NESTLÉ S.A.

2023 JP MORGAN FIRESIDE CHAT TRANSCRIPT

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Speakers:

Mark Schneider, Chief Executive Officer, Nestlé S.A.
Celine Pannuti, Head of Consumer Staples Research, JP Morgan

Celine Pannuti, Head of Consumer Staples Research, JP Morgan:

Good afternoon, good morning. Thank you everyone for joining me today. I am Celine Panutti. I head the Staples Research at J.P. Morgan.

I am delighted today, as part of our CEO fireside chat series to be joined by Mark Schneider, CEO of Nestlé. Good afternoon, Mark.

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

Good afternoon. Thanks for coming out to see us.

Question on:	**Managing volatility**

Celine Pannuti, Head of Consumer Staples Research, JP Morgan:

Yeah. Thank you for hosting me here in your headquarters in Vevey, Switzerland. Mark, maybe we'll start with a broad question on the endless volatility that we see in the marketplace and from a macroeconomic standpoint.

If I look at the sector and yourself, we have seen in the past quarter the hit from destocking, the hit from the normalization of consumption post-COVID, as well as your choice to decide to go for SKU rationalization and maybe some of the M&A that didn't work out the way it was expected.

So what I would like to understand is, when we look at all of that, how do you make of those? Do you think that we could see those in the rear mirror soon or already now?

Should we expect Nestlé's steadiness to come back? That's one of the features that investors are looking at for your company.

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

Sure. Completely understand. Look, I think it's a good high-level question to get started. I think there's a few sub-questions rolled into that. Let me start on volatility.

Obviously, the last three years, when you look at the combined effects of COVID, the war, inflation spiking, all of these are essentially 50 or 100-year events that were whacking around so many companies.

Obviously, the gyrations were so strong that no company, even the most stable ones, was completely exempted from that. We were no exception.

I think we have done well under the circumstances, but obviously things have been gyrating up and down. Just look at, for example, how real internal growth skyrocketed in '21 and then how pricing has been taking over in '22 and at the beginning of '23.

The important thing is that, relatively speaking, compared to the rest of industry and also compared to our sector specifically, I think we've been coping with these circumstances with what I consider to be, in all modesty, quite low volatility when it comes to the underlying stock performance.

So when I try to look at hard measures like, for example, equity beta, it used to be in the range of 0.7 to 0.8 in the years before COVID. It has come down to around 0.6. So, that's telling you something.

When I look at how some of our metrics, like organic growth and the components of organic growth and also our earnings, how they have developed and how the volatility stacked up against some of our industry peers, they're also, well while everybody was on somewhat different cycles, overall, the volatility in our metrics has been below average, while the total growth rates were actually doing quite well.

So I think on that one, while no one was able to escape the geopolitics and decisions that were outside of our control, under the circumstances, Nestlé has proven itself one more time as a relatively dependable and stable, growth-oriented company.

On the acquisition track record, here obviously there was a lot of attention on the two transactions that we pointed out in our Barcelona Investor Day, Freshly and Aimmune. We were very open about the fact that we did not fully meet our objectives there and have been continuing that full transparency throughout the Q4 coverage and Q1 coverage.

I think this, is in my view, textbook ways of handling with things that don't fully meet objectives.

Rather than trying to sweep it under the carpet or trying to gloss it over or switch the topic to something else, I think we laid it out to everyone as openly as possible, even though it's uncomfortable and unpleasant news.

Let me tell you, the fact that these two have not met objectives is something that personally I take very, very seriously. I hope that was visible as part of Barcelona and the Q4 coverage.

I would also like to point out that we didn't just bring the bad news. I think we attached a consequence to both of these cases.

So, in the case of Freshly, with the merger with Kettle Cuisine, there is a pivot strategically to something that looks a lot more promising for the next few years to come. That is catering to out-of-home environments that want to save on labor costs locally of food preparation.

In the case of Aimmune, I think we've been very clear that going forward the growth strategy of Nestlé Health Science is going to be so much more focused on consumer care and medical nutrition, that we're not seeking extra new growth and acquisitions in the Novel Therapeutic area, where we had a below par performance.

Overall, it's nonetheless a matter of pride to me that the acquisition track record, since we've done quite a few deals since 2017, has been a very favorable one.

There's a number of metrics. Did it contribute to growth and earnings? Yes, it did. Did the vast majority of these transactions meet or exceed the business plan? Yes, they did. Did we overall create positive returns? We shared all these numbers as part of Barcelona.

I think they speak overall, in spite of these two regrettable incidences, for a very favorable performance.

Question on:	**Real Internal Growth**

Celine Pannuti, Head of Consumer Staples Research, JP Morgan:

You mention real internal growth. Clearly, this year you are given a guidance of 6% to 8%, so organic growth that's ahead of your mid-term growth.

Real internal growth has been negative in the past quarters, but you are alluding to coming back to positive as we look into the second half.

Thinking of some of the points that I mentioned earlier about the SKU reduction or the Covid-related normalization have been hits to your performance.

I think on the last one on the normalization, I think you said it will take four to six quarters to wash out. Just would like to understand, where are we in that journey? Maybe in plain words, do we expect the rate to be back to 2% to 3% by '24?

