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PRESENTATION TRANSCRIPT

Nestlé's long-term value creation model

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Speaker:

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Slide: Title slide

Thank you Andrew, Good morning to everyone. I will run through a quick presentation and indeed after that we will move to a Q and A.

Slide: Disclaimer

Slide: Balanced and diversified portfolio in fast-growing geographies/categories

I will start with a quick introduction of Nestlé. I suppose that you all know Nestlé but just to give you a quick snapshot. So Sales of nearly CHF 90bn last year.

A very diversified portfolio in terms of categories. We are not at all overly dependent on any single category. Our largest category is Powdered and Liquid beverages, which is essentially Coffee, with brands like *Nespresso, Nescafé* and *Milo.* We are present in Infant Nutrition, PetCare, Culinary, Milk Products, Ice Cream, Confectionery, Water and some other categories as well.

We are very diversified as well from a country point of view, geography point of view, with a well-spread operation. We are operating in 190 countries. We are not overly dependent on one country. We employ 130,000 employees and we have 450 plants. We produce close to 1.2bn servings a day. So we are quite large in terms of operation.

Slide: First half 2018 performance

A quick snapshot on our first half 2018 performance, although it is not the main topic that I want to cover but our first six months of 2018 we were quite pleased because they support very much our growth agenda for 2020 both in top and bottom line.

Organic growth accelerated to 2.8% in H1 from 2.4% last year. We were especially pleased by the performance in the U.S.; last year we were actually flat in the U.S. which is our largest market. We enjoyed a decent level of growth of 2.2% in H1 in the U.S. which is certainly much better.

In China we were pleased with our second market as well. We were at 1% last year, in terms of organic growth, and we were at 4.8% in H1. So it is pleasing to see that our two largest markets gained momentum in terms of growth.

Our market share dynamics are improving as well. We had, in the first half of 2018, in 57% of the cells; a cell is a combination of a category and a market, we improved or stabilized our market share which is better than where we were last year. By the way in terms of market share we cover a better universe than the panels Nielson or Euromonitor because we have better view. They don't cover for example some of our businesses like *Nespresso*, like E-commerce and so forth. So we were relatively pleased by this momentum as well.

We increased our margin by 20 bps as well in H1 versus last year. We have an ambition to increase by more than that this year, we did plus 50 last year and we do expect clearly to do more than 20 basis points in the Full year. We knew that the first half of 2018 would be on the lower end because we had some headwinds in terms of commodities and we expect to get some tailwinds on the commodity side in the later part of the year.

EPS grew at almost double digit at 9.2% supported by our top line growth, supported by our margin improvement, supported by reduction of our underlying tax rate; partly coming from the U.S. tax laws but it goes beyond that as well.

Slide: Our long-term value creation model

Our model is based on three pillars; Top Line Growth which I will cover in more detail, this is very much about investing in our high-growth categories. This is about innovation, we are in the business of innovation. This is about leveraging digital opportunities, we want to be active in portfolio management and I will cover all of that in detail.

Our second pillar is Margin expansion. We intend to increase our margin to around 200 basis points, between 150 and 250 basis points, from 2016 to 2020. To do that we certainly need to be more disciplined on our cost base and we expect to take away from our P&L, from our 2016 P&L, between CHF 2-2.5bn of costs. To get there we are ready to spend significantly on restructuring cost if necessary.

As far as Capital Allocation and M&A are concerned we are very conservative. We have a clear dividend practice of increasing the dividend year after year. We are currently embarking in a share buyback programme of CHF 20bn, we have completed 40% of it as we speak. It will be completed by mid-2020. We have a disciplined view on M&A but I will cover that in more detail.

Slide: 1. Invest selectively in high-growth categories

Starting with our high growth categories, we have five of them; Coffee, PetCare, Water, Infant Nutrition and Consumer Health Care. These categories are structurally growing, mid-single digit, anyway we are by design and by choice very strong in these categories. We have leading position. They account for 57% of our sales. They account for 64% of our profit, which is very attractive, and they grow significantly faster than the rest of the business. If you look at it in H1 we had 2.8% growth on average. These high growth categories grew by 3.5% in spite of the fact that Water was only at 1. The other categories grew by 1.7% so it is good to see that we are investing in them and that they grow faster.

Through that slide please pay attention to one thing, although the Other categories grew at 1.7% many people conclude as consequence that we should dispose of them because they grew at a lower level. This is not the way we see things, some of these categories offer less growth potential but we may assign different roles to them. In many cases the role we assign to these businesses is really cash flow generation or margin improvement. We do need to pay a dividend and it is important for us to have categories that have a role more of cash flow generation or margin improvement.

Slide: Increase footprint in emerging markets with prudent capital allocation

If we look at Emerging markets I know that there is a lot of concern currently about the Emerging markets, we have a strong footprint there. Almost 44% of our sales are coming from Emerging markets, it has been a significant increase over time. We enjoy, in Emerging markets, a higher level of growth, actually Emerging markets have traditionally been growing 2-3 times faster than Developed markets so we are very happy about it.

