margins will increase by 50 to 90 basis points per annum over the next 10 years. Could you just run through what's behind that? Is that mix an operation gearing or is there something else? And also could you perhaps comment about European PetCare margins?

**Peter Brabeck-Letmathe**

Yes, I think when we are talking about the impairment test we, as you know, adhere to the modern accounting standards. We have to do the impairment tests and we have to disclose the full details, and therefore you refer to the one for Dreyer's, the acquisition that we have been able to finish this year. The reason why we are confident about Dreyer's to achieve this improvement of our profitability is that in the last couple of years, mainly since we have been acquiring this company, we were in an extremely intensive both marketing but also supply chain restructuring. On the marketing side I think you are all aware about the outstanding performance of Dreyer's, based upon a new technology which the brand of this is Slow Churned. This has revolutionised the American market, and Dreyer's had a volume growth of about 10% for the last couple of years.

This 10% growth of course had the major impact that our factories were running out, the supply chain was not up-to-date because there was so much growth, and this led us to make a very substantial decision, namely to build two new ice cream factories, one on the West Side, in Bakersfield, and one on the East Side in Laurel.

Now while we are building these factories we had to ship ice cream from one side of the continent to the other side of the continent, especially in 2005, and this is extremely expensive of course as you can imagine. So we had very high distribution costs this year which were mainly due to warehouse, renting and shipping around those products. Bakersfield is now fully working, so we will have already as of the beginning of 2006 we will have a substantial decrease of those distribution costs, and Laurel should be going on stream somewhere in May, April/May of this year. And then we will have really the two biggest ice cream factories of the world. Today Bakersfield is the biggest one, Laurel is going to be still a little bit bigger than Bakersfield, and both of them basically running hopefully very successfully. And this will bring our distribution costs down, and we will

have this heavy investment cost that we have up to now will be slowing down. That's why we are believing that we will get the improvement of our ice cream margins now.

We were of course looking at those figures very carefully. They were checked by KPMG, they were checked by management, and regarding the management we're also very happy to be able to say that Gary Roger and his team have agreed, Gary at least, to stay for another two years, which means that have the founder and the father of this incredible success for another two years with us.

And although we have now withdrawn the company from the NASDAQ stock exchange – you know, it was a publicly owned company until January of this year – we have now 100% of the company, we have withdrawn it from the stock exchange. We will keep the management of the company under Gary Roger and under the supervision of the fiduciary board where we will keep the three outside independent directors on the board, because we felt that their experience - they were people who were also in the ice cream business and distribution business – is still very valid for the next two years. I think two years from now, at the end of 2007, we will then fully integrate it and only then into the Nestlé organisation. So we are very confident that we should be able to achieve that plan as it is laid out in the books.

**Mark Lynch, Goldman Sachs.**

And European pet food margins seem relatively light. Can you just talk about your plans there and what your ambitions are in that business?

**Peter Brabeck-Letmathe**

Yes, well, I would say the European pet food margins are light. You might remember that not so long ago we were the number six player in pet food in Europe, and over the last couple of years we have achieved leadership in Europe. Today we are the leader in Europe which I think is quite an outstanding achievement. But it is also true whenever you are in such a position, this is a time of investment, of factory closures, of adjustments and things like this, and therefore our margins are not as high as for example in the much better established North American market.

If you look at the North American pet food business we have outstanding margins combined with good growth. In Europe we have been fighting our way up into market leadership which we achieved now, and I think from here onwards also again you will see hopefully less investments and therefore you should see a further improvement of the margins. That's why I'm also relatively confident.

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| <b>Questions on:</b> | <b>UK Confectionary business, Underperformers,<br/>Nutrition Sales base</b> |
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**Warren Ackerman, Citigroup**

I've got three questions. The first one's for Alastair Sykes on the UK. I was interested to see your comment about UK confectionary being a one-off issue. One might argue that you've been losing market share in the UK for much longer than just one year. Could you walk us through what's happening in the UK, where your share position is, and why the UK is proving so difficult to fix in confectionary. That's the first one.

The second one is for Paul. You mentioned that there was a strong focus on underperformers. Now that chilled dairy is out of the portfolio – well, in a JV – how would you rank the remaining underperformers within the portfolio? And finally on nutrition, interested to see that the sales base was up 7.6%. Could you actually tell us what the sales base was? I didn't see that in the press release. Thanks.

**Alastair Sykes, Nestlé UK**

Maybe I should start by saying I don't remember saying that the UK was a one-off. But what is a one-off is if I explain the market share actually last year for UK confectionary was stable. We remained at around 16.1% of the market, and actually if you compare that against our two big competitors that was a good performance. So market share was stable. In getting to that market share, there was a profusion of activity. There was an enormous amount of new product development, there was an enormous amount of variance and varieties going out into the marketplace, and that has had an effect on our manufacturing costs primarily, and that is what is the one-off.

Now our whole strategy has to be geared a lot more around fewer, bigger core brands and ongoing above-the-line support for those brands as opposed to the prolific activity that there's been in the past, and that's what's a one-off. Market share will therefore come as a result of that strategy. Does that answer your question?

**Warren Ackerman, Citigroup**

What about the new management team that was put in place last year in the UK?

**Alastair Sykes, Nestlé UK**

What about them?

**Warren Ackerman, Citigroup**

Are they still there?

**Alastair Sykes, Nestlé UK**

Yes. We have a new managing director for the Rowntree business who's been in place for three months, and we also have a new marketing director. The rest of the team has been in place longer. But yes, they're all in place, they're all extremely good people who I have every confidence in, and I think they can do a great job in that business.

**Peter Brabeck-Letmathe:**

I think it's interesting if you allow me, because this is a typical example of where we have somebody who has done a fantastic job – Chris White did a fantastic job in Australia to fix our ice cream business. And due to this success story we asked him to come over and to try to fix our Rowntree business. There was only one hitch with this thing. He applied the ice cream model on the confectionary model, and once more we have to learn that in a complex company like ours there is not one model that works. What is good for ice cream is not good for confectionary.

You see in the ice cream what you are doing is basically every year you have a new season, every year you have to bring forward new products. If you are not dynamic, if you are not constantly bringing out new products you will be out of the impulse business. Now what he did was exactly the same thing in confectionary, every three months there was a new product and every three months there was a new brand and every three months it was like an agitation, launching new product which on the one hand helped very much because we regained market share.

But what he didn't understand is that the business model in confectionary where you have a relatively heavy industrial setup, this complexity that he had created, created so many hidden costs that at the end of the day the costs were completely out of hand. So it was really the application of the wrong model to the wrong business which really made him fail. That's basically what it is very simply, and I think it's so important – this is what I tell all the time – don't ask me what is the model of Nestlé. There is no model of Nestlé. There has to be a model for ice cream, there has to be a model for water, there has to be a model for Nescafé and there has to be a model for sweets and consumables. And if you don't understand that, and if you don't want to accept that, which is in complexity, you will not be successful in a company like ours. That was the real problem we had.

