NESTLÉ S.A.

2014 HALF YEAR RESULTS CONFERENCE CALL TRANSCRIPT

7 August 2014, 08:30 CET

Speaker:

Wan Ling Martello, Chief Financial Officer, Nestlé S.A.

Peter Warne, Nestlé SA, Investor Relations

Slide: Title slide

Good morning, everyone, and welcome to the Nestlé Half Year results conference call.

Slide: Disclaimer

We'll take the usual disclaimer as read.

And now I'll hand over to Nestlé's Chief Financial Officer, Wan Ling Martello for the presentation.

Wan Ling Martello, Nestlé SA, Chief Financial Officer

Slide: Resilient performance

Thankyou Peter. Good morning and good afternoon. Thank you for joining us on this call.

Let me start with some highlights of our Group performance this year then take you through the business in more detail before opening up to Q&A.

Our results reflect a resilient performance over the first half.

The Group's sales momentum has accelerated, both in terms of real internal growth at 2.9%, and organic growth, 4.7%.

Where necessary, we have taken pricing - either in response to input cost inflation, or as a result of some of the extreme currency moves we have seen this year. Looking at these highlights on a constant currency basis, our trading operating profit margin increased by 30 bps, underlying earnings per share increased by 3.6%, and we generated nearly CHF 3 billion of additional free cash.

The global operating environment has not changed much since the last time we spoke. The emerging markets continue to grow, but at a lower rate than historically. The developed markets still face deflationary pressures and weak consumer sentiment.

What has become more dramatic is the effect of foreign exchange. This has had a significant impact at all levels of our performance, from sales, to profits, to cash flow, to earnings per share. You can see that it accounts for some 40 bps of difference between our trading operating profit margin in constant currencies, and our reported margin. A difference of that size is just unprecedented.

However, the progress we have made in the first half does allow us to re-confirm our outlook for the full year. That is, organic growth of around 5% and improvements in margins, underlying earnings per share in constant currencies and capital efficiency.

Slide: Resilient shareholder returns

An additional highlight is our announcement this morning concerning a new share buyback programme.

Our intention is to complete a CHF 8 billion share buyback by the end of 2015. I'd also like to confirm the message I repeat on our roadshows: We remain committed to our double-A credit rating; consistent with our Gold standard within the industry.

This proposed buyback programme, in line with our sustainable dividend policy, provides a very competitive return to our shareholders while at the same time underscoring our belief in the future of our business.

Slide: Consistent Group Strategy

So those were the Group highlights. I would now normally jump into more detail on our business performance, but this time I want to give a bit more context.

Specifically reiterating our group strategy. A strategy that has been very consistent and successful over the years.

Our objective at Nestlé is to continue our transformation into the world's leading Nutrition, Health and Wellness company.

It is clear that in today's highly competitive environment, that seems to have unending volatility and headwinds, products that deliver on the promise of Nutrition, Health and Wellness are amongst the fastest growing in our industry. They offer consumers more added-value.

Increasing our presence in this space and building more Nutrition, Health and Wellness arguments into our portfolio has led, and will continue to lead, to sustainably higher levels of growth and profitability.

In terms of strategy, the first half of 2014 saw us develop Nestlé Skin Health. It is in addition to Nestlé Health Science as yet another platform for our focus on delivering science-based breakthrough products that help people live healthier, happier lives.

Of course strategically there is always going to be an ongoing realignment of our existing portfolio. Divestitures so far this year include businesses in chilled Culinary, Ice cream, Waters and Nutrition.

In terms of organisation, Paul and I have both talked about the evolution within Nestlé. Sustainable improvement in profitable growth requires us to leverage our scale. Generating greater efficiency from our back offices and operations, through GLOBE and Nestlé Business Services.

We have stepped up our discipline, using robust and streamlined tools to assess our portfolio, ensuring we are investing all of our resources behind the real value drivers for the future, and holding ourselves accountable for their success.

In a nutshell that is what our roadmap is all about, an ongoing strategic and organisational evolution, focusing on our growth drivers, leveraging our strategic pillars and investing behind our competitive advantages.

Slide: Broad based regional growth

Turning back to giving you some more colour on our first half results, you can see here how our focus and determination has played out with broad based organic growth from across all three geographic regions.

When looking at both the Zone and globally managed businesses together our organic growth was 4.9% in the Americas, 1.4% in Europe, and 7.5% in Asia, Oceania and Africa.

Real internal growth was 2.4% in the Americas, 2.3% in Europe and 4.2% in AOA.

This resilient performance reflects the strength of the group's diversity especially given some wide variations in the operating environment within these regions.

Slide: Developed and Emerging markets

To split this global perspective another way let us now look at emerging and developed markets.

Our businesses in developed markets grew 0.6%. I don't need to tell you that the trading environment in these markets has remained tough around the world. In many cases we are dealing with deflation. Consumer confidence also remains low. So ensuring that our portfolio is fit to win is more important than ever.

We need to make sure we are truly differentiated and offering value to the consumers, and I believe our positive RIG performance across the developed markets speaks volumes to this.

Our emerging markets grew 9.7% and today represent CHF 19.1 billion of sales. The environment in the emerging markets remains a mixed picture. We continued to see very good growth in many of the smaller markets, some recovery in South Asia, while China remained soft in some categories.

