NESTLÉ S.A.

# 2019 FULL YEAR RESULTS CONFERENCE CALL TRANSCRIPT

13th February 2020 14:00 CET

Speakers:

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

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

**Slide: Title slide**

Good afternoon and good morning to everyone. I am Luca Borlini, Head of Nestlé's Investor Relations. Today, I'm joined by our Chief Executive Officer, Mark Schneider; and Chief Financial Officer, François Roger. Mark will begin with an overview of 2019 and the outlook for 2020. François will follow with a review of the full year 2019 sales and profit figures. We will then open the lines for your questions.

**Slide: Disclaimer**

Before we begin, please take note of our disclaimer.

And now I hand over to Mark.

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

**Slide: Title slide**

Thank you, Luca, and a warm welcome to all of you joining us on this conference call today. We appreciate your interest in our company.

**Slide: Key messages 2019**

I'd like to move right on to the key messages for 2019. I'd like to point out the picture of success that we've seen in this year, the continued progress with our value-creation model. As you know, for us, this value-creation model, the key cornerstones are success with top line, bottom line and capital efficiency at the same time. When all these three come together, it means good things for the company and also good things for our shareholder. I think that is the story of 2019.

Specifically, when it comes to organic growth, we were able to increase our growth from 3% to 3.5%; so 3%, 2018; 3.5% in 2019. We saw strong momentum in the United States, our largest market, and also from Purina PetCare globally.

In terms of the underlying trading operating profit margin, we saw an increase by 60 basis point to 17.6%. As you do know, going back to 2017, we do have a midterm underlying trading operating profit margin target in place for 2020. It called for a range of 17.5% to 18.5%, so we're inside that range one year early. So very good work here when it comes to the underlying trading operating profit margin and something that you saw coming as we progressed very nicely on that margin in 2019.

Now on both of these, growth and margin, I think we came smack inside our guided ranges here for the year. We were not only staying very close to the guidance, I think we were also staying very close to the profile of growth and margin development in the year that we led you to expect. So very strong first half of 2019, some of that also driven by the commodity cycle. And then we told you early on to expect lower growth in the second half and also a bit more pressure on the margin as some of these commodities were turning against us.

In the fourth quarter, also, mathematically, the fact that Skin Health was no longer part of the consolidation circle made itself felt. Skin Health, as you know, did significantly benefit from a strong, strong turnaround that we put in place in the years 2017 and '18. It grew by almost 10% in 2019. And so a CHF 3 billion business growing at almost 10%, when that leaves you, mathematically, of course, with the next quarter, there's going to be a bit of an air pocket, and this is what you saw with Q4.

Now the important thing is, first of all, please appreciate the precision here of the guidance and also the expectations, but the fundamental growth drivers when it comes to organic growth and also the underlying trading operating profit margin improvement, those are still in place, and you will see that later on reflected in our guidance.

Portfolio transformation, very much on track. I'll talk more about that later. Then you see a significant return of cash to our shareholders, CHF 16.9 billion through the share buybacks and the dividends in 2019.

On the dividend, the good news is also slated to continue. Our Board approved to propose a dividend increase of CHF 0.25 per share to CHF 2.70. If approved at the Annual Shareholders Meeting in April, this would mark the 25th consecutive annual dividend increase. So, CHF 0.25 in the 25$^{th}$ year of increase, a very stable, sustainable dividend increase over time that I think has become the hallmark of our company.

With this increase, we will then also join the rank of the dividend aristocrats whose stocks for the 25th consecutive year are able to raise the dividend. By the way, when it comes to not just raising it, but keeping it stable, we have a 60-year history now of not lowering the dividend. So for 60 years, the dividend has either been stable or increasing. So tremendous financial stability coming from the business to the benefit of our shareholders.

Let me also point out, we believe very much in creating shared value. So we created a lot of value in that past year, but I think we also took some pretty bold steps in sustainability and diversity inclusion. As you know, we followed the UN pledge to become carbon neutral by 2050. We unveiled major initiatives in plastic waste reduction. Then as part of the diversity inclusion plan, among many other things, we also unveiled a new parental leave policy in the fall of 2019, which now is in the process of being rolled out globally and which will grant primary caregivers 18 months of parental leave.

So all in all, a busy year with lots of successes across a broad spectrum and something to be proud of.

**Slide: Strong 2019 financial results**

Moving on to the next slide, I won't spend too much time on the detailed financials. I know François will talk about that later. The key message here is simply to point out the consistency across all the metrics. Again, stressing the fact that we saw success on the top line, the bottom line and also when it comes to cash and balance sheet intensity, and return on invested capital benefiting from that very nicely. I would also like to point out that our underlying earnings per share in constant currency increased in double-digit rates for the second year in a row. I think when top line and bottom line success come together, you typically see very nice things happening for underlying EPS.

**Slide: Continued progress towards mid single-digit organic growth**

Next, I'd like to talk about organic growth. You see here a slide that we have also featured in previous years showing you the main buckets of organic growth improvement; fixing underperforming businesses, portfolio management and then also advancing high-growth categories and innovation. So, in all three buckets, I think a lot of activity happening in 2019 and contributing then to that increase towards 3.5%.

On portfolio management, as you know, it's been a busy year on the divestiture front. The one we tried to have over the year is that we didn't do that much on the acquiring side. I hope that's going to change now in 2020. We already announced through Nestlé Health Science the acquisition of Zenpep in January, and we have a few other projects to work on. So, I believe that in 2020, we'll see a more balanced view between acquisitions and disposals, but it will continue to be a busy year on portfolio management. That much is pretty clear as from now.

**Slide: Developing our portfolio**

While on portfolio, I think it is worthwhile after a few years to kind of step back and to see what has been accomplished. You see here a summary of some of the disposals over the last three years and the companies we have invested in. I think it's pretty clear that the businesses we have invested in are higher growth, higher margin. They're more on trend, more in tune with younger, more affluent consumers. They're more premiumized products. They also make better use of digital opportunities and personalization. So very much continued trends here that are going to be very important for the company.

All in all, more than 50 transactions have been closed or announced in that time frame, and this represents about 12% of Group sales. So this is north of what we told you to expect in 2017. We had talked of about roughly 10% of Group sales. And looking now ahead, looking at the next 3 years, I would expect a similar level of activity when it comes to portfolio transformation.

**Slide: Supporting growth through faster innovation**

Next, I would like to talk about faster innovation internally. As you know, this has also become a hallmark of our company. Significant changes happening in our R&D and innovation engine. You see some of the key examples highlighted here. I won't talk about all of them in a great amount of detail, but I would like to point out a few.

So clearly, on Coffee, we saw a significant success with the rollout of the Starbucks product range. As you know, we unveiled that range exactly 1 year ago. It was very easy for you to see that we only had about 5 to 6 months to develop this because the Starbucks transaction only closed in late August 2018. And here, we were a year ago, in February 2019, showing you 24 SKUs at the time. Starting from March, these SKUs hit the shelves. We're now out there in more than 40 countries.

In November, when we saw already the overwhelming success of this launch, we told you to expect about CHF 250 million of additional sales to expect in 2019. As it happens, we beat those numbers. We came in at more than CHF 300 million of additional sales in 2019. So very nice success here on the Coffee front. As you know, that rollout is now being bolstered by continued innovation under the Starbucks label. It was very important for us after the initial excitement with these products to continue now with the new stream of exciting must-have products, and so we continue to be very bullish when it comes to that Starbucks franchise for 2020.

PetCare, as you know, as a category was flying last year, both in premiumization and also in veterinary and science-based products. So this is where we bring the full strength of our research and development team to the table. Here, again, we also continue to be very bullish when it comes to 2020 and beyond.

And then last but not least, plant-based food. As you know, that segment has received a lot of attention in 2019. One of the signature products that people talked about was the plant-based burgers where I think, early on, we were able to compete both in Europe and the United States: in Europe with the Incredible Burger, which is soy-based; in the United States with the Awesome Burger, that's yellow pea-based. Both of those fantastic products have taken good share in the market. This story, however, is way beyond the burgers. All in all, for this plant-based segment, we have achieved sales of about CHF 200 million. We're growing at double digit -- strong double-digit rates. And the good news is that these growth rates keep accelerating. So here is something that is way beyond just a short-term trend and rather something that does have runway in it.

