NESTLÉ S.A.

2023 BARCLAYS FIRESIDE CHAT TRANSCRIPT

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Speakers:

Mark Schneider, Chief Executive Officer, Nestlé S.A.
Warren Ackerman, Head of Consumer Staples, Barclays

Warren Ackerman, Head of Consumer Staples, Barclays:

Hello everybody. I am Warren Ackerman, head of consumer staples at Barclays. I'm delighted to be in Vevey in Nestlé's global headquarters with Mark Schneider, CEO of Nestlé. We've got a fireside chat. We've got an action-packed agenda. Thank you, Mark. We're going to try and get through as many questions as possible. So let's get cracking.

Question on:	M&A

Warren Ackerman, Head of Consumer Staples, Barclays:

Mark, first question. Welcome. Can we just start on M&A because since you've been CEO, you've rotated 20% of the portfolio and created a lot of value. However, there's been a few maybe missteps recently, particularly Aimmune where there's a write down happening. What lessons have you learned from that? What are the potential outcomes from the Aimmune strategic review and how are you thinking about the bioscience strategy within Health Sciences? The reason I ask this is because there is a little bit of concern about Seres, could it go the same way as Aimmune? What investors are asking me a little bit is has Nestlé taken maybe too much risk on some of the smaller deals and perhaps not enough risk on bigger deals? So it's a question around M&A and where we go on NHS and wider strategy on M&A.

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

Thanks for coming out to see us today and good to have a chat and good to connect with our investors.

So obviously, lots of good questions here related to M&A. Overall, while we were the first ones to admit that we did not meet objectives, in particular on Palforzia, it is important to point out that the M&A track record over the years has been, in my opinion, a good one. We've added to our organic growth, and our margin. More than 80% of our transactions met or exceeded the business plan. And even if you net out with the ones that failed, including Palforzia, I think there's been very good overall value creation here for Nestlé shareholders.

We took Palforzia very seriously and I hope you appreciated that we were very transparent with it right in Barcelona and also as part of all the investor contact since. I think when we disclose the situation, we also attach the consequence right away and that is that going forward we're focusing Nestlé Health Science more strongly on the two areas where I think we have a strong market position, we have experience and every right to win, and that is Medical Nutrition and Consumer Care. There are some aspects to that strategy from the past like Zenpep and also Seres that I think are going well and hence given that those are transactions from several years ago, there was no reasons to correct those. The deal with Seres is structured in very different ways from Aimmune in the sense that, after the upfront payment, a lot of it is related to milestones in performance, hence a much lower risk way of rolling those out. The product is approved now and so let's market it in the U.S. as we had foreseen. Generally, in that area of gastroenterology, so Zenpep and Seres, I think there's an established medical need and people are looking for better therapies, and hence the risk profile is much lower.

But overall, related to Aimmune the lesson was, let's stay closer to the areas that we know we're doing well and try to expand those. There's a lot of growth left in those, and you see that mirrored in the expectations that we have for Nestlé Health Science going forward, where we still believe is going to be one of our main growth drivers.

Question on:	**RIG** **Premiumization**

Warren Ackerman, Head of Consumer Staples, Barclays:

Moving to Real Internal Growth with a focus on mix. I think the market is a little bit spooked about the Q4 RIG decline, a better trend in Q1 obviously. Can you maybe lift the veil a little bit and explain what's happening to volume and mix trends? My understanding having followed Nestlé is that you look for volume of around 1% and a mix of 3% which tells me that premiumization is really key to value creation. And you said yourself that that's the best defense to commoditization – premiumization. You're now at 35% of the portfolio that's premium. How far can that go? And is there any risk of pushing premium too hard in terms of pushing differentiation when consumers maybe are looking to trade down at the moment? How do you kind of square that?

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

Yeah, so a few observations on that. I think the premiumization is strategy is something that we have pursued patiently over long periods of time. And I think it has served Nestlé and the shareholders really well. When we talk about premiumization in Food and Beverage, it may be different from other categories, where it's more outright luxury.

Premiumization with us starts when there is more of a quarter of a price premium over the average midpoint price. And so, to me, these are everyday affordable luxuries and hence the economic impact, when there's low or negative growth, is not as strong as in categories where it's bigger ticket items, and where people really have to have disposable income and savings in order to afford them. So that's why what we've seen over the years, the premium segment has held up really well, even when there was stress in the economy, just like the value segment has held up well. What typically gets squeezed is the mid segment and so from my perspective, no need to change that premiumization strategy.

You're right, while we don't disclose the exact breakdown of Real Internal Growth into volume and mix every time, mix is one of the key drivers here. And I think it should be obvious that at a time like this, when you've seen significant inflation on the one hand, and the normalization from the COVID environment, that volumes were a little bit under pressure.

If I reflect on Q4 and maybe that overreaction to the Q4 numbers, I think people saw everything too much through the lens of inflation alone, as if the low volume would have been a reaction to nothing but pricing. And I think the part that they missed is that just like we had some tailwinds going into COVID, as the world normalizes, it was very clear, and it was obvious to us, that there was going to be a period of four to six quarters as the world crawls out from underneath COVID where there was going to be a bit of headwind. So the cup of coffee for example, when you had five workdays a week until last winter, the winter of '21-'22 where you consumed your coffee at home. And maybe now you're spending two or three days in the office clearly, with our strong in-home market share, there was going to be a headwind. We always knew that.