I think SKU rationalization, there's already been a lot of discussion on that, but just one if I may.

Could you give us some tangible evidence when you have cut the tails and pushed the heads, what has it brought to the business?

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

Yeah. I think one of the most important disconnects, as we talked to investors over the last few quarters, was that any potential disappointment that they may have seen on volume growth and real internal growth was solely in the discussion attributed to pricing alone, as if that was a 100% push pull relationship.

As you pointed out in your question, there were actually several swing factors here at work. One was the post-Covid normalization. One was certainly inflation. That was a big one, no question about it.

Then there's a third one. That is the fact that we started this process of portfolio optimization.

As you saw, once we started talking about it, that talk was picked up by many other industry peers as well. So, I think everyone in a sense was facing very similar issues.

The reason that the post-Covid normalization is more than four quarters has to do with the fact that Covid didn't end everywhere at the same time. So, I think four to six is a rough estimate. It could also be seven or whatever.

Time-wise, I believe that starting from the second half of the year, unless we're seeing any other major surprises, you could safely say that that period should be out of the way.

Then, you still have the two others at work. One is the reaction to inflation and pricing and economic woes and the portfolio rationalization.

On the portfolio rationalization, to me, the most tangible yardstick and metric is simply that our service levels on the high rotating articles have been increasing a lot.

I think we pointed that out as part of the Q1 call, and that's exactly the intended logic. So, for the ones that are high rotation anyways, to drive their on-shelf availability and really make sure that those are always there when the consumer wants them.

Question on: Pricing

Celine Pannuti, Head of Consumer Staples Research, JP Morgan:

Pricing, you alluded, has been very strong. Now the market is quickly looking about the fact that some of the cost, spot commodities costs have come down.

It's not just commodities. You've seen, well, oil prices. You see gas prices. You see the easing of distribution cost.

So, there's a lot of debate about whether the industry as a whole will be able to hold onto quite extraordinary pricing that has been put through in developed markets, especially in the past two years and that as well impact Nestlé.

I know that you still have quite a lot of cost to go through this year in terms of COGS and hedging, as well as an impact, as well as SG&A. But at some point, Nestlé also will start to see that easing of cost coming into the P&Ls.

So the question is, when we hear politicians, like in France, when we hear retailers talking about having a good deal for consumers, how realistic is it that price will be sticky? How do you expect Nestlé to deal with that normalization of the commodity tailwind?

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

Yeah. Obviously, this is a period when you find a lot of comments on this subject from all sorts of corners, whether it's a retailers, consumer advocates, or politicians, as you pointed out.

We understand that affordability, especially for food and beverage, is a very important aspect and one that we're committed to.

The answer on how these gyrations flow is very different by category and by geography. So, it's very hard to give you one general answer here.

But obviously when you see now an easing when it comes to spot prices or when you see an easing on products that are sold without much value added, just like raw eggs for example, then that doesn't mean that for a large value-added strategy manufacturer like us, the situation is the same.

As you mentioned, there's forward contracting. Very often, if you have an easing on the spot price now, what people disregard is that there have been a full year of pricing building up before that, that we had to stomach.

So, then it's always important to look at it on pre-inflation levels. How does the current spot price compare to pre-inflation levels and not to the price from three months ago?

So all of that then leads to a true situation by category, by geography about where we stand. Obviously, we'll try to stay competitive with our products going forward. But overall, as you know from the consolidated gross margin, we still have catching up to do.

As I look at the P&L of so many of our peers, the situation doesn't seem to be very different.

So, it's important to look through some of the comments and also sometimes self-serving rhetoric and really look at the underlying facts.

Then, just like the spike was recognized late, I think now people cry victory a little too early, about maybe just an easing here from top pricing levels.

Overall, it's not a bad assumption to assume that underlying inflation rates in many economies during the 2020s will remain at a higher level than going into Covid.

Question on:	**European consumer demand**

Celine Pannuti, Head of Consumer Staples Research, JP Morgan:

Yeah. One area I would like to discuss about is the consumer demand. You mentioned at your Q1 stage that you got a bit little cautious about the European. So let's start there, the European consumer.

It's true, it has been rather resilient. We were expecting consumer in Europe to be under much pressure. It has been up to now rather resilient. You've been a bit more cautious. How do you think that the consumer in Europe will evolve? What could be the area of worries, downtrading, private label competition?

We also noted that some of the market data that we look at are starting to show effectively volume being under pressure, though it has not yet shown in your numbers.

Are we at risk to see the same impact in Europe that we have seen in the US, we were just discussing at the end of last year?

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

I think it's important when you look back on the past winter, compared to anything we ever feared last fall, late last summer, the consumer everywhere has held up so much better.

So yes, I think when you listening to some of the Q1 calls, everyone had expressed a certain amount of caution over April.

But here again, it's important especially in a nervous environment, a nervous investor environment that we keep apart seasonality in the way some of the holidays fall from what is true underlying sentiment.

It's unlikely to me that from one month to another, a consumer all of a sudden cuts spending sharply on something that is as much of a daily staple item as food and beverage.

