29th November 2022

Speakers:

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

Slide: Title Slide

Good afternoon.

Slide: Significant transformation of Nestlé

Before discussing our value-creating journey toward 2025 I will start with a short reminder of the significant transformation that Nestlé went through over the last ten years. Today Nestlé is much more focused category-wise than we were ten years ago.

If you look at Coffee, PetCare and Nestlé Health Science, they do account now for more than 50% of our sales, while it was only a third ten years ago. And we start seeing the impact as well of new categories like plant-based, which is already contributing to 1% of our sales. We are much more premiumized than we were ten years ago, with one-third of our sales today which are in premium products. So, we have largely walked away from commoditization.

We are also much more digital today than we were ten years ago, with 15% of our sales in e-commerce, while it was a very strong percentage ten years ago. I could mention there as well that we are much more digital, with almost 55% of our marketing spend in the digital space today.

We are also much more exposed to high-growth geographies like emerging markets, like the US. Today, the US we are much more American than we were actually ten years ago, with 35% of our sales in North America. It was 28% ten years ago.

And I could continue the list. We are far less capital intensive, far less labor intensive than we were, as illustrated by the fact that our sales per employee today in Swiss Francs are almost 25% higher than they were ten years ago. And this resulted in a strong financial performance.

Slide: Resulting in strong financial performance

You may remember that the three building blocks of our value creation models were the acceleration of our growth. We have met that with an organic growth over the last five years, which is on average at 4%.
The second driver was to improve our margin. There we have delivered as well, with the underlying trading operating profit margin which is up 140 basis points over the last five years, an underlying EPS growth which has been on average in the high-single digits.

And the third driver of our value creation model was the prudent capital allocation strategy. And there we have improved our return on invested capital by 300 basis points over the last five years.

We are not going to stop there, and we intend to continue creating value in the future. And I will cover, during my presentation, the four main levers of value creation going forward, starting with freeing up resources, which is absolutely critical. Starting with the restoration of our gross margin. This will allow us to invest for future growth, and we will continue to allocate capital prudently and to manage our portfolio in an active way.

Starting with freeing up resources, we absolutely need to restore gross margins. This year, in 2022, we expect to have a gross margin which will be around 300 basis points lower than where it was two years ago. As you know, this is largely the consequence of the timing difference between input cost inflation on the one hand and pricing. Even if we have done a lot of pricing, we have not been able to compensate fully for whatever we have received, which is massive.

So, we are very confident on the fact that we will be able to restore our gross margin to where it was before. But the speed of recovery may be impacted by external factors. If we go into recession, commodity cycle and many other factors as well. But, once again, the confidence that we have to get there is very, very strong.

The drivers in order to get there, we know what we have to do. Manage our portfolio actively, continue to premiumize our products, go for pricing. Do expect, for example, to see a significant level of pricing again in 2023.

And we need, as well, to drive savings and efficiencies. We have a good track record there in terms of delivering savings and efficiencies.
If we look at the period 2016 to 2021, we delivered on average CHF 700 million of recurring savings, recurring, so they are accumulating year after year. The main, the key drivers there were production efficiencies, where we closed around 30 plants, in addition to the businesses that we sold.

We consolidated our procurement activities above market in three centers globally, really leveraging on scale and delivering hundreds of millions of synergies there. We have increased significantly our shared service penetration, with now 6,500 people working in our shared services.

And we have consolidated, for example, our real estate assets. Just as an example, in the Vevey region where we work in Switzerland, we had 14 main buildings; today we operate with only four that we entirely own. In France, for example, in Paris, we had seven different buildings, we work only from one today. And in the US, we have reduced the number of head offices that we have by half, and we are going to go even further in the US.

Most of these drivers will continue in the future, but we are clearly raising the bar in terms of recurring savings going forward from ’22 to ’25, with an ambition to generate more than CHF 1.2 billion of recurring savings per annum, which means for the four years close to 5 billion.