## **Paul Polman**

So let's take the easy one first for a second. There's Nutrition, the 7.6% that we put up there. I did mention but I want to restate that again. We've corrected for this one-off China effect, so that's the underlying growth of the business. And obviously now that it's a standalone unit we will be reporting that, so it's also good to share the numbers. It's 5.2 billion in turnover, and it is definitely the number one player in the industry producing that growth, so that's the Nutrition.

The second question is now what is the focus on underperforming businesses after Dairy, if I may summarise it, and obviously the Dairy venture with Lactalis needs to be put in place over 2006 and we need to make that work effectively, and that's going to require some time and effort of the organisation. It's extremely important for the company that that works, that Chilled Dairy continues to be an incredible carrier for Nutrition, Health and Wellness. And that's one of the reasons why the Nestlé brand is so important in that venture that Peter explained and I think that cannot be stressed enough. We are putting our technology out there. We are building our brands there. We're just doing that in a better structure than we can do alone. It's an extremely strategic category, much like it is with Fronterra and dairy partners of America in the part of the world, or with Müller or Emmi in Switzerland or Germany, the different formulas to do that.

So I would not just cross that off and say, you know, that's not strategic or something. That would be wrong. Then it's very clear that there are other challenges that any company has of the size and portfolio of Nestlé. There will always be some businesses that either have competitive pressures or market challenges, and the first thing we'll do is to obviously continue to look at businesses that are being commoditized where you can't really add value.

A good example is of the recent divestiture that is underway of the Canadian potato business or the Eismann business. Nestlé has always done that and will continue to do that like any company will do, like weeding and feeding your garden for good housekeeping. Those are just commoditized segments that you get rid of, and we will

continue to do that and there will always be a few hundred million CHF in every year in my opinion.

And then there are some businesses that Peter has talked about many times, that we just need to look at how can we make them more profitable. We have the Chilled business. We've talked about the challenges in Confectionary. We just need to work and see how we can make that more profitable for the company. We have the home office delivery business on water - the European context that we certainly deserve better performance now that we are reorganising and consolidating that business.

And so that is what we will be focused on – strategic businesses that we know we can get better financial performance out of those. Either we change the structure – Food Services are a good example of that. We don't have to be ashamed of being number one in Food Service. You don't get there, you know, with dummies as I call it, but our business was not growing the way we thought it should be growing, and certainly not as fast the competitive set, and that's not right for a number one player of the stature of Nestlé. So changing the structure, putting the right people in place, having a focused strategy will also get translated in the financial performance

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| <b>Questions on: Cost of goods sold, Raw material and packaging costs</b> |
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#### **Ian Kellet, Blue Oak Capital**

I note with interest your slide on the evolution of cost of goods sold, and think back to I don't know, maybe 18 months ago when you told us that your auditors or you as a management team would no longer publish the raw material and packaging costs because it was an estimate that your auditors effectively weren't prepared to sign off, and I wonder whether the systems, developments in the group in the last couple of years have got you to a point now where you are able to publish the raw material and packaging bill for the company, and to what extent that's underlying those charts?

#### **Paul Polman**

Well cost of goods, obviously the cost of goods that we report very much includes the raw material and packing material cost, so that is part of what you see on the chart. But it also includes the efficiencies that are coming in with programmes like Operation Excellence. So what you see here, and compared with some other people in your competitive set, you see here 41.7% that has been able to stay constant when most others would report a worsening of these numbers.

So for example in water which is a standalone unit that we report on, you see a 20 basis points decline in margin which is relatively little compared to the cost pressures we've seen in PET and energy for example for that category. Some of our comparable players outside of Nestlé that we benchmark ourselves with are reporting margin declines of 150 basis points there, so it shows you a little bit how the efficiency programmes are working for us in the company.

But cost of goods sold is very much an indicator of how well you manage your cost, but it is also a little bit more. I think it's also an indicator of how well we manage the mix of our brands, because when we were talking about these branded added benefits and differentiating our products more, then obviously you do that to satisfy consumer needs, but you also do that to be able to capture more value. As we are transform our portfolio

over time, our brands, and as we are able to bring bigger benefits to the consumers, then by definition our cost of goods element should come down, because we are capturing higher margins and more value. So we continue to focus on that line.

Your second question is would we publish in detail the packing materials or raw materials on top of this cost of goods line, or could we do that or could we not do that. Of course we could do that if we wanted to. The question is, is that meaningful to put all this data out there. Here you have an aggregated figure that probably is more meaningful than talking about any individual element of our cost base.

**Ian Kellet, Blue Oak Capital**

So you are in a position today to be able to publish the raw material and packaging number with your order to sign off, if you wanted to?

**Roddy Child-Villiers, Head of Investor Relations, Nestlé SA**

The pie chart that you're referring to, the much-loved pie chart that used to appear in the annual report, that did not show, that did not relate to the P&L. That showed the spend during the year on packaging or raw materials, and of course you go into the year carrying stock, you leave the year carrying stock, so it didn't relate to the P&L. It was therefore perceived to be somewhat inaccurate, and it was under that pressure that we removed it from the annual report.

**Peter Brabeck-Letmathe**

We published it but it was you – not individually, but you who said that this is not relevant, take it off. That's what we did.

**Roddy Child-Villiers**

The number you're looking for, I mean raw materials is approximately 20%, packaging is approximately 10%. Those are the numbers, and they won't have changed dramatically since the famous pie chart.

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| <b>Questions on: Nutrition target, Problems in China in 2005</b> |
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**Sylvain Massot, Morgan Stanley.**

Questions on the nutrition business. You shared with us your target for the margin of 20% of this business, but could you tell us where you stand at the moment are you going to achieve this target? Is that mainly through introduction of new products like NAN-HA, or do you also see a room for restructuring? At maybe at the same time you can share with us where you stand in China after we see the problems of 2005. Is that now completely behind us?

**Peter Brabeck-Letmathe**

Well, first of all I told you this is my long-term target for this globally managed nutrition business. This business as I mentioned before has different parts. Some of these parts already have margins like this, frankly speaking, and higher. And some of the parts because again this is new to our company, we are in the modern investment phase, if you

talk about our infant formula business, well, I think we don't have a major issue to achieve what I have just mentioned. If you are talking about our baby food business we are substantially below because we are not a leader in the baby food area.

If I talk about our performance nutrition, well, we are not there because this is a still a relatively small business where we have to find our way through. We are trying, we are learning, and there our margins are not yet, and if I talk about the clinic business or the healthcare business as we call it now, well, this is a very strong growth business which demands a lot of investments which has to do with visitors, hospital visitors etc, etc. So my idea is and that's what I shared with you is that the totality of all this business should be able to deliver in the longer term a 10% organic growth and a 20% of EBITA margin on average between all these businesses that I mentioned before.