Aside from plant-based burgers, we are also talking about analogs for meatballs, for ground beef. We're talking chicken analog products like chicken nuggets and chicken fillets. And we're even working now on tuna salad analog, which I think holds great promise and should be out on the shelves later this year.

So, lots of good examples in the works. It's very important to gain credibility with these pure-play ingredients. But then the bigger picture of the size of the opportunity is to look at our CHF 12 billion category which we call Prepared dishes and Cooking aids. This category, as you know, is a signature category for us. It has delivered solid growth, but not exciting growth in recent years. I think what you're seeing here is a once-in-a-generation opportunity to revive, rejuvenate, reenergize this category because these ingredients, these plant-based ingredients can find their way in so many other dishes and follow-on products that make up this category. So, from a frozen pizza to frozen or chilled meals to some of the seasonings, the plant-based opportunity is one that I believe has lots of follow-on opportunities that we can use to make this category more exciting going forward. So very interesting development here.

Let me also point out, while we did not invent the no-compromise sector where we try to resemble the original product as closely as possible, due to our 30-year history in plant-based products, we were able to move up to this really fast. So this is why we didn't miss much of a beat. I think we're out there now among the top offerings, and we continue to be very much invested in that race.

**Slide: Business as a force for good**

Next, let me talk about business as a force for good. One thing you would have noticed starting from last March is that with each quarterly report, I'm also talking about a sustainability or ESG-type project that we pursue as a company. When we looked at the sheer number of projects we have, it was very clear that we have a lot of quarters to cover here with good things that we're doing for the people that do business with us, the people that work for us, the communities we live in or the consumers or suppliers that work with us.

This quarter, I would like to talk about, again, plastics packaging and packaging innovation in general. This builds on a press release that we issued in January that outlined two further steps on the road towards our 2025 commitment to make packaging sustainable and basically make all of it reusable or recyclable by that year.

The first one is to get a market for food-grade recycled plastics going. So we're devoting more than CHF 1.5 billion to incentivize supply in this area. We saw a weakness when it comes to food-grade recycled plastics. There was simply not enough capacity. People were reluctant to invest because they didn't see stable demand. So, by committing to purchase up to 2 million metric tons in this 5-year time frame and to pay a premium for this material, we hope to create a market, in particular, for PP and PE, where the lack of food-grade alternatives was quite troubling. On PET, which makes up the plastic bottles, the situation was better. But even there, you need to pay a premium right now to get your hands on recycled material.

As investors, it's important for me to point out to you that we have sufficient cost-reduction efforts under way that we can make this commitment in a cost-neutral way. This not coming at the expense of margin. But I do believe this is important to stay in tune with our sustainability commitment and also stay in favor with the public and consumers in general who expect from us that we improve the eco footprint of our packaging.

The right side of the screen talks about packaging innovation. As you know, traditionally, we looked at packaging as a supplier issue. But it is true that in this industry, there was not that much innovation coming. So we started to take things into our own hands. We inaugurated our Institute of Packaging Sciences last year where, as part of our research center, we do our own research in packaging material to drive innovation. We know from our Food and Beverage research that not all good ideas come from inside our own four walls. Hence, we complemented now the Institute of Packaging Sciences with a CHF 250 million venture fund that focuses on ideas that happen outside of our company.

So, these CHF 250 million are available to invest in start-up companies in this space, and we hope that way to get more innovation in the packaging space off the ground. We'll be looking at all options. So it's going to be reuse and refill, which I think in densely populated areas does have great promise. We're looking at recycling, of course, and we're looking at new materials, including biodegradable materials.

**Slide: 2020 guidance**

Before I hand it over to François, let me talk about the guidance for 2020. Looking at the first two bullet points, what you're seeing here is the good news continuing when it comes to organic growth and the underlying trading operating margin. On organic growth, however, what we did say is that when it comes to this mid-single-digit range, that 4% to 6% range, that we'll need another 1 to 2 years to make it towards that. So organic growth will continue to improve, but it will improve not quite as fast that we get to that range in 2020 yet.

So, looking back at the 2017 midterm targets, you see us basically being one year early when it comes to the underlying trading operating profit margin, and you see us one to two years late when it comes to the organic sales growth. The important thing, however, is on both of these, we will get there. We are there already on the underlying trading operating profit margin, and we will get there on organic sales growth. I think that's pretty apparent now. And the confidence level that we have a path to get there has certainly increased very much from the time that we had in 2017 when we were quite far away from these targeted numbers.

In terms of restructuring costs, we expect about CHF 500 million. Then when it comes to underlying earnings per share in constant currency and capital efficiency, we expect those to increase as in previous years. For good order, it's important to point out that it's too early to quantify the financial impact of the coronavirus outbreak. I think this is very much in line with the practice from other companies.

When it comes to the situation on the ground, I would like to recognize the enormous efforts from our team here. As you know, China is our second-largest market. The Greater China region accounts for about 8% of our revenues. We have spent weeks and weeks now to get prepared for this, tremendous effort from the team on the ground. It's important for us, of course, to be sure that our associates are safe. It's important that we cooperate fully with the local authorities to be sure that we take all measures to prevent the spread of the virus. And of course, given that we have strong responsibility here as a producer of food and beverage products, it's important to the largest extent possible to maintain the uninterrupted supply of these products.

I think in all these metrics, we're doing very well, thanks to the strong efforts on the ground. I think it's particularly important for the youngest and the oldest members of society that food production and food supply is maintained to the large extent possible. So especially when it comes to Infant nutrition and when it comes to Medical nutrition, we are giving it very strong efforts.

We have restarted the largest part of our more than 30 factories in China earlier this week. So, the largest part of these factories are running, albeit they're running at a lower rate than usual because, as you can imagine, distribution capacity is much tighter than usual. Also, some of our employees have not been able to leave their home provinces after Chinese New Year and rejoin us at these manufacturing sites. But overall, I would just like to underline our strong commitment to the Chinese market at this time and our strong commitment to work with the authorities to do all we can to overcome this challenge.

With that, let me hand it over to François.

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

**Slide: Title slide**

Thank you, Mark. Good morning or good afternoon to you all. Mark has shared with you the financial headlines, so I will provide you with some of the details behind those numbers.

**Slide: Full-year sales growth**

Starting with the sales growth with the different building blocks of our top line growth. Sales for the full year totaled CHF 92.6 billion, a 1.2% increase on a reported basis. Our organic growth increased to 3.5% for the second year in a row. Nestlé Skin Health contributed around 20 basis points of organic growth in 2019. The most significant contributor to growth was RIG, which accelerated to 2.9%, the highest level in the last six years. Our RIG was supported by innovation, strong growth in the e-commerce channel and portfolio management.

Pricing was 0.6% and returned to positive territory in the fourth quarter. Net acquisitions had a negative impact of 0.8%, largely related to the divestment of Nestlé Skin Health on the 1st October. Foreign exchange reduced sales by 1.5% mainly as a result of the appreciation of the Swiss francs against the Euro and against a number of emerging market currencies.

**Slide: Broad-based growth with stronger momentum in the Americas**

This slide illustrates the development of our sales by geography. It includes both our Zones as well as our globally and regionally managed businesses. Our growth was broad-based, both in terms of organic growth and RIG, which were positive in all geographies. Organic growth in AMS at 4% increased significantly versus the previous year. Pricing was positive in the Americas and AOA. Europe saw slightly negative pricing, mainly impacted by decreasing coffee prices. This was more than compensated by stronger real internal growth. And overall, we have been very encouraged by EMENA's resilience and momentum in a low-growth environment.