We have also taken a series of price increases across our emerging market businesses – either in relation to increased input costs or on the back of currency movements.

However, our sustained growth demonstrates the strength of our brands, the quality of our innovations, and how well our people are executing our strategy.

I should also highlight once again our ability to deliver growth in both emerging <u>and</u> developed markets

Slide: Trading Operating Profit Margin

At the Group level let's now turn to the trading operating profit margin.

As a reminder our H1 margin last year benefitted from a lower input cost environment. Also, this time last year we had increased our consumer facing marketing spend by 15% in constant currencies.

For the first half of 2014 we faced some increases as expected in our input cost basket, in the low single digits. The biggest increase was seen in Dairy, and that's partially offset by our ongoing efficiency programmes.

The 20 bps increase in Distribution is mainly related to a mix effect.

We have yet again stepped up our consumer facing marketing spend, up 5% in constant currencies.

The 30 bps improvement you see here in marketing and admin came from several restructuring programmes and improved efficiencies.

We have invested more into R&D, feeding the pipeline for future development.

Finally, here again is the effect of the strong Swiss Franc on our reported margin, 40 bps, the greatest recorded impact from currencies.

This gives us an overall 30 bps improvement in our trading operating profit margin in constant currency.

So, with that overview on Group performance, let us now look at the segments in more detail.

Slide: Zone Europe

Starting with Zone Europe. Zone Europe achieved 0.6% organic growth.

With 2% Real Internal Growth, offset by pricing action that was taken in what is generally a deflationary environment.

When we look across the categories and markets it is clear that the investments we have made in the past behind new products and brands are supporting this performance.

Western Europe saw a continued recovery in Iberia, with Switzerland, the Netherlands and Austria also delivering good growth.

The UK continues to be challenged, particularly due to tough market conditions and tough comparisons. France showed signs of a pickup despite deflationary pressures. In Germany, softer performances in Maggi, Chilled Culinary and Confectionery, were offset by good growth in Pizza, soluble Coffee and Ice cream.

The growth in Eastern Europe was driven by Russia, especially in Confectionery and Ice cream. Ukraine accelerated as we went through the start of the year, despite the ongoing tension in the region. Elsewhere the highlights included Hungary and improvements in the Czech/Slovak region. Poland had a tough start to the year, especially with the flooding there, but we do see signs of improvement.

Across the Zone, Nescafé Dolce Gusto, Wagner and Buitoni in Frozen Pizza and Felix, ONE, Gourmet and our range of Cat Snacks are some of the key brands that have driven a lot of the growth.

Premium offerings of Nescafé delivered good results, with Gold leading the growth.
In Confectionery we had a solid recovery versus the 1st quarter, as expected due to the late Easter, but the tough comparisons in the UK and France had an impact.

In Ambient Culinary, Sauces, Soups, Snacking noodles and the continued roll out of Papyrus cooking papers were the stand out performers, particularly in the Great Britain region and Germany.

To wrap up the categories for Europe, Ice cream had strong growth in many markets, especially with Mövenpick, but a lot of this was offset by the weather and economic conditions in some markets, such as Greece and Italy.

The trading operating profit for Zone Europe was 14.8%, slightly down 10 bps. This mainly reflects impairment costs.

Slide: Zone Americas

Now looking at Zone Americas. The Zone achieved 4.9% organic growth, 1.7% RIG, both North America and Latin America contributed.

In North America the Frozen Food business continued to be weak. However, as we discussed just a few weeks ago at our Investor Seminar in Boston, we will continue to drive innovation in this category, both with new product launches and our consumer communications.

Staying with the frozen aisle, but moving on to Ice cream. The Dreyer's premium business remained weak, but our super premium segment had a solid first half as Häagen Dazs Gelato continues to grow well. Both the impulse Drumstick and Outshine brands also did well.

Confectionery had tough comparables for the half in the U.S. The Butterfinger Cups remain the highlight. Confectionery in Canada enjoyed a strong performance driven by KitKat and Aero.

Soluble Coffee accelerated as we went through the half and Coffee Mate delivered another good performance, especially given the good growth we saw at the same time last year. As with many other positive stories, it is our support in innovation and renovation, particularly the special flavours we have launched in liquid, which continued to drive this growth.

PetCare continued to deliver good growth through line extensions and new product introductions. The brand 'Beyond' was re-launched and is a key initiative in the Natural segment. The Lightweight Litter continued to drive growth and we have reintroduced Waggin' Train snacks to the market.

In Latin America, Brazil again delivered, with the expected Confectionery growth recovering in the latter part of the first half. Mexico was more challenging, in large part due to the indirect effects of the fiscal legislation changes there, but it did improve versus the first quarter.

The majority of our smaller markets across Latin America also performed well.

Looking at the categories in Latin America, Nescafé Dolce Gusto continues to do well across the region and I would highlight the performances of Ambient Dairy and Powdered Beverages, Ice Cream and PetCare. In fact PetCare across the region continues to do remarkably well, the drivers being Dog Chow, Pro Plan and the Revena launch for pet specialty category in Brazil.

The Zone's trading operating profit was up 10 bps, at 18.0%.This was primarily due to lower restructuring and other expenses that offset the increase in our consumer facing marketing spend.