Now talking about China, I would say first of all the issue on China, from a government relationship aspect, because we should never forget that there was a few coincidences that there were thousands of Chinese containers being retained in Europe at the moment where perhaps as far as I know every single of the European companies had one or the other compliance issue in China. It just happened by coincidence.

But first of all this issue is fully behind us. I was personally down talking with Premier Hu and after my meeting with him in the People's Hall he called in television and said in public that from the government perspective they are very happy that Nestlé continues to invest in China and we get the blessing which in those circumstances in those countries sometimes is quite important. So this one is done.

The business outside of nutrition is running normally. We are back at the normal growth rate which you know were double digit, interesting double digit figures. Our business is running very well. In the nutrition area we are still suffering. I mean the impact when you have 126 newspapers talking publicly that these products are not safe, when you have all paediatricians of the country receiving an order from central government that they are not allowed to recommend a Nestlé product in that paediatric area, this has a major impact. And once you lose a baby, you don't get it back. A mother who is started on a different product is not going to change afterwards because a chairman decided that now we are acceptable again. So the mother is on a different product and finishes the period where she uses infant formula and follow-up milks with a new brand.

So this was a major issue. It is still affecting our business, we are still not back to 100%, but I hope that after a nine month period – because that's basically what it is, you have to get a new generation of babies in there – that basically after a nine month period we should be back to where we were in the nutrition business. But the rest of the business is doing as well as it doing before.

**Sylvain Massot, Morgan Stanley.**

And just on my second question about the success of the launch of NAN-HA, can you comment on the performance in the main markets where it's been launched to date and to what extent it's responsible for the market share gains?

**Peter Brabeck-Letmathe**

I think it was an outstanding success, frankly speaking. I think this was the event that we had in our infant formula now from many, many years. We are today in 20 markets

already. You correct me if I'm wrong but I think we are in 20 markets, 30 markets already as of today. This was where we saw also and we tested for the first time the new organisation, because last year we had the trial run all year already with the globally managed nutrition division, and we could really see how this new structure in the case of nutrition is working extremely well and which has allowed us really to gain market share in a substantial manner. So it was a big success, and we have 10 markets to come up this year. I think there will be 40 at the end of this year, so that's a very great success I must say.

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| <b>Questions on: Nestlé Accounting policies, Triple A credit rating</b> |
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**Julian Hardwick, ABN AMRO**

I wondered if Paul could perhaps talk about one area where a new CFO would typically be expected to have a look at the company's accounting policies. Are there any changes that he envisages making in that area? I'd be particularly interested in his thoughts on how Nestlé accounts for sales relative to the other FMCG (Fast Moving Consumer Goods) peers. And secondly could you indicate whether the board is giving active consideration at all to abandoning the triple A credit rating?

**Paul Polman**

That's a handful of questions. On the first one, on the accounting policies and if we're contemplating any changes on that, this environment is extremely volatile anyway, implementing all the new international accounting standards. You've seen of the restatements that we have in there, be it for share based payments, be it the way we account for goodwill, be it the discontinued operations. All these things are rapidly changing, so to introduce more changes on top of what we have to digest right now I think would not be to the service of anybody, and as such I just went through the closing of the books in Nestlé, as you can imagine, with KPMG who are our auditors, and it's amazing how many more people we need again on the auditing side versus last year just to understand what all the requirements are now that are out there. So I hope that we don't see significant acceleration of these changes. It's much more of a consolidation that we need.

The second area is the accounting for sales. Just to mention that compared to what we see some of our competitors do in sales accounting, especially on the trade spending, there are slightly different treatments on that and again there are accounting changes happening in Europe to move to a more uniform accounting standard. As you know we changed in I think 2001 it was to be comparable with the standards that we have done, then Europe subsequently moved and I think we obviously will continue to look at what that will mean for Nestlé when we move, and that needs to be carefully studied to understand the impact on the company not only externally but also internally on some of the drivers that we put out there for people. So we need to look at that very carefully, because at the end of the day we're only talking about an accounting change, not necessarily a business change coming out of that.

But over time if you want my best guess, and the time will come, is that we will all confer towards one system. It's better to do that properly after having studied it, and it probably will take, you know, it will not be in the next six months if that's what you're asking. It needs to be, because it has implications in a lot of different areas.

On the triple A credit rating I think Peter has said it very well, and I certainly do not disagree with that, not because he's sitting next to me. But the triple A rating is a reward for good financial management, for good capital management in the company, and it is true if you go back at the time. As you know the three fronts for an operation over net debt ratio that they're more or less looking for should be in the 90s, and at the time that the company made the acquisition for Ralston Purina which by any standards has proven to be a very fine acquisition for the company and for its shareholders by the way, running ahead of acquisition economics, at that time we dropped well below that in the 70s, and yet we kept a triple A rating. And the reason we probably kept that was just the sound financial management of the company as a whole.

But at that time I think that's why the question to me is a little bit surprising that it continues to come up, because at that time the company clearly made a decision, which is one of the main I think values and strengths of Nestlé and what is right for the long term. They made a decision that Purina was the right acquisition for the long term, even it on paper meant losing the triple A rating. The agencies looked beyond that and didn't take that rating away, but Nestlé took a decision to acquire Purina and they didn't see we can't acquire it because our ratio would fall below 90%.

And we will always look at what are the good business decisions for the long term. Now, sound financial management as we do requires a steady cash flow – we'll do that – requires continuous dividend payments – we've become more aggressive on that and I think clear reward to our shareholders – start up the buyback programme when that makes sense, and we've said we provide for a normal ongoing acquisition of about one billion a year.

So just to sit here and say, you know, do we want to lose it for the sake of losing it, no – it has to be for a good reason for the company I think to ensure that we have a healthy growth long term. But it's also fair to say that it has never been a simple objective for the company, much more of an outcome of sound management.

### **Peter Brabeck-Letmathe**

Perhaps one very, very short thing. I always have to remind you, because I'm continuously reading about the comparison of the margins. Well, if you compare margins, compare with accounting principles. There is a difference if you are accounting under US GAAP or if you are accounting IFSR. We are accounting under IFSR. This changed in 2001. We adapted to the IFSR. That had an impact on our margins as you have seen in the chart. It had immediately lowered our EBITA margin. If we would move over to US GAAP which many of our competitors are using, well, our margins would increase tomorrow morning without doing anything else but just changing the accounting standard. But would that change the results of the company? No. So again if I read tomorrow "Well, they only have 12.9, the other guy has 13.5" – well, 13.5 of what, and 12.9 of what?