It is not a straight line though it's not a rollercoaster either .it's a little bit of bumpy road from time to time. In H1, for example, we had significant issues in Brazil with the truckers strike. We had some issues as well in other markets and the business is difficult for example in Russia but on the other hand we did extremely well in China, as I said earlier, and we are doing extremely well in Africa for example. The fact that we are present in so many countries we can offset the difficulties of some with the good momentum of some others.

The interesting part as well in Emerging markets is not only that it drives growth but it drives margin because as far as Nestlé is concerned we enjoy a higher margin in Emerging markets than in Developed markets. So the mix is positive because we grow faster and we have a higher margin and we are fully committed to Emerging markets.

Slide: 2. Address underperformers

Part of our growth acceleration by 2020 – we have an ambition to grow mid-single digit by 2020, is coming from the fact that whenever we have an underperforming business, it does happen from time to time, we have to move faster, we have to make sure that we fix it and that we address these underperformers.

Just some examples of the issues that we have been facing. In 2016, for example, *Yinlu* declined, it's more than a $1bn business in sales, the business declined by 22%. We have really re-invested in it, renovated the two main categories which is Congee, a traditional breakfast in China, as well as peanut milk and we have other assets there such as ready-to-drink coffee for example. We moved from minus 22% in 2016 to mid-single digit currently so it is pleasing

Gerber is a very nice brand that we have in the U.S. where we sell essentially meals and drinks. It's a sizeable business but we had been losing market share for some time. We were slightly negative, no drama but we have really re-vamped the entire range, worked on it in order to restore growth and we are pleased to see that over the last couple of months we start to regain market share. We launched the entire range in organic and natural, we re-vamped the entire marketing mix from packaging to formulation and so forth and we start to see some interesting results.

Nestlé Skin Health is a business where we have been facing some difficulties a few years back. We invested significantly in order to restore growth, and focus on the high growth platform that we have, mainly Consumer Care and Aesthetics. We did a massive restructuring effort that led to the reduction of the head count by 20%, we closed the industrial site, research centres and so forth. Now we are back to a decent level of margin and we have decided to explore strategic options. I will come back to that in one of my next slides.

Slide: 3. Product and business model innovation

Innovation is really at the heart of what we do. Innovation is very important and we need to accelerate innovation, we need to accelerate time to market. Some time ago we used to develop products within maybe two years, between the time we started to work on a product to the time the product reached the market. We now aim at being closer to six months and we have managed to do it already with some of our products. It is important because we see the time to market accelerating in the market anyway. Innovation goes much faster, and this is what you see on the left hand side of the chart, and it goes much deeper as well so we need to put even more effort in it.

A lot of what we do is about Premiumization and I think we are very good at doing it. Premium products, I define them as a price premium of about 30-40% over mainstream products, and when I look at what we have achieved in the first half of 2018 premium products represented 22% of our sales worldwide, whilst it was 11% five years ago.

Examples of premium products, if I take *Illuma* in Infant nutrition, it is a product that has a price per kilo which is, roughly speaking two times the price of the mainstream product. In China, this is only for China *Illuma*, we made *Illuma* a billion dollar product, more than a billion last year, while it was zero sales six years ago. So you can see what we can do and it really drives obviously sales and margin.

S.Pelligrino and *Perrier* as well premium Waters obviously. If you take *Blue Bottle*, a cup of coffee with *Blue Bottle* costs about $5 you can see the Premiumization versus *Nespresso*, a cup costs 50¢ or even *Nescafé* a cup costs 5¢. So we move from 1 to 10 and from 10 to 100 so this is really what we can do extremely well.

By the way premium products have a margin which is, on average, 300 basis points higher than mainstream products so not only does it drive sales, growing 2x faster than our average sales, but it is driving margin as well.

Innovation is not only about new products, innovation is about new business models as well. One example of it is Direct to Consumer, we are very interested in DTC and it accounts already for 8.2% of our sales. With Direct to Consumer we control the entire value chain so we have a lot of data about consumers, their shopping habits, what they like, what they dislike and so forth. Whenever we want to do specific actions or promotions with consumers we can decide to do them. If we have to go with retailers we have to call them and then we have a meeting in two weeks and then we discuss and then we have another meeting a month later and then they say no but my promotional plan is already frozen for the next six months. If we want to do a promotion for some of these businesses like *ReadyRefresh,* that we have in the U.S. which is delivering water to home and offices, or *tails.com* which is personalized dog food in the UK that we are expanding across Europe, or *Nespresso*, if we want to do a specific promotion tomorrow morning we can decide to do it this afternoon and it will be effective tomorrow. So there is a lot of value there with the Direct to Consumer channel.

Slide: Leveraging on evolving consumer trends

We are really leveraging on evolving consumer trends and it takes different shapes and forms. It can be science based innovation what we did there with Infant nutrition with oligosaccharides that make Infant formula much closer to breast milk. What we did with *Milkybar* as well, for example, which is there again deep science where we have a patented technology that allows to reduce the sugar content of some our Confectionery products by 20-40% without altering the taste, so it is really deep science.

