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CEREAL PARTNERS WORLDWIDE
TRANSCRIPT

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Roddy Child-Villiers - Nestlé Head of Investor Relations

Ian Friendly has been president of CPW for a year, although it is his second spell at CPW so he's got rather more experience than that might suggest. At General Mills he's been in senior positions, he's been president of both Yoplait and Big G Cereals. Ian thank you very much.

Ian Friendly - Cereal Partners Worldwide (CPW) President & CEO

Well good afternoon. Listening to the question in the last section I thought I would make something clear at the beginning just so you're all at rest, and this is around the question that came up about how many cats are indoor cats, and I thought I should comment, I can speak with some confidence that something like 98% of all cereal eaters are indoor, cereal eaters and so you do not need to worry about that for the rest of this presentation. I'm very glad to be here with you today to talk about what I think has been a very successful joint venture. Next month actually CPW celebrates its 15th anniversary, will hit over 2 billion Swiss Francs in sales. And I think a fairly successful joint venture by almost any measurement. But I'd also say it's been a successful joint venture qualitatively in terms of how Nestlé and General Mills views the joint venture and the collaboration that's gone on between the partners and the growth in that collaboration over the years. So what I'd like to do today is take you through a little bit of our past and just kind of go over the basics behind the joint venture, happy to answer any questions later if you're curious about how it operates. I'll then follow through to the present giving you some statistics on the global cereal markets and our performance within it, and then finally, at least my perspective on the future and the strategies that will continue to propel our success.

So first the past.

CPW was established in 1990, it is a 50/50 joint venture which I think is actually very important to its success. It is equally owned by both Nestlé and General Mills, it is a separate legal entity from either company. I report into a ten person Board of Directors composed of the five most senior executives in both companies and Peter Brabeck and Steve Sanger co-chair that Board of Directors. We're headquartered here in Switzerland, just down the road in Lausanne. Our scope is global outside of the US and Canada, and today we have sales in more than 130 markets which I think is delivering against that scope.

Synergy is a term oftentimes gets overused, but I think that really applies very much to CPW and is the reason why the joint venture has worked the way it has. Both Nestlé and General Mills pre-1990 had tried various experiments in the cereal category and I think they met with mixed success finding something was lacking in the formula. Indeed what General Mills has brought to the party is proven cereal marketing expertise, great proficiency in R&D and products, and all in all a great depth of category knowledge. But what it lacked was global scope and global capability, that is for sure what Nestlé has brought to the joint venture. Don't need to tell all of you that Nestlé is the world's largest food company with a very strong organisation worldwide and very deep market and distribution knowledge, and I'll touch on this more during my remarks about how the joint venture works later.

Two milestones in CPW's history. We got going in terms of business in 1991 with the purchase of the RHM cereal business in the UK which gave us an immediate foothold in the largest cereal market outside the US being the UK, as well in South West Europe where these were more established cereal markets. In 1992 we went to the largest cereal market outside of Europe with Mexico, went into South East Asia in 1993, which is a large population base but low consumption, rolled out into Central Europe with Poland and to the South America in '94, and then entered Eastern Europe which has been a great success story for us in 1997 with Russia.

Then in 1998 we became profitable, one of the first things the joint venture said and set up a, really, a very simple set of goals early on, was to become a strong number two in the global cereal market and to have $1 billion in profitable sales within ten years. And when they wrote that I don't think that was calculated, I think it was just basically a statement of intent, but we were able to achieve it in fact a couple of years earlier than foreseen.

The most recent two entries are interesting for different reasons. In the case of China we entered what's obviously a very large, the largest population market but with very little or no cereal consumption. In the case of Australia, very small relatively speaking population, very large cereal consuming market, and I'll touch on those a little bit later.

Today CPW is selling in the sixth inhabited continents but white space does remain, or on this chart it's actually light blue space, in the rest of the world. Most of our growth and prospects I think are right where we're at, but there is still some geography that we can contemplate entering when we choose to do so. We manufacture in 4 continents with 15 plants.

Now I'd like to turn to the present.

First of all let me tell you about the market. The global cereal market is just under €12 billion in sales, growing, to look at rest of the world which actually represents where we compete which is outside of North America, it's roughly half of the global cereal market and is driving all of the growth in the global cereal market.

This growth we're seeing actually is quite widespread and across all regions. In the more developed markets like Western Europe and the UK it's in low single digits, Mexico would be similar to that, and everywhere else in the world it's actually in fairly good double digit growth off a small base.