It was like the old time when we discussed you know with you about the RIG figures and finally you convinced me that I talked about organic growth figures. Okay, fine. We're talking about organic growth, we're comparing at least April with April. And the good old time you compared organic growth of my competitors with RIG with me, and each time it was the same story, and now we have the same on the margins, okay. 12.9 is not comparable to 13.5, I'm sorry. I think it is 12.9 can be more than 13.5, but you just have to take the thing you make the calculations a simple rule of three, as simple as that. But I think it's important, therefore the question about accounting rules was very relevant. It's

very important you have always to take into consideration what are the rules under which you consolidate what.

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| <b>Questions on: Delflation in Japan, Strong Q4 in USA, Milk pricing</b> |
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**Alan Erskine, UBS**

Four very specific questions. First of all in Japan was the deflation specific to coffee, or was that across the wider product mix? Secondly the US had a strong Q4. Was there any one-off though? Was there any benefit moved from one of your competitors being impacted by the hurricane, or is there nothing we should adjust over in looking in to the Q1s?

Thirdly, on milk pricing I was a little surprised to see in working through what the fourth quarter numbers were that you're still seeing quite significant price increases in places like the Philippines. When in '06 would we expect that milk price to drop out and return to more normal pricing? And finally in the UK if my numbers are right the fourth quarter RIG was negative mid to high single digits. Now I know wasn't comparing like-with-like because of the chilled dairy coming out, but if that was right was there some issue in the fourth quarter in the UK? Thank you.

**Peter Brabeck-Letmathe**

I think let's start with the fourth quarter in UK. Alastair, that's the easiest thing.

**Alastair Sykes**

We're back to confectionary again, and the fourth quarter in the UK saw a huge drop-off in the confectionary volumes and that's essentially what drove it.

**Peter Brabeck-Letmathe**

Okay, US fourth quarter, no one-off, very normal behaviour. I think you have seen in the US it's now the seventh consecutive year that we have volume growth of more than 4%, outperforming all industry by clear. I think it has more to do with the strength of the brands, I think the innovation capability and the new businesses which we have acquired. No doubt Nestlé Purina PetCare very strong growth. If you look at Stouffer's - fantastic growth, market share gain, Chef America, even I would say very pleased our relatively weak confectionary business had good growth in the US. So there is nothing, no one-off or as far as I know anybody else suffering and we're gaining. It was just very strong performance.

**Paul Polman**

And we're one of the few companies that didn't put it in our results because I look a lot of companies obviously now to get some ideas, but one of the few companies that didn't talk about Katrina in their results. You don't see minus 20 basis points, Katrina.

**Peter Brabeck-Letmathe**

We didn't talk about Katrina, no. Japan deflation I would say it was the general environment without any doubt. You know that the competitive pressure in Japan is very

strong, so in general it was not only soluble coffee. And the milk prices it is true and we have said before, the milk prices in Asia were very much affected. In Asia almost 60% of our business is based upon milk in one way or the other, so the impact was very strong. Now milk prices for 2006 I think they will be stabilising or slightly coming down, so in this respect I think we will have a little bit of a better time in the Philippines. Now there might be some other more difficult issues in the Philippines but they have nothing to do with milk prices. They might have to do with the overall situation in the Philippines which is not very easy just now. But milk prices I think the pressure for Asia should be much less in 2006 than they were in 2005.

### **Roddy Child-Villiers**

Just in the US we did have a very strong finish in chocolate. Obviously we had Halloween and Christmas. We had a very strong finish in chocolate, which is a big category for us. Even if we're not number one in the market it's still a big category in terms of sales.

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| <b>Question on: Factors expected to effect cash flow in 06</b> |
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### **Mark Lynch, Goldman Sachs**

The raw materials and work in progress rose by 16% in 2005. Are you content with that? Obviously there's an overall negative effect on cash flow, and you've also talked on the conference call about the effect of the GLOBE roll-out and the further negative impact on working capital. I was wondering if you could us an idea of what you think that's going to be in '06 and the impact on cash flow.

### **Paul Polman**

Let's start with the GLOBE one. On the GLOBE one we have clearly seen this year as you look at the results we've published a slight increase in working capital at the end of the year, and that is basically infant where we built up in some of those countries where we're going through a transition. One of the things we've set as a goal, and I certainly agree that it is the right goal, is that we do not want to lose a case a result of a conversion to GLOBE. We don't want the business to suffer as a conversion to GLOBE, because it does require a lot from an organisation to put a GLOBE system in place.

The good thing is that where we do this now, we check this very carefully and in the 30% of the countries where we've implemented GLOBE we don't see any correlation between the business results and the implementation of GLOBE. Many companies actually that have implemented GLOBE are growing faster than the company average, and there are some exceptions on the other side.

But the one thing that we do need to do in that transition which is prudent is to build some stock. We had a big conversion in Brazil - I believe it was at the end of the year. I need to look at the schedule of timings again, but so that required stock built up. Canada required stock built up. So as we now move again into 2006 and have some big countries come upstream at the end of the year, we'll need to assess that in our working capital context for the end of the year.

But again what I will be focused on which is more relevant to me is the average working capital performance throughout the year, not just a year-end position. And frankly I have to honestly tell you I don't know exactly yet how that will fall by country with the GLOBE

implementation, because there's a little bit of flexibility there. But I'm more interested in seeing an overall trend of working capital going in the right direction.

### **Roddy Child-Villiers**

I think the raw material question is whether we are satisfied with the build-up at the end of the year in the raw materials, and the answer obviously is "No, we're not satisfied." We need to improve that management.

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| <b>Slide 42: 2005 full year results roadshow</b> |
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### **Roddy Child-Villiers**

I think we need to wrap up, I'm afraid. If I could just come back to Mark's earlier question on the goodwill and fairness tests, the assumptions, just to say don't assume that the assumptions are the same as the management's targets. And also just on depreciation, reading all the research a number of people have commented on how our results have been helped by the decline in depreciation of basis points as a percentage of sales. And I just really wanted to say that depreciation is based on your asset base, not on your sales base, and if we grow our sales at 7.5% it stands to reason our depreciation is going to fall. And so to say that that's an easy win for us on our EBITA margin, our margin improvement I think is a bit unfair. I think we should actually be applauded for working at it harder, rather than criticised for the depreciation being less as a percentage of sales.

I would say the same comment also for the marketing spend being down a bit as well. Again that level of sales growth, the marketing spend is down by 10 basis points. I'm not sure that it's something we should be criticised for. I think we should be applauded for working on marketing a bit harder.

So that's my little grouch at the end of the thing. Just to say therefore and to reconfirm Peter's statement that we believe we will once again hit the organic growth target of 5-6% as well as also improving the margins, constant currency. Thanks very much indeed.