We are leveraging big time on consumer trends like organic and natural moving many, even in PetCare it works and with Gerber with Infant nutrition, you name it.

Food intolerances, Gluten-free and so forth are big, very strong trends as well. Plant protein based products, many people, especially Millennials, want to move away from animal protein so we are addressing that with a lot of offerings in plant protein based products.

Local origins, ready-to-drink, we are moving somewhat further than powder in Coffee or in some of our products, from powder to ready-to-drink. Personalized Nutrition, I have mentioned that for pet food but we do quite a lot for example in Japan in terms of specialized and personalized nutrition for elderly people. Convenience is another trend.

I am just mentioning some but there are plenty of them and we are investing heavily in all these trends.

Slide: 4. Embracing digital opportunities

We are leveraging on digital opportunities, in both aspects. In terms of communication, to start with, all of the media spend that we do more than a third is actually spent on the digital side of it.

E-commerce we are investing quite a lot as well. E-commerce accounts for almost 7% of our sales. The good news with E-commerce is that whenever we can compare our market share on-line and off-line we are quite happy to see that 55% of the cases we have a better market share on-line than off-line.

We are happy to see as well that on-line in 71% of the cases we are gaining market share in these businesses which is very positive as well.

Slide: 5. Actively manage our portfolio

We are very active in our portfolio management both on the disposals side and acquisitions side. We actually did CHF 15bn of transaction value over the last 18 months both in terms of disposals and acquisitions. Disposals we disposed of our U.S. Confectionery business for 2.8bn, we disposed of *Gerber Life Insurance* business for a little bit less than 1.6bn. As well we put Nestlé Skin Health under strategic review, I'll come back to that.

We did quite a large number of acquisitions. The bigger one being the rights for the *Starbucks* products in consumer and Foodservice, outside their coffee shops with the exception of ready-to-drink. *Tails.com* I talked about. *Atrium Innovations* which is a leader in the US for VMS, Vitamins, Minerals and Supplements. We bought *Merrick* in organic and natural PetCare. *Blue Bottle* in super premium offering in coffee shops in the U.S. and Japan.

Sweet Earth and *Terrafertil* in plant protein based food. *Chameleon* is cold brew coffee. So we are really doing as much as we can both organically and inorganically to strengthen the position in our high growth categories.

Slide: Building a unique coffee portfolio with three iconic brands

Just a few words on the *Starbucks* deal. We have now $17bn or CHF 17bn of sales in Coffee which makes us the undisputed leader in Coffee. We already own two of the best brands in coffee with *Nespresso* and *Nescafé*. We get access now to the third best brand which is *Starbucks* with a very good complementarity. We can really now put *Nespresso* as a super-premium offering, *Starbucks* as a premium offering and *Nescafé* as a mainstream offering. Even within *Nescafé* we have some offers with *Nescafé Gold* which are clearly on the premium segment as well. So with the brand there is no real cannibalisation with very good brand architecture and integration.

Slide: Starbucks® transaction: a significant growth opportunity

It's an interesting deal. It gives us access to the North American market where we had maybe a little bit of a gap there. Especially as the soluble coffee market is relatively small in North America.

We get access to Roast and Ground and Foodservice. Roast and Ground is a category where we were not present in the past but *Starbucks* has an interesting franchise there with a premium offering. We will launch as well *Nespresso* compatible capsules branded *Starbucks*. You will see that probably, maybe within a couple of months in many markets. So this is a market, the *Nespresso* compatible market, is a market where we were not present among retailers but we will have our own offerings within a couple of months.

The transaction is attractive. I think that we paid a reasonable price, 15x EBITDA. It is reasonable. We see a lot of transactions in our space with 20-25x EBITDA. This one at 15x EBITDA I am confident in the fact that we will have a good return out of it. It is an interesting deal, we are not taking over any assets really so it will be already accretive from next year in terms of margin with a 24% EBITDA margin.

Slide: Exploring strategic options for Nestlé Skin Health

Nestlé Skin Health, so it is a sizeable business. CHF 2.7bn made up of three different parts, Consumer care, Aesthetics and Prescription We have really turned around the business over the last two years. Both on the top line, we are growing at high single digit as we speak, we restructured the business and we have now a competitive cost structure on P&L.

Clearly when looking at it, because we really revisit our portfolio at least once or twice a year, we established that this business is predominantly, more than half of it, is outside our strategic boundaries especially the part on Rx, Prescription and the part on Aesthetics so that is reason why we have decided to do a strategic review of that business.

That being said we looked at Nestlé Health Science at the same occasion and Nestlé Health Science is really nutrition and really close to Food and beverage so this is totally outside of the scope of this strategic review.

Slide: 2020 underlying TOP margin improvement target

Moving to margins, as I said before we expect to increase our margins between 150 and 250 bps by 2020 over 2016. That means if you take the mid-point, about 50 bps improvement on average per annum. We actually did 50 bps improvement last year so we really moving in the right direction.