Slide: Zone AOA

Now moving on to Zone AOA, we had 4.7% organic growth and a slowdown in RIG from the first quarter to 1.9%; this is partly due to the pricing we have taken in several key markets and a subdued China.

Overall, our premium offerings and roll-out of new products continued to deliver good growth for the Zone.

Just as an example, Nescafé Dolce Gusto delivered double-digit growth as its rollout continued.

New launches including Yinlu Walnut Milk in China and renovated packs for Milo in Australia both had excellent starts.

In the emerging markets strong performances in the Philippines, Turkey, Pakistan and many markets in Africa were offset by a continued softness in the Zone's largest market, China. However, we do see the fundamentals of our business there improving.

South Asia has recovered somewhat, its growth reinforced with new products in Beverages in India, Nestlé Masala Buttermilk and Nestlé Sweet Lassi. We also launched Nesquik Optistart in some markets. This new and improved Nesquik has been a success in Europe and has now had a good start in Turkey and the Middle East.

There was solid growth across the Zone for Milo in cocoa and malt Beverages, Maggi in Ambient Culinary, and for creamers.

Developed markets had a reasonable start to the year, with a particularly strong first few months in Japan. Our two big categories in Japan, Confectionery and Coffee, with KitKat and Nescafé, continued to deliver.

In Oceania we had a successful rollout of low fat Carnation Cooking Cream and Felix cat food.

The Zone's trading operating profit margin decreased by 20 bps to 18.9%, reflecting the input cost increases, mainly in dairy, but also the currency environment in which we are operating.

Slide: Nestlé Waters

Next up, Nestlé Waters. The bottled water market continued its growth trend in developed markets and grew double digit in the emerging markets. Nestlé Waters ended the 1st half with 6.1% organic growth confirming the good trend of the 1st quarter, which was 6.2%.

All geographies had solid volume performance, however pricing remained challenged in mature economies. We had RIG of 7.3%.

More specifically in North America we saw an acceleration of our growth versus last year, this was driven mainly by strong volume across U.S. Retail, thanks to our regional Spring Waters and our International Brands, Perrier and San Pellegrino.

In Europe, while pricing was down reflecting the market environment, RIG was very good, with some markets double digit. Now of course the good weather did help.

In our emerging markets, Nestlé Pure Life continued to drive growth, especially in China, Egypt, Brazil, Turkey and Pakistan. Just as a side note, I'd like to remind you that Nestlé Pure Life was first created in Pakistan. Which just goes to show that Nestlé is a company that can take innovations from anywhere in the world and turn them into global successes.

To close the comments on Waters: the 80 bps increase you see here in the trading operating profit margin was largely driven by leveraging the growth I've just described, and also by the continuous improvement mind-set that has resulted in cost reductions across all parts of the Nestlé Waters value chain.

Slide: Nestlé Nutrition

Looking at Nestlé Nutrition, an organic growth of 7.9%, 3.8% of which was RIG, showed acceleration through the 1st half. The main drivers were double-digit growth in infant formula and infant cereals. The pattern of growth was similar to that of the 1st quarter.

Our emerging markets remained the key driver of growth.

And as I said back in April, the choices we have taken in the U.S. on being more selective, focusing on value generation, and optimizing use of our assets has had an impact on our top line growth for developed markets.

The trend with regard to our Infant Formula brands is the same as the first quarter too.
The premium and the super-premium offerings, such as NAN and Illuma delivered outstanding growth.

Infant cereals had good growth, especially in Latin America and Africa.

The U.S. has also had a good half year following the new packaging designs launched last year.

Our meals and drinks business has suffered as a result of the declining category in Europe and the intense competition in North America.

The improvement of the trading operating profit margin to 21.1%, up by 110 bps, reflected the good performance of Wyeth Nutrition and active portfolio management, focusing on value added innovations such as NAN HA, our hypoallergenic formula.

Slide: Others

Finally, taking a look at our 'Other' businesses. They achieved 5.9% organic growth with 4.7% RIG.

Nestlé Professional growth gathered momentum during the 1st half. Our emerging market businesses were the key drivers in Professional.

We saw signs of recovery in our Chinese out of home market, and the Philippines, Malaysia and Singapore did well.

Russia was the stand out performer in Eastern Europe.

In Western Europe and North America the macro conditions continued to affect growth.

The Beverage business in Latin America has had a good start to the year and our dessert solutions had a good performance in Zone AOA.

Nespresso. Nespresso again delivered strong global growth. The business has shown its resilience in the increasingly competitive market of single portioned coffee. We continue to grow well where the brand is established and have accelerated our geographic expansion, opening 14 new boutiques around the world in the first half.

Innovation continues to drive performance: whether it is through the extension of our Grand Cru coffee range, the introduction of new machines, or even the Nespresso Cube, a completely automated boutique.

I'm also happy to report that our investments in North America with the VertuoLine system have seen a good response.

Moving on to Nestlé Health Science. New products and the continued rollout into additional markets of Peptamen, Alfamino and Vitaflo's Carbzero and Betquik achieved good results.

Boost in the U.S., Meritene in Europe and Nutren in Brazil also achieved solid growth.

The trading operating profit margin for 'Other' was 18.4%, down 80 bps.

This is a reflection of our marketing investments, such as those for Nespresso.