*END OF SPEECH*

### **Questions from New York Roadshow, 7 March 2006**

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| <b>Questions on: Reporting of gross sales not net-sales, European Water business.</b> |
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#### **Participant**

There are two issues that kind of bothered me Peter, and the first just is in trying to compare your margins with other food companies I struggle because you still for some reason, you know, report gross sales not net-sales. My first question is why do you resist this change? Is it for social reasons you almost want to show lower margins? And my second question, just gets into what I kind of view as your most challenging area, Europe and specifically Water in Europe, it is like it's trying to back out the growth of water, it looks like the US probably accounted for all the Water growth. It looks like you have some old assets, some low priced competition coming in Europe Water. Isn't there a restructuring need there?

**Peter Brabeck-Letmathe:**

Well thank you very much, well first of all this is a valid question. We are consolidating under IFRS, we changed in 2000, okay? And the question is you know if every two years you're changing your accounting standards it's something which afterwards transforms all the time the thing. And that's the reason we changed and according to the latest in 2000 and that's what we are keeping up for the time being. Now I don't know, most of my competitors first of all, who are America based companies therefore they have to comply with US GAAP, which are different accounting rules, or like Unilever, they have - they are quoted in New York therefore they had to change to US GAAP. Now we are not obliged to change to anything because we are not quoted in the United States and therefore we are applying the IFRS rules, that's all. And they talk about accounting and this is the way it is.

Now is it relatively easy, frankly speaking, to make the transformation. I am always a little bit flabbergasted to see that it takes so much. I mean you can just take off an average of trade spends and then see that the margins would increase immediately, if we were under US GAAP the margins would increase by 200 to 250 basis points. So if you just want to make a rule of the game you say okay 12.9 let's say be on the safe side, put it 2% and then you'd have 14.9% comparable margin. It's as simple as that.

The reason is because we are under IFRS and we are not under US GAAP that's all. Now we know that IFRS is now discussing - in order to see whether they will go to the US GAAP criteria, but this is not yet the case and once this is the case then we all hope that there will be a certain convergence or a mutual recognition of the accounting rules. But we are for the time-being are under the IFRS and most of my competitors are under US GAAP that's all the difference, okay? But the impact is around 200 basis points, 200 to 250 basis points. And then you can compare apples with apples.

You know, this reminds me of the long discussion we have for years and at the end of the day recognised it was my own fault. I mean we were discussing about RIG figures everybody else was discussing about organic growth figures. I was reading in the newspapers, my competitors are growing six and I'm growing four and therefore we don't have the performance. Well until the day, which I changed around and said okay I'm going, to present also organic growth then there's no problem anymore. And now I think we have overcome this thing. But on the margin it's just the same, if you take about 200 basis points more to be conservative you have the comparable margins on the two businesses.

Now the Water business in Europe I think - first of all I mentioned this in my first words, I was extremely pleased with the performance of the water business in the United States, extremely. I think we have an outstanding management and outstanding position in the markets and really in those circumstances we were all in last year to have been able to grow so substantially was really an outstanding achievement.

The situation in Europe is a little bit different. The situation in Europe is first of all we are talking historically of a traditional mineral water market. Now when I say that it has to do with legislation, that means that in the European legislation, which is over one hundred years old, if you want to have a mineral water it has to be first of all coming from the source where the name - the name of the source. And technically it was to be filled on the site of the source. Because it was considered to be a functional product, this was the first functional health product that existed in Europe, mineral waters.

But it has its limitations; certainly it cannot be bottled in a container bigger than 1.5 litres. Now this is quite a lot of limitations. Because what it means is that for every source you have you have to have a bottling station. You are limited in the amount of water you can bottle and therefore you have high overheads and distribution costs all over the place, but that's the legislation.

On the other hand you have table water. Water, like we said, bottled water here. Now this business you can use - you don't even have to indicate the sources but this is the cheap private label water that is being used mainly by the distributors themselves. So there you have the advantage on the one hand that you have no restrictions on the bottling size, you can bottle it wherever you want, you can treat tap water if you want and put it into bottles etc, etc. This type of water has of course a much lower price. And it is this low priced water that is really growing very fast in Europe against a very high priced, I would say the champagnes. Which has a name like the Perrier or like the San Pellegrino or like the Vittel or like all these brands that we have.

Now recognising this we have changed and we are restructuring our water business in Europe completely and substantially. What we have done is first of all we recognise that in Europe there is an in-between segment which is what they call 'quelle wasser', which is a water which is a mineral water but that doesn't have to come exactly from the same place, yet you have to indicate the source where it comes from. And what we did, we created a European brand in order to leverage better Europe, which is called Aquarel, Nestlé Aquarel. And we can bottle that in Poland, in Germany, we can bottle it in France, we can bottle it in Italy, we can bottle it everywhere. But it is one brand in order to give the synergy to this. And it is located, price wise just between the very, very cheap Crystalline and private label products and the higher ones up there.

This category Nestlé Aquarel is growing volume wise by more than 50%; it's a great success. But of course at the same time we are selling and closing down several of our mineral water plants, which we have. They are very small brands that you would not know because they are known in Italy in one certain place, in France in one certain place. And we have three left in France, for example, relatively local regional waters, which we are trying to eliminate, to sell, or to close down. So we are in this process of substituting part of the mineral water through this new water Nestlé Aquarel, so we are restructuring this completely.

Now talking about the profitability you know the history we have with Perrier, it's a long one. We have been able to achieve in the negotiation finally with Perrier a breakthrough. Their productivity has improved. We are now, I would say at an acceptable EBITA margin, but it is far below the average. But at least Perrier is not anymore a value destroyer as it is today. But we have in front of us the next challenge, which is basically to find a purchaser for our glass making activity that we have still integrated in Perrier, which is CDL. And we are seriously looking and negotiating to be able to sell this glass-making factory off, as a next step in order to further improve the efficiency.

So what you are seeing in Europe is a big restructuring exercise that we are doing. But it is also true that the profit margins are not in Europe, where we would like to have them, this is true.

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| <b>Questions on: Nestlé Financial strategy, Expertise brought by Mr Polman.</b> |
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## Participant

Just a question for Paul, coming to the company with fresh eyes can you give us some thoughts about your look at the financial strategy of Nestlé, the balance sheet, return on invested capital, the way that you look at the business and perhaps some of the things that you bring from a financial point of view to Nestlé? Thank you.

## Paul Polman

Okay thanks for the question. I always say that I wish I would had known some things ten years ago, to apply it in my former job. If you compare two companies, and I was in Boston this weekend and I picked up a Fortune magazine and was very pleased to see that Nestlé was rated first in the food industry and then P&G rated first in their respective industry. So if you have these companies that are playing in that league there is no doubt that you have good things in both of them. And obviously if you could combine the best of both, you'd be even better. And that's what we're trying to do.