So, that's why I think it's probably important to read out May and June and with the second quarter and the performance over the summer, get a clearer picture here on what happens.

Every time I see a strong movement from one month to another, it usually doesn't tend to be macroeconomics at work. It's more likely that it's something else, like the calendar for example and the number of trading days is at work.

That's why it's important not to overinterpret some of that softness that was discussed during April.

Question on:	**US consumer sentiment and premiumization**

Celine Pannuti, Head of Consumer Staples Research, JP Morgan:

Right. Maybe another big region is the US. I think in the past weeks we heard some of your customers, retailers have been talking about maybe a bit more prudence from a discretionary standpoint for some of the US consumers.

Now on the US your portfolio lends itself to more premium. If I think about pet, coffee, nutrition. Could you tell us, what percentage do you think of your portfolio is premium in the US?

And going into that, if there were more of a pressure on the consumer going forward in the US, or a recession, how would you expect some of those categories to behave?

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

Sure. Let me comment on how I interpreted some of these statements on the US consumer then also specifically comment on our US premium sales share.

So it's not a surprise to me that for truly discretionary consumer items, and especially some of the higher priced ones, more durable ones, there's got to be an impact when the economic sentiment worsens. And this may not be the best time to go out and buy a new flat screen TV. So that I get. But when I look at the nature of food and beverage, there's so much more continuity building. That's the nature of the beast.

And even the premium part there, usually, I mean, what we're talking about starts at about 20-25% of a markup over the average price in the category. So this is not leaps and bounds. This sometimes only boils down to a few cents or a few dollars. And I think you're seeing sufficient numbers of categories in the food and beverage space where even in recession times that little low-priced everyday luxury actually becomes very, very dear to the consumer. That's not something they want to go without when they have to delay other major purchases and maybe not have the vacation plans they had in mind and what have you. So that's why it's important not to confuse the two.

Now, on premium, as you know, for the group overall the share of premium products stands at about a third. It is true that Zone North America over-indexes slightly on that, but not in leaps and bounds. So there the number is around 40%. And I think we've frequently mentioned that from any readout we have from past economic cycles, usually the premium part in our portfolio and in food and beverage in general tends to hold up really well. So I don't see it as a liability. In fact, I see it more as a strength. Should it be a liability, it's important to know that while the US and Zone North America slightly over-indexes here on premium products, I think in our most important core categories we also have a successful lineup of brands at different price points. So it's not that we're totally losing that consumer. And so that's why I think there's some resilience built into the business setup we have, including for North America.

Question on:	PetCare growth drivers

Celine Pannuti, Head of Consumer Staples Research, JP Morgan:

Right. Staying on North America, one, I think, key success has been the pet division, the pet food division. I think structurally the fundamentals are quite good for this division. And you are also, I think, still capacity constrained. But what I would like to understand is how we should think about the normalization after a very strong period of growth going into the next couple of years. I think on one side, if you could comment on pet adoption, which has been very high, are we seeing now a plateauing level?, Or, you still see growth over a very high level? And then on the mix side, you were just alluding that premium tends to be resilient. When you look at pet and the absolute price point, do you also think that this would be the case for that category?

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

Yeah. So on the pet category overall, and when it comes to private pet ownership, we see that even post-Covid, the pet population tends to grow at around 2% to 3%. So it's not like we're seeing all of a sudden a steep dip here, and I think that bodes well. And then when you think back to one of the key growth drivers from before the pandemic, and that was the rising share of what we call calorific conversion in emerging markets, that also tends to be underway. So it's not like all of a sudden that stopped. So more and more households in emerging markets, as their earnings over the years increase, they switch from feeding the pet with household food waste to dedicated pet food, which of course is much more hygienic, has health advantages for the pet and also gains the households some time and convenience.

And that catch-up area is still very, very vast. So for each 1% of calorific conversion that we see in emerging markets, that translates into about a billion dollars of market size. So this trend continues in an undiminished fashion. I mean, clearly, for a quarter two, or maybe just for the normal lapping, could you see at some point a bit of a normalization here from some of the very, very strong growth we've recently seen? Yes, absolutely. But when it comes to the true underlying trend, clearly it points to continued very successful, above par growth when I compare this to our other categories. And that's also why we were so happy to commit the investment here, to be sure that we are always have the ability to supply because we know that even if we're off by a few months here, sooner or later we will grow into that new additional capacity. The risk of creating white elephants, which means large plants that run at permanently low capacity utilization, is very low.

On the premiumization and how recession-proof that is for pet food, let me answer with a quip and that is dogs and cats do not know where we stand in the economic cycle. And if you own a pet, you know that their willingness to trade down is very, very limited. They know how to make you unhappy and share that feeling. And as a dog owner, I can tell you about that from firsthand experience. And so that is why around the world, not just North America, when I look at last recessions, downturns, whatever, periods of hardship, usually that premium part has held up really well.

Let me also say one other trend that I think skews very nicely when it comes to our portfolio in particular, over the years, the population in cats has been particularly on a tear, and I think that fits very nicely with our portfolio strength. And then in dogs, small dogs are also seeing above average growth. And here again, that's a good fit with our portfolio.