**Slide: Growth acceleration driven by increased RIG in developed markets**

Now turning to growth dynamics between developed and emerging markets. Developed markets, especially North America, saw increased growth momentum. The increase came mainly from RIG and was largely driven by innovation, strong growth in the e-commerce channel and disciplined execution. Emerging markets posted steady mid-single-digit organic growth. The slowdown in China was offset by an acceleration in most of the other regions.

**Slide: Zone AMS**

Let's now look at the result of our five operating segments, starting with Zone AMS, where we are pleased to see a significant increase in organic growth. Sales were CHF 33.2 billion. Organic growth was 3.9%, supported by a strong RIG of 2.6%. North America grew at a mid-single-digit pace, led by the United States, which saw 4.1% organic growth when including the globally managed businesses. Organic growth in the U.S. reached its highest level in the last 10 years.

This performance reflects a pipeline of successful innovations and strong demand for premium products across categories. The largest contributors to organic growth were Purina PetCare and Beverages. Purina PetCare saw strong sales development in e-commerce and science-based premium brands such as Purina Pro Plan, Purina ONE and veterinary products. The Beverage category saw high single-digit growth, supported by strong demand for Starbucks and Coffee-mate products. The transition of the U.S. Pizza and Ice cream businesses from a Direct-Store-Delivery system to a warehouse distribution model was successfully completed six months ahead of schedule. The DSD transition will have a marginal negative impact on Group organic growth in 2020.

Latin America posted mid-single-digit growth with positive contribution across all categories. Brazil returned to mid-single-digit growth, supported by better results in Dairy and strong performances in Infant nutrition, KitKat and Nescafé. Mexico grew at a mid-single-digit rate with Nescafé being the standout performer. Latin America recorded double-digit growth for Purina PetCare and strong mid-single-digit growth in Dairy and Coffee.

The Zone's underlying trading operating profit margin increased by 10 basis points. Pricing and structural cost reduction more than offset cost increases from commodity inflation and one-off transition costs associated with the DSD exit. Marketing and commercial investment increased to support innovation and brand building.

**Slide: Zone EMENA**

Next, Zone EMENA with sales of CHF 18.8 billion. Organic growth was 2.7%. RIG was 4.2%, the best level in the last 5 years. In a low-growth environment, the Zone made broad-based market share gains across categories and geographies. Each subregion had positive organic growth with an acceleration in both Western Europe and Eastern Europe, particularly Russia.

By category, the largest contributor to growth was Purina PetCare, supported by Felix, Purina ONE and the expansion of Tails.com. Infant nutrition grew mid-single digit with strong growth in Eastern Europe and MENA, helped by innovation, particularly with human milk oligosaccharides or HMOs. Coffee saw positive growth, particularly in the second half of the year, with mid-single-digit RIG, helped by the launch of Starbucks and a stronger performance from Nescafé. Confectionery maintained solid momentum with good growth for KitKat. Vegetarian and plant-based food products grew at a double-digit pace, supported by the successful launch of Incredible Burger and Incredible Mince.

The Zone's underlying trading operating profit margin increased by 20 basis points. This improvement was supported by structural cost savings, operational efficiencies and product mix. Marketing and commercial investment increased to support innovation and brand building.

**Slide: Zone AOA**

Moving now to Zone AOA with sales of CHF 21.6 billion. Zone AOA posted 3.2% organic growth for the year. RIG was 2.5%. Growth was solid in spite of a slower momentum in China and negative sales development in Pakistan due to the challenging trading conditions.

China had slightly positive growth with some benefit from the timing of Chinese New Year in the fourth quarter. Culinary, Coffee and Ice cream performed well. Yinlu peanut milk and congee continued to see a decrease in sales. Infant nutrition in China posted low single-digit growth as strong sales momentum for illuma was largely offset by a decline for the S-26 range. With more than CHF 1 billion in sales in China, illuma is now a member of our billionaire brands.

Southeast Asia posted good growth with strong momentum in Indonesia and Vietnam. Bear Brand, ready-to-drink Milo and Nescafé grew at a double-digit rate. South Asia reported mid-single-digit growth driven by strong sales in India. Maggi, NAN and Nescafé performed well, helped by innovations, distribution expansion in smaller cities and strong execution. Sub-Saharan Africa accelerated to mid-single-digit growth, supported by Infant nutrition, Maggi and Nescafé. Japan and Oceania maintained low single-digit growth with strong demand for Purina PetCare products and the newly launched Starbucks range.

By product category, the largest contributions to the Zone's growth came from Culinary products, Infant nutrition and Purina PetCare. Infant nutrition maintained mid-single-digit growth with good momentum in all markets, with the exception of the S-26 range in China.

The Zone's underlying trading operating profit margin at 22.7% was unchanged. Pricing, structural cost reductions and favorable mix offset cost increases from commodity inflation. Marketing investment increased to support innovation and brand building.

**Slide: Nestlé Waters**

Moving on to our globally managed businesses and starting with Nestlé Waters. Organic growth for the year was 0.2%, driven entirely by pricing, as RIG finished at minus 1.9%. Total sales were CHF 7.8 billion.

In North America, organic growth was slightly positive. International premium brands saw double-digit growth with strong demand for S.Pellegrino, Perrier and Acqua Panna. The launch of S.Pellegrino Essenza resonated strongly with consumers. The ReadyRefresh direct-to-consumer business grew at a mid-single-digit rate, helped by pricing and the deployment of a new online platform. The mainstream segment, particularly the case-pack format and Nestlé Pure Life, continued to be challenged.

Europe saw negative growth, impacted by high comparables and a soft market in the second half of the year. Emerging markets posted mid-single-digit growth. Nestlé Water is now managed as part of the Group's three geographical Zones from January 1, 2020. This move is one of the several steps we are taking to address the underperformance of the Water business.

The underlying trading operating profit margin for the Water business increased by 80 basis points. The improvement came through increased pricing and structural cost reduction. These more than offset higher PET packaging costs as well as higher marketing investments.

**Slide: Other Businesses**

Finally, we review our Other Businesses, which includes Nespresso, Nestlé Health Science and Nestlé Skin Health. We completed the sale of the Nestlé Skin Health business on the 1st October 2019. Total sales for Other Businesses were CHF 11.2 billion. Strong organic growth of 6.4% largely came from RIG at 5.8%.

Nespresso maintained solid mid-single-digit organic growth with positive momentum across all regions. North America grew at a strong double-digit pace with significant market share gains. The Vertuo system was a key contributor to growth as sales grew more than 60%. The out-of-home segment also had a good sales development. We also continued to develop and optimize our boutique network to increase availability while maintaining personalized services. As of the end of 2019, Nespresso operated 810 boutiques, more than 70% of them being in a smaller format.

Nestlé Health Science grew at a high single-digit rate, supported by the strong growth of Medical Nutrition and Atrium products in Consumer Care. Successful innovation and strong growth in the e-commerce channel were key contributors. In September, Nestlé Health Science expanded into personalized nutrition with the acquisition of Persona, a leading personalized vitamin business. Nestlé Skin Health posted high single-digit growth for the nine months of consolidation until September. The underlying trading operating profit margin of Other Businesses increased by 220 basis points as a result of broad-based improvement across all businesses.

**Slide: Positive organic growth across categories**

Looking now at our growth by product categories where all segments sustained positive organic growth. Powdered and liquid beverages, which is largely coffee, maintained solid organic growth, driven entirely by RIG. Pricing declined slightly, largely as a consequence of lower green coffee prices. Coffee had a good momentum, helped by strong demand for Starbucks products rolled out in more than 40 countries.

Nutrition & Health Science performed well, driven by solid RIG in all three subcategories. Infant nutrition posted 3.1% organic growth with robust momentum in emerging market outside of China. We already commented on Nestlé Health Science and Nestlé Skin Health.

PetCare accelerated to 7% organic growth with positive contribution from most regions, brands and product segments. The strong performance was supported by successful innovation and sustained demand for premium products. The e-commerce channel grew by more than 40% and now slightly exceeds 10% of our total Purina PetCare sales. We are also particularly pleased with the progress made by the Tails.com in Europe, which grew above 50%. These platforms open up exciting opportunities in the areas of personalized nutrition and direct-to-consumer.