Question on;	**SKU rationalization**

Warren Ackerman, Head of Consumer Staples, Barclays:

Maybe turning to SKUs because one of my big takeaways from Barcelona was the disclosure that you had 100,000 SKUs and 34% of them are 1% of revenues and then 12% of them are 80% [of sales]. So it's quite polarized. Given that, would you accept that perhaps Nestlé has a bigger tail of SKUs than of some of your peers? And what's the right way to think about SKUs and your plans to simplify the business? You have called out Canadian Frozen food? It's a big book of business, but investors are asking are there other Canada Frozen foods and could this actually be a drag, a longer drag, than perhaps investors perceive? Just interested in terms of the genesis of how this started, and how far through this are we, and are you having to address things that maybe you've got slightly out of hand over quite a long time?

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

Yes, so here again, super interesting set of questions. And let me try to shed a bit of additional light on it over and above what we have shared in previous calls. So the sheer number, 100,000 even though that's materially larger than many of our peers, that alone should not spook you, because we're also, as a company, materially larger than many of our peers. And when you are in 10 + categories, and 186 markets, the fact that it's a very big number shouldn't be surprising. Having said that, we did say openly that 100,000 is too many. I think we've started early. You've seen us start that discussion, I believe as the first company in our space and now several other companies chiming in onto the same theme because I think everyone was onto the same issue. And that is in the latter part of the last decade, in a low growth environment, you were eager to get additional growth everyone was busy launching new products. At the same time cutting products would have come at a volume and growth penalty and at a time when you're fighting for every 10th of a percent of organic growth, even if you don't get the order to maintain the products. I mean, there's a strong incentive for everyone to do it. Hence may be a bit of a bolus was building up there. When some of the supply chain shortages came about and when you had to make choices all of a sudden we saw if we not only cut the tail, but also devote all that effort and emphasis to our top selling high-rotation items, we're getting efficiencies here, higher service levels, everyone in the last few years was struggling with service levels. And then also for the retailer, I think, it's a better use of their shelf and the shelf space.

So in terms of where we are, by now, we have reduced the number of SKUs by about 20%. That comes either from straight cutting or from what I call harmonizing because, as we delve into it, sometimes what happened is you may have ended up with 10 or 15 SKUs where the differences were minute and then what you're trying to do is collapse it into just one or two. And my expectation would be that for the remainder of the year, there's probably another 10% or so to go.

Question on:	**Focus on categories**

Warren Ackerman, Head of Consumer Staples, Barclays:

One of the other big questions coming out from investors in the last couple of quarters is people can see clearly the amazing franchise of Pet food and Coffee, which about half your sales. But the question we're getting is what about the other 50% of Nestlé where Confectionery, Dairy, Water, some investors have asked me is there actually a two speed Nestlé, where all the focus is on Coffee, Pet and Health and the other 50% gets less attention and perhaps is more at risk of commoditization over time. How would you sort of answer that?

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

I can see in light of the stellar growth we've posted in these three categories, Coffee, PetCare, and Nestlé Health Science, how that impression may come about. I don't believe it reflects the reality inside the company and I think there's a few very specific examples that we can point to. So, for example, inside Confectionery *KitKat* has been one of our growth stars and a real nice global franchise and brand powerhouse coming up there. And that did not come across accidentally. I think this is something that we worked on patiently with a lot of global effort, and I can only congratulate the Confectionery team for pulling that off.

You've seen the tremendous turnaround in Infant Formula, that's important to us because that's the category we were founded on, it's very close to our mission, providing the best possible start in life is one of those key components of that mission. And in particular, China, I think, managing that turnaround, against the backdrop of very low birth rates, I think was significant and shows you that when we focus on a problem we can really bring about tremendous change and so yes, we are committed to the full spectrum of what we're doing, and we will do what's necessary to make it succeed.

Question on:	**Medical Nutrition**

Warren Ackerman, Head of Consumer Staples, Barclays:

Maybe just digging a little bit into that Nutrition comment. My team and I have undertaken a quite big piece of work on Medical Nutrition, which is your oldest pillar within the NHS. How big is that for Nestlé? And can you talk a little bit about whether you're seeing any acceleration in growth? And related, we are starting to see regulatory changes in China for example, where some of these enteral products are moving from drugs to food for special medical purposes. How significant is that for Nestlé? And how do you ensure that you get your fair share of that growth, particularly in China, particularly in Medical?

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

So, you're absolutely right. This is a very attractive segment of Nestlé Health Science. I'm quite familiar with this segment, because with my previous company, we were also one of the global competitors in that space. And for Nestlé Health Science, it's about a third of the revenue. And I've watched this now for over 20 years between my previous company and Nestlé now. And so this has very steady, above par growth, and it's very closely related to demographics and the ageing of major advanced societies because as you age and the number of medical procedures increases, the use of these products very often happens right before or after medical procedures and hence, you have that steady acceleration in demand. That is unlikely to change and so I think the next few years and the next decade or two will look just as exciting as the last two decades, and very excited about it.

China, I think is an additional growth booster, and that classification as food for special medical purposes that they have found which sits right between normal food and a drug, I think is incredibly helpful. With a super strong team on the ground. We have local manufacturing. So I think we're poised to capture that growth opportunity.