Question on:	**Nespresso**

Celine Pannuti, Head of Consumer Staples Research, JP Morgan:

Yeah. As a cat owner, I as well agree on how they can be very fussy with their food.

Now, my next question would be on Nespresso. Clearly, we've seen some weakness and clearly as well from a tough comparative base, but at the same time, I think you spoke in prior calls about the total single-serve portfolio. So is it that you are seeing a migration from high-end to maybe more mass market? And is that maybe what we should be looking at for the foreseeable future given the economic condition that we alluded before?

And then specifically on Nespresso, if I may, if you could talk about Vertuo and Nespresso in the US, the opportunities there and how sizable they have become.

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

Yeah, absolutely. Nespresso is a good example of what we discussed earlier, and that is overlapping cycles and generations of different nature. So yes, undeniably for a system that was wonderful for people working from home and trying to enjoy a fresh cup of coffee every time you just feel like it without much preparation, as people now migrate back, at least for a fraction of their time, to the offices, that normalization was unavoidable. So you're seeing that. And I think to me, Nespresso is a poster child of one of our categories that is now seeing a bit of post-Covid normalization, where I think as part of the Q1 call, we pointed to the fact that that should start to normalize in the summer and second half of the year.

And then there's the second trend at work where undeniably, I mean, we've seen significant inflation, people are looking for cheaper alternatives. There may also be a less optimistic economic outlook. And so people may stay with a capsule system but then look in retail for some other compatible capsules that they can still run on the same system. And that one we're answering through the rollout of Nescafe Farmers Origins so that we're not losing that consumer. So here again, good case in point on what I was trying to tell you earlier, that we stick with the long-term potential of premium, but obviously, having a trustworthy and well-known good brand at the mid-range available is a good way to not lose the consumer entirely. But obviously, other retail brands that offer portion coffee benefit from that trend as well.

But long term, I think Nespresso has always been able to convince the consumer of the premiumness of its product range, and we have undiminished faith in that. Specifically when it comes to Vertuo, I mean, the US rollout has been a super success story. We still have a fairly low penetration. We estimate that penetration to be in the single digit percent range. And so that also means that in addition to that wonderful past performance, I think you have a very nice runway ahead of yourself for the Vertuo system in the US.

Question on: Starbucks opportunity going forward

Celine Pannuti, Head of Consumer Staples Research, JP Morgan:

One deal that effectively created a lot of value and you presented at the CMD last year has been the Starbucks deal. Now, the deal was done a few years ago, and then in 2021, you signed on for the ready to drink development in LATAM and Asia, and you acquired the Seattle Best Coffee as well. I just wanted to know where we are in terms of how this franchise evolves, and if you could specifically also talk about the out-of-home opportunity for the Starbucks brand.

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

Sure. So I think the best high-level description was given by David Rennie in his Barcelona presentation at the end of November last year where he characterized that first phase from the beginning of 2019 to the year 2022 as the one where growth was extensively fueled by the global rollout and just basically getting to markets where Starbucks retail was not available before, and that clearly was a major contributing factor in addition to, for example, Covid driving in-home consumption and so forth.

And that we were now segueing to the next phase of growth. And that phase is a lot more driven by pipeline innovation and obviously our joint work with Starbucks here on capturing all these opportunities, from seasonal to additional whiteness and so forth. I think that is pivotal to try out that growth going forward and making it resilient and independent of geographical rollout. And so we have faith in that and we are quite impressed. I think we underlined that frequently, that we're seeing a very, very strong pipeline here going forward.

It also involves digital. So, any ways here to build more of an ecosystem I think is another way to make that Starbucks opportunity stick and grow for the long term.

Out of home, obviously the easiest way for a hotel to signal, whether it's in the room or in some public areas or meeting areas, that they really care about serving high quality coffee is to serve up a recognizable brand name. And yes, there is very few brand names in the coffee industry that are more recognizable than Starbucks. And as we're seeing now the number of meetings increase again and out-of-home stays and business travel, I think this is exactly the kind of price point that Starbucks and Starbucks-like hospitality places are well-positioned for.

Question on:	**Nestlé Health Science**

Celine Pannuti, Head of Consumer Staples Research, JP Morgan:

Moving on to Nestlé Health Science, you did a CMD, a lot of presentation on that. We're not going to dwell on it too much now. And I think you recently said that there's no reason why the profitability shouldn't bounce back post-Aimmune, so that's great news. Now, I wanted to understand from how you built that business, you said that you would concentrate on the consumer and the medical portion, and you have ambition to really build this as a pillar for Nestlé, but at the same time you are integrating Bountiful, so are we right now at a level where you are looking at integration rather than further acquisition, or whether could that business be built further on, yeah, different parts of it?

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

Yeah. So clearly, I would like to confirm that confidence that we can get to that 18% margin level that we outlined earlier. And it is not just Aimmune, it's also about making that consolidation successful in the US. Because one of the rationales, in addition to the wonderful brand names, for buying the Bountiful company was this very strong supply chain backbone that was promising us lots of industrial synergies. And so this is not a given. This is something we have to do and that we have to implement and execute in very successful ways. And that is certainly a priority right now. And so this is not the period where you put all your energy into deal hunting then for the two segments that we want to grow going forward, and that is the consumer care side and the medical nutrition side.