If you look at CPW's volume we have gained from the start. Now the early years we saw very heady growth, 21% compound growth rate up to the point we became profitable. Obviously that was a combination of growth in existing markets as well as quite a few new market entries. But since that time we've actually grown quite well as well, growing at an 8% compound growth rate and our most recent year would reflect that same level of growth. I will say our first quarter this year was relatively flat, but that was really driven by some changes in our biggest market in the UK in terms of new product timing as well as our trade flows, and we fully expect by year end to be right on the numbers that we set out to do, and indeed I can say that the first few months of the second quarter in our UK market have been highly, highly encouraging.

Our EBITA has grown obviously since becoming profitable in 1998, but I would remark that those early years where we had both deep and sustainable investments in the joint venture is a real testament to one of the strengths of the joint venture which was that Nestlé and General Mills together could afford to have a long term perspective about building the business rather than perhaps trying to drive the bottom line too early and not make us an effective competitor. Since '98 we've grown our EBITA at a much faster rate than sales, as a matter of fact our EBITA margins have expanded steadily up fourfold since that time. I will also tell you as a 15 year old company we had a lot of investment and a lot of things to create in our early years, and while there is still some of that ahead of us, most of that is done and as we drive more volume over our infrastructure we see a tremendous amount of leverage in what we can do.

The other propeller for driving obviously with improving profit margin has been productivity and supply chain costs which are coming both from leverage as well as productivity. We've basically improved it 100 basis points or 1 percentage point every year since the joint venture has begun, and looking at the initiatives that I know we have ahead of us I can tell you that I fully expect to see CPW continue on this trend. If you ask about return on capital we expect to gain about again 100 basis points or one full point of ROIC for the foreseeable future each year.

Now while our EBITA performance is very important to us and is something we take a long and hard look at, I really do think that our joint venture partners set us up to be a growth driver because they looked at the growth potential of the cereal category. The category is growing well, we have grown almost twice the rate of the category and this is on top of 7% or 8% growth a year prior as well.

Obviously if you're growing your top line in excess of the market growth rate you gain share, and this is our 13th straight year of share gains. We try and gain about half a share point per year in our business.

So our mission was to become a solid number two and essentially we have done that, we are a number two and we are a growing number two. Saying that, one must acknowledge that the number one player in the category is 50% larger still on a global basis and a formidable competitor, so we still have lots of opportunity and challenge in front of us.

But we have shown that we can grow and have grown in all the largest and most established markets effectively, and I think part of the good news that's on this chart is it isn't a zero sum game, there is opportunities for both us and our competitor to grow in all of these markets although one of the things we do hold ourselves to is we want to grow faster, and that is what we need to do as a challenger kind of company. So indeed across the largest markets that we compete against our key competitor, we have been able to grow somewhat faster.

I now guide your eyes to the right-hand side of this chart which shows the most developed cereal markets where we compete in, and we are as I mentioned a solid number two, with a somewhere around a 17% or more typically a 25% value share, and that is something that we have to keep gaining share on to grow in those markets. But I'd also like to talk to you a little bit about the left side of this chart. There are many places in the world where CPW is number one. Now I will tell you in some of these markets the global competitor doesn't compete there or in some of these markets our global competitor is rather small. But these are very large markets in many cases in terms of population and in some cases in terms of cereal. China, Poland, Turkey, Eastern and Central Europe really refers to Russia, and South East Asia don't forget includes Indonesia, together all of South East Asia is about 400 million people, it is a large group of people. Down at the bottom here Saudi Arabia and Greece are included, not because of their population size, but these are examples actually of markets where our global competitor has been for a long time and places that we've been able to become number one since the last few years, since competing in those markets. The other thing I'd mention is the left side of this chart represents well over 2 billion people. These markets are growing at three to four times the rate of those on the right-hand side of the chart, therefore I'm quite confident that we have enough logs to go onto the fire for the indefinite future, to keep adding new cereal users to the category, and I'll talk a little bit more about that in a few moments.

Now let me turn to the future and what I see for the breakfast cereal category and CPW.

I'll keep it simple, on this chart three things, I foresee continued category growth, for CPW I foresee continued share gains and most definitely I foresee continued margin acceleration. Let me touch on those.

Before I touch on those I will also acknowledge though that there are some headwinds that we have to face and any business has to face any year and any time. The ones I see that are most prominent in our business are twofold. One is the growth of low price retail format, you've heard Hervé speak this morning about the advance of hard discounters in Europe, that is indeed something that the cereal category faces, and it's they're not only a force in their own right, the hard discounters are a force because of how also traditional retailers respond to them by emphasising and expanding their private label. But as I showed you just a few charts earlier, we've been able to grow, we've been able to grow our share, and really what it gets down to is innovation and quality as it always has been in the market. I think the primary impact that we've seen in the cereal category of the growth of low price format has been against really the more commodity oriented brands and not so much the added value brands. Now we've been able to see ourselves compete and grow in this environment but I will say it presents a challenge and we always have to be very careful that the value added of our brands is at the highest level and I'll give you some examples of that in a moment.