Question on:	HMOs

Warren Ackerman, Head of Consumer Staples, Barclays:

And the other related part on Nutrition is human milk oligosaccharides, HMOs. We've seen big share gains from Nestlé, generally in Infant Nutrition. Would you say that HMOs is a big driver of that? And the reason why I asked is because in terms of your disclosure, we know it's about CHF 1.3 billion, a few years ago it was very small. So it's become big.

And what's your opinion about China, whether HMOs do get approved, there's been a lot of talk about that. Do you think that's going to happen in the near term? And if it does happen, do you think it drives another wave of premiumization in China, as mothers obviously want the best for their babies, and this is the closest ingredient to breast milk?

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

So HMO is very important to competitiveness at the very peak in Infant formula. And so we're proud of the technologies we had and being one of the earliest companies in the market. It is an important part of the growth we've seen in Nutrition, but it's not the only one. And that's important to me to point out that our Nutrition segment, it's not a one trick pony. And there are several other success stories that overall contributed to the recent success we've seen.

One of it is the basic turnaround in China, where I think a lot came from cleaning up the product portfolio, cleaning up the distribution system and just the basic blocking and tackling is just happening so much better than before. We're also seeing good progress in our Gerber product range and some innovation there, both in the U.S. and then also what we sell in China. So I think there's several components here that contributed to the success overall.

Going forward we have filed all the necessary applications for China. I am confident that over time we will get that, and it will continue to drive the growth in China because as you mentioned the Chinese consumer in particular is very focused on giving their children the best possible start in life and clearly with HMOs there's a good solid scientific foundation and that it is superior to previous technologies.

Question on:	Bountiful

Warren Ackerman, Head of Consumer Staples, Barclays:

The other pillar in NHS is Bountiful. Lots of questions on this as well. I am sure you've received as well as I have. You sounded confident about the second half, getting back to high single digit growth after negative growth at the start of the year. Can you maybe elaborate what will drive that acceleration? And can you share some of your plans for the brands? Which ones are you most bullish about? Can these brands really travel? And what ideas have your R&D team come up with to improve the science and ultimately consumer loyalty to the category? We've seen Starbucks has been an amazing acquisition, where do you think revenues could be, what would you be happy with, to say in five years' time that's success.

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

So overall, we're very happy with how the Bountiful acquisition has been going. Now there's several components to it. Several things that attracted us to this transaction. First one is that in addition to all the pre-existing U.S. brands we had, there was a strong industrial backbone that promised significant synergies. We're now in the first half of '23, we're just in the process of driving all of this together, and it should give us a much stronger supply chain in the U.S. and also a much more efficient one. There were also certain technologies that are very much on trend, like for example gummies, that Bountiful was strong on and that'll benefit the entire portfolio, not just the brands that we acquired with Bountiful. So that U.S, consolidation play, plus industrial synergies was a key part that attracted us.

Then you have very significant brands and, in my opinion, well there were several ones, and all of them looked attractive to us. The two that standout are clearly *Solgar* and *Nature's Bounty*. *Solgar* is, I think, globally recognized as a very nice premium brand. It already had gotten some nice international traction and of course, we'll work hard to use our global footprint to roll that out even further. I think that's going well. And then *Nature's Bounty*, similar, very strong presence in the U.S., but also a good degree of international attention to it.

Going forward when it comes to the portfolio. The last two or three years, understandably, everyone's been interested in boosting the immune system. And that has been almost like the one main theme that was driving growth, I think now to broaden the scope here and to look at different life situations and problems you want to solve and then having the right mix of micronutrients to address those. That's really the focus. So it's not going to be a one trick pony. It's going to be something that rests on several growth drivers going forward.

In terms of the growth number. This is one of those categories, just like Coffee where obviously, after this mega growth that we've seen in '20 and '21, and maybe the first quarter or so in '22, we knew there was going to be a period where growth was going to be moderating. Not just because of the lapping effect, but also because as people got less concerned about boosting the immune system, some of the consumption was going to go down or change to different profiles. And so we believe that period is coming to an end. We're not only tracking the sell in but also the sell out and so as I look at that and as I look at where some of our retail partners stand, we have good indicators that suggests that starting from the summer things will turn around. As a reminder, already in Barcelona, we shared the expectation that for the second half of the year, we should come back to high single digit growth.

Question on:	**Nestlé Health Science margin and return**

Warren Ackerman, Head of Consumer Staples, Barclays:

And the other feature for Barcelona was the 18% margin target for NHS. I think it's 14% now so 400 basis points quite big uplift, can you explain what needs to happen for you to get there? I look at return on invested capital, you disclose it in your annual report, and you put it with Nutrition, but when you look at the all-in number, it's quite low single digit, and that includes Nutrition, so you ex-out nutrition, it implies that the returns are negative. Maybe I'm wrong on that, but that's what it looks like. So even if you get to 18% margin is still going to give you an acceptable return on capital?

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

So let's separate the operating margin from the return on capital. On the margin it's not the 18% that stands out it's the 14% that stands out because you're looking at a year before these major synergies that will come from driving together all of our U.S, VMS activities. So it's part of our business plan, we always knew that it was going to take some preparation in stock building, and then you know, you flick the switch, and that's happening right now as we speak. And then from there, there's going to be significant industrial synergies kicking in. And then also '22 was the year where we still had all of the significant R&D expense related to Aimmune and yet a revenue number that was very far from our expectations. Hence that weighed on the underlying trading operating profit margin, and as these things correct themselves and as the growth also comes back from the second half of this year, in my view, 18% looks like a good number. Previously, before the latest Bountiful acquisition and also before the R&D expense related to Aimmune came in, we were also pretty close to that number. So again, nothing unusual, nothing that seems out of reach entirely.