Now, having said that, in business it's rarely completely black or white. It's more like shades of gray. And so if something really tempting and something that is a great fit came along, obviously we would be open-minded. But at the moment, you're right, the bias is more towards a picture perfect integration, reaping all these synergies according to business plans and then really making sure that we're well-positioned for that profitable growth going forward. That, to me, is no contradiction to a very ambitious plan going forward in terms of growing this business. And again, if something tantalizing short term does come up where we kind of feel it will be sad to let it go, it won't come back in the future. Then yeah, we'll be ready for this and we'll find the energy somehow to make it happen.

Question on: Healthy foods

Celine Pannuti, Head of Consumer Staples Research, JP Morgan:

Moving from health to healthy foods, some investors have asked Nestlé to set a target to increase the percentage of healthy foods in your portfolio. Can you share your views on that? I think I heard you in the past talking about the importance to bring indulgence with confectionery or convenience in prepared food or frozen foods. So can you try to help us understand how we can reconcile those with your stated ambition to bring healthy foods to consumers?

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

Absolutely. And I appreciate the opportunity to lay out our thinking on this because I still see that in the public debate there's quite a bit of misunderstanding about that. And to me the starting point is that we have given you now a sustainability report for year '22 as the first company, to my knowledge, among the large food and beverage players, complete global transparency across the Health Star Rating in the full global portfolio. So no longer just pointing to individual country markets and then highlighting the portfolio composition there. But rather you have now the complete visibility across the global portfolio on a rating system that is globally recognized and is also used for example, by Access to Nutrition Index, ATNI. So I think this is one that carries a lot of credibility. And so that transparency we are very much committed to and I hope it gets appreciated by our investors just as much as by the public.

Now having said that, we will also lay out a target for where we intend to take the healthy products over time and that'll come later this year, but it'll be a target that'll talk about how this grows. It will not be a target that talks about the portion of healthy versus products ranges that are rated at three and a half or less on this Health Star Rating range. And the reason is that one should not see one at the expense of another. As we look at the reality of what we eat every day, clearly just relegating yourself to something that is higher than three and a half is not mirroring the reality of how people eat. And we want to be a complete food and beverage company, one that covers the healthy aspects just as much as the enjoyable aspects that may have a lower rating.

And we have a different thought pattern for that part that gets rated lower. And that is here we should make more efforts over time to encourage what we call responsible consumption. And that comes, for example, with one of the leading marketing to children policies that we issued last year that will come into effect July 1st. We will over time become more active and roll out new commitments when it comes to portion guidance and full transparency on what's on those packages.

So, here I think we're trying to fill with life this whole notion of putting educated consumers in a position to make educated decisions about what they're taking, how much of it should be taken and how that compares to recommended maximum levels. The healthy part has been growing even without a commitment a lot more over the past few years. We don't foresee that to slow down. So automatically, we've been on a path already where that part is growing more over time and hence yes, I think it does make sense to articulate some sort of target size down the road, but it should not be articulated in ways where you kind of give the lower rated parts of the portfolio a second fiddle because clearly people eat for enjoyment just as much as they eat for nutrition and health aspects.

Question on: Confectionery and snacking

Celine Pannuti, Head of Consumer Staples Research, JP Morgan:

In fact, that brings me to my next question. Confectionery is not one of the category we talk a lot about, but if I look around at Nestlé, but your competitors as well, we've seen that the growth for confectionery snacking has been quite elevated as well as translating into good returns for shareholders in this category, value creation. So I just wanted to get your thoughts on how you feel about that. I would've thought, I mean KitKat obviously is the flagship and a very successful brand. The portfolio then is quite fragmented. I was wondering whether there would be more of a need to cut down some of those local brands or would M&A be part of the journey there?

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

So, a very important question and maybe also a way to point out some of the structural differences in our portfolio and confectionery compared to some of our peers. And the KitKat example tees it up perfectly. I think that's the most copied example of how people feel value should be created in confectionary. And that is create these global mega brands and then drive it out the ballpark. And clearly KitKat is a good example for that.

And you're absolutely right, we only have one. But compared to some of our peers that have several of those, what we also have in that fragmented part as you call it of the portfolio, there are some very, very strong local stars. Brands that have tremendous local relevance, are seen as part of a local identity and where you may not have the same opportunity to make them global superstars, but clearly locally there's lots of growth opportunity as you widen the portfolio, offer some varieties and basically develop those brands as well.

So examples would be Bacci in Italy, a truly iconic brand, Sahne Nuss in Chile, which clearly has an iconic standing there or Damak in Turkey. So these are high share of mind brands locally that I think we've proven over the years that in our hands we've been developing these brands quite successfully. And so yes, here and there you will also make adjustments and pruning when needed, but it's important that you're not treating that fragmented part all the same, but rather that you also are having a discerning eye for some of the local stars that are in this tail.