The other thing that I think caught us a little bit by surprise was some of the health and nutrition issues that emerged in the past year, not that there are health and nutrition issues however obesity is a global problem, most certainly is. I think what caught us, and I think most of the people in the cereal category, by surprise is that any of this got directed at the cereal category, most prominently in the UK I would say. Cereal, as anyone who knows the category, is extremely healthy, and even the pre-sweetened and varieties still represent a fairly good health proposition, but we have certainly seen some severe criticism in the press on this issue. And I don't think the industry has done a very good job up till now defending itself because we were kind of caught on our heels on this one. The fact remains that cereal is, including pre-sweetened cereals, is quite a bit healthier than any other breakfast option, we have detailed this, I could show you charts on this, but it is a low calorie, nutrient-dense product. The other thing that there are quite a few studies on that show that people who eat cereal, including children, have a lower body mass index than those who don't. But I think in time we'll be able to get the message out that cereal is part of the solution, it is not part of the problem, and we really have to do a better job communicating our health benefits.

Despite those headwinds I appraise this presentation of a world of opportunity because that is certainly how I see the breakfast cereal category to be in on a global basis.

The first point I would make is in the area of per capita consumption. If you look at this chart you'll see that in the UK or Australia where they have per capita consumption very similar to the US, about 6 kg, very high, typically that would represent about 95% category penetration, most people use cereals regularly. We would also characterise South and Western Europe, France for example, as developed cereal markets, but in essence they're really consuming somewhere between 1 kg to 2 kg. There's quite a bit of upside I would say even in those markets, and here the cereal category would have roughly give or take depending on the market about 65% category penetration. Mexico is very similar to that, but if you get outside of those markets you're talking about 100 g or less per capita cereal consumption.

One reason I think the cereal category can grow is no other reason than how low these numbers are and we now have two global players promoting, advertising and supporting the benefits of breakfast cereal, which are very compelling I think anywhere in the world because it's convenient, it's tasty and it's healthy, and that is a potent combination. Even in Asia I would say where the habits and the cultural aspects are quite different for what people have for breakfast, we are seeing good progress. In the markets where we've been marketing longer and that has some income, such as Singapore or Hong Kong, we see per capita consumption four or five times the rates that I would normally reflect for Asia, and these in many cases, or in the case of Singapore it's Chinese culture consumers. So we can convince consumers I think, in other parts of the world to eat breakfast cereal, but they will also need to have the income to afford the product category.

Related to the fact that per capita consumption is bound to go up is that we have a very well positioned infrastructure within that.

If you look at the five most populous markets that CPW competes, they have about 31% of the world's population but almost, just over 10% of the consumption, so there's a lot of upside. Now when you look at entering a big market, let me use Indonesia as an example, 240 million people, and yet a cereal category that when we entered basically didn't exist, it would be extremely difficult, extremely expensive to go in there and figure out who you're going to sell with, what's the account structure, what's the politics of the country, getting a broker even interested in your category, understanding the legalities of that country and so on and so forth. And it would be extremely distracting for management to figure out all of those macro issues before even getting down to the marketing of our cereals. In this case we get to partner with one of the most capable food companies in the world, Nestlé. Most of that stuff has been figured out, we have expertise in the developing markets and we have efficiency in that we sell and approach those markets very much hand in hand with Nestlé, so we are able to develop China, we are able to develop Indonesia, we are able to develop Russia in a very effective manner than a stand alone company, which would have a lot of difficulty if not a lot of expense doing it.

The third area that where we have great opportunities is accelerating margins, I already showed you the operations side of this which I again foresee that we're really at the front end of watching how our margins expand.

But our efficiencies I would also say expand to the marketing plan and the joint venture helps us a lot here as well. One thing, because we started out and have been a globally managed business, we've been able to basically do one ad for the world with language adaptation, sometimes we may have to shoot two, but we are not shooting 130 ads for 130 countries which some companies are more oriented to do. If you think of an ad costing $½ million or more per year, right away that's quite a bit of savings. What we've also found is that good creative ideas are hard to find but when you do find them they travel well, and we've seen great success using the same Nesquik ad across every country.

The second area Ed touched on in a way which was media purchasing, we participated in the Nestlé AOR (Agency Of Record) and we get the benefits of the Nestlé AOR. But essentially CPW, which spends a lot of money advertising on television is able to buy in collaboration with the local Nestlé market, so we get to approach our media partners as a 2 billion plus Swiss Francs buyer of media rather than just our own size with again tremendous efficiency.