Once again, the one that we executed from 2016 to 2021 will continue, but we have new ones as well. Laurent touched this morning on the project TASTY with SKU optimization and new recipes. Laurent touched as well on the last one, on project AGILITY. And, in addition to that, we saw with Bernard and Aude this morning, digitalization. By the way, digitalization goes beyond marketing. It applies to my functions. It applies to HR. It applies to operations as well, with connected operation and my colleague, Magdi Batato will cover part of it in one of the workshops tomorrow.

So, clearly we have raised the bar in terms of savings going forward. Most of these savings have to do with variable costs and we need to go even further than that by tackling as well fixed costs, or what we call internally structural costs, which is a sizeable bucket. It is about CHF 14 billion of value, which is around 15% of our net sales.
able to tightly control these costs that have increased at a significantly lower rate than our sales, generating between 60 and 70 basis points of margin improvement over the last couple of years.

In the years 2017 to 2020, we let that flow to the bottom line, which largely explains the margin improvement that I talked about earlier. And since 2021, we have used it to compensate for inflation. We use it as well to invest in sustainability, for example. in 2022, just as an example, our sales will grow between 8% and 8.5% and our fixed costs will grow by around 3%. So, we have a very strong track record.

Slide: Investing selectively and efficiently to support future growth

Generating resources, delivering savings and efficiencies is absolutely critical so that we invest selectively and efficiently to support future growth. This is really one of the pillars of the growth strategy for Nestlé, starting with R&D.

So, Stefan talked about it this morning. We spent about CHF 1.7 billion a year in R&D. We are the largest spender by far in our industry. The objective there is not necessarily, as Stefan explained, to spend more. It is about getting more out of it, and this is what we have been doing with a lot of success over the last couple of years.

The largest bucket of investment that we have is marketing and trade spend. We should not look only at marketing, by the way. We look at marketing and trade spend jointly because we arbitrate very often between these two lines of the P&L.

Trade spend is obviously above net sales, and it has to do with customer discounts and allowances as well as promotional rebates. But this is even more important in today’s world where consumers are more and more looking for value for money. So, we look at both items together. There clearly, we have a strategy to raise the investment because it is really driving growth, even if, in the case of 2022, we had to reduce a little bit our marketing spend exceptionally this year, much more as a consequence of the fact that we were short of products for some categories like PetCare, due to increased demand over the last couple of years.

We invest a lot in CAPEX as well, 5.1 billion CHF last year. I will cover that item later on.
Then we want to invest as well a lot in digital, as we discussed this morning. A lot has to do with data analytics really leveraging on all these data points that we have, and we can really create value. There again we want to increase the investment.

And sustainability is a sizeable investment that we do. Most of it is P&L related. 95% is P&L related. We are talking predominantly of the two large parts of these investments have to do with our zero-carbon journey towards 2050 as well as sustainable packaging. Moving away from non-recyclable, non-reusable plastic, moving back into paperization and so forth, some of the topics that were covered this morning as well.

Sustainability, we spent half a billion last year, it was already two times more than year before. This year, in 2022, we will probably spend a little bit less than 800 million CHF and next year it will be north of one billion and it will be north of one billion as well for the following years.

We will really look at that as an investment because we know that consumers are valuing sustainability investment. We know that today more than 60% of consumers take sustainability as an important attribute in their purchasing decisions. And we make sure as well, since we treat it as an investment, we need to make sure that we get value for money to a certain extent, so we have a clear objective to maximize the output, carbon reduction, plastic reduction, water reduction, whatever it can be, and to minimize the investment on the other hand as well.

**Slide: Investing to create new categories is part of our DNA**

We go beyond investing into these businesses, we also want to create new categories. This is part of our DNA. We always invest for the long term. And Nestlé has the depth and the width in terms of both P&L and balance sheet to afford investing for the long term. This is what we have done successfully over the years.

If you look at Nespresso, I mean, we lost money for 11 years before reaching a break even, but today we have a business which is CHF 6.4 billion in size, with a margin which was last year at 23%. The same happened more recently with Nescafé Dolce Gusto, where it took us seven years to reach a break even. Last year we had a business which was north of CHF 1.5 billion, with a margin which is north of 20% as well.

