

NESTLÉ S.A.

EUROPEAN PET CARE  
TRANSCRIPT

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**Presenter: Mr John Harris  
Head of European PetCare  
Nestlé S.A.**

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## **Roddy Child-Villiers - Nestlé Head of Investor Relations**

The next manager that we have for you today is John Harris over here. Some of you will have met John before because John was responsible for the integration of Ralston Purina and the Nestlé PetCare businesses and you will hopefully all remember that that was delivered ahead of time and above the target cost saving. John's reward for his success is an interesting insight into how Nestlé manages its people, because he was sent to Europe which as we all know is a rather tougher market than the US in PetCare. John's been with us, or through Carnation with us for 31 years and has been a PetCare expert through that time. John over to you.

## **John Harris - Nestlé Head of European PetCare**

Thank you. Before I start I'd like to ask the question. How many people in this room have a dog or a cat? Not very many. OK that will impact how I proceed. For those who don't know, if you have a dog or a cat the probability is you're going to live longer. If you have a dog or a cat the probability is your kids are going to be better adjusted. So for those who don't have a dog or cat I would suggest you get a dog or a cat. And the beauty of dogs and cats, we were talking about it last night, it's one of the few times in life you get unconditional love. You don't have to worry about it, you don't have to hear the problems of the day, a dog will run up to you and wag its tail. A cat may not but the dog will, and show you a lot of affection and emotion and that's very important in today's society. And that's one of the reasons why the dog and cat population is growing around the world.

Roddy mentioned what has happened in terms of the acquisition between Nestlé and Purina, and Nestlé had a very powerful business in North America, it was the number 2 player. It was number 1 in premium cat food, it led the market, it had over a 50 share. Purina was basically the number 1 dry company.

When we put this acquisition together we learned something and you learn a lot, we didn't put much value to what we learned but we learned a lot and what we learnt was that pet food insight was global. People's attitudes about pet food was global. And we believed that and so basically what we did was we took that concept and said OK we're going to take the ideas that work very well for us in North America and apply them literally to Europe. And Mr Brabeck figured that I was the best person to do that. And so I was selected to come over and do that and what I want to do today is take you through what we've done to our pet food business in Europe and how we've transformed it.

The business is not anything like it was ten years ago. Ten years ago we had basically a wet business with multi-serve cans and I'll show you what a multi-serve can is. What that means is that people can get more servings out of this can, which is interesting because what happens is consumers will scoop about 100 grams of product out and they'll put it in the refrigerator. And for those of you who have dogs and cats it's not as good when you put it in the refrigerator and pull it out. In fact those who don't have dogs and cats you don't want to see it in the refrigerator.

So from a consumer insight standpoint we learnt in North America that consumers wanted smaller cans. So we came out with this item called Fancy Feast which is one of our most profitable businesses we have in the world and one of our biggest businesses in North America. We took this concept and the concept of small servings and started applying it to

Europe and this is a pouch, a small serving again. It's about 100 grams and for comparison standpoint this will sell for, depending on the brand, about 60 cents. This is 400 grams. This will sell for about 45 cents and it's 100 grams. So the premium is pretty good. So given that background in terms of pet food I'd like to take you through what we've been able to do.

We have focused basically on what we call our strategic brands and some of the brands that I've listed here are pretty much brands we picked up through the Ralston acquisition. ONE is basically a premium brand, Bakers is basically a Beneful brand in the UK, by the way Bakers is the number 1 dried dog food in the UK. Felix single serve is that pouch I showed you there, focusing on single serve. And then Dog Chow Gourmet which is our premium and in terms of a Fancy Feast type product. Pro Plan which is our super premium and the product that competes against Eukanuba. And we have Friskies dry cat food which has always been in our portfolio. What you see here over the last two years as we've been able to grow what we call our strategic brands, in many cases double digit. So the performance of those brands are very, very key. And we've lost some businesses in terms of private label, we've lost some businesses in terms of the big cans but fundamentally we've shifted the basic strategy of the business.

Our results through April, you can see the momentum is continuing; I showed you the chart where ONE is growing at a 30%, 40%, 50%, it continues to grow at 50%. Bakers continues to grow. We had a fantastic April and we had a fantastic May. So May results will be even better than this. So we started a little slow this year because of scheduling and planning purposes but from a business standpoint we're doing quite well and we're very pleased with where we are.

From a market share standpoint and for me, market share is the key to long term profitability. You've got to have strong market share and what we've been focusing in on is narrowing the gap between ourselves and Mars by taking these ideas and building market share. What we've also done is getting rid of brands that aren't as important to us; so when you look at the numbers you've got some brands coming out, coming in but fundamentally what you'll see is Mars has lost share. Mars is gone from a 42 share and a year to date share is down to a 39, 38.9 to be exact. And our share as you can see is starting to inch upwards, so our share is going up. Private label is coming and private label has made a direct impact on Mars pretty much because much of Mars' business is in these big cans. And that's where they're being hit. We've moved our businesses and transitioned our business out of this big can into what we consider high value premium pet food.