We also had currencies impacting our margin, particularly from Professional's emerging market businesses.

With that wrapping up our segment reporting I will now move on to take a brief look at our product segments.

Slide: Products

I have touched on much of this already from the Zone perspective.

From a sales point of view we have had good organic growth in the majority of our categories. On the flip side, our Prepared dishes have been challenged as I mentioned earlier, mainly due to the Frozen aisle in the U.S.

Confectionery had tough comparisons in terms of organic growth and the competitive environment in our key markets remained intense.

From a trading operating profit margin perspective I would highlight the improvements in Nutrition, Waters and PetCare, with the latter being affected last year by the voluntary withdrawal of Waggin' Train.

Prepared dishes and Cooking aids margin reflects the lack of volume growth in Frozen.

And Confectionery faced higher commodity costs.

Slide: Income Statement

Now, looking below the Trading Operating Profit to the rest of the income statement in more detail you can see that we have a drag on the net operating expenses.

This is mainly due to monetary corrections driven by hyper-inflation accounting.

It is also clear that there is an impact on net profit, which when coupled with currencies has affected the reported earnings per share. However, as I mentioned earlier, underlying earnings per share in constant currency are up almost 4%.

Slide: Free Cash Flow

Our free cash flow is at a similar level to last year. Especially when given the currency impact.

I realise that it is not the whole picture as we are only half way through the year, but looking at CapEx spend and other elements we have seen an improvement.

In terms of working capital, the delta from last year is a tough bench mark as it was quite a major improvement. Having said that, we have continued to lower working capital as a percentage of sales.

I can assure you that from an operational perspective our people continue to focus on delivering sustainable improvements on all areas of working capital year on year.

Perhaps at this point it is a good place to remind all those listening to our priorities for the use of cash.

Slide: Discipline in use of cash

First and foremost our priority is to continue to invest in our business, behind our brands, creating innovative products, investing in the future growth drivers of our business.

You've heard me talk about the new rollouts and hopefully you can see the evidence of our work wherever you buy our products.

At the same time we have stepped up the rigour in our capital allocation decisions, focused very much on the higher return, higher growth opportunities.

Second, we continue to enhance our portfolio with acquisitions.

As we have always said acquisitions have to meet all three criteria – not one, not two but all three. That is first a compelling strategic rationale, second a good financial return and last but not least a strong cultural fit between us and the acquired company.

Looking at 2014, post our Nestlé Skin Health transactions, the likelihood for the balance of the year will be bolt-on acquisitions.

In addition to acquisitions, we continue to either fix or divest under-performers. As our CEO Paul Bulcke always says we accelerate, we fix or divest as we look at our portfolio. Dealing with businesses or assets which are making inefficient calls on our capital. Capital that we can employ behind businesses that are clearly doing well, or businesses that have a lot of potential that we should be accelerating.

Thirdly, we also believe in a competitive shareholder return through a sustainable dividend policy and, where appropriate, share buybacks. Our announcement today of the CHF 8 billion share buyback is a consequence of our discipline in generating and managing our cash.

Slide: Summary

So, to recap. Our half year performance was one of broad-based profitable growth, in what remains a tough and volatile trading environment.

Positive contributions from both the Emerging and Developed Markets reflect the agility of our different businesses to react rapidly and effectively to their individual challenges.

Our performance to date also shows the value of our brands and the importance of innovation, that allows us to price as necessary while delivering volume growth.

And in terms of our execution and the Nestlé Roadmap, I have talked about the strategic and organisational transformation that continues within the company.

Our portfolio continues to be reshaped in line with our Nutrition, Health and Wellness strategy.

And I'm very happy to confirm our outlook for the year: which is organic growth around 5% and improvements in margins, underlying earnings per share in constant currencies and capital efficiency.

On that note, I would now like to open up to questions. (31.44)

Q & A Session

Questions on:	**Organic sales growth in Q2 and Easter impact** **Share buyback and M&A for remainder of the year** **Hyper-inflation accounting**

.

Jon Cox, Kepler:

Hello, good morning. I have a couple of questions for you. Just on the organic sales growth in Q2, it appears to accelerate to around 5.2%, obviously from 4.2% in the first quarter. I was just wondering what you think the Easter impact was? Do you think it was maybe 20, 30 basis points in Q2? Or are you pretty comfortable for us just to go away and start penciling above 5% organic sales growth for the second half of the year? That's the first question.

The second question just on something you said about [indiscernible] and obviously the CHF8 billion share buyback you've announced today, so maybe you can just reiterate, you don't see any sort of big bang M&A then for the remainder of the year? I know you won't comment on individual cases, but there is obviously a lot of speculation in the Infant Nutrition and Medical Nutrition space specifically?

Then just a last question on the hyper-inflation accounting. I wonder if you could just elaborate a little bit? I guess you're talking about Argentina there specifically? Thanks very much.

Wan Ling Martello:

Thank you, Jon. On organic growth you're right; we saw an acceleration in Q2. But let me be clear on this. In terms of guidance for the balance of the year we remain – I reiterated that it is going to be around 5%. Earlier this year we spoke of growth being weighted to the second half. At the first quarter we expected the growth for the full year to increase sequentially. And indeed like you said the second quarter is much stronger. So much so that we now expect organic growth to be more balanced between the first and second half.