And, even more recently, we did the same with Human Milk Oligosaccharides or HMOs in Infant Nutrition. I remember when I joined the group seven and a half years ago, we had lost already
200 million, [I don’t mean] lost, we had invested 200 million already in R&D only to develop these new technologies. Today, last year, we had CHF 1.3 billion of sales, with a margin which is north of 20%. By the way, we achieved that in the third year of marketing, which is quite exceptional. Actually, the success has been even faster than what we could see with Nespresso and Nescafé Dolce Gusto. In the third year, we made it kind of a blockbuster, if we were a Pharma company, we would call it a blockbuster, in the third year, without having the right to market it in our largest market, namely China, where the registration is still in process.

Investing to create new categories doesn’t work at all times. From time to time, we don’t succeed. For example, with BabyNes we tried with the technology relatively similar to what we have with Nescafé Dolce Gusto or Nespresso, we did not crack it. We tried and tried again, and then we made the decision to stop. We talked a few times already about Palforzia as well, it doesn’t work at all times.

Slide: Developing growth segments through science & innovation

But we continue to invest in new segments and growth segments to make a difference through science and innovation.

This is what we do with plant-based food. Last year we reached more than CHF 800 million of sales. We are still growing double-digit this year, in 2022. Allergy is another domain, which is in between Infant Nutrition and Nestlé Health Science. Products are sold on both sides, with CHF 600 million of sales last year, growing at 30%. We do the same with Healthy Aging, half a billion of sales, growing double-digit, really capturing the demographic trends of an aging population.

What is important as well, when we develop these new businesses, I think it is extremely important, we always target to have a decent gross margin up front. And, for all of these new businesses, we try to have a gross margin which is north of 40% or 50% up front, to make sure that whenever we reach maturity, the examples I gave you before, we will have a good and attractive level of profitability. This is extremely important.

Slide: Clear capital allocation priorities

Moving to the next lever of value creation, which is capital allocation. There we have clear priorities. First of all, we want to invest in our business. This is less risky to a large extent
because we know our business. This is exactly what I discussed, investing in marketing, CAPEX, R&D, sustainability, digitalization.

This means also investing for inorganic growth. And there I am talking of M&A, with the search for assets that meet our expectations from a strategic point of view, cultural point of view and financial point of view.

What do I mean by strategic fit? I mean, for example, businesses that meet our ambition to be in the Nutrition, Health and Wellness business as well, NHW. When I talk of cultural fit, I am referring essentially to businesses that share the same values and purpose as we do. And, in terms of financial thresholds, we are targeting at first delivering the acquisition plan that we build before buying this asset. And we are looking at achieving a good return over time, which means a return on invested capital above the WACC of the acquisition.

Beyond deploying capital for profitable growth, we also want to return capital to shareholders in terms of dividends. We don’t have a dividend policy, but we have a dividend practice of increasing our dividend in Swiss Francs year after year. In a currency, the Swiss Franc, that tends to revalue year after year over most currencies. And we have been exercising this practice for more than 27 years now. In addition to that, we want to return cash to shareholders through share buy-backs. We have a policy there to use excess cash and to return through a share buy-back. You could ask me, what do you mean by excess cash? It is essentially our free cash flow, minus our dividend, minus – or plus or minus bolt-on acquisitions and disposals over a reasonable period of time. It does not apply to one single year, obviously, because share buy-back programs are over a couple of years.

In addition to that, we have returned historically proceeds from significant disposals, like what we have done with the reduction of our stake in L’Oréal last year, or what we have done with Nestlé Skin Health a few years ago.

Coming back to some capital allocation priorities, I just want to cover two specific topics where we have decided to temporarily allocate more capital. One of them is CAPEX. We used to spend between 4% and 5% of sales in CAPEX. It has been more last year. It will be more this year and next year. Next year will be probably the peak in 2023.