Question on:	**Water strategy**

Celine Pannuti, Head of Consumer Staples Research, JP Morgan:

Another area where there's been some divestment, I mean in the US, the water division I think is now around less than 4% of your portfolio yet recognized as a growth category. So I just wanted to understand where we are now in that journey. I know you've been focusing on premiumization but it still seems to be quite a small part of the business. So is there any development that can be made there in organically or not?

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

Yeah, so this is another great example of these overlapping cycles that we talked about earlier. So as you know with our announcements from 2019, 2020, we had focused the water business and articulated a strategic transformation plan towards the more premium side of the business and the functional side of the business. And we made good on this in part by divesting some of our US mineral water plants.

We also made good on it partially and with one specific transaction. And that is with Essentia in the US which is a good offering and a very successful one in the functional space. But then two things happened. One is Covid and Covid of course wreaked havoc to out-of-home consumption patterns and hence that left a scar on our waters development just like on any other beverage company that has a strong out-of-home stance.

And when that was waning and normalizing or starting to normalize and when we started to see nice growth again, we had another hit. And that is through the war and energy costs and inflation and waters gets hit particularly hard by that when it comes to profitability because you do have a fairly low weight to value ratio. So relatively speaking, transportation cost is a higher fraction of the total offering. And then also when it comes to the plastic resin for packaging, of course that's a major part of the cost structure. So you had first hit on growth and then you had a hit on profitability. And here also it's important to kind of see through these two overlapping cycles and then see in a more normalized state going forward, first of all, they were delays and in completing the portfolio transformation we have in mind. So we'll do that over time. And second, this is probably the worst moment in time from a profitability point of view to look at that business right now because simply of these exogenous factors.

Question on: Divestitures

Celine Pannuti, Head of Consumer Staples Research, JP Morgan:

In terms of disposals, we talked about the US disposal. I think altogether you disposed around 26 billion worth of business since you came as a CEO. I thought that we were kind of done with that process, but then you talk about the SKU reduction, Canada Frozen Food that's going to be folded out and then the JV with your Frozen Food Europe. So I wanted to know what else… are you looking again at the portfolio and is there effectively more that could be looked at from a disposal standpoint?

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

So, in fairness, even before we started talking about the SKU rationalization, when we did some of the last major divestiture steps, we were always underlining that portfolio adjustment.

There is no beginning and end to this process. So we didn't say it stopped now and now we have the wonderful portfolio for all times.

So we did point out that yes, over time, while some of the heavy lifting had been done in the years 2017 through 2021, there were always going to be portfolio adjustments. Now for this period, I think our CFO put it in very nice terms. What we're really talking about is an ongoing portfolio optimization. And at one end of the spectrum that may be SKU rationalization. At the other end of the spectrum it may be partial transactions like for example the pizza joint venture here in Europe or the pizza discontinuation in Canada. And so across that spectrum, yes, you should expect ongoing activity in the name of optimizing the portfolio going forward. And I think that's very much what investors want to see.

Question on:	**M&A pipeline**

Celine Pannuti, Head of Consumer Staples Research, JP Morgan:

If we speak about divestment, we're going to speak as well about M&A, so we spoke already some of the few deals that you did in the past. Now we have been in a time where multiples have been quite elevated and you've been quite focused on making sure you strike the right balance in terms of value creation. We are also now seeing that multiples are a bit less, but effectively access to credit may be a bit more complicated for at least your competitors in a bid. So how should we look at the M&A pipeline going forward? I also recall you saying that the sweet spot was the midsize deal and effectively we talk about Bountiful and Starbucks, but there have been no other of those midsize deals. So is it a lack of available assets? Is it an issue, a bad valuation?

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

I think in hindsight when you look at the overall market valuations through the end of '21, I think it was good that we did more divesting at a time when the market was going very strong and that we were quite selective on new acquisitions including midsize acquisitions in that period of time. The ones we've done, I have no regrets over and I think those strategically are very valuable. But had we gone overboard, we may now live to regret that. So being selective on the acquiring front I think was a saving grace in hindsight.

Now, as I look at the market, you're right, some multiples have moderated, but still value expectations continue to be quite strong. There is individual circumstances where maybe access to financing may be driving factors or thinking about some venture financed startup companies, but that's not the sweet spot of where we acquire.

And so ideally I would want to wait for things to move a little bit more into a range before you ramp up significantly. But let me also underline that you can't always time it like that perfectly, and sometimes you have to strike while the iron is hot when an opportunity presents itself.

But having said that, I just wanted to underline, while things may look better than at a perfect moment in time, like the second half of '21, it's not that everyone's valuation expectations have come significantly down and hence it still pays to be cautious and to be selective. Having said that, we're open for business across the full spectrum as we always pointed out. Not that we want to announce anything in a hidden way, but simply to underline that why should we rule out options to grow our business in our core categories? We've always been open towards that. So to me it's not a news item. It's basically something that is a mindset and that continues to apply.

Question on: Emerging markets

Celine Pannuti, Head of Consumer Staples Research, JP Morgan:

I would like to move to the emerging markets. In fact, I will have a question about acquisition potential there. But first, if I think about the emerging markets performance has been quite strong, but how do you see the opportunity and the landscape as some of those emerging markets have themselves emerged or are still emerging from Covid in the case of China?