The third area is promotion synergy, and here, being a globally managed marketing effort, allows us to really bundle our markets to find efficiencies in our purchase as well as tie up very good partners. Sometimes it will be movies like what's coming out right now, Madagascar, which we'll do on a global basis, or next year where we will be tying in with the World Cup which we've done in the past. We're able to get fantastic events and make it quite simple for all our markets around the world to execute against these fantastic events. We're also able to partner with General Mills and their large domestic cereal division in the purchasing of premiums and in the negotiations with our partners.

And finally we have a committed sales force and I would not touch on that lightly, I think it's actually a very important part of our success, again particularly when we go out to developing markets and we're able to sell with Nestlé, people who really want to know our business, care about our business, it is different than selling through a broker or through and agent, and then they go into the store and they have all the selling clout of the entire Nestlé product line rather than what could be a very small cereal business in some countries, gives us I think tremendous efficiency and advantage.

Last part, and the part I'll spend a little bit more time talking about is the focus on brand building.

There's really four things that I think have allowed us to succeed in the past and will certainly allow us to even do better in the future; one is to deliver health news on all our brands; two is to strengthen and globalise our core brands; three is I would say selectively execute geographic and channel expansion; and four, to introduce innovative new products.

Probably the biggest news that's occurring right now as we speak is the conversion of all our cereals to be a good source of whole grain. Now whole grains have been proven in many, many studies, in many places in the world to have all sorts of positive attributes around various disease states; they've also been linked to reductions in obesity, and also pretty well across the world most populations do not get nearly enough of the whole grain that they need. So we've re-formulated all our products to contain whole grain; at the same time on the kids' products we have been able to bring the sugar levels down as well as on some of the all family products bring the sodium levels down, and equal the taste or even improve the taste of our products. All of this couldn't be done without leveraging our other partner, General Mills, who had done a similar conversion to whole grain in their product line about six months ago, so we've been able to use a lot of that R&D and apply it to the CPW products. It's already shipping and basically on shelf in the UK, it will be shipping to South Western Europe here in the next few months and we fully plan to bring this around the globe over the next year.

But marketing on health and nutrition is not a new wrinkle for CPW; it basically has characterised our marketing since the very beginning of the joint venture. Our biggest market, so I'm going to use a few examples from there, is the UK, and here our Shredded Wheat franchise has really been sold on this basis. We were the first ones really in the UK to talk in cereal anyway about heart health and linking it and proving the claims on whole grain and heart health; we've been doing it for a number of years; you'll see I'm going to show you an ad in a second, but you'll see in the ad that we use a celebrity of sorts, Ian Botham, who was one of Britain's greatest cricket players, we used him when he was an active player and we use him in a more interesting role today as a family man to support our brand, and I can tell you this has been a great success. This is a 100 year old brand and it grew a full share point last year; you don't see that too often, and this is the role that health can play in driving our portfolio.

We equally saw opportunity on our Bite Size Shredded Wheat business; here it was a very different consumer insight; here we saw that women were an important component of the consumption of bite size and that women were indeed quite interested in heart health; the challenge was to find how to say that in a way that was relevant to women. I'm going to show you the two ads now and we've succeeded I think quite well in this one because it grew 7% this last year and reached a record share. *(Advertisement being played.)*

Another very important franchise for us is our Shreddies franchise. This came from a different consumer insight; it's still directed at Mom, but it's in her role as a gatekeeper for the family. And one of the most important things for any parent really is that they want their kids to start off their day with some energy and to be able to perform and concentrate in school. There have been now several independent studies that show that whole grain complex carbohydrate products like Shreddies helps kids concentrate better in school. And we came up with an ad campaign where you'll see Mrs Kelly, which is not her real name, but she is a real teacher actually, talk about these benefits. We put this on air about the middle of last year and our Shreddies business has taken off ever since. Let me show you one of those ads. *(Advertisement being played.)*

Probably though the most fast moving trend is around obesity and weight management; we've had our Fitness range around the world for the last ten years but it is showing enormous growth. We try and position a little bit different than competitive products; we talk about it being the sensible way to keep your line, and rather than yo-yo diets or lose a certain amount of weight over a few weeks, we kind of support and represent this brand as something that's smart over 52 weeks of the year, not just for one or two weeks of the year. It does have quite a few built in points of difference, it's always been a whole grain cereal product; at a blind taste test it normally beats its competitor 70/30 in preference. So it's a very strong brand, I'll show you the ad in one sec; it'll be in French which is where it was shot, but I'll tell you this brand has enjoyed great success, up 36% last year. *(Advertisement being played.)*