This lays out how we've done in some key markets and what I have are two markets; I have the UK and I have France. And the point of this slide is just basically pointing out we've been able to narrow the gap between ourselves and Mars. Mars is tied with Nestlé in terms of it being the biggest pet food company in the world; Mars is a big pet food company. When people think of Mars they think of Snickers but pet food is a big part of their portfolio. It's on debate whether the pet food is the biggest part of their portfolio. Our performance in France has been outstanding. We have narrowed the gap and in the most recent period we tie with Mars from a leadership standpoint, and we are anticipating to continue to improve in France.

In terms of Iams, Iams' P&G's entry in the pet food category, Iams came to P&G by way of acquisition. If you look at our market share compared to Iams we've been focusing in on ONE. ONE has done quite well. We've been able to pass Iams from a market share standpoint so we're very pleased with the results there.

Laying out all the markets, not all the markets but most of the markets in Western Europe you'll see that our performance on ONE which is our super premium item, has done quite well in all the markets. Again the focal point starting a few years ago we've been able to move the market share up. So we're very pleased with where we are. In Switzerland we have over 25% of the total market so we're very pleased.

We've just launched Beneful taking the same concept that Beneful is in the United States and applying it exactly to Europe and in the first 11 weeks we've achieved a 5 share in a test market in Holland. We're expanding it in France and Germany. We've been able to establish the brand in Holland faster than the US has been able to establish. In the US it's a \$200 million business. We think it's going to be an incredible success for us in Europe. But again we're basically taking the concepts that work in North America and applying them to Europe.

We've also done some hard things from a plant standpoint. Since 2001 we've shut down nine factories; one of our weaknesses before the acquisition was our industrial base, it was not competitive. And so what we've done is establish a competitive industrial base and shutting down nine factories in Europe is a pretty good accomplishment but more importantly it allows us to be competitive in the marketplace and allows us to position ourselves to achieve our ultimate goal to be market leader.

This is how we've done from a profit standpoint using 2001 as the index of 100, you'll see that our profit has improved. We're looking to further improve our profit through supply chain savings which means factory shutdowns and overhead reductions but 40%, 50% improvement in profit.

In terms of size and when you look at the pet food business people think of North America as being the biggest part of the world from a pet food standpoint; from a size standpoint Europe is roughly CHF18.7 billion, it's bigger than North America from a size standpoint. When you look at it, compare pet food in Europe to other categories and I've changed from euros to Swiss Francs, I've changed to euros here, in terms of categories that Nestlé competes in in Europe it's the third biggest category, over €5.5 billion.

So it's a big category, there are a lot of dogs and cats and when we take a look at it, and this is how we do take a look at it, in terms of the number of dogs and cats that are out there in Europe there's 86 million cats compared to 85 million cats in North America. And 77 million dogs compared to almost 66 million dogs in North America. Now the beauty of pet foods is that the dogs and cats eat every day. They don't go away from home, the weather doesn't bother them too much and so we've got a great business. And our objective is to basically get them to use commercially prepared pet food.

What you have here is a chart laying out the percentages of food that they feed their animal that's commercially prepared. In the United States 80% of the pet food is commercially prepared. In Western Europe only 50%. We think there's a tremendous opportunity to expand this business by increasing the percentage of pet food fed to animals as part of their diet; commercially prepared pet foods. So it's a tremendous opportunity.

When we take a look at some of the markets and I mentioned 80% for the United States, our best market is cat food in the UK at 70%. Opportunity to grow in cat food in the UK. Opportunity to grow in dog food in the UK which is only 51%. France 61% of a cat's diet is commercially prepared foods, opportunity to grow in France. 50% of a dog.

But when you look at that and these numbers are off versus 80, when you compare that to some of the other markets like Russia where we're looking at 8% of the animal's diet in terms of cats that's commercially prepared food and in the Czech Republic it's 38%. So we think there's a tremendous amount of opportunity to grow. And our business in Russia for the last two years has been growing quite well so we're very pleased with that.

In terms of value and I mentioned before what we're focusing in on, we're focusing in on dry dog food and single serve wet food. And what you have is a chart laying out where the growth is taking place. The growth is taking place on dry and the growth is taking place on value and we are as a company the largest dry company in the world. And so are well positioned with tremendous ideas I'll talk about later to leverage and continue to grow in this category.

