

NESTLÉ S.A.

2018 Coffee Partnership Call

7th May 2018 19:30 CEST

Speakers:

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

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

Luca Borlini, Head of Investor Relations, Nestlé S.A.

This transcript may have been edited for clarity, and the spoken version is the valid record.
This document is subject to the same terms and conditions found at
<https://www.nestle.com/info/tc> .

Luca Borlini, Nestlé S.A, Head of Investor Relations:**Slide: Title slide**

Good afternoon to everyone. I am Luca Borlini, Head of the Investor Relation Department at Nestlé. Today's discussion will be led by our CEO, Mark Schneider dialling in from Seattle and our CFO, François Roger here in Vevey.

Earlier today, Nestlé announced an agreement for the perpetual global Licence of Starbucks consumer and foodservice products. The purpose of the conference call is to discuss the transaction in more detail and give you an opportunity to ask questions related to the deal.

Slide – Disclaimer

I will take the safe harbour statement is read. And I now hand over to Mark Schneider.

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

Okay. So Luca, thanks, and warm welcome for investors today and thanks again for joining. We always appreciate your interest and also ask for your understanding that we're improvising here a little bit, I'm dialling in from Seattle and it was important to us, as we announced this transaction, that we spend this day with Starbucks and also with the Starbucks partners who are joining us as part of this transaction.

It was also important to connect with you, our investors, today and give you a chance to discuss any questions and explain to you the strategic logic of this transaction.

It's certainly the largest transaction that we've done in a while and larger than the deals we've done last year. But it follows one basic discipline that we established last year and that is, it is very much category specific and it builds on the leadership position in a specific category. So in this case it's our coffee category and as such I think it is very disciplined and strengthens us in one of our leading high growth categories.

Slide – Building a unique coffee portfolio with three iconic brands

Turning to page 3 specifically, you see that it brings together three leading brand names in coffee that are certainly iconic. I think as you see from the description on this slide, each of these brand names has its own distinct identity and approach to our consumers. So we're very proud in addition to *Nescafé* and *Nespresso* to now be responsible for the retail and foodservice side of Starbucks. This is a brand that was admired for a long period of time. And

it's admirable to see what Starbucks single handily has done to the development of American coffee and how they scaled this up in the form of their international expansion. So being with them as we continue on this growth path is certainly a privilege and an honour for us.

Slide – Strategic rationale

Turning to the next page, you see the strategic rationale from our side. So again building that unique coffee portfolio with three iconic brands as the starting point; second, from a geographic point of view, strengthening our position in the North American coffee market where I think, traditionally, our market presence in North America has not been quite as strong as in select international markets. And with this transaction now, we're certainly building our presence in North American retail and foodservice markets.

Then of course, there's a lot that we bring to the table when it comes to the global expansion. This is in all presentation forms whether its premium roast and ground, portioned coffee, soluble coffee and tea, I think this is where we bring the global Starbucks brand appeal together with our unsurpassed distribution presence in 190-plus countries.

So together, this is all about growth. This is a growth deal. I think, we can go for geographic growth and we can certainly build our out-of-home channel, which I think is one thing that is quite often underappreciated about Nestlé that in out-of-home we do have a significant presence and one that the Starbucks brand will certainly support. François will cover the financials later, but this deal does offer very attractive financial returns and is fully supporting our mid-term growth and margin targets.

Slide – Shared purpose and values

Turning to page 5 and before handing it over to Francois just a quick look at one other item that was very, very important to me and that we all witnessed during the negotiations; and this is the shared purpose and values between Starbucks and Nestlé. I think here you have two companies that are truly focused on excellent coffee and everything that goes with it.

We're very much committed to responsible sourcing practices and reflecting sustainability, as part of our sourcing approach, and we really live that from both company sides on the ground each and every day, as we deal with those fragile agricultural communities from where we source our coffee, and we fully respect that this is an agricultural product that needs good care, so that going forward high quality supply is available.

I think we're also committed to just the excellence when it comes to coffee processing, and research and development when it comes to developing new varieties. So again there's a lot going forward that both organizations can learn from each other.

I think both companies have been just super successful in premiumizing coffee over the years and now pooling our resources here in the retail and foodservice channels I think will give us some additional success in that space.