Along with delivering a health note, our second strategy was strengthening core brands; our oldest and our biggest brands in CPW on a global basis are Nesquik and Chocapic; they have 13 years of uninterrupted growth; they have grown every single year, and the fact that last year Nesquik grew 17%, more than twice the CPW growth rate on our biggest brand. And that comes from a combination of good advertising, good promotional support and ongoing renovation as Ed spoke about. These brands both will be getting whole grains, reduced sugar levels and taste improvements in the next few months; but let me just show you our Nesquik ad which leverages the Nesquik brand icon very well in this cereal. *(Advertisement being played.)*

Another key to how we grow is the globalised core brands, and once we figure it out in one or two or three markets, then we try before we go to the process of invention, let's take the stuff we've got and bring it further, that's a lot more efficient and effective than trying to invent new things from scratch. Two examples, very different, different heritages.

In the case of Milo, and for those of you who are not familiar with Milo, this is a Nestlé heritage brand, it's also a milk modifier more known for its energy and in certain markets it is the market leader. We've had this brand in Chile and Malaysia for over a decade, but as we examine the very large Australian cereal market to enter just about a year ago, year and a half ago, we saw that Milo is one of the strongest brands in Australia, probably the strongest Milo market in the world. And so this became an instant success; it's the most successful new cereal in the Australian market in 25 years and it's been holding its share very strong, and now we're bringing that to New Zealand which is an example of how we can go to many places with the same sort of innovations. I'll also give a compliment to our colleagues in Nestlé Australia who were able to get full distribution in less than three weeks on this brand.

Cheerios is a different example for those of you who know the US market, for General Mills this is not only General Mills' leading brand but it is the leading cereal franchise in the United States. It was obviously one of the first brands that CPW the joint venture looked at when we were formed, but I will tell you that learning how to sell Cheerios outside the United States proved a little bit of an adventure as we had to find the right product formulation and the right positioning. We did that and it's been one of our major growth drivers for the last five years in the UK and in Poland and in many, many markets. And now we're bringing that to Mexico; we just launched it about a month ago. I hear from our team there it's off to a very good start and it's about to enter Australia as our second brand into Australia, in this case borrowing technology and a brand from our other partner, General Mills.

Both of those are good examples of how we can take success in one area and translate it across. Innovation though is the lifeblood of any company and certainly for a challenger company we have to be innovative. One example of an innovation we did in the past year that I think really leveraged our parent company's strength was Fitness & Yoghurt. Now you'll notice the name of this is not Fitness & Yoghurty or Fitness & Yoghurt Flavour, it's Fitness & Yoghurt. We actually have live and active cultures sustained in the dry grocery product and this was a very successful launch in Mexico and we're certainly looking at this for global expansion in the near future.

We have a lot of other new products coming to market this year as we speak; just some examples, I think the one I'm most excited about is really the first one which is Chokella which is really the first cereal to bring the great taste of hazelnut, like in a hazelnut spread, to the market. It leverages again both parents, in the case of the product form it's a very unique technology that General Mills has that we've leveraged; the brand name Chokella is actually a Nestlé brand we leverage to bring in to form the product. It's in France and Germany, just shipping as we speak and I think we'll probably be quite aggressive in expanding this brand.

Going to the right you'll see Strawberry Milk Stars, that flanks our leading brand in China which is Milk & Egg Stars, a good example of how we customise if need be the flavour of our product to the local market taste. This tested as the next biggest flavour and we expect us to grow that line very, very well.

Choca Minis flanks our Cini Minis business which has been quite a big business in Central Europe and so we'll be bringing that out. And I didn't really spend much time in this presentation but I would like to reference that about three years ago we entered the very fast growing cereal bar market which has been a very good source of growth for CPW in Europe and we're now flanking some of those products in the case of Fitness with Chocolate and Pear, and in Poland where we have a leading market share in both bars and in cereals, the leading item is Nestlé Corn Flakes and we've been able to develop a very good tasting Nestlé Corn Flakes bar.

So I hope you see why I think there is a world of opportunity for CPW. Per capita consumption, we have a well positioned infrastructure against that; our margins are really at the front end of their accelerating phase and our strong and ongoing focus on brand building. Just to sum up and then I'd be happy to take any questions. I think what you saw is a dynamic global cereal category, it's going to grow without a doubt, the cereal category is going to grow. When it comes to CPW I think we have some very good strengths to lean on of our own as well as the partner strengths that we gladly borrow and leverage to the best of our ability. We're in a very good position to continue growing at a rate faster than the market and as I have reinforced now a number of times, I view our bottom line acceleration to be substantially even faster than our top line. With that I'd be happy to answer any questions.