Now the difference in timing reflects the volatile environment as you would have already seen in the results reported by so many other companies. I should also say that our business is large and diversified and so forecasting to the last basis point is kind of meaningless. So just to give you a sense, 10 basis points amounts to something like a few hours of sales for Nestlé. What's important to bear in mind is that we confirm our outlook for the year, organic growth of around 5%. An improvement in margin, underlying EPS, constant currency and capital efficiency. In short, progress on both top- and bottom-line.

On your question in terms of monetary corrections related to Venezuela. This is a result of hyper-inflationary accounting. I'm not going to go and recite what the IFRS paragraph is on this. The corrections have been made on monetary items on the balance sheet that is exposed to currency devaluation. This is something that we do year-in and year-out. This is not something new. We do this. There was an amount that was recorded also last year.

Again I think I said this in the fall during our nine-month conference that Nestlé has been in many of these countries for many, many years. So it is 'Been there, done that, got the T-shirt for it.' This is nothing new. It's something that we're very comfortable with. Venezuela is a relatively small market for the Nestlé Group. You mentioned Argentina. Argentina is even smaller. We've been present in Venezuela since I think 1895 when the first product was sold via distributors. We continue to serve our consumers in Venezuela. This is not something that we lose sleep over.

In terms of the CHF8 billion buyback the pacing of the share buyback programme. Our plan is to complete it by the end of 2015. Clearly it depends; the pacing of it depends on market condition.

I think that answers your three questions, Jon. Next question please.

Questions on:	**Emerging market growth acceleration** **Maintaining AA credit rating** **European environment**

Eileen Khoo, Morgan Stanley:

Morning, Wan Ling, hope you're well. Eileen Khoo here, Morgan Stanley. A couple of questions from me. The first one is actually on the emerging market growth acceleration. It looked like there was sequential growth – sorry sequential acceleration to around 11% in the second quarter. I was wondering if this is an actual underlying trend? Or are there other related factors, et cetera, that you'd like to call out? And if so what is the actual sort of trend overall on an underlying basis?

Secondly, would you be able to remind us what sort of leverage ratios you need to remain within in order to satisfy your double A plus credit rating? So metrics like net debt to EBITDA, et cetera?

Finally on the environment in Europe, which is deflationary overall, Do you have any view on whether this is primarily a cyclical issue, i.e., due to the recession, or are we potentially looking at a more long-term structural issue? Maybe there is a shift in the balance of power between retailers and producers? It would be interesting to get your view there.

Thanks very much.

Wan Ling Martello:

Hey, Eileen, how are you? Let me start with emerging market. Like I said before it's mix. We see acceleration in smaller markets, subdued in China, although we're seeing a mixed picture even within the China, because some categories are doing really well and some other categories have actually slowed down.

Let me just remind everybody. Emerging markets now account for, at least in H1, 44% of our sale. Now even though these economies have slowed we continue to be bullish, because it does represent a huge opportunity for the future. Growth in emerging markets is usually volatile. What we saw in Q2 is broad based acceleration versus Q1. Even in BRIC [Brazil, Russia, India, China] we also saw acceleration. India and Brazil improve. China for us on a NiM [Nestlé in the Market] basis also accelerated. And by product the drivers for Q2 acceleration were Confectionery, Infant, and Culinary.

In terms of your double A, even with the CHF8 billion buyback over this year and next year, it allows us to maintain the double A credit rating. There are many criteria that the credit rating agencies look at. But obviously one of the main financial criteria is EBITDA to net debt. But I'm not go into the details in terms of how much and what it is.

In Europe we are seeing some pickup in terms of, as I mentioned before, the Iberian region, but we don't foresee any change in terms of the deflationary environment that we continue to operate in. It's in terms of RIG in Zone Europe if you look at our business, RIG did accelerate after a slow Q1.

However it's very obvious, price remains in the negative territory. It depends on the country and on category, Dolce Gusto, PetCare continues accelerated. Some categories picked up, because, as we have called out, of the Easter impact.

Good luck with your baby, Eileen!

Eileen Khoo, Morgan Stanley:

Oh. Thank you very much, Wan Ling.

Questions on:	**Russian situation** **Growth rates in China**

Jean-Philippe Bertschy, Vontobel:

Good morning, Wan Ling. Thanks for taking my question. The first one would be on Russia. You were here saying that the market was quite strong there. How do you see the situation right now with the political situation? Do you see any impacts from the announced agricultural imports ban that was announced last night?

The second question is on China. If you could share with us maybe the growth rates if it was actually in the low single digit? Thanks very much.

Wan Ling Martello:

Hey Jean-Philippe. Comment ça va? I think the first of your questions is on Russia. Obviously the situation in Russia continues to be fluid. We pay close attention to international sanction and obviously ensure that our businesses activities are conducted accordingly. Now just want to point out over 90% of our products produced in Russia are distributed and sold domestically. Clearly whatever happens going forward will have an impact in terms of consumer demand. But we're very pleased with the performance in H1 in Russia. We have eight factories, 10,000 employees there. Good first half growth, thanks to innovation, despite the economic uncertainties, driven by its Nescafé Dolce Gusto, Confectionery, especially with KitKat, PetCare, and Ice Cream.