I talked about the portfolio shift and this is very very key in terms of visualising our business. What we had before is this big red block which is multi-serve cans which was a big part of our business. We've shrunk the size of that red box and we're selling premium value added high priced items. In the US on this big can it represents roughly about 10% of the market in terms of cat food. In Europe it represents over 30% of the market. So we feel that that's going to continue to decline. What's going to grow is the single serve and the dry. And that's what we've been doing and that's what our portfolio's been doing and it's been a transition that we've been working on but we're very pleased with how it's coming.

When you compare Europe to the rest of the world, and this is a very, very key chart, you have the rest of the world which we call AOA, you have Americas and you have Europe, you have a red line and a blue line. The blue line is wet pet food and the red line is dry pet food. And what you see there is every market in the world, dry is the preferred way to feed your animal except for Europe. Our goal and our task is to make dry the preferred way to feed an animal in Europe. And we think, we know we're doing that from a growth standpoint. We're seeing good growth in our dry business, good growth in the dry category and you'll look at that line and you'll see that the red line is coming up. It's coming up slowly but surely it's coming up. So fundamentally we believe long term we're going to build a fantastic business.

The objectives, I talked about them already; dry, premium food and improve our margins. We want to get our operating margins up to the average in Europe which is a very important priority for us. We want to also continue to put pressure on Mars.

How we plan to do that is we're focusing in on our consumer, the pets and I'll talk about later how we do that. We're focusing on the owner in terms of having appealing products. We have products that help the dog and cats live longer and I'll talk about that. And we're focusing in on these seven brands for us; Pro Plan, ONE, Beneful, Bakers, Gourmet, Felix and Friskies. And also we're focusing on channels. We have different channels then grocery, and about half of our business is sold through pet specific channels, pet outlets. We have a dedicated sales organisation that focuses on that and we have dedicated brands for that channel and Pro Plan happens to be one of them and we're focusing in on that. The other thing is we're looking to build Purina as a trusted corporate brand.

Dogs and cats are what it's all about, making them happy.

And the question was asked last night, well do you guys do 60/40? Yes we do 60/40. And well how do your products stack up? And what I've got, we do 60/40 and I want to show you

how our products stack up. You'll see that our products are second to none from a quality standpoint. We beat our competitors in Sheba, Mars' product, Pedigree is Mars' product, Royal Canin is basically Mars' super premium type product, we beat them in most cases 70/30, in some cases 80/20. We've got some fantastic products. We're able to do that because we spend a great deal of money in terms of R&D and we have some of the best R&D minds in the world in terms of pet food because we've been able to put the Purina people with the Nestlé pet food people and build a tremendous organisation.

I talked about product appeal and we sell both to the pet, which is what you saw there, the pets reacting to our product, and we also sell to the owner. And for the owner in many cases they want the product to look like something they would eat. It is true. They want it to look like something they would eat. And what you have are products that look like something that people would eat. And I did an experiment, I opened up a can and put it out as a pâté last night and some of you guys ate crackers with it and you loved it. But seriously some of the quality of these products you cannot tell the difference between that and human products; it's excellent quality products. And that's what we focus in on. The products look great, you saw some of the commercials, we have Felix 'As Good as it Looks' which is doing very well and we go for pet appeal and owner appeal and it's working for us.

In terms of living longer and one of the questions I was asked last night was, do you have any research on lifespan and these things must take a long time. Yes it does take a long time but we've done a study and basically the results of the study say that if you feed Pro Plan your dog will live two years longer. And we've run commercials on that and it's worked very well to help propel the growth of Pro Plan. And we spend again a lot of money on not only product appeal but on nutrition and this is reflected in the quality of our products.

In terms of Gourmet and this is what I'm holding, this Gourmet can, you can see from a business standpoint it's gone up from a \$300 million business to over \$400 million business and it's all focused on quality.

This thing sells for, depending on the range, it sells for 60 cents to €1 and you can look at the price points. It sells for basically, depending on the brand, close to what this sells for and the costs aren't the same. But double the price, triple the price, quadruple the price, depending on how you look at it on a per gram basis, fantastic business for us and growing.

This is Etoile, and this is our top of the line wet product. And we actually have two of them but we sell this thing for over €1 a can, that's like \$1.23 per can, that's incredible. And consumers buy it and you look at the market share; the market share is going up.

Felix 'As Good as it Looks' is basically using our technology that gives us a superior appearance. We've introduced that in the UK and it's taken off, we've achieved an 8 share, 9 share and growing.

As I mentioned before we focus in on basically three classes of trade and the classes of trade are quite different. The grocery stores, they're looking for a wide assortment, specialist stores are looking for a lot of information, discounters are looking for a narrow assortment and we try to service all those classes of trade. And we've outlined where they fit on a continuum in terms of the information and assortment and we basically put our sales organisation against that. And we've gone in and worked with key customers like Carrefour, we've worked with pet specialist stores in Europe, we've worked with Lidl to build our business.