The first thing to really do - quoting a little bit of Stephen Covey - is seek first to understand before being understood. And looking at the Nestlé model it's actually a very impressive model. In fact the shareholder return over the ten years has out performed P&G just for the record. That was something I didn't really realise before joining Nestlé. So the bigger challenge for us is really how can we get that same performance of the last ten years in the coming ten years? Recognising that the world around us is changing, so you can't just do the same thing. But if we would put in that same performance of what Peter eloquently calls the Nestlé model that would be very important to us.

Within that there are some possibilities; you've seen the more aggressive management of our capital structure. I think Peter has talked about that enough. And we'll continue to look at that obviously. But within that we have a few opportunities to drive Nestlé to the higher levels and coming back to the question on the margins as well I think it's related to that. It's can we better capture scale in the areas that we don't have to compromise with the consumer, I call it none value added costs that he or she is not willing to pay for and those are huge opportunities. Can we drive even more discipline into some of the under performing businesses that's a lot of opportunity.

And so, this year much more focus on the working capital, solid performance, there are opportunities. Return on invested capital has become a performance measure, a bonus measure if you want to for the strategic business units, which are working on the longer term, more continuous innovations. So also there we'll be able to drive more discipline and to get higher performance. So I see those opportunities are clearly there, if we work on those we not only can maintain our top line growth and make the model work, but we can also obviously then strengthen the bottom line. So that's where we'll be focussed on.

A little bit longer term and that's why we're putting this emphasis on the wonderful brands that we have and a little bit longer term is obviously driving our brands to the higher levels. And that's where innovation comes in and I'm very excited myself with the decision that Nestlé took, and it was certainly one of the element I looked at before Peter offered this opportunity was for example the growth fund we are created. I'll be on the board of the growth fund, which my predecessor Wolfgang will be leading. And those are tremendous opportunities again to drive in new innovations in the company to accelerate that growth.

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| <b>Question on: Input cost pressures and outlook for those pressures in 2006</b> |
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## **Participant**

On the 155 basis points of input cost pressures in the last year, could you give us some idea of what some of the big chunks of that, were? You mentioned milk was one. And then secondarily, at least directionally if not degree, what those pressures look like either headwinds or tailwinds for 2006?

## **Paul Polman**

So obviously what we have seen is a little bit of an exceptional year, I believe, and I don't think there are many years where you've seen the energy prices go from the \$20 to the \$60 dollars and actually staying there. And we've seen the same obviously with some of these prime materials. If you were to take very quickly a look at those, sugar, it is very clear that sugar prices have strengthened more than probably people anticipated. There are more people entering, it's now a bio fuel - this is putting more pressure on the demand. So that has been a market where prices have gone up. You've seen the same with coffee both on the Robusta and the Arabicas. We've seen the increases a little bit less on cocoa. And then obviously the energy prices got played through and the PET and then the costs of transportation.

Despite that, just coming back to waters and the question on Europe waters despite that if you look at our water business for example, which is heavily influenced by the PET, by the transport so you'd think that's a very big effect on that business. If you look at our primary reporting where we break out water you actually only see a 20 basis points decline. Looking at some of our competitors and where we can break out waters to the best of our knowledge we saw one of them reporting 150 basis points decline. So I mentioned that because we have these cost increases but at the same time we're driving these efficiencies in the company, to be able to do better.

What has happened over 2005 is obviously these increases have gone on during the year. So we'll get a full year effect of that next year, there is a little bit of carry through. We've also been able to price for that. I think looking forward for 2006 we'll see slightly lower inflation in the prices, some of that we've covered already. But then also less of a - pricing than we've seen in the past.

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| <b>Question on: Hard discounters in Western Europe</b> |
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## **Participant**

Can you talk a little bit about the environment in Western Europe, particularly your ability to better penetrate hard discounters? I know Lidl is putting more branded product on the shelf. What are you doing there to help grow sales, in what continues to be a really difficult underlying environment?

## **Peter Brabeck-Letmathe**

I think Paul already mentioned it that there is no real reason why Western Europe shouldn't be able to grow. As a matter of fact we proved last year that even France, we had an organic growth of 1.7% and I don't think we have really exploited all of it because our management was mainly occupied in restructuring and not in really ensuring growth. Because you know, we had the part of the Perrier issue we had the Saint Menet issue, and

we have the other issues which are taking a lot of management time and dedication. But in spite of all of that we were growing 1.7% in France. We are growing 3.5% in the UK. So nobody can say that you cannot grow.

It was mentioned Nespresso, more than 30% growth with a premium product in Europe, pet food etc, etc. Now part of this growth - what you have to do of course is to follow your consumers. Perhaps for certain periods of time we did not follow, which is our third pillar - to follow the consumer whenever, wherever and however he wants to shop. And in Europe the consumer, for many reasons, being the price one of them and not the only one of them. I think the vicinity is as important as the price. The consumer started to have a certain preference for hard discounters. And we were not sufficiently present.

You remember two years ago here, I said that this is going to be a new dedication of our management. We established a hard discounter strategy, as a matter of fact we established different ones for the different customers that we have, differentiated for each one of them. And today we have sales of one billion Swiss francs in Western Europe, in hard discounters growing by 20%.

Which shows you just, that if you really look well, you always find opportunities. If you don't get paralysed just on some threat or something some people are saying. Now I just want to say for me, hard discounters, where we are very successful now and you mentioning Lidl. Well Lidl is not the only one - take for example the strongest hard discounter in Europe for many, many years Migros in Switzerland - it had up to 50% of total market share of the market, I mean incredible. Now ten years ago you wouldn't find a Nestlé product in Migros. Today you can go and you find confectionary products, you find the waters, you find San Pellegrino, you find Vittel, you also find infant nutrition products, you find pet care products of Nestlé and Migros, this incredible hard discounter, has become one of the sales channels for our products and so on.

So I think this respect we are relatively very positive about other opportunities to grow. You have seen that Aldi is starting to look and saying well I'm losing market share because I'm too heavily concentrated on private label and you remember that there was another famous chain in the UK who once was leader and then believed that by concentrating hard on private label they would sustain their leadership. Well they lost and they are number three now.

So I think most of the retailers are learning that private label, yes it's an important part of the portfolio management, but it's not the only part of your portfolio management. And that real growth can only be achieved if you work together, as a partner, with the industry. And I think in this respect we have done quite a lot. But I also want to say that this is not the only sales channel that exists. I don't want to say now that Nestlé can only grow through hard discounters. The new legislative situation in France will give a new emphasis into the hypermarket no doubt. Because up to now they were not legally allowed - to compete, well think they will start to compete. And this is going to have - I would suppose that this is going to bring new growth into hypermarkets in France again.

We talked about food services, I showed you how this segment is growing very fast. Many of our businesses, like for example the ice cream business or like ready- to- serve and ready-to-drink businesses are on the streets. Vending machine businesses are growing.