Prepared dishes and Cooking aids saw RIG-led growth. Ambient culinary benefited from strong momentum in Maggi bouillon and noodles in emerging markets. Confectionery posted positive growth, all RIG-driven. KitKat delivered another year of high single-digit growth, supported by innovation and geographic expansion. We are continuing to premiumize our product range. During the year, we opened new Chocolatory boutiques, expanded KitKat Ruby and successfully launched Les Recettes de L'Atelier Les Bouchées in the high-value gifting segment.

Waters, we already discussed.

**Slide: Underlying trading operating profit margin by category**

Moving now to profit evolution by product categories. Our largest categories, Powdered & liquid beverages, Nutrition & Health Science as well as PetCare continued to deliver the highest levels of margin in our portfolio. Most categories maintained their profitability at a similar level to 2018.

The margins of Nutrition & Health Science increased significantly, largely due to Nestlé Skin Health, which benefited from our turnaround efforts. Nestlé Health Science margins also increased based on strong sales growth. Milk products and Ice cream margins increased, helped by pricing and operating leverage.

**Slide: Further improvement in gross margin**

Looking at our gross margin, we finished the year at 49.6%. Excluding the impact of Nestlé Skin Health, which we disposed of, the gross margin improved by 20 basis points.

Significant structural cost reduction in manufacturing, positive product mix and pricing more than offset increased commodity and packaging cost of about CHF 350 million. In manufacturing, we continue to optimize our production footprint. Our factory fixed overheads declined by 5.5%. In procurement, we continue to leverage our scale. Global buying through our three global purchasing hubs increased from 55% in 2018 to 61% in 2019.

**Slide: Margin expansion supported by structural cost reductions**

Now looking at our underlying trading operating margin. We have delivered a significant improvement of 60 basis points in underlying trading operating profit margin in 2019. The improvement adds up to a 160 basis points increase since 2016 to a record operating margin for the company.

It also means we are within our 2020 guidance range one year ahead of schedule. The improvement mainly comes from the successful execution of ongoing restructuring initiatives, which reduced our structural costs for the third year in a row. We also had some benefits coming from pricing, improved portfolio mix and marketing efficiencies. All of these savings more than offset an increase in input cost.

Consumer-facing marketing expenses increased by 3.4% in constant currency, which underlines our growth focus. Digital spend continued to increase, reaching 41% of total media spend.

**Slide: Significant increase in underlying EPS**

Moving on to the P&L items from underlying trading operating profit down to underlying EPS. We had restructuring costs of slightly more than CHF 550 million, and we expect to spend around CHF 500 million in 2020. Impairment of assets increased by 100 basis points, largely related to Yinlu. As a result, our trading operating profit margin was 14.8% on a reported basis, represented a decrease of 30 basis points versus the previous year.

We benefited from higher income related to gains made on the disposal of Nestlé Skin Health. Net financial expenses grew by 30 basis points, mainly reflecting an increase in average net debt during the year. Our underlying tax rate declined by 220 basis points to 21.6%, mainly as a result of the development of our geographic and business mix. As a result, net profit increased by 250 basis points to 13.6%.

Underlying earnings per share increased by 11.1% in constant currency, a second year of double-digit increase. Although this growth level will moderate in 2020 as a consequence of the disposal of Nestlé Skin Health and U.S. Ice cream, we expect to maintain UEPS growth at a sustainable mid to high single-digit level going forward. The share buyback program contributed 1.9% to the underlying earnings per share increase, net of finance costs.

**Slide: Further progress on working capital**

Moving on to working capital. The chart shows our working capital levels based on a 5-quarter rolling average. In 2019, we managed to deliver a further 80 basis points improvement in working capital as a percentage of sales. The main factors driving this improvement was continued strong improvement in payables. We continue to see opportunities for further improvements and expect working capital to trend towards 0, but at a more moderate pace going forward.

**Slide: 5th consecutive year of ROIC improvement**

Return on invested capital improved for a fifth consecutive year. Given our disciplined approach to capital allocation, we expect ROIC to continue to increase and trend over time towards 15%, including the impact of any future midsized acquisitions.

**Slide: Record free cash flow of CHF 11.9 bn**

Free cash flow grew strongly, increasing nearly 11% to reach CHF 11.9 billion or 12.9% of sales. These results reflect the reliability and sustainability of our profitable growth model. As we grow, so does our cash flow.

The increase in 2019 was mainly the result of higher operating profit and disciplined capital expenditure. We continue to work on all the levers of cash generation, growth, margin improvement as well as working capital improvement. Going forward, we expect our cash flow to remain at around 12% of sales.

**Slide: Temporary net debt decrease**

Net debt decreased by CHF 3.2 billion in 2019, closing at CHF 27.1 billion on December 31, 2019. The decrease in net debt largely reflected our strong free cash flow generation and the net cash inflow from acquisition and divestments, mainly the disposal of Nestlé Skin Health.

During 2019, we bought back nearly CHF 10 billion worth of shares through our buyback program and paid over CHF 7 billion in dividend. This mean that we returned a record CHF 16.9 billion of cash to our shareholders in 2019. We are committed to maintaining our 25-year practice to increase the dividend every year in Swiss francs. Future dividend increases will be more closely linked to underlying EPS growth.

At the Annual General Meeting on April 23, the Board of Directors will propose a dividend of CHF 2.70 per share, an increase of CHF 0.25. The net dividend will be payable as of April 29. Our net debt-to-EBITDA ratio stood at 1.4x. The net debt level will increase again as we initiated a new share buyback program of CHF 20 billion in January.

This concludes my remark. I now hand over to Luca to open the Q&A session.

**Q & A Session**

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

Thank you, François. And with that, we move to the Q&A session. We open the lines for questions from financial analysts. Please limit yourselves to no more than two questions.

The first question comes from Céline Pannuti. [Technical difficulty] Warren, can you please go ahead?

| | |
|---|---|
| **Questions on:** | **Achieving growth in Zone AOA**<br>**ROIC target** |

**Warren Ackerman, Barclays Bank:**

Two questions from me, please. First one is for Mark. It's more of a bigger-picture question. So, when I look at the geographies, Mark, Zone AOA, 3.2% growth in the year is lower than we would expect midterm. Obviously, coronavirus is a short-term headwind. But what can you do to get growth back to mid or high single digits in the Zone? Or is the pushback in the mid-single-digit because of Zone AOA? I'm just trying to work out how much work do you need to do to premiumize the portfolio and whether you could do a similar job to Zone AOA as you did in the U.S. a few years ago when you turned around the growth. Just interested into the perspective of what you're thinking about with Chris Johnson running the Zone.

Then the second one is for François. Just on the ROIC target, so very interesting. You've given us a target today of 15%. It's quite a big uplift, almost 300 bps. Could you maybe discuss the drivers or the buckets for that big uplift? What are you assuming on things like the key levers, the margin, the assets? Where are we on the asset side, for example, where you're trying to reduce it by 30%?

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

Warren, this is Mark, and thanks for your question. I think the question on AOA is absolutely spot on. So we have a number of specific issues to address, and we know that I'm in total agreement with Chris Johnson on this. So one is, for example, in China, as you know, we have been slowed down by Yinlu where we felt in 2017 and '18, we had stabilized the situation, but we saw in 2019 that, that was not the case. So we work on the strategy. We'll be back to you later this year on how to address that.

We had a situation in Pakistan that really slowed us down last year, which we're in the process of overcoming. We have new leadership there in place. I was actually in Pakistan end of last year to convince myself that we have good solid growth strategies in place, and I'm quite bullish on that. We have a few specific issues in Japan to address. We're working on those.

So once these specific issues are addressed, there is no reason why we would just stay at the growth rate that we are. So midterm, I fully expect AOA to be the growth engine of the Group, which it rightfully should be given Asia's importance for the world economy and the growth rates we're seeing. This is what our clear ambition is, and I think Chris and I are working towards that.