And then my second point there would be about China and India. China is 6% of your sales, India, 2% of your sales, big business. But relative to Nestlé size, it's quite small. And I think you were talking about, I think you had more ambition to grow China when you came four, five years ago. Can you talk about the potential for evolving the portfolio and is it an issue as well to do M&A? And shall we think that the pivot now would be more focusing on India, given what seems to be higher growth prospect for that country.

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

Yeah. So let me try and cover a few of these points. And my apologies if this is going to be a somewhat longish answer, but I think all of these are very worthwhile points and I understand there's a lot of investor interest attached to them. So on emerging markets overall, they stand for about 42% of our revenue based on 2022 numbers. And what is important to note is that when you look at the past 10 years, they have been performing above average, not only on total posted organic growth but also on the underlying real internal growth, and that to me is a very positive indicator. And I do expect going forward that their performance over several year time stretch will continue to be above par. You won't be able, in a nervous political environment, to say that for every year, every quarter.

But in aggregate over the years, I think that success story will continue to apply. And the composition then, which market specifically is contributing to that may also change over time. But the fact in all of them we have long-standing presences and are seen as market insiders and strong local management representation I think is a strong plus.

Another fact that's often overlooked is that the profitability, so our underlying trading operating profit margin coming from these markets is also above par. And that is a striking difference to many companies that rake it in, in their core home markets, but then they dilute their margins as they grow in emerging markets. With us it's the opposite. So the fact that this part is growing above par is also structurally helping our profitability because we don't see that situation changing over time. So that's just an important high level differentiator here that investors should be aware of.

Now, specifically on China, would I love to do more ... yes, absolutely. So our sales figure 2022 in total then was about 5.8 billion Swiss francs. And we were quite open about the fact that over the past few years, until things started to turn around last year, we had not realized our full growth potential. In fact, for reasonably long periods of time, 10, 15 years I think while we were growing, we were growing at rates that did not do the full market growth justice. And that was also one contributing factor to this reorganization that we announced in the fall of '21 and that we implemented beginning of '22 where we now made it a fully dedicated zone led by a Chinese national, someone who with this team can read that market in much better ways because that market has evolved significantly. And guessing from a western mindset, international mindset, what exactly the Chinese consumer has in mind is not the best way to serve the consumer.

So I think we now have a much more China-centric strategy there. If that can be bolstered with acquisition, I have complete faith in that leadership team that they will pull vision off well. And so very supported there. But going back to what I said earlier, sometimes you do have frothy price expectations in emerging markets and what I don't want to do is then invest at the top of the market or invest some outsized value expectation. But both from an organic point of view with that new leadership team at the focus and from a M&A point of view, you will see us open for business there. And I think, I know there's been a bit of concern over the growth in China this spring. This is another one where individual company circumstance may be quite decoupled from the macro circumstance. Because what I see actually is improving strength in our Chinese operations and I don't see that changing for the rest of the years. I'm quite optimistic, under the circumstances, how we will perform in that market.

India is about two billion Swiss francs in size. And here again after the Maggi recall in 2015 and the one-time setback we had there, you've seen a string of years that were a stellar success organically. Couldn't be happier here again, super strong leadership team, very strong local CEO doing a fantastic job. But it is true that our presence there is quite selective. So we don't have the same board based category presence that we have in other core markets. Ideally, I'd like to have a stronger footprint there. But then at times of very strong market growth expectations you also find over the top valuation expectations. We are not playing that game there, so we will stay selective and not lose our common sense.

Question on:	Capital allocation

Celine Pannuti, Head of Consumer Staples Research, JP Morgan:

Talking about capital allocation, so you are now into a 20 billion share buyback that will end in 2024. In the absence of M&A, should we expect that a share buyback will be continuing as long as you are in quite target range on your leverage. And then my other question on that point was about L'Oréal. So you own 20%, which allows you to consolidate a percentage of the profit of L'Oréal. Does it mean that it's a level which you will not go below because otherwise it'll be quite diluted from an earning standpoint? So is it a bit of a no change at this level?

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

So let me try to be as helpful as I can, but also I hope no one is disappointed if what I can say is limited. So on the share buybacks, we're still in the first half of what is a three-year share buyback period that began at the beginning of '22 and goes through the end of '24. And so speculating now on what exactly the situation is going to be like at the end of '24 and what that means for buyback activity going forward after that, in my opinion, is a little bit early. I think we've always very dutifully implemented these several year programs in line with the announcement. And when you read at something that we put very consistently into those announcements, you also see where the preference is. On each and every one of them, starting with June 2017, we were saying that should a significant opportunity come along, we reserve the right to adjust the volume of these buybacks.