We are at the lower level in H1 but we knew that anyway, largely linked to specific commodity pricing in H1 versus H2. I am not saying that we will do 50 in 2018 but let’s say on average we are targeting to do that and we are really on track to get there.

Slide: 6. Significant savings programs

To get there it is a combination of growth, as I covered before, combined with cost discipline. We aim at taking between 2 – 2.5bn of cost out of our P&L. Essentially in non-consumer facing activities which is manufacturing, procurement and G&A. We try to ring fence as much as we can marketing and R&D because they are really driving sales.

So you can see that we are already working, it’s a four year programme, we already took away from our P&L CHF 0.5bn, this year it should probably be close to a billion. We have a little bit less than we expected in manufacturing and a little bit more in procurement and in G&A. Manufacturing is a more complex. It is not that we will not deliver the savings but it may take a little bit more time so maybe part of that it will deliver or achieve in 21/22 but no specific concern there.

Slide: Freeing up resources

Clearly we are focusing on manufacturing, procurement and G&A in terms of saving and that we want to let flow to the bottom line in order to raise the margin. The efficiency that we generate in R&D and marketing, because we do ask these guys as well to be more efficient and they are doing a very good job there. But potentially we are quite happy to re-invest these efficiencies that they generate for growth because we know that they have a direct impact on our top line.

Slide: 7. Restructuring costs: an investment for the future with attractive returns

To improve our margin to go into our saving programmes we are totally ready to spend whatever it takes as long as the returns are good. In terms of restructuring costs we have accelerated significantly the restructuring amount. We were close to CHF 700m last year we should be close to CHF 700m this year. The returns are actually quite good so we will not hesitate to do whatever it takes.

Slide: 8: Prudent Approach to Capital Allocation and M&A

Just a few words Capital allocation and M&A. In terms of priorities for Capital allocation, first of all we want to invest in our business, which is R&D, which is Innovation, which is Capex, which is Marketing. We do quite a lot already, I think what we spend is correct.

We are obviously interested in M&A as you saw. We want to be disciplined there, we want to make sure that we get a proper return and we are very careful today because clearly asset prices are quite expensive.

We value shareholder remuneration. We have actually returned quite a lot of cash to our shareholders. We have returned CHF 10bn to our shareholders last year in a combination of dividend and share buyback. We have done, as we speak, already CHF 11bn this year. So CHF 10bn last year CHF 11bn this year.

The dividend, we don't have a dividend policy *per se* but we have dividend practice. We increase the dividend in absolute value year after year in CHF which is a currency which tends to revalue. Year after year over that last 23 years. As I said we have a share buyback programme currently going on for CHF 20bn which will be completed by mid-2020.

Slide: On track to deliver our 2020 financial targets

Just to conclude before we move to Q&A we are really in the business of growth and growth through innovation.

We want cost discipline as well. We are not in the business of aggressive cost cutting but we want to manage our P&L in disciplined way with an ambition to increase our margin by around 200 bps.

As a consequence of two things growth of the top line and cost discipline on the P&L. We value shareholder return. We will be active in managing our portfolio. We have said we will rotate about 10% of our portfolio, that 10% figure includes both what we expect to buy and what we expect to sell. As you could see we are already doing quite a lot.

That concludes my presentation and now we move to the Q&A.

Andrew Wood, Sanford Bernstein:

Before I get to the questions that we have already received we had a conversation yesterday where you explained how Nestlé is managing the acquisitions it is making, i.e. through the board of directors, the pull vs push approach that you have. Perhaps you could share with investors how you are approaching managing the acquisitions.

François-Xavier Roger:

Managing the acquisitions, so first of all we want to focus on our core categories which is, once again, PetCare, Water, Infant Nutrition, Coffee and Consumer Health Care. So we are predominantly looking at making acquisitions in those categories because they are high growth categories.

After that we look predominantly at what is happening in the market in terms of opportunities. We are very careful today because we see transactions happening at crazy prices. If you look at PetCare as an example we saw some cases recently at 25-26x EBITDA or 6x sales. I won't mention any of them but you all know. We are very careful because we do not see any return at that level bar a specific issue if you have for example a fantastic opportunity in terms of synergies which is not that common. So we are very careful and very disciplined in terms of price. You saw for example the multiples that we got for the transaction that we got with *Starbucks*.

This is maybe a little bit different when we buy some of these smaller companies, some of those that I mentioned. There it is much more about buying start-ups so there obviously the valuation can be rather high, but the total consideration or the total value is not that high. We are more buying brands for the future and investing in these brands. We are buying as well competencies, skills that we don't necessarily have so it is a totally different view.

So we are totally committed to M&A. We have said publicly as well that we are not desperate for a large acquisition. We are predominantly looking at small to medium sized acquisitions for two reasons. The first one is the fact that asset prices are high so we need to be careful at this time, not to put all our eggs in the same basket. The other reason is that who is growing in our industry – it's predominantly small to medium sized companies. The big guys have a tendency to grow moderately or rather decline which is a reason why there is no real point in paying a heavy price for let's say flat to declining assets. Who is growing or gaining market share in our industry? Small to medium sized companies.