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

Warren, François speaking. So on your question on ROIC, first of all, you need to understand that even in 2019, we have been able to make some progress of 20 basis points in spite of the fact that we had significant impairment which reduced our ROIC. Actually, without the impairment for Yinlu, for example, we would be already north of 13% last year.

In the future, to move from, let's say, the 13% underlying last year to the direction of 15% over time, we will use all levers, which means accelerated growth, as we discussed earlier, improve margin, as we discussed earlier. We will continue to reduce our working capital, maybe not to the same extent as what we have done over the last few years, but still we expect to be probably at 0 or below 0 already in 2020 and to continue to slow down a little bit further in the negative territories.

You talked of asset turnover. So we will be disciplined there. I must say that the asset turnover ratio used to go down. And over the last 2 years, we started to move up again, so which is very good. We are very disciplined on CapEx as well. We have introduced much tighter policies. We don't limit CapEx because CapEx is driving growth. But we have reduced the payback, on average, over the last 3 years, by about 1 year, which is quite significant both in terms of cash, a positive impact, but in terms of ROIC as well.

We will continue to be disciplined in M&A, as we have been. It doesn't mean that we can't do any. I mean we bought Atrium. We bought Starbucks rights and other assets as well. You noticed as well that we gave that indication of a direction towards 15%, including mid-sized acquisition, which de facto means that we could potentially exclude any large acquisition, if any.

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

Céline, you are the next one in the queue. Please go ahead.

| | |
|---|---|
| **Questions on:** | **Outlook and impact of DSD exit**<br>**Cost savings update** |

**Céline Pannuti, JP Morgan Chase**

So I have, first, clarification on the outlook. Could you remind me what the impact is of the DSD? I think it would be 20 basis points for 2020, is that right? And I understand that reaching the mid-single-digit in 2020 has been delayed because of the DSD and also the Skin Health disposal, both of which we knew at Q3 stage when you said you were on track for 2020. So I wonder if there was anything else that you've seen since Q3 last year that led to the top line as of today.

My second question is on the savings. Where are we in the journey? If I remember correctly, in 2017, Mark, at the Capital Market Day, you said that there needed to be a step-up in terms of cost savings. And now you have reached the bottom end of the 17.5% to 18.5% target range. Are we done? Or is there more to go in 2020 in terms of that step-up before we get into a more normalized margin development?

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

Thanks, Céline. Let me address both. So for 2020, we do expect some negative consequence as a result of the DSD exit. This is unavoidable given the pretty heavy surgery that we're doing there in our operations. Let me confirm, everything that we have seen since we announced the step and put it in place totally convinced us that we're doing the right thing for the company here to position us better in the U.S. market at a time when these separate DSD systems are falling more and more out of favor. So we're doing the right thing. It's going exceedingly well. But again, there's going to be a minor price to be paid in organic growth in 2020. We did not itemize it here by the basis points, but there is a minor price to be paid, and we nonetheless took it because we felt it's the right thing to do. Midterm, you will see, as a result of that step, significant benefits when it comes to operational efficiencies. Those will get reinvested towards further growth. So again, it will strengthen the U.S. business significantly.

When it comes to the outlook, I think that you should see the positive side of what we're saying, and that is we are expecting further increase in our organic growth. That leaves us very little downside here when it comes to where organic growth could go. So compared to traditional 2 percentage points bands where we had guided in the past, I think this is a strong statement. All we're saying is, towards the top end, it may not cross over towards the 4% yet. To me, one of the swing factors here clearly is the fact that our Waters business is not in great shape, and the fourth quarter has confirmed that. The change here in governance of the Waters business from a globally managed business to one that's managed by the Zones has also confirmed some of the issues. We're very busy working on a strategy. We will unveil to you that Waters strategy in the first half of this year so that you have some confidence where we're going with the Waters business. So we're addressing all of this with a large degree of certainty and intensity. We'll give you a better sense of where exactly we're going with that business in a short order of time.

Secondly, when it comes to the savings, clearly, inside the company, we will continue to target this with a lot of intensity. We will start to reinvest more back towards growth because clearly, that is the best long-term value driver. I think this is in everyone's best interest to do that. But there's still lots of savings efficiencies to be had, and we will patiently pursue those.

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

Next question is from Richard Taylor at Morgan Stanley.

| | |
|---|---|
| **Questions on:** | **Coffee strategy**<br>**Plastic** |

**Richard Taylor, Morgan Stanley:**

I'd like to start by asking a strategic question about Coffee. If you reflect on the last 20 years, Nestlé has stayed the #1 player. But I suppose the -- as the #1 player, the profit pool in Coffee that you've, I suppose, actively chosen not to participate in is the retail Coffee chain. You've got your Nespresso boutiques, of course, and you bought Blue Bottle a few years ago, but you're tiny in context of the overall retail chain profit pool in Coffee. So please, can you give us an update on Blue Bottle now you've owned it for a little while? And then maybe some more strategic thoughts on how you think about that profit pool and your non-participation.

Then secondly, just on plastic. You set out some leading industry targets on plastic, but 2 million tons of plastic is still a great deal even if it is recyclable. So, can I ask a bit more specifically how much you expect to be recycled? How much will be biodegradable? And maybe you can give some more details on how you expect your investments and incentivizations to create the ecosystem that you need, so perhaps collaborating with peers, that kind of thing.

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

Sure. Thanks, Richard. So, let me start on Coffee. So Blue Bottle is doing very well for us, both in the cafés and when it comes to exploring CPG opportunities that are related to the Blue Bottle brand. I'm particularly excited about the Asian growth opportunity with Blue Bottle. But in addition to that, when it comes to the home U.S. market, that business is doing fine. So, this is one of those cases where it's not a Coffee shop-only player. I think it's one of those where you have a Coffee shop opportunity and a related CPG opportunity at the same time.

Clearly, our home is CPG. You see that also from our Starbucks transaction, where we're focusing on what we do best, and we're doing it well. In addition to that, there's kind of a halfway house, and that is the out-of-home opportunity where you cooperate with foodservice operators, people that run canteens, cafeterias, hotels, restaurants and so forth. You basically make sure that your Coffee brands make their way into those situations, but that doesn't mean you have to own the real estate. You don't have to own the place. You don't have to run the place. You just need to make sure your products are in it. Here, again, the strong stable of brands that we command, whether it's Starbucks, whether it's Nespresso, whether it's Nescafé, I think helps us to make a foray into that segment. So, I feel pretty good with the focus that we have, and that focus is not Coffee shops per se.

Now on plastics, let me just be very clear, recycling is not the only game in town. So, you have other options like the refill and reuse and biodegradable material. In order to make a real dent into the waste problem, I think you have to pursue every opportunity that's available, and this is what we're doing. It's too early to give specific indications as to what percentage will fall to recycling and what percentage will fall to reuse and refill or biodegradable.

It will also be vastly different by geography. So, for example, markets that have a very dense population and on also a population that is in a more north and moderate climate, I think those markets will be more attractive for reuse and refill. And markets that have vast distances and also an absence of recycling systems, those may be more interesting when it comes to biodegradable material. But again, these are early indications. I think everyone is in the process of testing and scaling various alternatives. Then once we see the winners, we can give more specific numbers as to how fast that will scale up and what they will mean.

What we saw is that for PET, which makes the largest part of the water bottles, that we do have sufficient recycling quantities so that we can actually use recycled PET to very good percentage for most of our bottles. But when it comes to PE and PP, two very important packaging plastics, there was pretty much a complete absence of a food-grade recycled material. So, by committing to purchase this 2 million metric tons and paying a premium for that, we hope to get that market going.

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

Next question is from Jon Cox at Kepler.

| | |
|---|---|
| **Questions on:** | **Coffee and Starbucks**<br>**Commodities outlook and Pricing** |

**Jon Cox, Kepler Cheuvreux:**

I have a couple of questions. One on Coffee and Starbucks and the boost to the business. Just looking at the sort of like organic sales growth from Powdered beverages and in the Other Businesses, you don't really see any acceleration in terms of organic sales growth. I'm just wondering what is actually going on there. Maybe instant or other parts of the Coffee business aren't doing so well. I guess the Others segment is impacted by the Skin Health removal. I wonder if you can sort of talk us through that on the Coffee side.