This is essentially linked to the fact that we had significantly increased demand for some categories, more specifically PetCare and Coffee, during the pandemic and the demand is still
staying and continuing at a high level. We need to be able to meet demand, so we are really investing in some of the projects like what you can see at the bottom of the page. After ’23 it will start to decline, and we expect after that, in 2025 and the following years, to be around 5% of sales in terms of CAPEX investment.

Slide: Working capital temporarily impacted by supply constraints

Likewise, we have decided to do a temporary investment in working capital in the context of significant supply chain disruptions lately. In the context of the energy crisis that we may be facing in Europe this year, we have decided to increase our inventory level temporarily. I think this was the right thing to do. By the way, it helped us a lot during the pandemic to gain market share.

We want to make sure that this winter we will be able to supply products even in case of energy shortages in Europe, for example. This is totally temporary. We had been, for two years in a row, at zero in terms of working capital after having been historically up to 8%. We will go back to zero; absolutely convinced of that, by 2025 at the latest, and even post 2025 we already have the building blocks in order to go below zero into negative territories.

Slide: Sustaining strong cash flow generation

These two investments that we have decided to do in CAPEX and working capital that are, once again, temporary, will have some negative impact, will put a little bit of pressure on our cash flow generation this year. Cash flow generation was historically between 10% and 12%. Might be a little bit lower this year, but this is temporary, and we expect to go back towards 12% of sales by 2025.

Just to give you an illustration of the fact that cash flow generation is absolutely intact if you look at the cash generated from operations, which means before CAPEX and working capital, you can see that this is very stable and dependable, around 20% year after year. There is a little bit of a small decrease in 2021, which is linked to one-off contributions to a pension fund, so no concern on cash flow generation going forward.

Slide: Pulling all levers to drive return on invested capital
This will result, all of this capital allocation, disciplined capital allocation, into the pursuit of continuation of our return on invested capital after goodwill and intangible assets towards 15% by 2025.

There was a little bit of a dip in 2021, which was linked to the acquisition of the Bountiful Company and that accommodates some bolt-on acquisitions for a few billion Swiss Francs a year, if needed.

We will use all levers in order to secure an increase of our return on invested capital. I mean the enumerator increased growth, increased margin and denominator discipline on working capital, on CAPEX, on asset intensity, on our industrial base as well.

And, as you probably know, return on invested capital is also part of our long-term incentive program, which means that the entire organization is very aligned there to drive ROIC up as well.

One last item on our capital allocation, which is, we want to have an efficient capital structure. We have been very active in terms of share buy-back over the last years since 2003, over 20 years, we did CHF 90 billion of share buy-back programs with a reduction of our share count by 30% and, on average, we created a lot of value because, on average, we bought those shares for CHF 66 since 2003.

We want to have an efficient leverage and an appropriate level for leverage, which should be between 2 and 3 in terms of net debt to EBITDA ratio. The level should be around 2.4 this year, impacted by the high level of inventory and high level of CAPEX. We are quite happy to be in the double AA space where we are today.

Our cost of debt is reasonable, around 2.2% lower than what we have experienced over the last ten years. It should not move too much in the near future because we have already 70% of our current debt which is at fixed rates. And we have taken the opportunity over the last couple of years with very low interest rates to expand significantly our average debt maturity, which used to be at two years a few years back and which is now almost at seven years.

Slide: Active and disciplined portfolio management

Now I would like to move to the last part of the value creation driver, and the last one is active
and disciplined portfolio management. So, we have been very active over the last couple of years since 2016, we made CHF 26 billion of acquisitions, and you have the list there.

We have done exactly the same amount in terms of divestiture, that excludes the disposal of the L’Oréal stake last year. We have been very active. But we have been very disciplined at the same time. During that same period, we looked at CHF 50 billion of potential acquisition, and when I say looked at, we even discussed them with the Board of Directors, so this is not just that we had a quick look and disregarded it. However, we really looked at it seriously and decided to walk away by a lack of financial return or, in a certain number of cases, due to negative due diligence findings.

**Slide: Creating significant value through portfolio management**

I just want to show you as well that the impact that we have generated on our operating matrix is quite significant.