In terms of China, we are not the first to tell you that China has slowed down, so that no new news. For us the difficulty relates to some categories like Coffee, Wafers. But if you think about a big market like China and a big market slows down, there is going to be a certain level of destocking that has to happen when it slows down. That is exactly what we're seeing. But in categories like Professional, Waters, Nutrition, we're doing well. Our expectation for the second half in China is in fact a gradual recovery. So I think that answers both your questions in terms of Russia and China. Thank you, Jean-Philippe.

Jean-Philippe Bertschy, Vontobel:

Excellent. Perfect. Thanks very much.

Question on:	**Pricing in emerging markets**

Jeremy Fialko, Redburn:

Morning. Jeremy Fialko, Redburn here. Really just one question, which is on your pricing in emerging markets. You talk about the RIG in Zone AOA coming under some pressure, because of the fact you'd taken pricing to offset higher input costs. Could you talk about what the competition is doing? Whether you have actually been the one that has gone in front and the other people are now catching up? Or do you find your competitors haven't really responded to the higher costs. And you're still losing a little bit of market share versus the ones that haven’t moved. If you could just give us some more colour on that would be very useful. Thanks.

Wan Ling Martello:

Hey, Jeremy. At the risk of sounding like a broken record, pricing is local. It depends on category, it depends on market. But let me give you some colour. Pricing overall, like I said, is slightly driven up by emerging market and our expectation is we should accelerate further in H2. But again we don't guide on pricing sitting here in Vevey.

Now pricing in H1 of 2014 was driven by, like we talked about, emerging markets. It's in terms of category it was Dairy, Confectionery, Nutrition, Coffee pricing is starting to also take place, but developed markets continue to be very deflationary. And if you compare Q2 to Q1 pricing did increase. That's all I can say about pricing.

In terms of competition I don't really comment on what competition is doing. And again our local market does what it has to do to remain competitive. We go back to pricing is local, pricing depends on market, pricing depends on category, even within a market.

Thanks, Jeremy.

Jeremy Fialko, Redburn:

Thanks.

Questions on:	**RIG and Pricing in U.S.** **Input costs**

Warren Ackerman, Société Générale:

Good morning, Wan Ling. It's Warren Ackerman here at Soc Gén. I have two questions. The first one is just on the U.S. Obviously coming back from the Investor Seminar you gave us a lot of detail about your thoughts on the U.S. But I was wondering whether you could just tell us what is RIG and pricing was in the U.S. in the first half? Is there any reason to expect an acceleration in the second half? That's the first question.

The second question is just on input costs and coming a little bit back to Jeremy's question. I've been thinking about the four of your big ones, Dairy, Sugar, Coffee, and Cocoa. We've seen some big differences and movements. Sugar is well down. We've seen global Dairy trade auctions now down 40% since February, which ought to give you a big gross margin tailwind. I was just wondering whether you think you can retain these benefits?

Then on Coffee. Coffee prices have moved up a hell of a lot year-to-date. And you talked about taking some Coffee pricing. But you've also seen Cocoa pricing moving up a lot well. One of your competitors yesterday talked about significant pushback from the trade on getting that pricing through.

So obviously you've got a lot of different moving parts here, Wan Ling. I'm just wondering whether you could sort of talk about those four commodities? And what it all kind of means for you particularly with reference to sort of second half margins. Thank you.

Wan Ling Martello:

Hi, Warren. Let me start with your first question which is about the U.S. As you rightly pointed out, we took the opportunity in our yearly Nestlé Investors Seminar to deep dive and give our investor community a lot more colour and specificity on a specific area of our business. This year was in Boston highlighting every single category in the U.S. For those of you who did not have the opportunity to participate, the presentations are all on demand on our website. So please I would encourage you to do that. In the presentation our management team was very transparent in highlighting what the issues are and what the plans are going forward in terms of addressing those issues.

But let me come back to H1 from a U.S. standpoint, and I will talk about NiM [Nestlé in the Market]. There is no question that the USA is subdued, but it has positive RIG and organic growth at a NIM level, okay? I already talked about the news there. Frozen and Ice Cream continues to be challenged, but PetCare good growth, Water continues to be good, Professional improving albeit from a low level.

The environment is challenging. But no other company has the breadth of Nestlé with 40 segments in the U.S. Consumer spending is low due to a whole host of factors. But we know we're focusing on improving communication, focusing on NHW [Nutrition, Health and Wellness] and adjusting to trends like natural, protein, and gluten-free. The really good news too is we have achieved our cost reductions in the U.S. and continue to be focused on that.

In terms of COGS, it's our input costs. Let me just give you colour in terms of agriculture commodities. Now you know we do take hedging and forward cover to deal with short term volatility of prices of our key agricultural commodities. Year-on-year we've seen price increases mainly in Coffee and Cocoa. While it has been more benign for other raw materials that in Coffee prices as you know has been up, especially Arabica is up 40 I think year-on-year due to Brazil drought and the fund buying. Cocoa prices also up supported by strong demand. So if you look at our COGS we talked about our COGS was up 20 basis points due to a slight input cost increase in Dairy and Cocoa, but our input cost increase was offset by NCE [Nestlé Continuous Excellence] efficiencies.