Q & A Session

Question on:	**Emerging market growth**

Andrew Wood, Sanford Bernstein:

With Emerging markets growth at 4-5% can they ever return to former glory of 8-10% plus, which I suppose is what Nestlé requires in order to get to mid-single digit total company organic growth.

François-Xavier Roger:

If it happens we will take it. No, I don't know, I don't have any crystal ball either so it is difficult for me to say. I know that there are significant concerns that rather than going to 8 they might go south from the current level.

We will take it the way it goes in Emerging markets. We are in an industry that is relatively stable because people continue to eat regardless of whatever happens in the market so we are in a relatively stable business. Emerging markets, once again, we like them because they drive growth even if it brings a little bit of volatility. But that volatility we can partly amortize because we are present in many countries. They bring growth and they bring additional margin for us because we have higher margins.

We have been in many of these countries, if you take the larger ones, we have been there for more than 100 years. We are usually number 1 or number 2 in these markets. We are fully committed to it and we will stay there. But even if we experience some difficulties from time to time, take Brazil for example, in Brazil we lost $120m of sales in the month of May because of the truckers strike. We recovered part of it in June but not totally. But we hardly talked about in our June half year results. Why? Because in the meantime China was doing very well, and India did very well and South East Asia and Africa and so forth. We can amortize it, will it grow by 8%? I am a little bit sceptical maybe but we will see.

There is another thing. I often have the question. If there is an economic crisis – be it in Emerging market, be it in Developed markets tomorrow, especially when I talk of Premiumization, what will be the impact it will have? Maybe people can spend more and we can develop our premium offerings quite well today. If there is an economic crisis tomorrow what is going to happen? I am not too concerned because we are present in the three main segments of the consumer pyramid. We have offerings in Premium, we have offerings in Mainstream and we have offerings in the affordable segment, what we call PPP; popularly positioned products. So even if, because of an economic crisis wherever – in an Emerging market or in a Developed market, people have to trade down in terms of shopping habit we will get them back. Just as an example if someone can offer today *Nespresso* at 50¢ a cup and that person cannot do it tomorrow, they have to trade down. We can get them back with *Nescafé* if they have to trade down at 5¢ a cup we can get them. But even within *Nescafé* we have *Nescafé Gold* which is a Premium offering within the *Nescafé* range which is probably 20 - 25¢. We are so wide and so deep in terms of presence that we will be able to accommodate that.

Question on: E-commerce and Amazon

Andrew Wood, Sanford Bernstein:

Two questions that I am going to join together. Can you discuss Nestlé's relationship with Amazon and is E-commerce an opportunity or a threat to Nestlé?

François-Xavier Roger:
I will start with the second one. E-commerce is an opportunity. You saw it. So we invest heavily so this is already almost 7% of our sales. We are totally committed to it. It's an opportunity because it is driving growth, part of our growth is coming from E-commerce.

E-commerce we manage, predominantly, locally because it takes different shapes and forms. If you take, for example in China it is predominantly about Alibaba and JDE and these guys have a different business model. If you take the UK it is Ocado, if you take France it is Leclerc but both of them have a totally different way of working because if you take Leclerc, or other operators in France, it is about Click and Collect with a very limited assortment. If you Ocado in the UK it's the concept of the infinite shelf which is exactly the opposite. If you take the U.S. it is predominantly Amazon but all of these guys work differently so we are managing all of that predominantly on a local basis, while providing some tools and some support centrally in order to be very efficient.

Just answering the second question. With Amazon we work very closely with them. We have even an implant with them which means we have a Nestlé team within Amazon, in the same as we have it for example in Bentonville with Walmart, which shows really the fact that we are very close to them. This is mainly for the U.S. market.

Just one thing on E-commerce so once again it is an opportunity. There is a little bit of a threat somewhat because we see that the development of E-commerce is putting pressure on traditional retailers. Why? Because they are losing traffic somewhat in their stores and they are sitting on huge pieces of real estate so their returns are a little bit under pressure. They have different reactions. Some of the retailers are tempted, in order to bring back traffic in their store, to go into a price war because they believe that if they lower the price the consumers are going to come back. Usually it doesn't work so this strategy, in our opinion, is destroying value for them and destroying value for us. But we have other retailers who have a totally different strategy which is to say – traffic is going down can you help us to bring traffic back into our stores by developing some specific promotions, which we are very happy to do. By developing new products, through innovation and even by giving us exclusivity on some of these new innovations and new products. That we like because it is a win-win situation. We can help them to bring traffic back into their store, It is a value proposition. This is not a value destroying proposition this is a value creation proposition.

This is a little bit the limit of E-commerce today but we can manage, I think it is okay.

Question on:	**Pricing power**

Andrew Wood, Sanford Bernstein:

What does the lack of pricing at Nestlé say about your lack of pricing power?