And that shows you that as a company that live and breathes by building its business, we do place a premium on in fact growing our core business over just buying back shares. And I think that should not surprise anyone, in fact it should be seen as a positive side because we have faith in the categories we operate in, what they have to offer going forward. And so that has not changed. And so that's why, all things being equal, there's always going to be under the right circumstances, a preference for acquiring over just doing buybacks. When it comes to L'Oréal, again also not in position to comment, I think everyone can look up what the accounting and consolidation rules are, but I think what we've proven there over the years is, first of all, that we see this as a large financial stake, want to avoid any misunderstandings here that came from the word strategic in the past, and that we've been acting as very good stewards of Nestlé shareholders only in this very valuable asset with a superbly run company, but then basically administering that stake with value for Nestlé shareholders in mind.

Question on: Gross margin recovery and reinvestment

Celine Pannuti, Head of Consumer Staples Research, JP Morgan:

As we almost near the end of this discussion, I wanted to go back to the P&L gross margin recovery, which you added early on when we were talking about inflation. So you're still at a stage where you need to recover that, and if I look versus 2020 gross margin of about 400 basis point below that level. So any reason why structurally you could not get there? But then if I look at your EBIT margin guidance of target 17.5% to 18.5% by 2025 at the midpoint, that would imply hundred basis point of margin improvement. So 300 basis point of reinvestment would be the implied guide. So can you talk about those reinvestment? Or, can we as well think that there's some form of conservatism in how you've guided on the margin performance?

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

Very important question. And let me start with the gross margin and underline full confidence that we can repair that over time. But also remind investors about one thing that we said from the beginning when we saw that the gross margin was sliding under the inflation impact and that is we were saying that repairing it over time would take longer than the time it took to get it down. So you should not model it in ways where it took about 18 to 24 months to bring it down to where it is that exactly in that time period, you're repairing going forward. That repairing has to be more nuanced the longer we go into it. And you see this reflected in the current pricing discussions where there's more pushback understandably, and where you have to limit yourself selectively to those situations where there truly is some repairing to do.

You can't now so much operate with vast across the board price increases anymore. And so that's why we have to become a lot more surgical and targeted and be sure that retailers, consumers, the public understand our moves. Is it doable? Yes, it's absolutely doable. I think the brand's strength and our innovation capabilities will help us make that happen. Now, having said that, the easy map, if you repair all of that, aren't you going to be overshooting your underlying trading operating profit margin? That overlooks a few other items that we also want to pay for going forward. So yes, there is the fraction which is the underlying trading operating profit recovery because we're below our target range now. So first of all, we have to get back to that target range.

Second, we also indicated and underlined that we want to spend more on marketing spend going forward. So here and also innovation pipeline spent. The whole growth aspect of the business going forward is one that we don't want to lose sight of, and so that'll take extra spending. And then we also made it clear that the sustainability side of the house is only going to be increasing year after year. Especially when you look at the large flagship commitments around greenhouse gas emission reduction and plastic waste, just to name a few and it's not an exclusive list and an exhaustive list, there's going to be more, but just those alone are very important and very expensive undertakings.

I do think we're well-advised to actually stay on track and deliver those commitments and be online, but those over the years as some of the low-hanging fruit is taken, I think also will progressively become more expensive. So if you put all of that together for a company now on a several year times span to say, look, we're getting back up to this range, is also something that in my view, in all modesty compares quite favorably to what you hear from other industry players and hence, it's important to stay realistic as to how much that can be and not now try to model in something that's over and above the range. I think whether you look at the end of last year or whether you look at this guidance or other types of expectations that we articulate, staying with where we are as opposed to going north, I think usually does get rewarded.

Question on:	**EPS growth**

Celine Pannuti, Head of Consumer Staples Research, JP Morgan:

And maybe just to conclude on that, because we were talking about the defensiveness of Nestlé at the beginning, you articulated the target of 6% to 10% EPS growth at the end of last year, which I think was meant to give visibility to investors as we look over the next two, three years. So that confidence in growing that 6% to 10% EPS, is that coming from, you think the visibility you have on rebuilding that margin? And what is your confidence on the 4% to 6% in an environment that, as we discussed, could still be a bit choppy in the next couple of years?

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

So the EPS was meant as a helpful additional piece of map. It's not a switch in the way we guide because our core guidance items continue to be organic growth and the underlying trading operating profit margin. But I do understand that below the line, we are still a very large and sometimes hard to understand company where people could easily misjudge currency swings with not below the line, but impacting all factors in the P&L, but then tax rates share buyback actions and so forth. And I wanted to be sure that people have a good understanding what our expectations through the year '25 translate into when it comes to the underlying EPS. That was the idea behind it.

It's not that all of a sudden underlying EPS is taken over when it comes to the guidance. It compares quite well with what we've done over the last few years, it's not something that's out of the ballpark. So it shouldn't surprise people that we are kind of pointing to that range. And so we have a confidence level that we can make that happen is there. On the 4% to 6% organic growth, yes, that is and that continues to be our longer term organic growth ambition and expectation for year '25. Again, could you see, depending on what circumstances happen geopolitically or quarter after quarter gyrations that take you above or below, yes, you can. Like we're above now. But does it over time compute to something in that range? Yes, I have a lot of confidence in that.

Celine Pannuti, Head of Consumer Staples Research, JP Morgan:

Mark, thank you so much for the discussion, for your time and sharing your thoughts. It was a pleasure. Thank you everyone. Good afternoon.

End of Transcript