

Letter to our shareholders

Dear fellow shareholder,

2016 was an exceptional year in exceptional times. We reached a milestone, our 150th anniversary, a celebration of a century and a half of passion for nutrition and for quality. But this achievement comes as our industry is at a crossroads. Expectations of Nestlé are changing substantially as consumers embrace new trends, habits and lifestyles. We see a reshaping of the competitive environment. We are on the brink of a 'fourth industrial revolution'; a transformation of society that will be unlike anything we have experienced before, presenting us with challenges but also great opportunities. We are responding by sharpening our focus and strengthening our efforts to create value. We are investing in science and innovation, and building new capabilities and platforms to secure our long-term prospects while at the same time delivering the sustainable, profitable growth you expect from us.

Organic growth was 3.2%, with real internal growth reaching a three-year high of 2.4%. Pricing was limited at 0.8%, with some improvement in the second half of the year. Sales increased by 0.8% to CHF 89.5 billion, with a foreign exchange impact of -1.6%. The Group's trading operating profit was CHF 13.7 billion with a margin of 15.3%, up 20 basis points on a reported basis and up 30 basis points in constant currency. We achieved this margin improvement while increasing investment in brand support, digital marketing, Research and Development, and in the new nutrition and health platforms. Net profit of CHF 8.5 billion was impacted by several items, the largest being a one-off non-cash adjustment to deferred taxes. Reported earnings per share decreased by 4.8% to CHF 2.76 for the same reasons. Underlying earnings per share in constant currency increased by 3.4%. Operating cash flow improved by CHF 1.3 billion to CHF 15.6 billion. Free cash flow improved by CHF 200 million to CHF 10.1 billion or 11.3% of sales. Based on these results, the Board of Directors is proposing the 22nd consecutive dividend increase, underlining our commitment to continuity, up from CHF 2.25 last year to CHF 2.30 this year.

During the year we confirmed our Nutrition, Health and Wellness strategic direction with a newly articulated purpose that echoes the motivation of our founders: enhancing quality of life and contributing to a healthier future. Those who started our company were pioneers and entrepreneurs who were motivated by the needs of society and overcame the challenges they faced with expertise and determination. We share their values and their passion, passed down through the generations. Over the last 150 years your company has faced constant change. Today is no different. This is the moment to put in place measures to ensure Nestlé thrives in this new environment. So, in this anniversary year, we made choices and investments that will shape the future and ensure your company's continuing success.



Paul Bulcke, Chief Executive Officer (left), and Peter Brabeck-Letmathe, Chairman (right). As part of our 150 years celebration, the original site of Henri Nestlé's factory in our home town of Vevey was refurbished and opened to the public as a discovery centre.

Henri Nestlé had a vision of a better world thanks to nutrition, an idea which is still pertinent today. Through innovation we can help people to live healthy and fulfilling lives. Innovation is our heritage, the foundation on which our brands are built, but also a key enabler of future success. The strength and depth of our Research and Development differentiates us from the competition, and helps us respond to the major changes we see in society. We are constantly acquiring a deeper understanding of nutritional science, and developing products and services with the potential to help people to live healthier lives and to address rising healthcare costs globally. One good example is our research collaboration with Samsung, which will explore the potential of nutrition science and digital sensor technology to provide new insights into healthy living. We continue to further extend the boundaries of our Nutrition, Health and Wellness strategy with Nestlé Health Science and Nestlé Skin Health. With their innovative pipelines of products designed to make a major contribution to the health needs of large parts of the population, they offer the promise of further growth and value creation.

We are well aware of how fundamentally digital is transforming society and for some time now we have been building the knowhow and talent to respond effectively and efficiently. Digital is changing not just how companies operate but also our relationships with partners, suppliers and the people who buy our products. It requires attention and investment to enable us to seize opportunities. Among others, we have enlarged our 'Silicon Valley Innovation Outpost' in San Francisco with staff drawn from the company's marketing and technology functions. During the year, we launched the Henri@Nestlé open innovation platform, enabling start-up entrepreneurs to work with Nestlé as collaborative partners on projects that matter both to the company and to the millions of people who buy our products. We are creating a digital-first culture. This bold ambition will shape the next 150 years of the company's progress.

We have always balanced investing for the long-term with delivering against our current financial commitments to drive growth in today's challenging trading environment. We have increased investment behind our brands and sustained it.

Our long-term commitment to operational excellence delivers savings that benefit both growth and margins. During the year, we committed to further structural savings beyond those delivered annually by our continuous improvement initiative *Nestlé Continuous Excellence*. Leveraging our size and scale offers further opportunities to maximise efficiency. Nestlé Business Excellence is driving efforts to simplify, standardise and share support functions, and as such to leverage our scale. Here too digital contributes: delivering new capacity or routes-to-market

without the need to construct ‘bricks and mortar’ infrastructure, or new possibilities to concentrate investment on projects that create more value. We continue to adapt our structure and organisation, finding the right balance between local focus and global scale to ensure we are best placed to exploit the fast-changing environment.