Now on the ROIC. Even on the very good transactions, the ones that you're super happy with, typically, they're way down on your ROIC for the first three to five years, that's normal, that's understandable. So that's why, with a lot of deal making happening in Nestlé Health Science, it's a mathematical fact that yes, for the time being that weighs down on your ROIC. To me, that's still no reason not to do it, because it's more important to see the business plan through and then to make sure that after let's say 3,4,5,6 years, the whole thing swings into an acceptable range, and that's what we're targeting.

Question on: PetCare

Warren Ackerman, Head of Consumer Staples, Barclays:

Switching gears we published a piece on Pet food today, it has been a big growth driver. The question keeps coming about supply chain additions and how you view that. You said that you think supply demand might be temporary over capacity and then demand-supply then rebalances. But can you maybe just reassure on that point because there is just a lingering concern that we might get an overcapacity situation which will impact then pricing and margins.

Then diving a little bit into the U.S, because on some of the market share points it isn't quite clear because we don't see every single channel, it does look like Nestlé might be losing a bit of share. Maybe you can, you can clear up what you're seeing in terms of U.S. market share.

And then I guess the other quick element on that is EM Pet food long term. How do you make sure you get your fair share of that growth?

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

Yes, so I saw the paper and agree with the growth drivers that you're outlining. So, this is, for good reasons, one of our most attractive categories and we're very proud of the strong position we have in it. So nothing to take away from that.

On the capacity shortages, let’s revisit the time right before COVID struck. We were already pretty close to our capacity limits. No one had an idea that something like COVID was about to happen, that pet adoption was going to be through the roof. And I think that pushed us as a company over the brink and then of course in a rush we were commissioning additional capacity, but with COVID around us, to put that in place also took longer than it would have taken under normal circumstances. There is already an organizational learning from that which is that for high growth categories, so PetCare, Coffee and others, the trigger points at which we start to commission additional capacity have been lowered, so that there's a bit more of a safety band. And I think giving up a tiny fraction of return on invested capital by commissioning this earlier is well worth it because the damage down the line if you miss sales and earnings is, of course, much greater.

Having said that, most of that capacity now will come on stream between this quarter, so we're starting with our China capacity, and then second and third quarter next year. I think gradually you'll see all of these capacity constraints easing. I think that should also help us then claim our fair market share in particular in North America where some of the inability to supply held us down. And so that to me was the only part of the paper that I wasn't so much in agreement with, but I don't think there's a perpetual market share problem. I think there's a temporary one and across all channels. I don't see us lose against any one specific competitor.

Warren Ackerman, Head of Consumer Staples, Barclays:

Who's winning on the market, because it's hard to get the read on say Blue Buffalo versus you. We see a little bit of private label at the margin. Are people trading down because they can't get hold of specialty and they're trading out a bit more to mass?

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

I think you've what you're seeing is a lot of scatter, because everyone has capacity constraints of some sort. Hence things are bouncing around and not seeing a clear secular trend where one is winning at the expense of others. And that's why I believe with that additional capacity coming on stream that we're in good shape here. So certainly the one company that you named now that was winning, I don't see that from our data that covers all the channels and hence I'm a lot less concerned on that.

On emerging markets. It's important that Purina traditionally had been a more U.S. centric business we brought it to Europe, and I think over 20 years have been on a wonderful journey in Europe. Of course, we are giving now a lot of emphasis to Latin America and Asia as well. China, as you see with our latest investment, also we're putting the groundwork in. I think at this point, given the sky-high prices for some of the assets of this space, it's probably best to focus on internal growth. That may take a little longer. But I think we've proven in Europe that if you do it patiently and systematically it will get good results over time. And of course, it's it works wonders for capital returns.

Question on:	Emerging markets

Warren Ackerman, Head of Consumer Staples, Barclays:

Maybe switching gears again, I want to ask you a more generalized question about emerging markets. Just a bit of a kind of a crystal ball. How do you see some of your key emerging markets developing? You mentioned you've been in China recently but I'm thinking about Indonesia, India, Brazil, China. What does success look like for Nestlé in some of these big EMs by 2030? What are your big priorities in some of these big markets?

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

So I think one of the strong points of Nestlé is that early foray into emerging markets and the strong indigenous standing we have there with strong local brand names, established manufacturing capacity and also, well connected management teams that know how to read those markets well. So while you will see continued ups and downs between different markets depending on what the economic situation is, collectively I would expect above par growth coming from emerging markets going forward. That means that the share of emerging markets will continue to creep up over time. Not in leaps and bounds but gradually, year after year. And that to me would be the definition of success that we participate in this above par growth with our fair share.

Question on:	**Marketing Spend**

Warren Ackerman, Head of Consumer Staples, Barclays:

I want to move on to marketing spend, it was very interesting that you're going to disclose, in the first half, your marketing spend I think that is going to be very welcome. You said the marketing spend is going to be up in Swiss francs and I think as a percentage of sales this year, which areas of the business need more the uplift and how do you think about the balance between marketing spend and trade spend, given your comments about last year where it was a bit more trade spend? And then related to that? Where are you seeing promotional intensity increasing within the Nestlé portfolio and are you internally expecting a step up in promo activity as commodity inflation rolls over? That's a question that keeps recurring and I'd love to get your perspective on it.