And then geographically, when it comes to our core priorities I think the U.S. we discussed; China, which of course is a growth focus for Starbucks. That's our second largest market and this is one where I think we will bring a lot of distribution strength to the table. Then as we go into this partnership we'll discuss other key priority markets be they in Asia-Pacific, in Europe or Latin America that together we can develop in the retail and foodservice setting.

So, this concludes my part. With that slide, let me hand it over to François, who will take a closer look with you at the transaction rationale and also the financials.

François-Xavier Roger, Nestlé SA, Chief Financial Officer:

Slide – Main transaction terms

Thank you, Mark. Good morning or good evening to all. This deal is a clear confirmation that we are progressing our portfolio management with discipline and focus on our high growth categories. And this is exactly in line with what we have been communicating over the past year.

This is our third and by far the largest coffee acquisition that we have made in the past 12 months, following *Blue Bottle Coffee* and *Chameleon Cold-Brew*. Each of the coffee acquisitions that we have made have helped to broaden our portfolio and this deal is exactly the same.

Through the agreement, we will market the following Starbucks branded products, premium roast and ground, portioned and soluble coffee, and also tea. The premium roast and ground segment is growing fast and this deal gives us an opportunity to increase our presence with immediate scale in North America. It also gives us another platform to grow in foodservice, which is a channel where we have a lot of experience. We already have more than CHF 5 billion of sales in Nestlé Professional today, roughly half of which comes from coffee with our iconic *Nescafé* and *Nespresso* brands. There is a strong complementarity in adding the

Starbucks brand and particularly premium roast and ground capabilities to this existing business. And it allows us to become a complete provider of coffee solutions in out-of-home.

From a geographical dimension, the vast majority of what we are acquiring is in North America and gives us some scale in a market where we have been underrepresented compared to our coffee strengths elsewhere in the world. But clearly this deal is also about the very significant growth opportunity to use our global reach to expand the availability of these products internationally beyond North America. And so it is important to us that it is indeed a worldwide Licence for the brand. We will be taking every opportunity to leverage these products in growing markets, where Starbucks has built a coffee shop presence and consequently has built awareness of their brand. Markets like China, but many others as well have a lot of potential.

It is also an important point that this licence is perpetual. So we have the opportunity to invest for the long term to drive growth globally. We do need to clarify which products and point of sales are not included. Any sale made within Starbucks coffee shop is excluded and that means also the consumer products that are available within the coffee shops. In terms of product, the RTD coffee business of Starbucks is not part of the agreement.

This is a very light deal with regard to fixed assets. We are not buying or we are not receiving any material infrastructure, only the licence for the brand and its customers. As part of the agreement, around 500 full-time employees of Starbucks will join us and become part of Nestlé.

Slide – Main products included in the deal

This slide is to give you some examples of the category segments on main products that we have acquired the licence for. As I mentioned before, this includes Starbucks Premium Roast and Ground, Premium Soluble Coffee, and also Portioned Coffee. We will market the existing K-Cup business in Portioned Coffee, and we also intend to develop products for our own coffee systems. In Soluble Coffee, we will market the premium Starbucks VIA brand. And in tea, there is a Teavana brand, which we will also launch for *Nescafé Dolce Gusto*.

Slide – Financial information

In terms of the financials, this is an attractive deal for us on all metrics. We are paying \$7.15 billion, which means the multiples of 15 times 2018 pro forma EBITDA. When you look at

recent transaction multiples in the industry, we feel that this is a fair price, which shows our determination to be disciplined in our portfolio management.

The business that we are acquiring has annual revenues of almost \$2 billion. So we will add about 2% to our group revenues. It strengthens our global leadership in the Coffee category, increasing our total coffee sales by almost 15% to CHF 17 billion.

There are clear opportunities to grow this business as we have discussed during the presentation and we fully expect this deal to contribute positively towards our target of accelerating our growth to mid-single-digit by 2020. It has a good level of profitability which is accretive to Nestlé in terms of underlying trading operating margin after royalty payments.

There are minimal integration cost as our respective businesses and geographies are complementing each other.

Overall, this means that the deal will be accretive to our EPS in year one, which will be 2019.

From a balance sheet perspective, there are basically no fixed assets being acquired, but there are obviously goodwill and intangibles related to the brand licence and customer list.