For the full year 2014 we still see input costs up in low single digit. Now that's but higher than in 2013. Now pricing taken in the first half help COGS, should help COGS in second half with regards to higher cost of Coffee and Cocoa and cost of other raw material should be more benign. So that should answer your two questions. Thank you, Warren.

Warren Ackerman, Société Générale:

I was going to say can I just follow-up very quickly just on Dairy, Wan Ling, because I think that Dairy is one of your biggest soft commodities. And we're seeing global trade auctions, pricing collapsing. I mean you were talking about down to 40% now since February. I mean should that not give you quite a big gross margin tailwind of some kind?

Wan Ling Martello:

Yes Dairy prices have moved down from a high level. It's still up, but it's moved down from a high level. And that's due to global supply increases exceeding the demand growth. And so that's what we're seeing in terms of Dairy.

Warren Ackerman, Société Générale:

Okay. All right. Thank you.

Wan Ling Martello:

Thank you.

Questions on:	**Foreign Exchange** **Situation in France**

Alain-Sebastian Oberhuber, MainFirst:

Yes good morning, Wan Ling. Alain Oberhuber, MainFirst. A short question on currencies. If we see currencies remaining stable how much would be then the negative impact on your margins for the full year?

The second question is more specific about France. Do we see a similar situation then in the other European markets? Or is France picking up or just staying at these levels?

Wan Ling Martello:

Yes. Let me answer your first question first in terms of FX. I highlighted in my presentation earlier that this is a very significant headwind. There is a 40 basis points impact on margin.

FX mainly has a translation impact. I think everybody knows that, so that is sort of like stating the obvious. However, we sell where we produce. Therefore, we have a good match between cost and sales generation. I do not want people to forget that. There was a significant impact of FX on H1 figures. Sales were negatively impacted by 8.8%. Trading operating profit margin was impacted by 40 basis points

Now having said that we do not guide what the FX impact should be for the balance of the year. However, do also remember that from an FX standpoint, it would be easier comping for the balance of the year. That is what I can say without giving specific guidance.

Your second question is on France. We did see a Q2 pick up in France but we are still facing a deflationary environment in France. We saw positive RIG and OG with broad based Q2 acceleration despite the deflation. OG still impacted by contracting categories, whether you talk about Culinary, you talk about Soluble Coffee or Chocolate. But we saw improved and strong performances in Nescafé Dolce Gusto, pizza, Ice Cream, chilled water, Nespresso. Where we saw slow performance was chocolate, culinary. And so yeah so that should hopefully give you some color in terms of our French market. Thank you, Alain.

Alain-Sebastian Oberhuber, MainFirst:

Thank you.

Questions on:	Restructuring costs Working Capital

James Edwardes Jones, RBC:

Morning, Wan Ling. Two questions from me as well please. Your restructuring costs in the half were CHF40 million, CHF41 million. So 0.3% of sales. You have been talking for a while about restructuring costs increasing. Has that got into reverse?

And secondly, CapEx – sorry working capital. You had quite a chunky outflow in the half year. Have the sort of easy benefits, in terms of working capital, been made or is there still more to come

Wan Ling Martello:

In terms of restructuring, no, we do not guide on these items. As this our restructuring expenses are booked when incurred. And it's hard to guide on this.

I will say though trading items decrease 10 basis points in the first half, because of lower restructuring in Zone AMS. If you recall last year we had the Waggin' Train voluntary recall. So that was an item that was in H1 of last year that clearly was not repeated this year. But it's also offset, partly offset by higher impairment of assets in both Zone Europe and Nutrition. So when you talk about restructuring it's very difficult to forecast because it's just a lot of moving parts.

CapEx is in line with our objective to lower CapEx to between 4% and 5% of sales.

James Edwardes Jones, RBC:

So sorry I that – I misspoke. I meant working capital, Wan Ling.

Wan Ling Martello:

Like I said we continue to improve in terms of working capital from an operational perspective. Across accounts payable, receivable, inventory, we continue to improve it. In fact if you look at working capital in Swiss francs in absolute level it increased versus last year year-end 2013, but was below the level of June 2013.

Now we have some seasonality in working capital for inventories so it's normal to see an increase at mid-year. But I can tell you that working capital as a percent of sales decreased between H1 of 2014 and H1 of 2013. And trade networking capital as a percent of sales is also down.

So from an operational perspective I'm very comfortable and very happy to report that the organization continues to be very focused on it.

Questions on:	Input cost pressure in H2 Confectionery EBIT margin

Patrik Schwendimann, Zurcher Kantonalbank:

Good morning, Wan Ling. Again regarding the input costs. You were mentioning for the full year that you would expect again a low single-digit increase as it has happened in H1. Did I get this right that you don't expect increased pressure in H2 from the input cost side?

Secondly regarding EBIT margin development in Confectionery, which was down 210 basis points in H1. It was already down last year in H1 by 110 basis points. So what's happening here in Confectionery? Thank you.

Wan Ling Martello:

Good morning. Patrik. Yes. In terms of input costs like I said, the basket of our agricultural commodities that we buy I just have to repeat that for the full year, it's low-single digit higher than 2013.

In terms of Confectionery the trading operating profit margin is impacted by higher input costs. The decrease is due to chocolate impacted by cocoa butter and also intense competitive environment. Most notably in Western Europe, in developed markets where the environment is deflationary, it's tough for our businesses to take pricing.