Then just an outlook regarding commodities for 2020, just wondering what your thoughts are in terms of commodities; and pricing, generally, pricing remains relatively fragile, although obviously, it did improve in the fourth quarter.

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

Thank you, Jon. So, let me take both questions. Indeed, the Powdered and liquid beverages category has slowed down a little bit. So, this is not necessarily linked to Coffee. If we take the different bits and pieces of this category, first of all, Soluble is positive, but it is growing a little bit less than it used to, largely as a consequence of declining green coffee prices. And this is especially true in Western Europe, as you know, where we had to pass on to the trade and to consumer part of the significant decline in commodities. We are not talking of a small number. It's close to 25% last year versus the previous year. The other thing within this category, you have other assets as well, Nesquik is one of them. Nesquik is under pressure somewhat across geographies. Then the last section is Milo, which continues to grow nicely but at a slightly lower level.

Moving to the question on commodities. So, we had an increase of commodities and packaging material last year, which was around CHF 350 million, an increase which was totally reflected and passed on in terms of pricing on our side to the trade and to consumers.

This year, in 2020, we expect to get an increase of commodity and packaging material, which will be higher than the one that we had last year, so more than CHF 350 million. It will be different from last year, although it will be essentially targeted at Dairy and packaging, which was different from what we had in '19, which was largely cereals, grains and cocoa.

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

Jon, if I could just follow up on this. Let me point out that in Q4, we did return, as projected, to positive pricing. So, I know this was a point of concern in our Q3 conference call. So, I think our prediction at the time proved to be right.

Then second, I'd like to remind everyone that with the system we use, real internal growth versus pricing, the pricing is the pure like-for-like pricing. At this day and age of increased transparency and digitalization, that usually means passing on commodity cost increases. The bit that comes from innovation, the new products this exciting engine here of innovation that we got going, all of that is essentially in RIG. We call it mix, but essentially, it's innovation. Hence, I think you're seeing here this very strong picture with RIG doing very well even in challenged geographies, but then giving up some of that in pricing when there is price pressure. But it's important to know that system is different from some of our competitors that report volume and then pricing, on their side, includes innovation. On our side, the innovation is in RIG.

**Luca Borlini, Nestlé S.A, Head of Investor Relations:**
Next question is from James Targett at Berenberg.

| **Questions on:** | **PetCare growth in 2020**<br>**Vertuo growth** |
|---|---|

**James Targett, Berenberg:**

Two questions on categories, please. Firstly, on PetCare, clearly, very strong growth, 7% in 2019. I just wondered how confident you are that the drivers of that growth, the premiumization, vet, et cetera, can sustain that level of growth in 2020.

Secondly, on Coffee, just obviously impressed by the growth rate in the Vertuo business. Can you maybe give us an indication of how big Vertuo is in the context of Nespresso, considering it's growing at over 60%?

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

Thanks. On PetCare, I think we're very bullish on the fundamentals going forward. Having said that, I mean 2019 was truly a stellar year, and so I would not exactly pencil in that growth rate now year-after-year. But I think this is a category that is clearly on trend in emerging markets and developed markets. So, we see us very well positioned in there, playing to all the major trends. And so going forward, it's going to be a very reliable growth driver.

On Coffee, yes, Vertuo doing fantastically well, making good progress in Europe. We try to be helpful, but I also ask for your understanding that we're not disclosing the separate sales on that. As you know, we're not even disclosing the total sales of Nespresso. So, I think we want to stay away here from any competitive signaling, and that's in your best interest.

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

Next question is from David Hayes at Société Générale.

| **Question on:** | **Waters slow down**<br>**L'Oréal stake position and future acquisitions** |
|---|---|

**David Hayes, Société Générale :**

So, two for me. Firstly, on Waters, just to come back to that. Obviously, we have seen a slowdown in the second half in the marketplace you mentioned, Is that a backlash by consumers to the plastic water usage? Is that, therefore, a trend that you think will continue to get worse through 2020 and beyond? And I guess related to that, I think Waters was one of your core categories alongside Beverages, Nutrition, Pet food. Is that still the case? Or has Waters now changed its dynamic and maybe it's perceived to be slightly differently as you look at portfolio management?

The second question is actually related to some headlines that came out earlier. I think, Mark, you were on TV being interviewed, but we didn't manage to see that, unfortunately, but the headline suggested that you talked about the L'Oréal stake being a potential source for bigger acquisitions. So, I guess the two questions on that are, is that a new position you've got on the L'Oréal stake? And secondly, is that an indication that some of these acquisitions could be larger as you look at 2020 and beyond?

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

Thanks, David. Let me start with the second one first because it's the easiest one. No, there's no change in position whatsoever. I think we've described this. It was not news. We described this as a financial stake before. It's a very significant financial stake. So, this was not any signaling or hinting here on my part. I think I also made it very clear that we're not intent to day-trade with the L'Oréal stock. Let me also point out that I think over 40-plus years, this investment has done very well for Nestlé and Nestlé shareholders, and that includes recent years.

On Waters. So, we continue to stay committed to Waters as a growth category, and I think healthy hydration is a growing trend and one that can deliver serious growth. What we have to do is to position the business better in the segments of the Waters business that are doing well. So, we are over-indexed in some segments and geographies that are not doing so well. We are under-indexed in some of the ones that are doing extremely well. That shift is something we have to do, and we have to outline to you. As I mentioned, we will come back to you in the first half of this year and give you a very specific plan. As you recall, when we announced the geographic transition here from a globally managed business to one handled by the Zones, we told you that, that structural change alone is not going to be enough. It really has to be a new strategy, and that's the one that we will unveil to you later this year.

When it comes to the softening of the business in Europe, I know everyone is jumping to that conclusion. It must be about plastic. Plastic in some isolated markets and some isolated circumstances has something to do with it. But I would attribute much more of this to this whole notion that we are in quite a few segments and geographies in the market segment that was not doing so well. That's usually the lower-priced segment where you battle private label and other low-priced competitors. Where we're doing extremely well is in the premium and functional waters. This is where you're seeing good growth and good margin.

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

Next question is from Jean-Philippe Bertschy at Vontobel.

| **Questions on:** | **Innovation**<br>**Confectionery performance** |
|---|---|

**Jean-Philippe Bertschy, Bank Vontobel:**

I have two questions as well. The first one would be on innovation, the fast innovation. Is it possible for you to quantify the growth contribution of the products launched in the past 12 months?

The second one would be on Confectionery. Growth in the past three years were actually anemic. Your competitors are growing faster. The margin is trending down. The return on capital is, let's say, unimpressive. What are your thoughts or your strategy with regards to the local brands in this category over the long term?

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

Jean-Philippe, maybe I'll start with the second one on Confectionery. So, I think you are seeing a bifurcated picture here where we're doing extremely well on some of our flagship brands, and so the consolidated numbers do not do justice to the amazing success we're seeing on some of the key brands. I think the poster boy for that is KitKat, which is just flying. So, I tip my hat to what the team has done to revive this. So, on the key brands, usually, the larger ones, the more international ones, we're doing extremely well. On the local ones, we do have some pockets of success. Here, again, nice job. But then we also have a few that are still weighing us down. So, this to me is very clearly in the fix category and something that we now devote a lot of attention to. For example, that also includes the Hsu Fu Chi business in China. So, we're working on that. But I think this is one of those moments, if you just take the average now, you're not seeing the significant success of the ones that we have focused on and where we actually got things going, and we will do more of that. So, when it comes to simple turnaround efforts, frankly, inside the Group and sort of looking at the work that various categories have done, I think Confectionery is one of those stellar examples.