François-Xavier Roge:

There is no lack of pricing power. Let me be a little bit provocative. Pricing doesn't exist anymore, pricing *per se*. If you look at pricing in H1 for us. 0.3%, next to zero, last year 0.8%, the year before it was 0.8 or 1%. If you look at the quality of this price it came essentially from Emerging markets and it came essentially from the fact that we passed on, to the consumer, rather than to the trade, the impact of currency deprecation in Emerging markets. But it has no value, it is just a pass through. We have to do it because if we suffer from either commodity pricing going up or currency devaluation then we have to pass it on to consumers. But it doesn't create any value neither on the top line nor on the bottom line.

That being said it is reported in organic growth. I am not interested in that personally, I am interested in value creation which is, I would say, indirect pricing which is more about mix. What I showed you with for example Premiumization, there we create value. When we sell *S.Pellegrino* and *Perrier* at two times the price of basic water, and when you have *S.Pellegrino* and *Perrier* growing at 8% and our other waters growing at 0 or 1% this is where we create value. When we make *Illuma* a $1bn product in six years, from zero to 1bn, which is a super-premium offering at a high price because it is about functional benefits. This is where we create value. This is not reported in price though, this is reported in what we call RIG, Real Internal Growth, which is a combination of volume and mix. I like Premiumization because we are creating value. Passing through commodity pricing, passing through currency depreciation to consumers, no value. Premiumization, personalization, customization, innovation, there you bring relevance to consumers. Consumers are ready to pay for it.

The example I gave earlier, when you move from 1 as a price point for *Nescafé* to 10 with *Nespresso* to 100 with *Blue Bottle* there we create value. This is not reported as pricing this is where we create value through, I would say, indirect pricing. I give you examples across the board because it works in all categories.

Question on: Starbucks deal

Andrew Wood, Sanford Bernstein:

A slightly provocative question. Why spend $7bn acquiring the distribution rights of Starbucks, acquiring the rights to a competitor product?

François-Xavier Roger:

I agree that it looks a little bit odd when you look at it in the first glance because indeed we are promoting the products of one of our competitors.

That being said first of all we acquired these rights for perpetuity so we have them forever. This is first of all a fantastic opportunity in the U.S. It's a $2bn business, predominantly in the U.S. which is growing nicely as we speak, with a good margin, 24% EBITDA margin. It will be accretive already from next year. We have to do some accounting adjustment and some inventory step just by the end of the year but next year it will be accretive on margin and it will probably be accretive on growth as well for the U.S. business.

In the U.S. we had a relatively soft position so far because the soluble market doesn't really exist in the U.S. and because the initial offering that we had with *Nespresso* was not fitting the U.S. consumer needs because they want long coffees and the original *Nespresso* machine we had is offering short coffees. We came later on with this *VertuoLine* machine which is doing short and long coffees and we are doing extremely well in the U.S. with *Nespresso* today. We are gaining significant market share. That being said we get another $2bn business in the U.S. We get access to other businesses which is Roast and Ground – we were not in Roast and Ground so far. Roast and Ground is a commodity business but

Starbucks have been able to develop that business beyond commodity with good margin because they premiumized the offering and they did very well. We get access to Foodservice as well which is very interesting.

The large opportunity of that transaction is outside of the U.S. because the business that we bought hardly exists outside the U.S. We can develop it. This is about putting the *Starbucks* product on the shelves of retailers. This is what we do. This is our bread and butter. This is what we do from morning to night.

When you look at, let's take an example, China. *Starbucks* they have 3,000 coffee shops today. They open one every 15 hours. Their products are not on the shelves of retailers so we can just put their product on the shelves of retailers, next to where they have their stores and we expect that it will take off.

Another interesting dimension is that we can enter the *Nespresso* compatible market, there is the *Nescafé Dolce Gusto* but the more interesting one is the *Nespresso* compatible market. *Nespresso* is only sold through our own network of boutiques. We have 728 of them. And through our own website, exclusively, But if you go to Tesco here in the UK if you want to have *Nespresso* capsules you don't find them. You find these compatibles. We were not in that market because we wanted to keep the exclusivity of our distribution platform. This is about availability in the modern trade. Now with *Starbucks*, in a couple of months you will see *Nespresso* compatible capsules, branded *Starbucks*, so we can enter that market which is a very interesting opportunity for us. We will do the same for *Nescafé Dolce Gusto* as well.

So it is interesting. The complementarity of the brand, there is no cannibalisation of the brand. The three brands of *Nescafé, Nespresso* and *Starbucks* are probably the three best brands in coffee in the world, they are very complementary one to each other. Once again *Nespresso* super premium, *Starbucks* premium and *Nescafé* predominantly mainstream but even within the range some premium offerings.

Question on: Competition from Coca Cola and Costa

Andrew Wood, Sanford Bernstein:

Three investors have asked this question so clearly it is top of mind. Are you worried about increased competition from Coca Cola and Costa?

François-Xavier Roger:

Frankly speaking it is always good to have professional competitors and I respect the names of the people that we have. When you have competitors like JAB and Coke coming into coffee it confirms one thing, we knew already and we didn't need them to come to confirm that, but we know that the category is very attractive.