The Board of Directors took steps to ensure Nestlé’s continuing success after the transition necessitated by our changing roles. Peter Brabeck-Letmathe steps down in April having reached the mandatory age of retirement after 12 years as Chairman and before that 11 years as Chief Executive Officer. Paul Bulcke resigned as Chief Executive Officer at the end of 2016 after more than 8 years in the role, after the Board put him forward for election as Chairman of Nestlé at the upcoming Annual General Meeting. The Board appointed Ulf Mark Schneider to succeed him as Chief Executive Officer, a role he took up on January 1st 2017. Mr. Schneider was formerly Chief Executive Officer of the Fresenius Group, a company that offers products and services for dialysis, hospitals and outpatient treatments. This concludes a process that the Board began more than two years ago to appoint a strong leadership team to deliver the company’s short-term and long-term performance goals.

In September, it was announced that Luis Cantarell, Executive Vice President and Head of Zone EMENA, would retire at the end of the year after a long and distinguished career with the Group. Luis was one of the architects of the company’s Nutrition, Health and Wellness strategy and his contribution to its success cannot be overstated. The Board of Directors appointed Marco Settembri, Executive Vice President and Head of Nestlé Waters, to succeed him. Maurizio Patarnello, Market Head of Nestlé Russia and the Eurasia region, was appointed Deputy Executive Vice President and Head of Nestlé Waters. The Board also decided to change the business structure for Nestlé Professional from a globally managed business to a regionally managed business supported by a Nestlé Professional Strategic Business Unit from January 1st 2017. As a result of these changes, the Head of Nestlé Professional, Martial Rolland, left the Executive Board to become Market Head in the Russia and Eurasia region. We would like to thank Luis and all of those who retired in 2016 for their contribution to Nestlé’s success over the years and extend our best wishes to them as they begin this next chapter of their lives.

During the year, in addition to the succession planning, the Board reviewed the Nespresso business, Nestlé Nutrition and Nestlé Health Science. It examined our talent development strategy and appraised the company’s portfolio management and the performance of the acquisitions of recent years. The Board also reviewed how we track the external image of the company and travelled to China in order to better understand the dynamics of our second largest market.

In 2016, Nestlé partnered with R&R, a leading ice cream company based in the UK, to create Froneri, a new ice cream, frozen food and chilled dairy business in 22 countries across the globe. Building on each company's achievements, Froneri brings together decades of business and manufacturing expertise to create a new global player in the ice cream industry.

In this fast-changing world it is more important than ever that Nestlé is consistent, reliable and respected, in order to build trust. The consistency of our purpose: enhancing quality of life and contributing to a healthier future, has led us to act throughout our history as a responsible member of society. We strongly believe that the private sector is more than just an engine for economic growth and job creation. We are part of the fabric of society with its challenges and opportunities. As a global company we can make a substantial, positive impact in society, and inspire and work with others to achieve even more. Creating Shared Value describes what this means in practice; creating value for our shareholders with projects or business opportunities that at the same time benefit the communities in which we operate, and furthermore, society as a whole. This Creating Shared Value approach to doing business was started at Nestlé ten years ago. We are heartened to see others in our industry and beyond embracing the concept of shared value today.

A good example of our determination to make a difference is the *Nestlé Global Youth Initiative* which we started in Europe three years ago. During 2016, we pledged to offer to under-30 year olds thousands of jobs, apprenticeships and traineeships in each of our three geographical Zones over the coming years, on top of those already created. We believe that through these efforts to promote readiness-to-work we can make a significant contribution towards addressing the social cost of youth unemployment. Through the 'Alliance for YOUth', which Nestlé founded, we are creating an even bigger impact, working with more than two hundred partner companies to provide training and jobs.

Each day we touch billions of lives worldwide, from the individuals and families who enjoy our products, to the communities where we live and work, and the natural environment upon which we all depend. Our 42 public commitments provide the framework for our efforts in these areas, and our progress towards meeting them is detailed in the *Nestlé in society* report published alongside this *Annual Review*. They are fully aligned with the United Nations' 17 Sustainable Development Goals (SDG's) which set out a vision for ending poverty, hunger and inequality, and protecting the earth's natural resources. The SDG's help to guide our actions around a common agenda: an agenda to create a better world that we fully endorse and actively contribute to.

For 150 years we have adhered to a set of values rooted in respect: respect for ourselves, for others, for diversity and for the future. All of us at Nestlé live these values with passion, determination and discipline. They have withstood the test of time. They are integral to our success. It is our respect for future generations that compels us to act with responsibility and courage, even when times are difficult. So while we continue to take care of the short term, we are building and investing for the long term. We are well aware of the intensely competitive context in which we are operating today and are taking the steps necessary to further develop and strengthen your company. We are investing in the capabilities we need, the know-how and the talent to continue to create value for you, our shareholders. This is the approach which we have followed successfully for 150 years.

We would like to thank our 328 000 employees for their commitment to Nestlé. It is their hard work, alignment behind our strategy and dedication that enables us to deliver on our promises. We also want to thank you, our shareholders, for your continuing support, your confidence and above all for your trust. Rest assured that our passion for nutrition, health and wellness, and our passion for quality will continue to generate the sustainable, profitable returns you rightfully expect from us.



Peter Brabeck-Letmathe
Chairman



Paul Bulcke
Chief Executive Officer