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

On the innovation side, we don't measure it as a percentage of sales. The only thing I can tell you is what we share usually, which is the fact that we have about 1/3 of our SKUs which are fully renovated or a part of total innovation every year. Or to turn it another way around, we have about 1/3 of our SKUs today in the market that did not exist 3 years ago, which is about the same concept.

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

Next question is from John Ennis at Goldman Sachs.

| | |
|---|---|
| **Questions on:** | **Inventory levels in China**<br>**Portfolio transformation to achieve growth** |

**John Ennis, Goldman Sachs:**

A couple of questions from me as well, please. The first is on inventory levels in China. Do you have enough inventory in the system to ensure that retailers have products to sell given the distribution and production issues in the region?

Then my second question is on the guidance for mid-single-digit growth in '21/'22. You helpfully outlined some category-country combinations that need to be fixed in AOA. But I wondered if you think that you can get to mid-single-digit growth with the current portfolio? Or is it -- or is that target reliant on more rationalization and acquisitions as well?

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

Thanks, John. So, look, on inventory, we do have inventory, of course. Inventory sits at various levels, raw materials, work in process, finished goods and then, of course, there's a lot in the supply chain towards the retailers. So, I think whether it's sufficient or not will all depend on what the next few weeks will look like and to what extent transportation distribution capacity will be constrained and what the future of this outbreak is looking like. So hence, I think it is too early to give a precise estimate of where we stand.

What I did applaud is the efforts by the team to really be available to start up early, take all precautions that are necessary and work very closely with the Chinese authorities to do as well as we can because we understand that, in addition to a business, we also have a responsibility to fulfill. So, I feel very, very good about that.

On the guidance, I think I did point out that for the next several years, you should expect a similar level of portfolio transformation as you've seen for the past 3 years. That will contribute to improved organic growth just as much as, for example, improved innovation and strengthening our high-growth categories and fixing underperforming areas. So again, it's going to come down to the same three buckets that were accounting for the past improvements. We should not forget, I mean 2 years ago, we were looking back at a year that had 2.4% of organic growth. We're now looking back at a year that has 3.5% of organic growth. So, I think that balanced plan to build on those three buckets is working, and we will bet on the same tools going forward. I feel very confident that will help us get there.

So, you heard about some of the issues we're fixing in AOA. You heard about the Water plan that we will unveil to you later this year. And then clearly, more innovation, more work in the high-growth categories and more portfolio transformation will help us to get there.

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

Next question is from Patrik Schwendimann at Zürcher Kantonalbank.

| | |
|---|---|
| **Questions on:** | **Nescafé**<br>**Acquisitions and buyback program** |

**Patrik Schwendimann, Zürcher Kantonalbank:**

Coming back to the Coffee business, what has to change at Nescafé besides pricing that you can reach a mid-single-digit organic growth in the future again?

Second question, you have mentioned that you would like to do more acquisitions in 2020. Is there a possibility that this could impact the buyback program? Or would you say you still will have more bolt-on acquisitions in mind?

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

Thanks, Patrik. So, on the acquisitions, clearly, small to mid-sized acquisitions, aside from any buyback considerations, are the surest and best way to create value. So that has always been our preference and continues to be. I wouldn't want to rule out large deals, but clearly, the sweet spot is small to mid-sized. Usually, it's the much larger integration job, which means more financial certainty. And there typically tends to be much less antitrust risk and antitrust leakage because, typically, you'd get by without any antitrust divestitures. So clearly, that's the sweet spot.

Let me say that just with the Zenpep acquisition alone, which we announced a few weeks ago, the buying volume is already going to be larger in 2020 than it was in 2019. So, it was a pretty low hurdle here that we had to clear. We have a few more projects to work on, and all of those are in the small and mid-sized category. But overall, I think everyone will understand that the portfolio transformation, ideally, you do it on both sides of the ledger, the buying side and the selling side. We want to position the portfolio towards higher growth, but we don't want to deleverage the company when it comes to the size and the operating leverage that we have. That's why, I think, a balance between buying and selling is the best way to go. I don't see, as of this point, any threat here to the ongoing share buyback program.

When it comes to Coffee, so clearly, there was some pressure on green coffee prices, and Nescafé tends to be exposed to that. I think we have a lot of good other initiatives underway in Nescafé to give that a whole new lease of life when it comes to growth. So, I feel pretty good about the work I'm seeing around the world in Nescafé.

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

Next question is from Alan Erskine at Crédit Suisse.

| **Question on :** | **Coffee** |
|---|---|

**Alan Erskine, Crédit Suisse:**

If I may, I'd like just to go back to Coffee. The Powdered and liquid beverage division grew at just under 3%. I know you mentioned the other product categories. But it looks like Coffee was mid-single-digit growth in Zone Americas. It looks like Nespresso was mid-single digit. And Coffee was mid-single-digit RIG in Zone EMENA. So, I just want to check, was most of that RIG canceled out by negative pricing in Zone EMENA? Or were there some headwinds in Zone AOA specifically for Coffee? Just as a follow-up, can you give us an idea what the growth was for Dolce Gusto last year, please?

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

Alan, let me take that one. Just to come back because I think I can answer too partly the previous one on your question as well. First of all, Nescafé had positive growth overall and across the three Zones, which is important. Even in Europe, where we are feeling the pressure in terms of pricing, we are growing and we are gaining market share at the same time, which is good. Nescafé continues to grow mid-single-digit in emerging markets as well. So, the picture is not bad. What we are suffering from essentially is the low coffee bean prices which are putting pressure on organic growth, but there is nothing dramatic there.

Nescafé Dolce Gusto, it's a sizable business for us. It's feeling the same pressure at the end with green coffee prices as well. We have a sizable business with a mixed performance by market. We have positive growth, for example, in France, in Benelux, in Iberia, Brazil. It's a little bit more difficult in some other markets and especially a few European ones. But we focus on margin improvement as well, but nothing really negative there.

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

Please, Jeff, please go ahead. This is Jeff Stent from Exane.

| Question on: | Organic growth contributors |
|---|---|

**Jeffrey Stent, Exane**

Just one question, if I may. I recall when Mark outlined the strategy in 2017, you showed a chart with 3.2% organic growth in '16. And then the three building blocks of the base business, portfolio change and high-growth categories would take you into mid-single-digit growth. But given today, you said that M&A has added 35 basis points. It kind of implies that in aggregate, the base business and high-growth categories haven't added anything since '16. Am I misinterpreting that? Or how should we think about it?

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

Thanks, Jeff. I think what you're seeing here is that the borders between the portfolio side and what is internal development are blurring at times. The single-biggest example, I think, is Starbucks where the origin of it all was a transaction, the acquisition of those Starbucks rights. But that would not have been worth very much without the very diligent work that the teams have done to develop a whole range of very cool products and then do picture-perfect launches all across the globe. So, it's kind of an internal-external hybrid that for the purposes of the slide, we have sort of attributed to M&A., but you might as well say, it's a good example of advancing a high-growth category. So, all in all, I think all three buckets are active. Depending on which year, I think it's one more than the other, but continue to count on all three buckets going forward to contribute to organic growth.

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

Next question is from Alain Oberhuber at MainFirst.

| Questions on: | Transformation<br>Turning around Hsu Fu Chi and Yinlu |
|---|---|

**Alain-Sebastian Oberhuber, MainFirst Bank**

Two questions. Just to come back regarding transformation. So, what we heard this afternoon is, obviously, we'll see a similar trend. But I understand you're right that it will be much more into divestment versus acquisitions. If you could verify that.

And the second question is regarding China. It had significant impairment in Yinlu of more than CHF 1 billion as well as in Hsu Fu Chi of CHF 0.5 billion. Do I read it correctly that's the first step for the exit? And if not, what you have to do in order to turn around Yinlu and Hsu Fu Chi?

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

Alain, I think the impairment is an accounting recognition of a reality that has happened. And so, this is our conservative financial practices to be sure that we recognize what has gone on and reflect that in our carrying values for these businesses going forward. That should not be read about where something is going, going forward.