Because we are not transferring fixed assets and we already have our own manufacturing and distribution infrastructure in place, there will be very limited CapEx required from our side for this business. We will use some of our existing manufacturing facilities outside of the U.S., which will enable us to increase our own capacity utilization. When you consider this low CapEx with the high margin profile, we are looking at a very cash generative business, which is one of the attractions of the deal.

From a timing perspective, we expect to close by the end of 2018, but it will be towards the end of the year. For your modelling, you're probably best to assume 2019 as year one.

And finally, to be transparent from the outset, we want to be very clear that this transaction does not change our current ongoing share buyback program. This will be maintained as before.

That concludes my presentation and I now hand back to Luca for the Q&A.

Q&A Session**Luca Borlini, Nestlé S.A, Head of Investor Relations:**

Thank you, François. Thank you, Mark. With that we move to the Q&A session and we open it up for questions. The first question actually comes from Eileen Khoo from Morgan Stanley.

Questions on;	Making the growth from deal accretive to Nestlé Fit with global coffee strategy and potential conflicts
----------------------	--

Eileen Khoo, Morgan Stanley:

So I've got two questions, Mark and François. The first one is, I was interested to see that you've said this is growth deal. Love to understand more the assumptions behind this given that the business is predominantly a domestic U.S. business and it's gone from 8% to 10% historical growth to more like 2% now. So I'd like to understand why you're confident that you can get that growth to become accretive to the Nestlé Group? That's the first question.

The second question is, I wondered if you could give us more colour on how you see this deal fitting in with your global coffee strategy given that it excludes some of the fastest growing parts of the Starbucks business. Do you see other gaps in your global coffee portfolio that needs to be addressed? And if so, are there some potential conflicts perhaps at Starbucks given that it might include things like Blue Bottle which are actually coffee chains? Thanks very much.

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

Thanks, Eileen. Let me take a crack at both of these. So, on the growth side, it's important to not just look at North America in isolation, but look at it from a total point of view and that's North America plus then the international opportunity, where from very low levels of activity we'll be able to ramp up the retail and food service side of the Starbucks business and benefit from the prime building that they have done in those markets, so China being the most notable one.

In North America as well, do keep in mind we do bring significant distribution strength to the table both in retail and in foodservice. As I was trying to allude to in my prepared remarks, I think our focus on foodservice and out-of-home is quite often underestimated and I think we can do a lot for this brand and product range in that space.

Then also do keep in mind that we have additional cartridge systems like *Nescafé Dolce Gusto* and *Nespresso* where we can basically present more choice to the consumer by

having them pick Starbucks products in those formats as well. So, when you put all of this together, we do see a very strong growth case and that was certainly the assumption from both sides behind this business plan.

On the global coffee strategy, again, the perimeter of what we are discussing here is pretty large. And so it really covers the premium roast and ground, the soluble, the various cartridge systems and then a vast number of geographies where we can expand. So I'm not primarily looking at limitations here, I'm looking at opportunity. It does not include the ready-to-drink, but in ready-to-drink I think we have many of our own brands, be they around *Nescafé* or around the recently-acquired *Chameleon*, or *Blue Bottle* for example. So I think we do have some good brand names here to expand our own ready-to-drink business in various locations.

Blue Bottle, that's a question that did come up a few times, clearly while this transaction is giving us, each company, its area of focus, so coffee shops with Starbucks and retail and foodservice for Nestlé. It was also understood from the beginning that there was going to be some overlap going forward. So for example, after this transaction closes, when you buy from Starbucks coffee shops any coffee, that's outside of our scope. But then also we will be permitted to continue our coffee shop activities that we have started up in various countries under the *Nescafé* name, the *Nespresso* name, and also of course under *Blue Bottle*. So we will be able to develop those businesses going forward. So I think both organizations realize that there's going to be areas of focus and those are going to be beneficial to both organizations and then there is going to be some overlap that is going to be absolutely tolerated and fine.

Luca Borlini, Nestlé S.A, Head of Investor Relations:

Our next questions come from Jean-Philippe Bertschy from Vontobel.

Questions on;	Developing the Starbucks brand Organisation of Starbucks employees joining Nestlé
----------------------	--

Jean-Philippe Bertschy, Vontobel:

The first one would be on *Nespresso* and *Nescafé Dolce Gusto*. Can you please give us some colour how you want to develop the Starbucks brands on these two platforms, please?