Questions & Answers

Question #1
Future acquisitions

So far CPW has been a pure organic growth story, would you be open to any acquisitions to strengthen your brand portfolio?

Ian Friendly - Cereal Partners Worldwide (CPW) President & CEO

We would be, and are and have been, very open to acquisitions if they make sense, and in fact we've had three acquisitions in our history that have been very successful, maybe we've been lucky with that. But our initial acquisition was of the RHM Holdings business in the UK which gave us all the Shredded Wheat and Shreddies businesses, and really most of our bulk in the UK. The business we have in Poland was an acquisition that's tripled in ten years since we bought it, and a few years ago we bought a very small cereal business with a plant in Russia to help us get going in that market which has also been a good means to get us into the market so that we can then bring our global brands into Russia. We've had three acquisitions, to date all of them have worked quite well and we'd be interested in anything that made sense.

Question #2
Growth segments within cereals & EBITA margins

Two questions. Could you talk about some of the more interesting growth segments within cereals, so maybe breakfast bars, what your view is of hot cereals versus ready to eat cereals, that's the first one. And the second one is now that you're profitable in terms of EBITA, you kindly gave us the EBITA base level growth; is there anything stopping you giving us the exact EBITA margins and if not will you do so in the future?

Ian Friendly - Cereal Partners Worldwide (CPW) President & CEO

I'll address those in order although the answer to the second one will be fast! In terms of the fast growing segments, the fastest one has been in cereals in adult area on the line segment where Fitness competes; that has been pretty much the fastest growing segment in cereals although there is growth in many of the segments. The bar segment, depending on the country, has been a very fast growing segment for let's say the last three years, but we have seen this year that that growth has really, it's still there but it has moderated from 20%, 30%, 40% types of growth rate into single digits. Still a very good growth rate but not the growth rate that it was a few years ago. That being said it's a very interesting business to us.

As relates to your second question, no. We leave it to our partners, if they wish, to talk about the profitability of the businesses in exact terms; what I can tell you is that we have actually a quite good EBITA margin, I think it would be respectable compared to any packaged goods company, but I can also benchmark it against cereal companies and cereal specific margins and I believe that while our margins are quite good there is still quite a bit of opportunity and room for our margins to grow.

Question #3
Product development process

Could you just talk a little bit about the product development process you go through, and specifically I'm sitting here with two cereal bars in front of me, one of which appears to be Nestlé and the other one which appears to be Cereal Partners Worldwide. How do you cope with potential conflicts between products you want to develop, products Nestlé want to develop,

Ian Friendly - Cereal Partners Worldwide (CPW) President & CEO

You've touched on a challenging one. In the area of cereal bars, in the case of cereals let me just say it's quite clear that everything in cereals globally is inside the joint venture. In the case of cereal bars we had to be careful because both General Mills and Nestlé have bar products and so we had to define our scope quite carefully. And basically our cereal bar business in CPW is by design limited to extensions of the breakfast cereals brands, so it's Fitness bars, it's Nesquik bars, we're not going to invent a brand new cereal bar that doesn't exist as a cereal. Now, our partners might, and there's nothing precluding General Mills or Nestlé from competing in the bar business, but the breakfast cereal bar will be with CPW champions. We do have to be very careful about that territory; we have good discussions with both partners; as it relates to the R&D and technology though, both partners are more committed to seeing the joint venture succeed than protecting information; we're careful with information and CPW is careful with information but we have access to the R&D of both General Mills and Nestlé to develop our products.

Question #4
Cash flow and dividends

I wonder if you could say something about the cash flow characteristics of the joint venture, are you generating cash now or are you still in a heavy investment phase? Do you pay a dividend to the parents and what happens if your parents can't agree, how is that resolved?

Ian Friendly - Cereal Partners Worldwide (CPW) President & CEO

OK, let me just try to get hold of this. We are cash flow positive. As it relates to dividends, that is done, it's interesting, the legalistic structure of CPW by the way is that in each market Nestlé designated structure and the General Mills designated structure owns CPW. So in CP Poland it is owned by General Mills and Nestlé in Poland and similar in all the other countries for the most part. And in that case the dividend policy is set in that country depending on the fiscal aspects of that country and our treasury position in that country, but that is how the partners get their cash out of the joint venture, but it's country by country. A dividend is most certainly paid but needs to be determined in each country. And the last part of your question was if there is a disagreement, do you mean like an operating disagreement or a disagreement on dividends?

Participant

Well operating or strategic disagreement, in the context of a 50/50 JV.