When it comes to the transformation, when it comes to buying and selling, the point I was trying to make is last year was certainly more weighted towards the selling. If necessary, if we feel that there's no other option, we will continue to look at these options, but we are also eager to build the business and to buy where we can strengthen attractive categories and market positions going forward. That's my hope for 2020, that we'll come to a more balanced picture in that regard, which I think is a good thing to build and to grow the company.

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

Next question is from Jeremy Fialko at HSBC.

| Questions on: | M&A<br>Impact of divestitures on margin |
|---|---|

**Jeremy Fialko, HSBC:**

A couple of M&A-related questions from me. So, the first one is really just clarifying on your answer to the previous question. To what extent are you saying that your divestments going forward are going to be rather more contingent on your ability to find suitable acquisitions?

And then the second part is that you're clearly going to be exiting quite a bit of turnover in 2020 relative to 2019. So, can you talk about what the size of any unrecovered overhead hit might be to your margin, just a sort of a kind of a little hump that you have to get over in 2020, even though we know that you are guiding for margin expansion overall?

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

All right. Jeremy, just I'm glad you're bringing this up. I want to be sure I'm not misunderstood.

If we come to the conclusion on a business that has to be sold, we will not slow that down just to wait for something to be bought. That was not the intended message here. I think you saw us in 2019 do exactly the right thing for shareholders on these three businesses, Nestlé Skin Health and U.S. Ice cream and Herta. I think that's proof that even in a year where there was almost no acquisition, we did exactly the right thing for shareholders at the right time. That attitude is going to continue unchanged in 2020 and beyond. All I'm saying is, with a lot of diligent work, we have started to refill our pipeline of interesting projects on the acquisition side of the ledger. I was expressing hope that by more success on that front, we'll come to a more balanced picture. But you should never assume that we're slowing down anything that has to happen simply because there's a lack of buying opportunities.

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

Jeremy, François speaking. On the question of the absorption of our fixed costs and central costs and the impact of the leverage and especially in the context of disposals, this is something that, obviously, we have fully factored in our guidance and in our model. We are not worried at that stage, first of all, because we continue delivering outstanding results in terms of saving program. For the third year in a row, we have reduced our structural costs, fixed factory overheads and fixed distribution cost and G&A in general. We still have a lot of room to go. So this will help us as well to absorb the fact that we have a little bit less leverage as a consequence of some disposal, but it's not that material either. So, no specific concern on the impact that it has on the margin going forward.

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

We are approaching the end of the call. I think we still have time for 2 more calls or 2 more questions. Andreas von Arx from Baader, please go ahead, Andreas.

| | |
|---|---|
| **Questions on:** | **Plant-based business**<br>**Chocolate beverages** |

**Andreas von Arx, Baader-Helvea:**

Just a quick one. I mean you called plant-based the once-in-a-lifetime opportunity for Prepared dishes and cooking aids. Could you explain to me why you need a Frozen food business to expand on a mostly chilled plant-based products? I mean where are here exactly the synergies?

And secondly, on your sugar drinks businesses, like Milo and Nesquik, which seemed to slow down in recent, I guess, quarters or even years. I mean wouldn't it be now prudent to think about early about an exit of a category where also behavior of consumer seems to be changing?

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

Thanks, Andreas. On plant-based, let me be very clear, the business in and for itself is super attractive. When you have a CHF 200 billion business, growing it strongly and accelerating double-digit rates, there's nothing to reject. The point I was trying to make to you is that over and above that, with our footprint in this category, we also have lots of follow-on opportunities which we intend to pursue. That's not the only reason to maintain that business. I think we've seen a turnaround in Frozen as a category overall. And I think we're also seeing very promising work in our own Frozen business when it comes to improving growth rates. But I think it's one added opportunity here to breathe new life into this category, hence, I was saying it's a once-in-a-generation opportunity to rethink these products and to give them competitive advantage.

On your Frozen versus chilled, let me just be sure and point this out to you, the beauty of these products is you can actually do it in both ways. So these are chilled products and we have a chilled pipeline, and then you can also serve them frozen. The same happens out-of-home, some people prefer them chilled. Others prefer them frozen. You can actually serve these up both ways, which I think makes them very versatile. That's one of the reasons why these ingredients are very, very powerful and very good to breathe new life into our various follow-on dishes and products in this category.

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

On the chocolate-based beverages, I mean we have, first of all, a sizable business which is growing and which is delivering an attractive level of growth. I just said before that it's a little bit less than what it used to be. So there is absolutely no plan whatsoever to dispose of these businesses.

There are changing consumer demands and especially the move from powder to liquid beverages and ready-to-drink. And by the way, ready-to-drink is growing double digit, and we have very attractive position there, so which we are really leveraging upon.

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

We move on to Tristan Van Strien at Redburn. This is the last questions of the day. Please go ahead, Tristan.

| | |
|---|---|
| **Questions on:** | **Restructuring charges**<br>**Zenpep and limits of medical nutrition** |

**Tristan Van Strien, Redburn:**

Just two for me, please. Just first one, on restructuring. When I look at Nestlé over the last 20 years, you've averaged about 50 bps of restructuring charges a year and again last year. And again, you're guiding to put this a bit more than that next year. How do you think about -- is this – does it just cost CHF 0.5 billion a year for a business like Nestlé every year to stay on its toes? Is this just a normal charge the way you think about it, to keep Nestlé going over the next decade on a per annum basis? Maybe a bit of a philosophical question.

The second one, just a question about Zenpep. You seem to skirt the line of going into much more pharmacological area. Where is the line in your mind for that, Mark? What won't you or will you look at as you go on the edge of medical nutrition?

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

Thanks, Tristan. So let me start on Zenpep. This is a prescription product, but it's very clearly designed to address the metabolism deficiency. It is not a high-tech product. It's not something that, for example, needs to be injected or so. It's not a biotech product. It's actually a fairly established technology. And as such, we had several other products and initiatives in our Nestlé Health Science portfolio that already came very close. So while the owner at the present time is a traditional big pharma company, it is not something that we saw as out of bounds and something that we cannot handle.

That's not only our view. In order to qualify as a buyer, we had to submit all of this to the FTC in the United States. The FTC wanted to be sure that the buyer is a qualified buyer and owner. They came out with a strong thumbs-up that they see us as a qualified buyer and owner for this business going forward. The last thing that the FTC wants is that Zenpep as a product withers away under a new owner. I think they convinced themselves that Nestlé Health Science is a very credible owner for this asset going forward.

So, on the restructuring, maybe I'll do this together with François. But let me just say, we have seen ups and downs. We have seen numbers as low as CHF 150 million in recent years, and we have seen numbers as high as CHF 700 million plus. I think the CHF 500 million number shows you that a big deal of what we wanted to do in terms of restructuring is behind us. I think some people like to see these numbers all included. Other people like to see them before restructuring expenses. We cater to both needs. We are fully public and transparent on underlying trading operating profit margin, but we also give you all numbers, including the trading operating profit margin. So whichever you want to look at it, I think we're focusing on both sides.

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

Yes. I think you said it all, Mark. But just -- I mean we had 2 years of heavy restructuring in 2017 and 2018, which were around CHF 700 million, but that followed a few years where we were between CHF 100 million and CHF 300 million. I think that we had heavy programs like what we did for our Nestlé Skin Health, what we did recently for the DSD exit as well in the U.S. These were heavy programs. We don't have any heavy program currently ongoing, but we continue managing quite a large number of small to medium-sized projects, and there will be some further one in the future, obviously.

**End of Q&A session**

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

So, as we close up the call, I appreciate you staying with us here. We ran slightly longer than usual at almost 90 minutes. Appreciate your patience. I think this gave us a good opportunity to answer all the questions on your mind. Look forward to talking to you again as part of Q1. I just wanted to assure you the value creation journey here continues full-fledged on all of the key metrics that we talked about: top line, bottom line, capital efficiency. So we are as bullish as we have been, and we'll continue to work in that direction. Appreciate it, and talk to you at Q1.

**End of Transcript**