If we look at the impact of this acquisition on our top line, it has contributed on average, since 2017, to an acceleration of organic sales growth by 50 basis points. It is not just about buying growth, because it had a very positive impact as well on the bottom line, contributing to around one-third of the margin improvement since 2017 as well.

We don’t look at portfolio management purely in terms of M&A, we also look very actively at our own portfolio. Part of it is linked to TASTY that we discussed this morning. However, it goes even beyond that. In a certain number of cases, we do not hesitate to discontinue some business lines; because we still have some businesses that are either loss-making or with low margin businesses and we do not hesitate even to discontinue some of them, as we did, for example, for some commoditized Dairy products that we discontinued at the end of the summer in the Middle East and North Africa. And we did the same in Brazil as well.

Another example is what we did with D2C in Japan, we like D2C in Japan, but it happened that we had quite a lot of SKUs with low volumes or with low margin and we decided to discontinue 80% of our SKUs for D2C in Japan.

**Slide: Significant value creation through M&A**

Coming back to M&A, I just want to share with you the way we look at M&A. The way we look
at it before we sign any deal and the way we look at it after we have executed some deals and the way we look at it with the Board of Directors. Because we present to the Board of Directors once a year a post-mortem analysis for any asset that we have bought for more than half a billion Swiss Francs over the last few years.

We look at it under two dimensions. The first one, for the first three years after the acquisition, we look at, we assess our capacity to deliver the acquisition plan, which is a good discipline, but we want to make sure that we achieve or exceed the acquisition plan that we have set up, both on the top line, value-wise and organic growth-wise; and on the bottom line as well, both in terms of margin rate and margin in absolute value.

And after the three years after the acquisition, we look at the financial return that we get from this acquisition with a certain number of matrix. The main one is that we want to secure that we have a return on invested capital above the WACC of the acquisition within five to seven years, which is quite tough at the end.

And, if we look at what we presented last time to the Board of Directors, we have eight assets that fall into that category. In six out of the eight cases, we did reach our target: Vital Protein, Zenpep, The Bountiful Company, Essentia, Atrium Innovation and Starbucks. Even for Starbucks and Atrium, we will reach the ROIC above the WACC in year five or at the end of year four, at the beginning of year five, which is really at the bottom end of the objective. And we missed it for Palforzia and Freshly, as we discussed this morning.

That means that if we look at it globally, in terms of outcome, in 83% of the cases, value-wise, not number of assets but value-wise, we have achieved or exceeded our acquisition plan.

We also look at the way we created value, and we look at the same methodology. We use the same methodology as what private equity is doing, which means we are taking the EBITDA, the latest EBITDA that we have for 2022, latest estimate for example. In this case, we use an EBITDA multiple, which relates to the market, which in that case is lower than the EBITDA multiple we paid for the acquisition for this asset. We are on the conservative side.

And we add the tax benefit, and we have made a very conservative assumption in terms of impairment for the two assets, for which we missed our targets, Palforzia and Freshly. With that calculation, we arrive at a value creation which is between CHF 7 billion and 9 billion of value.
created, which is equivalent to a return per annum between 11% and 13% per annum, which is higher than our WACC.

**Slide: Our value creation model and 2025 targets**

So just to conclude my presentation before we move to the Q&A session with Mark. Just a reminder of our value creation model. This is clearly an extension of what we had before, but that shows to a large extent that we are working with continuity, stability, dependability of our model, of our financial model, even during turbulent times.

So we have these three buckets, operating performance with sustainable organic sales growth in mid-single digit space, underlying trading operating profit margin between 17.5% and 18.5%, the annual underlying EPS growth that applies for each and every single year between 6 to 10% and free cash flow, as I covered earlier, trending towards 12%.

The second bucket is about capital discipline, with working capital, CAPEX, ROIC already covered earlier, with very clear goals there.

And the third bucket is financial policy, with dividend, net debt to EBITDA ratio, with a little bit more specific KPIs there, as well as share buy-back with very clear priorities.

Thank you very much. And now we move to the final Q&A that I will do with Mark. Thank you.

**END OF TRANSCRIPT**