The category is growing mid-single digit. We have a leading position. We have CHF 17bn of sales in Coffee. We are the undisputed leader, I think the number two is probably at 10bn. We have now a very comprehensive offering. We are in premium, we are in mainstream, we are in affordability. We are in Roast and Ground, we are in single serve coffee. We are in coffee shops even with *Blue Bottle* now. We are in cold brew with *Chameleon*. We are everywhere, we are basically in all countries of the world as well.

It is good to have very professional competitors because we know that these guys are not going to destroy the market. We know that they are not going to go into a price war. They are in the value creation game as we are, in the category. You know there are opportunities that they will probably help us to develop. When we look at what we have done, because I think Nestlé largely did it, to transform formerly tea markets – like the UK and Japan, I hope you will agree with me, that were traditionally tea markets we made them large coffee markets. Nestlé did it in Japan and in the UK. We can do that in China, we can do that in India. If some people want to help us to do it, because these are fairly big chunks, that's a big challenge. We can do it. I think there is space for more than one player.

So we are not afraid of competition. We welcome competition, especially when it is quality competition.

Question on:	**The U.S. food industry.**

Andrew Wood, Sanford Bernstein:

Interesting question. The U.S. food industry has created its own problems. How do you elevate yourself to be differentiated from your U.S. peers? What is changing considering your U.S. performance has been underperforming?

François-Xavier Roger:

Last year we were very disappointed by our performance in the U.S. because we were flat. We were at zero growth last year in a flat market. I am not happy to say we are flat in a flat market because we have ambition to do more than that. First of all that the market was flat last year is a concern and I tend to agree with the question. We were flat but we were flat across categories. We were flat in PetCare, flat in Water, we were flat or even slightly declining in Infant Nutrition and I could continue the list. So it was not satisfactory.

We clearly lacked innovation. What we started to do last year is really tackle it by making innovation across the board. In Water for example we extended our offering in mainstream with our six regional brands, like *Poland Spring, Ozarka, Deer Park*. We extended from mainstream still to mainstream sparkling because the sparkling category was the fastest growing. So it required a little bit of Capex but then it helped us to grow again in Water. In Coffee we are pushing big time *Nespresso*, so we are investing big time in *Nespresso*. We are really gaining market share very significantly in Coffee in the U.S.

In Infant Formula, I mentioned it within Infant Nutrition with *Gerber* we have renovated the entire range. We have moved the entire range into organic, natural. We are back into more interesting territory. It is not totally complete yet but we are back into a more interesting platform. If I take PetCare we were flat last year. It was a concern because the category is growing at mid-single digit. We invested heavily. Again there it is about innovation in for example snacking, in organic, in natural. Organic and natural is a very strong growth platform in PetCare. So this is very much about innovation.

It pays off because we were quite satisfied to see that we were flat last year but at 2.2% organic growth in the first six months of the year. But we need to do more than that even. Once again this is about innovation and relevance in the market.

Just one addition. We know that innovation and top line growth are interesting. I am quite pleased that everybody seems to rediscover the benefit of growth in our category because over the last couple of years we had massive pressure to follow the route of aggressive cost cutting at the expense of the top line. Everybody was moving into the direction of aggressive cost cutting. Now everybody is discovering again that there are merits to grow and everybody is rediscovering the benefit of innovation. The market is not flat anymore in the first six months in the U.S. either. So I think that the strategy that we have always followed which is driving growth through innovation, I think that now people, our competitors are rediscovering it as well, which I find relatively healthy. It doesn't mean that we don't have to be disciplined on our cost base.

Question on: U.S. Frozen Food

Andrew Wood, Sanford Bernstein:

Semi-related question. How is your current performance in U.S. Frozen foods and are you still committed to this business?

François-Xavier Roger:

On the second part we are committed to that category. Mark Schneider, our CEO, has been very clear when we had our capital markets day here in London, a little bit more than a year ago, that we are committed to Frozen. Frozen is not as bad a category as many people think. People often perceive it – I think there is a perception idea with Frozen. It is often perceived as emergency food but it is worth more than that. Or it is often perceived as junk food or bad food. It is not. Frozen is as good or as bad as what you put into it when you freeze it. If you freeze junk food it will be junk food when you get it out of the microwave. If you freeze organic or natural food it will be still organic or natural when it gets out. If you freeze plant protein based stuff it will be still plant protein based. By the way Millennials like frozen food much better than their parents, which is a good sign already.

So we believe in the category. We have to work on the fact that we have to bring that category to a better level and the category responds quite well to innovation. We saw it two or three years ago, I think it was two years ago, we invested massively in innovation and we grew by 7% in the category. By the way we pulled the category.

We have interesting positions as well, we are present in two sub-categories. One in is Frozen prepared meals. We own 40% of that market. When you own 40% of the market usually margins are good which is the case. So we have an interesting platform.

We are in Frozen Pizzas and we own 40% of that market as well. Again when you own 40% of the market usually margins are good.

What we need to do is more innovation. We are working on it and we need to work along with the competitors in order to restore the category. We are actually quite pleased to see that Conagra bought Pinnacle because Conagra believes in the category as well. So it is always good to have competitors who believe in the category because it is always difficult if we are the only one who is really investing in the category. So whenever we have good and professional competitors investing in the category it is always very positive.