Ian Friendly - Cereal Partners Worldwide (CPW) President & CEO

This is what the Board structure is, and we're not unlike a public company in that regard, is we will bring capital decisions or any important strategic decisions to our Board for acceptance, and the Board has a chance to vote that down or accept what management is proposing. And we've really had very few conflicts of that nature but that is something that is voted upon and decided upon with our Board. As it relates to more operating details, they've entrusted me to do that and to make the decisions of what I think are right or wrong. And they hold me accountable for those decisions. So in that regard we're not too different I think from a publicly held company other than obviously the Board that I have is quite informed on food business and very knowledgeable in the things that we're facing. What I can tell is it's a very collegial and collaborative Board and I think any of the hot topics would tend to get discussed long before they surfaced as stand offs in the Board meeting.

Question #5
Involvement with the GLOBE project

Whilst you're an independent company there's no reason why you should be involved in the GLOBE project. Are you or will you be GLOBE compatible?

Ian Friendly - Cereal Partners Worldwide (CPW) President & CEO

We're fully involved in the GLOBE project; it was a decision that we made and wanted to make, so it's not a forced decision, but given that across the world we leverage Nestlé infrastructure, the idea of running our own infrastructure or taking on our own SAP type project would be highly inefficient and illogical really for us. And while GLOBE I think in the short run, obviously you have to get over the implementation, if you think of a globally managed business we may even get more value and opportunity out of the transparency that GLOBE creates than many businesses. So I'm quite excited actually about what Glove will represent for us and it's one of the reasons I'm quite bullish on our margin acceleration.

Question #6
Cost of Nestlé Sales force & Ownership in Iceland

The strength of Nestlé's sales force, you don't really totally borrow it, you pay for it, as a fee you pay Nestlé. Can you quantify that fee and can you suggest whether there are any debates about the fee, what's paid, whether it changes? And then what is Iceland all about? I guess is still owned by General Mills?

Ian Friendly - Cereal Partners Worldwide (CPW) President & CEO

I can give you what I know about that one which may be more limited than all the ins and outs of it. Let me answer the last one first which is Iceland is exempted. I believe it has to do with a lot of history and contracts between General Mills and the company that distributes cereals there, and for whatever reason when the JV was negotiated it was US and Canada and Iceland, and so that just is the case. The way we do sales with Nestlé is a negotiation; it's a very healthy process I think in terms of a discussion that we do once a year with market by market, so it's not a global discussion. My country manager in France will sit down and discuss with Nestlé's market head in France the upcoming year, look at a variety of statistics and try and arrive at what is a fair payment for those services. In the early years when we were new to a country it was fraught with lots of back and forth battles and discussions, although it gets resolved; once we're up and running it's quite smooth I would say.

Question #7
Sales splits between markets

You put a chart up showing the countries where you're number one and countries where you were number two, could you just give a split of your sales, how they split between markets where you're number one and markets where you're number two ?

Ian Friendly - Cereal Partners Worldwide (CPW) President & CEO

I don't have the numbers accumulated that way but what I can tell you is it would be some exceptionally high percentage where we're number two. Because the ones on the right, and I hope I reinforced this, these are the biggest cereal markets in the UK, France and many of the Western Europes, Mexico, these are big, big cereal markets and Kellogg's is a very strong capable number one in those markets. And so if you tuned all the world together outside the United States, those five, six, seven markets would dominate the denominator and so it would be a high percentage where we're number two. And I wouldn't want to give the impression that's anything other than that; we are a solid and growing number two but we are no doubt fairly distant from the number one.

Question #8
Future organic and asset growth

This may have been implied in some of the slides, but what are your expectations for organic growth over the next five, six, seven years and what would your expectations for asset growth be relative to that?

Ian Friendly - Cereal Partners Worldwide (CPW) President & CEO

Our volume growth, which is not quite organic growth and I'll touch on that in a second, my expectation is that we'll double our volume growth in ten year horizon roughly speaking, so it's basically the compound growth rate that I showed you of our recent years. Our sales growth, which essentially parallels organic growth has tended to be over our history somewhere between one to two points stronger than our volume growth, due to a mixture of either pricing or of mix in that equation. And so I would say that that will continue going forward although I expect the curve when you get into the time horizon that you mentioned, I would expect the curve to flatten somewhat over time, just as the weight of the size of our company gets bigger. As it relates to capital expenditure growth, I don't think I'll divulge any specific plans other than to say that our growth in capital will be as a percentage substantially lower than our EBITA growth and our top line growth.

Question#9
Pricing outlook & Private label manufacturing

Private labels have been growing quite fast in the cereals market, could you talk about pricing outlook in this category, I was talking about private labels? And well secondly, do you manufacture any private labels?