And the second one is on the employees you're hiring from Starbucks, roughly 500 people. I think that Starbucks was very clear as well that they intend to still participate in the innovation

and kind of development of the brand. Are you thinking of a merge with the Nestlé team or you will leave them in standalone? Thank you.

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

Right. Thanks, Jean-Philippe. So, I think when it comes to *Nespresso* in particular because as you know this is a close system with us. It's very important that we want to make that system available. But we want to make it available without creating brand confusion. And so, you will be able to buy Starbucks branded capsules, but those will not go via our *Nespresso* club or our *Nespresso* boutiques. So, we will look for other outlets for these capsules, and this could be e-commerce down the road. So we will make the system available, but we also will be very clear about brand identity and not unnecessarily creating any confusion there.

On *Nescafé Dolce Gusto*, I think we have been building up some co-branding experience already and so we'll follow in that same vein. As you know, that was always an open system and has a very large number of installed units, especially in international markets.

Regarding the employees, it's very important to us to have a smooth transition here and make it as easy as possible for the Starbucks employees that are joining for us. As such, we'll be maintaining the location out here in Seattle and then work very closely together to bring the expertise from both sides to the table and not create a disruptive move right at the beginning. So I think this is going to be, as we said, very much focused on growth. It's not going to be focused on any cost synergies.

Jean-Philippe Bertschy, Vontobel:

Thank you. I just have a follow-up on *Nescafé Dolce Gusto*. Are you intending to follow the expansion in the U.S.?

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

This is something we'll be looking at very closely with Starbucks, and yes, that is the plan for now.

Luca Borlini, Nestlé S.A, Head of Investor Relations:

Well, we go now to the next question. Hello, Jon. Jon Cox from Kepler.

Questions on;	Return on invested capital
	Cost saving potential

Jon Cox, Kepler Cheuvreux:

Thank you Luca. Thank you, guys. A couple of questions for you, really on the returns aspect. It looks like the return on invested capital is around 4%. Assuming 10% growth in operating profit over the next couple of years, I assume you'll get to about a 7% return in about year six. Is that a correct assumption or am I being a little bit too conservative given what you said in terms of maybe a top line roll out?

Just as an add-on, is there any cost savings potential there in terms of people you're taking on or sourcing of coffee or really cost savings, forget it, it's really all about the top line roll out? Thank you.

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

Jon, I think you're a little conservative on that. And again, what we didn't want to do is to go too deep into some of the financial assumptions, but from a return profile point of view, we're very, very enthusiastic about this opportunity, and again, this is against what we consider to be a realistic and conservative business case. But maybe François you can give a bit more background.

François-Xavier Roger, Nestlé SA, Chief Financial Officer:

That Jon's assumption is too conservative. This is clearly a high margin business with no material assets acquired beyond goodwill. This is a growth business, and mainly outside of the business as we indicated. The acquisition will be dilutive to ROIC initially, but this transaction probably less than others for the reason that I mentioned before with limited assets on a high margin. The ROIC is confirmed to being fully in line with our previous guidelines that we communicated in the past.

Just to answer the question on cost savings, this is not about cost savings. This is much more about growth. It doesn't mean that we can't find some saving on the way, but this is once again not about cost saving because we have a very complementary business both in terms of geography and categories and activities. So this is not about cost savings.

Luca Borlini, Nestlé S.A, Head of Investor Relations:

The next question is actually coming from Alain Oberhuber from MainFirst. Go ahead, Alain.

Questions on;	Acquisition activities
	Conflict of interest

Alain-Sebastian Oberhuber, Mainfirst:

Good evening, Mark, François, and Luca. I have two questions. The first is regarding the acquisition activity you now have. I recall that you said for large acquisition, and I assume this is a large acquisition, it's not the time given the high multiples. Has that changed now in your perception?

And the second is regarding the conflict of interest with that deal, given that Starbucks has also an alliance with Keurig K-Cup. Could you explain that a little bit how you will deal with that?

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

Yes. Thanks, Alain. Happy to comment on both. I think when it comes to acquisition activity as we outlined in our presentation, the financial parameters here look very attractive to us. I think that view has been vindicated by a lot of outside commentators today. So this is a very reasonably priced transaction for us. Is it larger than what we had initially contemplated near-term? Yes, it is. But again it's right smack inside one of our growth categories and one that we really intend to develop going forward. So I think it clearly makes sense. It's not one of those transactions that cuts across the number of different categories or may require extensive divestitures and complication. So this is a fairly easy integration job and it really strengthens a core category of ours.