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

So, let me try and comment on it as far as I can. There is sometimes a level of detail where I can’t go to just for competitive signaling and also given that the situation is so different from country market to country market, But generally on disclosing the number, I just wanted to say yes, we don't want to keep you guessing as investors and hence the best way is to be committed to transparency and then lay it out and lay out the reasons for why the number is what it is.

Also I wanted to reiterate on my side, no regrets over last year. I think against the backdrop of this highly unusual year that saw its fair share of supply chain constraints, some of our own capacity issues and then also in the wake of inflation hitting us, I think we've made the right call. We were able, to much stronger extent that many of our peers, to preserve our margin, hence value for you as investors. And yes, I think with trade spend then, to stabilize the situation, also I think tactically was the right call, in the right circumstance. But we were also very clear in our full-year call that this is not the way forward to build the company and to build brands. So this was a specific reply to the situation we thought last year. Now it's back to the more systematic way of growing and brand building that has built this company and in line with that I think the transparency on the number will give us a good way to show that to you and prove it to you.

Question on:	Margins

Warren Ackerman, Head of Consumer Staples, Barclays:

I want to go a bit into margins because your gross margin has fallen 400 basis points in the last few years. You've been pretty clear; you think there's no structural erosion in gross margin and it's simply a timing difference on price versus when inflation hits your cost of goods. Given you expected gross margins to recover in the second half of '22 and that didn't happen and you're now guiding to gross margins being down again in the first half, do you still think 400 basis points happens? I know you've not given a timeframe for it, but your pricing is already quite high and we're not seeing much recovery in gross margin. Or does it require commodities to roll over quite significantly to get your gross margin back from the 45% level today back to the 49% that it was in 2020, 2021?

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

So as a starting point, when it comes to last year, it's important to be at peace with what happened and why, because I think no one really expected that tremendous spiking of inflation that actually got even more fuel as we went through the year. Hence that repair to the gross margin didn't happen. And I think you'll see that reflected with many other players as well.

I think now from what we know today, and with the normalization we're seeing we are having a much better chance of making happen what we forecasted and I think one of our peer set said in a Q1 conference call, peak inflation may be behind us, but the pricing is not behind us because some catching up still has to happen, and many price levels for commodities, energy and labor are still above the numbers that we've seen before the spiking started and so we need to reflect that in our pricing. That pricing now happens much less across the board. It's much more targeted, either by category or brand or country. And so the discussions with retailers are a lot more nuanced, but they're still about essentially reflecting the reality around us, the cost increases that we're all witnessing. So, with that yes, I do believe we're well positioned to repair this over time. But we also made it clear in Barcelona that this is not going to be something that happens here from one year to another and hence it's kind of a multi-year period in which that benefits us. As a recap in big picture terms when inflation hits you in surprising ways as it did last year. That is a headwind to the gross margin, not just for us but everyone else, because clearly, your pricing happens more slowly than your cost increases. And for those people that are having a stronger presence outside of the U.S. market where the pricing was easier you could see that pricing was kind of slower to react. When inflation continues but moves more or less within expected bands then to me it's kind of a pass-through item. It's something that's more or less a wash. And that's important for all those people that may have a private concern that over the next few years inflation is not quite entirely disappearing. Inflation per se is not a gross margin killer as long as it happens within roughly expected bands. Then finally, when inflation eases, goes down, then I think it'll turn out to be a tailwind to our gross margin because then also prices tend to be somewhat stickier than the cost decreases we're seeing in that environment. And so that's the big picture term. And now we need to see how the economy and inflation unfold as we go through ‘23.

Question on:	**Gross margin recovery**

Warren Ackerman, Head of Consumer Staples, Barclays:

So I guess the question is I can see gross margin recovering but 400 basis points is a big number. And I guess my question is around reinvestment because when I look at the reinvestment buckets that you have, we know you have got more ESG costs this year than last year, you disclosed that. You said marketing spend is going to be up as a percentage of sales. You've got more wage inflation this year compared to last year. You’ve probably got more digital spend this year because you've got the target out to 2025. So these are quite big reinvestment buckets. Can you maybe talk a bit about those buckets and what happens if the gross margin doesn't recover as quickly as you think? You're not going to be able to postpone wage inflation and say to people listen, we can pay you when the gross margin recovers. You need that gross margin to fund that reinvestment. It'd be interesting to hear your perspective, if you can put any numbers around some of these buckets it would be really helpful.

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

So look, the way you describe it is very similar to how we analyze the situation; that is you run the ledger with puts and takes and then there is a list of sources. And so you have your efficiency programs and structural cost control, structural cost leverage. The gross margin repair, the pricing that goes in, premiumization and improving the mix over time. And then you have uses and here you have the fact that you want to improve not only your gross margin, but also the underlying trading operating profit margin. You want to spend for innovation. You want to spend more on marketing. You want to spend more on some of the sustainability costs. And on a multi-year basis the two need to be in balance. As we look at that, and as we look at the efficiencies that we can get, hence, the various projects we were driving on structural cost control and SKU reduction. And as we look at what we need, I think yes there is a path, and it is in balance and it's something that can get us to the 2025 picture that we painted for you in Barcelona.