Ian Friendly - Cereal Partners Worldwide (CPW) President & CEO

Yes, private label has seen some good growth, much of it driven by distribution and gains of stores as was shown earlier today through discounters who many of them, or at least several of them, only carry private label which has driven a good portion of that growth as well as traditional retailer response. Again most of that growth has been in products like cornflakes or the more commodity oriented products, and I think as long as we see the hard discounter expansion go on we'll see private label grow for a while.

When you look at pricing, I think it moderates your perspective on this topic, since I agree with what Ed Marra said, is pricing is a function of the value you create. I can tell you some of our highest price products are growing brilliantly, so if the value is in the product, the consumers really like what you're giving them, then private label isn't the issue. I think private label is an issue when your products are not well differentiated from that of the offering of the private label company. So I don't see it as the end of their ability to price by any means, and we've been able to price in this environment, but it's certainly something that dampens the ability to price.

And on private label manufacturing, this came up this morning but I'll just remind people. We do manufacture and sell private label in the UK. When we bought RHM back in 1991 it was a very important and significant part of their business and is still, it is not as high a percentage as it was at that time but it's still an important and significant part of our business and it is profitable, but our policy outside of the business we acquired is not dissimilar to Nestlé or General Mills which is to really focus on our branded products and not supply private label products. We've limited the one that we bought.

Question #10
Profitability & International expansion

Just returning to profitability, could you give us a feel for how profitable the markets where you move into the first place are today, I mean you said earlier that overall CPW profitability which was quite respectable by package food company standard but much lower than breakfast cereal. And my question is actually related to the fact that you are a distant number two and whether that precludes your margins from going to the top. And the second part of my question is with regard to international expansion, are you going to continue the expansion, we've seen the maps with the white gaps, so that the margin progression in the next few years will still remain relatively limited or as your international expansion is more or less completed you should actually see margin accelerating.

Ian Friendly - Cereal Partners Worldwide (CPW) President & CEO

As I've said, our margins are quite good and they are better in our older markets and our profitability tends to be better in our longer lasting markets. But what depresses to some level our margin against some global benchmarks, it may not be entirely due to new markets but rather that we had, we had to grow enough volume leverage over that business to get that cost structure. And it's more about volume leverage than it's about new markets, although new markets enter into this. And we're now at a place where we have most of the volume leverage, and as I tried to show you in the presentation as well, even some areas where you wouldn't think we have leverage we actually do because of our partnership with Nestlé; we do have a fair amount of cost leverage and efficiency because we're part of a bigger enterprise than a stand alone cereal business. So why I feel very good that our margins will expand as our volume grows ? because we've built our infrastructure, we've built our capabilities, there's still some work to be done, we're a teenager, we're 15 years old, we're past our growing pains, but we still have some investment in front of us but I really am quite confident that our margins will expand at a very nice rate.

As it relates to future expansion, I would hope that there will be a day that CPW has now white space shown on that map. If you really look at that map to where there's existing cereal markets, there's basically three left so it isn't so many. I'll tell you what they are, I'd call these mid-size markets, cereal markets, but South Africa we're not in and there is a good established cereal market there, and to a lesser degree both Japan and Korea have mid-sized cereal markets left. And those are really the only substantial cereal markets. The remainder of that white space I think could be entered on a break even or better basis.

Question #11
Joint venture duration

When the joint venture was formed, or today, was there any suggestion of some plans for the joint venture; will it still be a joint venture in 20 years' time or is there an exit strategy?

Ian Friendly - Cereal Partners Worldwide (CPW) President & CEO

Well the protocol was written with a very long timeframe and it has an automatic renewal at the end of that very long timeframe, and I think the partners foresaw a long productive partnership. The two events that could have changed, and could change, is if there was a major breach in the protocol which there hasn't been and at this point in our history there won't be. And the second event that could change things would be a major change in ownership structure of one of the other companies, in which case it doesn't mean it's over, it just means that the other company would have a chance to look at that and there's a whole thing in the protocol about valuing the business and being able to go down that route if the other company so chose. But my expectations, and you'll have a chance to talk to Peter tomorrow, but my expectations are very much that the partners are quite pleased with the result. I've heard a phrase in Nestlé a few times where they said they'd rather have 50% of a success than 100% of a failure, and I think that's kind of true, that both companies probably feel that way, that as long as the joint venture is doing something both couldn't do on their own, it's a valuable joint venture. I would also say it's probably an exception as joint ventures go as the founders really got it right. I think when most joint ventures fail or get off the track it's perhaps because the reason they set it up didn't end up being the real reason thereafter. In our case this benefit and advantage that both companies brought has become very real and I think dictates how we run the business.

Roddy Child-Villiers - Nestlé Head of Investor Relations

Ian, thank you very much.

END OF CONFERENCE