Question on: Competition from small local players

Andrew Wood, Sanford Bernstein:

This is a question that is principally focused on Emerging markets but I think it does have some relevance to the U.S. market as well. How do you see the threat of small local players taking share, especially in the Emerging markets but let's add the U.S. to that as well? What changes are you implementing to be able to fend off this competition?

François-Xavier Roger:

Competition in Emerging markets depends, there are many different cases. Some of these guys do not necessarily always play by the same rules because many of them can be potentially ready to go into price wars. That we don't like because we don't like price wars. We like creating value in a market. Like what I shared before which is about Premiumization, Personalization and so forth because we can differentiate ourselves. But if we have competitors that are damaging the category or going into a price war and moving the entire category down in terms of price, that we don't like. But this is not the case in all Emerging market players.

Anyway we are in the business of Brands as well, so we need to develop strong brands. We need to develop relevance to consumers so I don't think that we should only premiumize because it doesn't work at all times. But even in Emerging markets we can bring relevance to consumers. Consumers in Emerging markets like Brands so we need to make sure that our Brands, our offering remain relevant to consumers. We need to make sure that we continue investing in innovation in Emerging markets as well.

Is there a real threat from these Emerging players? Not necessarily. Even if you look at it some of them are struggling by the way. Look at it in China, many of them have been struggling over the last two years for example. So it is not that they succeed and the big international guys are suffering. It does not always work that way.

We have some examples, thinking of one more specifically in Asia, where we have seen one of our competitors damaging one of our categories by devaluing entirely, big time the category. Moving into price. There is one example when we sell what we call three-in-one in Coffee. Three-in-one is coffee, plus milk, plus sugar. We do that because we know that in some markets people like to have white coffee with sugar. But when we do that we put a little bit of sugar, a little bit of milk in coffee. But if you have one of our competitors who puts a little bit of coffee and a lot of sugar. Consumers like it, by the way it is cheaper to produce because sugar costs nothing, and consumers like it because it is tasty. But we stand for Coffee. So we have to be careful of what we do. Obviously if you drive as one player as consequence the category down in terms of price that is not an easy one to do. We would not see this kind of thing with the professional competitors that I mentioned earlier. Some competitors in Emerging markets might be tempted to go that route. A very extreme case.

Question on:	**Disposal side of portfolio management**

Andrew Wood, Sanford Bernstein:

If asset prices are as high as you said wouldn't that be a perfect reason to be more active on the disposal side of portfolio management?

François-Xavier Roger:

We are somewhat, we sold U.S. Confectionery at a very good price. We sold our *Gerber Life Insurance* business. We are doing a strategic business review for Nestlé Skin Health. Strategic business review does not mean automatically disposal, it is one of the options we will review. So we are active in portfolio management. But you know it is not because, you know it works both ways, it is not because you have cash that you have to go shopping. It is not because you have a credit that card that you go shopping. Or it is not because you have real estate, if you have a house or apartment if real estate prices are high do you sell your house? Not necessarily. You have to sell if it makes sense. You have to sell if….Why did we sell U.S. Confectionery because we had a limited ability to win. We had 4% market share so it is better obviously if we sell these assets when asset prices are high. We sold *Gerber Life Insurance* because it is a non-core business. We are not an insurance company. It happened that it was part of the original acquisition of *Gerber* so we disposed of it. But we sell or buy our assets because it makes sense. Not because it is expensive or cheap. But it is always better when you dispose of something if the demand is high.

If I applied the rule asset prices are high maybe we should sell everything at the end, but no we are in the business of operating a company, operating a business, running a business but we are active in portfolio management. I am not pre-announcing anything necessarily but we will buy more and sell more as we are very interested to do it. I am not pre-announcing anything.

Question on:	**L'Oréal stake**

Andrew Wood, Sanford Bernstein:

Last question and I think it is a question that has been asked every year for the last 15 years since you have been coming to the conference. Is *L'Oréal*'s holding a strategic holding and would it make sense to sell to invest in these strategic areas that you identified?

François-Xavier Roger:

I am not going to discuss any of the options as far as *L'Oréal* is concerned so I have not much to say. I can only tell you that are a certain number of options and we want to keep the options totally open.

We do review these options regularly with the board, the board has a fiduciary duty to look at them and say whenever it is time to make a decision on one of the options, if any. Then we will make a decision. But be aware of the fact that we review them on a regular basis. I know it because I have to do the work to prepare that.

The important thing as well is that you know this discussion - is it a strategic or a financial investment - we can always debate about it. The only thing I can tell you is that given the value of this investment. Whatever we do, and once again I do not want to discuss any of these options, whatever we do, will have because of its value, because it is worth CHF 29bn I think as we speak. Whatever we do with it, it will have a strategic impact on Nestlé because of its value.

End of Q&A session

Andrew Wood, Sanford Bernstein:

Ok thank you very much François.

François-Xavier Roger:

Thank you.

End of Transcript