Question on: Frozen foods

Warren Ackerman, Head of Consumer Staples, Barclays:

I want to turn to the other big topic on people's minds, Frozen food, and there's obviously a lot happening in Frozen food. You're winding down the Canadian frozen business we discussed. You've got the European JV with PAI, which I find interesting. You're using PAI again, this time for Frozen pizza, as well as Ice Cream. Can you talk a little bit about how you've come to these decisions and what outcome and growth and margin profile of the business you would like when it's all done?

Then I know you've been very clear about U.S Frozen food a number of times, you've been asked it quite a few times, but there's still questions about it, given what's happening to Frozen elsewhere. Are you concerned that competitors like ConAgra seem to have done a better job than you in U.S. Frozen in terms of innovation and marketing? They've actually overtaken Nestlé as the overall leader, I think I'm right in saying, in U.S. Frozen. What does U.S. Frozen have to do in terms of the financials, for it to remain a core part of Nestlé?

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

So I know there's lots of views and opinions on Frozen and I think we've been quite consistent in our views from the past that Frozen is an important part of putting an affordable and also potentially high quality meal on people's table within a few minutes, using tools and equipment that are, especially in the U.S., very prevalent and widespread in all households. And you can do it under your own control. You're not dependent on the delivery service. You don't have to tip anyone when they show up at your door. And so the simplicity and you know, simply the ubiquitous equipment to prepare it is quite striking. And we've seen, especially among some of the younger consumers and some of the value-oriented consumers, a lot more focus on it. Because eating out these days, especially in the U.S. has become really pricey and this is where that value differential when eating out and eating in has risen to such a to such an extent that people are rediscovering eating in. So I think strategically our views and being steadfastly committed to it has been vindicated. When it comes to where you play, it's interesting to know that there's pretty much no global player in it because you're so dependent, not only on your product and brands, but on supply chain, and that supply chain needs to come with a significant market share it needs to be efficient needs to be used full extent. You can't afford to be a fringe player and hence everyone is selective, and we are too. Look at the Canadian situation against that backdrop, so it was just hard for us to compete with U.S. made product, shipped by long supply chains, cross border, across a currency differential, that longer term was actually to the detriment of us and then also into a lower price level that we saw in Canada compared to the U.S. So in my opinion it was the right move to focus that capacity and everything we have on the U.S. business and made that call.

Likewise, European Pizza. Again, very focused set of brands and few country markets but not a widespread, ubiquitous presence, not the sort of synergy that we're enjoying in the U.S. between the Frozen food part and Frozen pizza. And we've made very good experiences with PAI as part of our Froneri Ice Cream joint venture, they understand corporate partnering, and they're basically doing the best that private equity can do and that is bring a pretty much radical makeover to the business, pour in the necessary investment. Provide the management oversight that's necessary to do that and reorient the business. So we've seen it at work and create value as part of Froneri and so we were happy to team up here again. As I explained on the Q1 call, I'm very optimistic here about the expectations going forward because the category itself is one that, I believe, has also an interesting outlook in Europe. Pizza is one of the most beloved dishes, there's a premiumization opportunity that probably has been under-utilized so far. And that's exactly the playbook we've seen Froneri where some of these premium brands were really driving the growth. Also the situation gives us full optionality so we could step back into it a few years down the road, or we could disengage.

Warren Ackerman, Head of Consumer Staples, Barclays:

And on the U.S.?

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

On the U.S., I feel that what you're seeing right now, just like supply chain constraints were providing a lot of scatter in Pet food, as we discussed earlier, depending on when and how people did their pricing, you're seeing a lot of scatter right now in the US Frozen market. And I'm proud of the fact that our U.S. team priced early, priced right. I think they were guessing the full extent of that inflation spike in the correct way, and they were reacting to it. When you do that, temporarily, in a price sensitive category you do pay with market share losses, but overall when it comes to the brands we have, both on the Pizza side and the Frozen meal side I'm actually quite bullish on that.

Warren Ackerman, Head of Consumer Staples, Barclays:

Are there any parallels with U.S. Water, when you were in it. You took a lot of pricing and competitors didn't follow, private label didn't follow you. You've taken a lot of pricing in U.S. Frozen. Competitors have been slow to follow. If the pricing architecture is such that you're always taking pricing and ceding share and then others don't take pricing. Does that concern you, it is obviously concerned you in U.S. Water, why is it different in U.S. Frozen?

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

Well I think on a Frozen meal when it comes to the ingredients, when it comes to the recipe, when it comes to how you market it, there's a lot more differentiation than just a plain half liter bottle of water. So that's one and then the other one when I look at the specific pricing and inflation surge that we've seen in the last two years, I think this is one where over time, people will have little choice but to adapt to the new reality of higher costs. And so yes, we may have gone early, but it is not like other people were immune from some of the cost increases that happened.

Question on:	**Digital**

Warren Ackerman, Head of Consumer Staples, Barclays:

The other thing I want to touch on is on digital you've got this target by 2025 to get to 25% of your business that's online. I think the number at the end of ‘22 was 15% if I remember correctly, so it's still a big jump up it's 10 percentage points on 90 billion plus revenue portfolio. What more needs to be done inside the organization to get you to that target? Which categories or geographies do you need to make the biggest jump and are you confident that 25% actually can be achieved in that timeframe?