Our Confectionery business is growing overall if you look at that category. In the last five years the average organic growth was 6%. RIG was 3%. Our focus is to continue to grow our Confectionery business in emerging markets. It’s very exciting to see that a global brand like KitKat has very good growth even in emerging markets.

So Cocoa pricing is putting pressure on all Confectionery players' margins, and we're no exception.

Questions on:	Effect of Russian crisis on European economic recovery

Corinne Gretler, Bloomberg:

Hi. You already answered one of the questions from the analyst about the Russia situation on your business. Can I just ask one more question? Do you think the current crisis can and will hurt the economic recovery in Europe?

Wan Ling Martello:

I think we've touch on this before. I think the thing to underscore is the trading environment on a global basis, is very volatile. You've seen it in our sector, outside our sector, in the reporting season that started a few weeks ago. It's a very volatile trading environment. We do not anticipate that the deflationary environment in Europe will go away anytime soon. But this again speaks to the strength of our brands, our people executing very well, and our innovation. The environment is tough, the environment is volatile, but we will continue to deliver.

Questions on:	Impact of relations with retail trading partner

David Hayes, Nomura:

Thank you. Morning all. There will be questions on two areas from me, if I can? The first is on Europe and I guess France, specifically. Mondelez yesterday talked about very difficult negotiations in Coffee and Confectionary, in particular in France. They led to, effectively, a stand-off in shipments and ordering coming through. That would suggest some catch-up potential in the second half as those negotiations get resolved. I just wondered whether you had seen a similar dynamic in Europe? Will you similarly see, therefore, a little bit of uplift into the second half as you see that catch up?

My second question is on one-offs. I am just wondering whether there was any impact in beverages from the global re-launch of the Nescafé packaging. Was there stocking into that shift? I then have a similar question on one-offs in Nutrition. WIC Contract I think you walked away from three states, year-on-year, in the first half. I just wondered whether you can quantify whether that was quite impactful? What kind of impact would that have had on RIG in the Nutrition business?

Thank you very much.

Wan Ling Martello:

Hey David. You know what? With the impact of our retail trading partners in France, it is not easy all around. This is part of doing business, whether it is in France or it is any other developed market. It is not just in Europe, it is also in North America. It is part of doing business. I do not know what else to say beyond that.

In the Beverages category our trading operating profit margin was down 20 basis points. That is because of increased consumer marketing spend in Coffee and Cocoa beverages.

Your other question was on Nutrition and the US Infant business being impacted by the weak contracts. We do not pull out specifically how many basis points effect that would have had on our growth. I will say though that the slower Infant Nutrition in the US is in fact due to selective presence in WIC Contracts. You are right: we exited three states. That has had an impact. However, that is deliberate because we want to grow our business profitably.

David Hayes, Nomura:

Okay. Thanks Wan Ling.

Wan Ling Martello:

Thank you, David.

Questions on:	**Deflationary pressures in developed markets** **Divestment programme**

John Revill, Wall Street Journal:

Morning, Wan Ling. I have a couple of points. I was just wondering about developed markets. They seemed to have slowed quite a bit from last year. I was just wondering, generally, how much tougher is it getting out there? Can you give us a bit more colour on the deflationary pressures you are facing out there? What particular categories is it affecting? Is that the retailers forcing down the prices or is it just consumers refusing to pay higher prices, so you are having to lower your prices? And what are doing about it? That is the first point.

The second point is on your divestment programme that was announced last year. Obviously you said that is continuing. Could you give us any more colour about what is going on there, moving forward? Are we to expect any further big things, moving forward? What is going on with the review of the overall business?

Wan Ling Martello:

Good morning John. The macroeconomic environment in developed market continues to be difficult. We are seeing some patches of signs of economic improvement. However, in many cases it is not translating into more Food and Beverage spend. Consumer confidence still remains low and in many cases the environment continues to be deflationary. But we continue as you see, evidenced by our growth in H1 in developed markets, especially in RIG. That is our real internal growth.

Your second question is about divestment. In my presentation earlier I alluded to the fact that our CEO Paul Bulcke talks about how, when we look at our portfolio we either have to accelerate, we have to fix or divest. That is an on—going process of divestment. However, it is not just about divestment. It is also about acceleration and that is an on-going process. We are doing that on-going and it is a process. There is nothing more specific that I can share at this point.

End of Q&A session

So I think answers John question. And I will say I have one question for everybody who didn't ask the question. I think started with Jon Cox that asked the question about full year organic growth in terms of H2. I wanted to also build on that point in terms of trading operating profit for weighting in terms of H2.

Our margins benefited from operational gearing and stronger sales growth in H1. So maintaining our momentum through the second half and beyond will require further investment in the business to generate growth. We're committed to making this investment.

You should expect a constant currency margin improvement for the full year. That is what we committed and that is what I reaffirmed this morning. That would be lower than we showed for the first half. However, again we reconfirm our guidance of an improvement in constant currency margin.

So with that, I want to thank you all for joining us. I look forward to seeing many of you on roadshows over the coming months and speaking with you again at our nine-month call in October. That's I think 16th October.

Until then, thank you. Have a great summer and bye for now.

END OF TRANSCRIPT