So I'm recognising that the most difficult economic social environment to do business is in Western Europe but this cannot prevent us from growing in Western Europe. The growth

will not be as spectacular as it has been in the United States, where we have now the seventh consecutive year of outstanding performance of more than 4% volume growth, okay? This we're not getting in Western Europe but I think you should be able to get an organic growth rate somewhere around 2 to 3% in Western Europe. Add to this about the 6% in central Europe and add to that what I would expect, under normal circumstances, 6 to 8% of organic growth in Russia and you can come to a growth picture, which is decent for the European zone.

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| <b>Questions on: L'Oreal and Alcon; Future plans and general value</b> |
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### **Participant**

You have two very valuable assets you haven't spoken about today L'Oréal, your ownership there and Alcon. Could you discuss how you plan on using those assets in the future and how you view the value of those assets? Thank you.

### **Peter Brabeck-Letmathe:**

Well I'm already extremely pleased that you consider them to be valuable assets because for years I have tried to convince you that I have valuable assets and nobody wanted to give them any value. So now at least we recognise that they are valuable assets, that's a big step forward I would say. I think they are two different situations.

I think in the situation, let's stay with L'Oréal, you know very well that we had the 30-year contract with all the clauses, which were public, and you knew. We have changed that last year, basically through a new contract, we have eliminated basically the holding company structure that we had. We are now direct shareholders in L'Oréal. We have today about 28.6%, this changes because with every share repurchase of L'Oréal our participation increases without us doing anything, that's quite interesting also. So we have about 28.6% direct shareholding in L'Oréal, not like we had it before in the holding company. And we had a contract which was a public contract it's on the website you can look at that, which basically regulates this relationship for the next couple of years.

Outside of this contract we cannot do anything. So whatever we want to do we will do all depends on the time, what happens - unfortunately we always have to talk here about the life expectancy of Madam Bettencourt which plays a role in the contract and it's clearly established which role it can play. So I think there is from a strategic point of view for the time being very little that we can really do more than that.

This will open up in three to five years basically and then we can look at that in a different manner. But let's get these three to five years come out. In the meantime I think it has been clearly a good financial investment, an excellent financial investment and that's all I can say for L'Oréal for the time being.

I think it is right to say that Alcon is a different situation. First of all when I took over as CEO I was asked about Alcon, at that point of time I've always said I understand this is from the product point of view, not the strategic activity. But from a financial point of view it's a very strategic activity. And we felt that we can still get a lot more value out of it and I think we have been able to prove that for our shareholders today. It's completely transparent, you know exactly what it is worth and again I would say if I look at the future - looking at our research pipeline, looking at our performance that we have, I think there is no danger that this investment in the long run is not going to perform extremely well for us

and for the shareholders. And it continues to have a very important financial implication in the total performance of the group.

Therefore - also in this respect nothing has changed, however I agree that this is an asset that is a card, that you can play. I would say it's a beautiful ace or a joker you have in your sleeve, but it would be difficult to find the right situation where it is worthwhile to play this card. Because I still have to assure my commitment which I have taken with you that we are going to have an organic growth of 5 to 6% ,that we are going to further improve the EBITA margin year in year out. And in both senses Alcon is helpful to me in order to make this commitment. That's very clear, I mean this has a strong organic growth, has a much higher profit margin. So just to sell it off and then afterwards to do what, will be strategically an interesting challenge.

But I think in this sense we have to recognise that this is a different situation than in the case of L'Oréal. So it is a beautiful joker, we will continue to drive the value of this thing. But it is a joker, something you have in your arms and perhaps one day a situation comes that it is worthwhile to play it and we will play it.

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| <b>Question on:      Acquisitions in the USA</b> |
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**Participant**

Peter, now that Heinz is under attack from hedge funds, have your views with respect to acquisitions in the United States changed? Are you looking at opportunities here again? Thank you.

**Peter Brabeck-Letmathe**

Nestlé is not a white knight to anybody. I'm not interested; I have said that many, many times, I'm not interested in opportunistic external acquisitions. This was never our strategy; we have a clear strategy for seven years where we said we're only investing into ice cream, pet care and water. That's the only thing we did. 96% of all acquisitions since I have become CEO were in this area.

Then we have said we are going to do some fill-ins which we have done, like Chef America which was a fill-in. And now I'm saying we're looking basically, strategically into the area of nutrition, if there's anything there. I'm not aware that Heinz is very strong in the nutrition area; especially what is a left over. And you know we have been divesting our total Contadina business. Don't forget in 1990 we were the biggest tomato converter of the world with 1,200,000 tonnes of tomatoes converted. And we have basically sold all of this business, all over the world. We got out of this business completely.

We did an enormous restructuring, which is sometimes not being recognised. But we did, we sold off about 20 billion of businesses, which were more or less businesses that were commoditised. And by the way over the last year, last year again we deconsolidated about almost two billion of Swiss franc with the Chilled Dairy. The year before we deconsolidated Trinks. Okay that was another 1.6 billion / 1.8 billion of business. So we are constantly cleaning up, so I don't see how Heinz would really fit into our strategy. And we are making acquisitions only if it is a strategic priority, otherwise we are not making acquisitions. And I also hope by the way, I said it in Europe that with the Lactalis deal I don't have to read anymore that Nestlé is going to acquire Danone. I think now it is clear, even now if we wanted we couldn't, it's finished. So I hope that also this rumour is off the

table now, that Nestlé is only waiting in order to be able to acquire Danone. We will not acquire Danone. And we are not interested in Cadbury, because that's the other thing I'm reading. Just for the sake of good order - we are not a white knight to anybody.

We will continue doing what we have been doing and you have seen the figures. 5.7% organic growth, 1% acquisitions. Okay, let's rectify a little this image that we have and I don't know where it comes from.

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| <b>Questions on: Vision for further efficiency benefits beyond GLOBE 2007 target and role of SAP within those efficiencies, Reasons behind new structuring for Nutrition and Food Services.</b> |
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**Participant:**

A question for Paul, without setting explicit targets obviously at this point, what's your vision for further efficiency benefits beyond the current 2007 GLOBE target? And how do you see the roll out of SAP and the acceleration of that roll out this year, assisting that? And a follow on question for Peter, to what extent does breaking up the Nutrition and the Food Service businesses, both of which directly report to you, and assessing perhaps somewhat aggressive external growth targets for these businesses reflect your desire for market to explicitly realise the value of these business units as they have in the last three years as Alcon?

**Paul Polman**

Starting with the first part very briefly, if you look at GLOBE which obviously is a tremendous project of a tremendous scale and we're well into it, we're starting to see far more benefits than probably we realised at the beginning. You know the project was conceived with great foresight, to create this common template, starting with having best practices in the company and being able to share these best practices. So have common templates around these best practices.