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

So you should draw comfort from the fact that the number keeps going up even as we were going quarter after quarter through this post COVID. normalization? And that should give you comfort that it was not just a COVID phenomenon, but rather it was something that kind of jumpstarted a true consumer habit and that is now to order more food and beverages online either by going to a direct-to-consumer outlet or by dealing with one of the online merchants and platforms that we're dealing with. And so I think something changed here and flipped and that is a consumer behavior that is much more open to this in food as well.

We used to have a saying before that people prefer to pick their own bananas. And I think that has changed now as a result of COVID and hence, we see continued growth and I think every market, every category has its own dynamics, it's hard to generalize. But we have a good game plan that will get us there, or thereabouts. At the end of the day, this is unlike a margin, not one of those where 25.0% is success and 24.8% is disaster. What we were trying to tell you is that structurally, it'll go up significantly. We'll be dealing a lot more with online retail partners, or the online arms of traditional retail partners, and also drive up the digital part of our own direct to consumer businesses.

Question on:	ESG – Deforestation regulations

Warren Ackerman, Head of Consumer Staples, Barclays:

I wanted to talk a little bit about ESG. And one of the big topics at the moment is the new EU deforestation rules that I think were ratified by the EU Parliament just a few weeks ago, not to come in until 2024. But it does seem, quite onerous that you have to trace to a specific plot of land and guarantee that there hasn't been any deforestation. My question is what's Nestlé doing to prepare for the EU deforestation legislation? Are you confident the company will be ready, and actually could the legislation be an advantage for Nestlé because you've been doing a lot of satellite tracking for a while? And do you see that just being an issue of getting hold of some of these key commodities like cocoa and coffee and palm oil, because if you're small holder you might not want to sell to European companies, because the legislation, the regulation is so onerous that maybe you go to non-EU buyers. And the worst-case scenario, does it mean you actually need to think about your supply chain. So I know that it's quite a new topic in terms of the EU, but you've been thinking about it for a while. How does Nestlé play into this and how do you get your arms around what is such a big topic?

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

So avoiding deforestation is a topic that we're very committed to and it's not just a recent thing. It's not just a response to EU regulation, but something that actually goes back quite a number of years. And specifically when I look at some of the industry commitments that we were part of from 2010, on avoiding deforestation on the big four or five of our commodities it was interesting how things then unfolded because the industry overall missed by wide mark when you look at the commitments between 2010 and 2020.

There were two companies that stood out, getting very close, getting essentially 90% of the way there and also annually disclosing the numbers. And that was Unilever and us. We're now, based on '22 numbers, we're now pretty much at the 99% level. So, we didn't stop in 2020 even though the commitment time ran out, we said that we wanted to finish the job and that's exactly what we're doing. Yes, satellite tracking is one of the ways to help enable that but it's not the only tool that we have. And so it continues to be a topic that we're very committed to.

And yes, being able to make that direct link and the traceability and then being able, not just to fulfil the EU regulation, but also make that comforting message to the consumer that this product does not contribute to deforestation. I think that's an important part of our message going forward. Will there be other companies that may not disclose, that may not bother, that may sell to different standards and different jurisdictions? Yes, that can happen. Should that stop the leader from doing what's right? No, I don't think so.

Question on:	**Confectionery**

Warren Ackerman, Head of Consumer Staples, Barclays:

The final category I want to touch on very briefly is just on Confectionery, because in the first quarter, we saw quite a nice recovery in Real Internal Growth. And sometimes, we know about *KitKat* is an amazing brand, but we don't know much outside of *KitKat*, those other pieces within the puzzle. Is it just kind of out- of-home recovery, or are you actually seeing some kind of underlying improvement in RIG trends within Confectionery, how do you feel about that?

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

Yes. So clearly, the continued *KitKat* success story was a big part of it. But as you said, it's not the only part. And then, I think several other brands also sort of found their groove and even ones that in the past, here and there, disappointed us. So take *Hsu Fu Chi* in China as an example. So quite pleased that it's multipronged growth. But I'm also realistic, that the growth rate you've seen, specifically in the first quarter, benefited from some of that post COVID normalization. Hence another proof point that we're still in a normalization period, and categories that benefit for more from out-of-home, like Confectionery, those see a tailwind. Businesses that are very much out-of-home committed see a strong tailwind, and then categories that are more geared to the in-home environment or the COVID environment like the immune boosting interest that we've talked about earlier, those still continue to see a bit of a headwind. All of that should probably, if there's no other surge, all of that should normalize some point, middle of the year, and then I think we'll see the true underlying growth rates shine through more strongly.

Question on:	**EPS guidance**

Warren Ackerman, Head of Consumer Staples, Barclays:

In terms of your longer term, guidance, you're one of the few companies that really stuck your head above the parapet and given guidance out to 2025 - 17.5% - 18.5%. You've also given EPS guidance for the first time at the Barcelona CMD, the 6% to 10%. And as long as I've been following Nestlé and it's quite a long time, Nestlé hasn't really given EPS guidance. I'm just interested to know why you've chosen to be a bit more explicit about what investors might expect on the bottom line, has there been some frustration around the valuation versus the U.S. peers and the kind of slight disconnect? Clearly FX is a thing that is always a problem for Swiss franc reporters given the strength of the Swiss franc. So just maybe lift the veil a little bit as to what your thinking was around doing that, and is there a sense of frustration on that?