Regarding the Keurig system, we made it very clear and Starbucks also made it very clear that we intend to offer our Starbucks coffee then going forward on the Keurig system. So this is about increasing choice to consumers. This is about allowing them to pick Starbucks on a number of systems and the Keurig system is well-established here in the U.S. And so clearly from our side, no need to change that.

Luca Borlini, Nestlé S.A, Head of Investor Relations:

The next question is from Pierre Tegner from Natixis.

Questions on;	Guarantee of the perpetuity of the licence Brand equity issue
----------------------	--

Pierre Tegner, Natixis:

Okay. Thank you for taking my question. I have two questions. The first one is on the perpetuity licence. Is there something in case of Starbucks change of control; have you the guarantee of the perpetuity of the licences in such case?

And the second one is around brand equity risk on Starbucks because we have seen very recently some issues emerging around something happening in one coffee shop in the U.S. and there was a lot of noise. What are the key conditions between Nestlé and Starbucks in the case of a big brand equity issue emerging?

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

Yes, Pierre. Thanks for your questions. So, on the first one, I think, both partners really intend to approach this with perpetuity in the back of the mind, and a very long time mind-set. With that in mind, we also have a fairly extensive governance structure set up at the market level, at the brand level, and also the senior executive level, directly between the Starbucks CEO and me. So this is a project and a collaboration that both CEOs are going to be very much involved in going forward. This is really important to us that this works well. It won't be easy to break that relationship going forward. But I also ask for you to understand, that I wouldn't want to commit on details when it comes to the full contract between both companies.

When it comes to brand equity going forward, look, clearly both sides have an interest in the Starbucks brand being alive and vibrant and strong and positive, and so this is something that both sides will contribute to. The recent incident that you referred to, look from my side, I can only tip my hat to Starbucks handling this matter in a very professional, very empathetic and wonderful manner. I think it just shows that there is tremendous concern on the Starbucks side to keeping that brand name very healthy and untarnished and we will give the brand that same respect.

Luca Borlini, Nestlé S.A, Head of Investor Relations:

We still have one question from Vincent Baron from Oddo. Vincent, go ahead please.

Question on; Keurig – Dr Pepper acquisition

Vincent Baron, Oddo Bank:

Yes. Okay. Just a quick question about the fact that this is maybe a defensive acquisition regarding the fact that recently Keurig Green Mountain just bought Dr Pepper, so that might be a way for you to be still offensive especially on the retail side. What is your view on Keurig and Dr Pepper acquisition?

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

Yes, Vincent, I wouldn't want to comment on the acquisition, but let me just point out this is not defensive at all in nature. It also builds on contacts between the two companies,

Starbucks and Nestlé, that go back over several years because I think the fact that we think very much the same about coffee, that is something that goes back to my predecessors and certainly Kevin's predecessor. So we've always been in close contact, and we're looking at ways how to get the deal done.

Over the past year then Kevin and I really prodded to a way that we can announce this transaction today and we're very, very happy about this. But this is not a short term defensive reaction. This is about grabbing opportunity going forward, in particular when it comes to the international arena in all these countries where, if you see now, Starbucks coffee shops expanding and us then being able to capture the retail and foodservice part of that business. Also from a Nestlé perspective on really building the North American presence in coffee where you know that traditionally as François pointed out, we were a little bit under-indexed when it comes to our coffee presence here. Traditionally that has to do with our focus on soluble. I think now across the full range whether it's soluble or roast and ground premium and cartridge systems we'll be able to compete and that's a tremendous plus to us because North America is just a very important coffee market going forward. So this is not defensive at all. I think it brings two leading companies and three iconic brand names together and we're excited about the opportunity that that creates.

Luca Borlini, Nestlé S.A, Head of Investor Relations:

Well thanks, Mark. We don't have any further questions at this point in time. So we come to an end of our session. If you want to conclude Mark with a few words and then we will conclude the call.

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

Yes. Thanks Luca. Again, thanks for joining us and we are excited about this making it happen. If you have further additional questions, please feel free to contact Luca directly, and we'll talk to you again at the end of Q2.

End of Transcript