The second part of the GLOBE project was to have common data, so that we could talk to each other. The same understanding of a specification of the same product in one part of the world versus another. Shipments to one retailer like Wal-Mart in one part of the world recorded the same way as the other. And then the third element of GLOBE once you have these best practices, once you have this common language is put in common systems.

As we roll this out, it's very clear that there are many more benefits coming. Because now that we are getting - and this is the very exciting year, get to 80%, we're starting to actually see the benefits in our day to day operations from having a system like that. Which, by any standards by the way, is probably one of the biggest - in terms of scale - projects that any company has worked on, obviously.

The real benefits I think will come, and that is where the savings will come and I actually will explain that not in terms of cost and EBITA. But the real benefits will come when GLOBE is up and running, obviously we'll be able to capture better scale, obviously we'll be able to drive faster, where it makes sense, through shared services or selectively outsource. And those will be efficiency projects that we can drive in the company and there's no reason why with the scale of Nestlé we cannot do that and become best in class versus our competitive set. I don't see anything that should get in the way there.

But the real benefits will come from making further driving the culture, to creating more of a culture of real time. Information will be more transparent, information will be faster available, people will take decisions quicker. At the same time people in the markets will not have to get bogged down with a lot of the internal things. Because we are driving that scale or the selective outsourcing, they can much more focus on demand generation and being closer to the consumer. So the real benefits that we will see, is in the business and continuing to drive the Nestlé model with faster top line growth and then steady improvements again in the margins. And that's probably what people have not fully seen yet. I'm sure we can talk about that an intellectually explain that, but that will only become apparent when we can leverage the system in about a year and a half or two years from now, fully across the organisation. And that's a huge payout.

So yes, we'll be driving efficiencies on cost, that's a no-brainer. But more importantly we'll be able to accelerate or continue to accelerate out top line growth as well.

### **Peter Brabeck-Letmathe**

Regarding the other question. I think there is a huge difference between Nutrition, Food Service, PetCare and Alcon. Whereas in Alcon we really have been trying to optimise the value, through the IPO. In the case of the other businesses they are clearly part of the core strategic direction of the company and therefore we are optimising the value of the group and not the value of the individual business.

So I don't foresee any IPO for Nutrition or for PetCare or for Food Services. This is clearly here we are optimising the value of the group and not the value of the individual business. And by the way neither for Nespresso either because they would like to.

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| <b>Question on:      Exceptional input costs of 2005 compared to a normal year.</b> |
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### **Participant**

You commented earlier that 2005 was an exceptional year in terms of cost inflation on food and packaging inputs. Could you give us a sense of what it has been over time and you know what would be more indicative in a normal year without this wild inflation?

### **Paul Polman**

Yeah I don't know what a normal year looked like obviously. And by the way we haven't even talked about the effects of Katrina and others that some of our very creative competitors have used as once-offs that they had to deal as well. So I don't know what will be coming moving forward. But what is very clear is I think we will have a little bit of an easing of the input costs, so hopefully that will help us next year. That's why, with a little bit of moderate confidence, we should be seeing a margin improvement as well next year, coming out of that.

It's difficult to see in the future, we see inflation picking up a little bit but at the same time we are driving efficiencies. Obviously a lot of our costs that we have is basically - call it agricultural driven. We buy most of our ingredients in the countries where we produce as well. And they're mostly systems that you know are partly set up by us and partly the global systems obviously where we can hedge. But I think in terms of the efficiencies that

we're driving, in terms of the prices that we're now seeing hopefully in the next year or two we should see a little bit of an easing of the input costs. That's what I'm hoping for.

### **Peter Brabeck-Letmathe**

May I just add to this, one thing you should never underestimate, is the impact of the exchange rates also on the raw material costs. Because as you have seen in this one chart, the ten-year chart you see this huge impact of exchange rates. It's very clear that if the dollar goes up and you have most raw materials being quoted in US dollars, you get an impact on the raw materials in any other currency or vice versa. For example we were not very worried when for example certain raw materials went up and the dollar went down from \$1.65 to \$1.50 because for the euro market this didn't mean there was an increase of the raw material prices, okay?

Now you can have stable raw material prices and the dollar going up and the pressure will come on some of the markets just because of exchange rates. So I just want to put this additionally into the thing. So it's not only the pure price of the raw material it's also the same.

On the other hand you have to understand that we have specially in those globally traded raw materials we have a very active and I think a very successful hedging policy, which also allows us to level off a little bit most of this high and lows that there are in the raw material markets. I mean normally they're much rounder in those things. So that's a soothing effect if you want. But the exchange rate is always difficult to forecast what's really going to happen.

### **Paul Polman**

And the more added value obviously driving your products the lower your cost of goods component becomes, that's an important thing as well.

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| <b>Question on: Pricing; Effect of rising input cost on retail prices, in current retail environment</b> |
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### **Participant**

Just a quick question on pricing. You know historically with higher list prices given the rising input costs, when input costs have eased there's generally been a stickiness to that pricing at retail. You know at least in the US market the last time we had any significant retail pricing was really many, many years ago. I'm curious if you think that dynamic has changed this time around given the retail environment is so dramatically different from the last time we had any real significant pricing? And maybe you have realised examples of where the dynamic still holds and why? Thank you.

### **Paul Polman**

Actually even in the US I think major retailers like Wal-Mart who have been obviously key drivers of that, start to realise that just the roll back strategy alone is not enough anymore. And you know you see it getting more into differentiation; you see it getting more into marketing. They see the success of target, where they are competing head on. And I think you'll see an evolution already fairly apparent, probably driven by them it's fair to say in not just creating deflationary environments. If you go around the world you see the

same thing. Don't forget that retailers in Europe for example would have a high percentage of their business in their own brands where the percent of cost of goods sold if you want to is much higher than for our products. When these raw material or input costs go up they are under significantly more pressure.

So as you've seen already in the 2005 results where the gap between the organic growth and the RIG is about 2% you actually see - which is a little bit higher than we've had historically - you see that there's a little bit of room for pricing. Now you go to other parts of the world - I was just reading in Japan where you know there seem to be encouraging signs of getting out of deflation. So the ability to price in the future I don't think will be less than what we've seen in the past, put it that way. But the main driver for that will always be the strength of your brands. If your innovations are meaningful and if you come out with what I was just showing you on the infant nutrition, on the Nesvita examples, or any you pick, that is the driver of our ability to pass it on to consumers.

And because we have these leading brands, and because they're getting stronger, I believe companies like ours are in a better position to deal with these input costs, let alone all the other savings we talked about.

### **Roddy Child-Villiers**

Great now thank you very much indeed for your questions. I think it's appropriate to finish on the subject of input costs because the raw materials sourcing will be one of the key subjects of the next presentation on shared value creation. Thank you very much for your interest in Nestlé. Thank you.

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