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

So let's focus on the first part and that was the ‘25 corridors that we issued for organic growth and the margin. And yes, we all know we're living in a volatile environment, but I think you've seen us in the past as a dependable and reliable company and we don't want to add to the uncertainty by all of a sudden saying OK all bets are off and we're not giving you a framework on how to think about the future. And as you saw from the presentation in Barcelona, and the investor contact since I think this is supported then by category specific and geography specific plans to get us there. So we feel good about these numbers that were issued there. And I would like to reiterate those, and I hope that our investors appreciate that, at a time like this, we're not just turning our backs on your expectations, but rather we're trying to give you certainty in an uncertain world. Now, on the guidance components, I want to be very clear that the two main pillars for us continue to be organic growth and the underlying trading operating profit margin. And organic growth and especially the volume-mix sum that's driving it, is one of the best long-term creators of value, and so that's why I think this is absolutely paramount. And then underlying trading operating profit margin. While I know some people are stepping away from operating margin components, I think it's really important to put you in a position to see how the company performs year over year, what is changing and to drive a discussion around that. We stay committed to both of these.

The EPS number that to me was seen more as a helpful additional complement, you know, we're complex company, lots of moving parts. And what I notice sometimes, even for the people that got OG and UTOP, more or less, right, somehow, what it adds up to on an EPS level, they got it wrong. And so we wanted to give some helpful framework for what that means. So see it more in that regard and not as the one that leads our set of guidance metrics.

Valuation - premium or penalty. Look, we can't escape the fact that we're headquartered and domiciled here in Europe. I think Switzerland already is kind of privileged compared to the rest of EU locations. The Swiss franc, yes, on operating level, it sometimes may work against you. But then of course, the share price is quoted in Swiss francs and the dividend is paid in Swiss francs and so I think comes back to investors and most people see through that. And valuation multiples premiums or penalties, those situations they come and go and it's not something that as management, we could easily change. So that's why it's not so important to see EPS as a reaction to that is more important to see the EPS range as just being helpful to you to see what our OG and UTOP number really add up to.

Question on: Innovation

Warren Ackerman, Head of Consumer Staples, Barclays:

And obviously, innovation is the lifeblood of FMCG companies. When you think about your innovation pipeline for this year, what innovation or how do you feel about your quality and quantity of innovation this year versus last year? Is there anything you're specifically excited about that actually can be a bit of a needle mover for Nestlé this year?

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

So nothing that I could call out ahead of time and wouldn't want to front run some of the launches here. But let me say in summary that when I look on the inside of the company, that change that we've made in 2017-18 to the whole innovation engine, that is probably the single most important internal change we've done. Maybe there's a second one now at the end of ’21 start of ’22, that the move from three Zones to five Zones. But clearly the change here when it comes to innovation, the flow of it, the timeliness and also bang for the buck; simply what we get for our budget. That was a very big achievement. The pipeline is chock full in most of our key categories. And so I'm quite bullish about that, that hasn't changed. And so going forward that will help us to drive growth and premiumization.

Question on: Next steps for Nestlé

Warren Ackerman, Head of Consumer Staples, Barclays:

A final question Mark. I think you've been in the job for six years. It's been a nice sort of journey over that period. But when investors ask me, what's the next leg, what's the next element for Nestlé when you look forward for five years as part of the investment case? Or maybe even put it another way. If you were in my shoes, looking from the outside in, what do you think the market is maybe missing on Nestlé? Where do you think the big opportunities and risks are from where you sit?

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

Yes, so look, very committed to running this business for the long term as I always have said personally. Then from an investor point of view, as I think about the single biggest disconnect over the last few quarters, it's been the fact that some of the volume slowdown had only been attributed to a reaction to pricing alone, as if it was a 100% push-pull relationship, you price you get whacked on volume. And that I think led to some of the overreaction here also in the share price to our Q4 results. What people probably didn't fully appreciate is the fact that yes, there is some volume reaction when you price like this in a positive manner, compared to previous decades, but over and above that, we still had to crawl out from underneath COVID. There was always going to be that four to six quarter stretch where things normalize and that normalization, just like it worked for us getting into COVID, we always knew it was going to be working against us getting out of COVID. So some of these concerns should normalize themselves.

But then going forward, very clearly making the most of the PetCare opportunity and maximizing that. Proving what we told you on Nestlé Health Science and the efficiencies and the continued growth of vitamins, minerals and supplements and getting that growth from continued innovation and premiumization. That is going to be another major proof point. And then on Coffee. I know some people were concerned that the Starbucks story has kind of run its course, the spreading to 80 plus markets. But as David Rennie pointed out in Barcelona, switching the growth story here from a geographic rollout growth story to one that is pipeline driven and constantly innovation fueled, that is now sort of the big next step of Coffee. But as I look across the spectrum here, optimizing the firm in a very steady way, improving the metrics again to what we have targeted for 2025. I think that is a pretty compelling investor story, and I'm very committed to making it happen.

Warren Ackerman, Head of Consumer Staples, Barclays:

I think we are on the buzzer, so we are going to leave it there Mark. Thank you for your time it has been very illuminating.

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

Thank you.

Warren Ackerman, Barclays:

I hope to see you again very soon in Vevey. Thank you for the investors joining us. Thanks, Mark. Bye-bye.

End of Transcript