In terms of the corporate strategic brand we tie everything together with Purina, you will find Purina on all our products and Purina means quality from a palatability standpoint, taste standpoint, and quality from a nutrition standpoint. We use the Purina endorsement on everything we sell. Our objective is to have Purina be recognised as the strongest pet food company in the world and definitely the strongest pet food company in Europe.

Coming innovations; what do we have coming next? And I think the key thing is the pipeline and I'll go through the specifics of the pipeline but I want to talk about how the pipeline works first. We are very fortunate in that we have such a powerful business in North America and basically what we do consistent with believing that pet food is global is we take the concepts that work very well in North America and try to apply them as quickly as we possibly can to Europe. And so we have proven tested concepts that we know work in the marketplace. And we know the idea that attitudes about the pets are universal, so we feel that because of that we'll be successful.

In terms of new items we've got Beneful coming for weight management. Many of the dogs you see are overweight and we've got products for that.

We've got lots of snacks and treats coming.

And we have a sensitive range for basically dogs who have allergies and I saw someone outside today; today's a bad day for allergies; I've got them myself and pets have them also. And we've got a premium line for that.

We have the same premium line for ONE that we offer for allergies and sensitive eating habits in grocery stores.

We have a soft piece that we're coming out with that replicates meat that we've tested in France. And we basically added a soft piece to our Friskies line and we picked up 4 share points, we went from a 15 share to close to a 20 share of the market, so we're very pleased with that.

So we've got a pipeline of innovation and we believe that innovation is the key in terms of moving this thing forward. There was a question yesterday, someone asked how many cats were indoor cats and there are about 63 million cats in North America and I think 60% of them are indoor cats. We have the same issue in Europe and we do have an indoor line that we've been introducing on Friskies which I did not mention. But we've got a pipeline of innovation that we can pull from North America and because we have that pipeline we feel we were on track to growing this business, growing market share and improving profitability. On that note I'll open it up for questions.

## **Questions & Answers**

### **Question #1** **Speciality channels**

Good morning. In your presentation you focused on the grocery channel but could you tell us a bit more about the speciality channels as well? First how big is a speciality channel in

Europe versus grocery? How fast is it growing versus grocery and how big is it for Nestlé and what's your market share in this channel?

**John Harris - Nestlé Head of European PetCare**

The market share data is very hard to get and there is no reliable measure of market share. So no-one knows actually the market share. The size of the category is roughly, depending on the market, and it varies dramatically depending on the country, it varies from 50% of the market to 30% or 40% of the market. Pet specialists are basically stores like in the US it would be Petco or Petsmart, those stores tend to be mom and pop stores or small operations in Europe with some exceptions in Germany, they're bigger. So it varies from market to market. It is, and we estimate the category will be about CHF18 billion, 30% to 40% of it is in the pet specialist store. So it's a big category and there's a big opportunity there. That category in Europe is dominated or led by Royal Canin which is a Mars brand. Hills is there with a good brand then we're there with Pro Plan. The growth is probably 6% or 7% growth in pet speciality, maybe 1% to 2% in grocery. So the growth is there. And that's why we put a lot of focus on growth. We've got exclusive brands in that channel that are doing quite well. I showed you Dog Chow's results, I showed you Pro Plan's results, the results there are phenomenal and those brands are only sold for us in the pet speciality channel. So we're focusing in on that channel and we're getting good growth out of it. But it's going to be a good channel, it's going to continue to grow. In Europe we are number two in terms of the grocery channel. If you look at that channel by itself we're probably the number three player in that channel behind Hills. It's Royal Canin, Hills and then it would be us. But our focus point is to improve on that.

**Participant**

*(Unable to hear)*

**John Harris - Nestlé Head of European PetCare**

It's hard to say in a sense because we sell some brands in both channels but it's around 30%.

**Question #2**

**Private label/commodity percentages**

Am I right in thinking, looking at one of the charts, that about 25% of the business is currently private label/commodity? Is that correct?

**John Harris - Nestlé Head of European PetCare**

No, the chunk you see there, that red box is this stuff. So it's not private label. Some of it is private label but it's not private label.

**Participant**

What about commodity?



**John Harris - Nestlé Head of European PetCare**

It's not quite a commodity but it is a less differentiated item than the rest of the portfolio. That would be a more accurate way of saying it. We do get a premium price for these cans depending on what we put in them, but these cans are not long term for this world so to speak.

**Participant**

I guess what I'm trying to get at is what percentage of the portfolio is actually not growing, what percentage is shrinking.

**John Harris - Nestlé Head of European PetCare**

That 25% there is shrinking.

**Participant**

It is? OK.

**John Harris - Nestlé Head of European PetCare**

But the rest of it is growing.

<p><b>Question #3</b> <b>Time scale to achieve average margin of Europe</b></p>
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And you talked about your ambition to get to the average margin of Europe, obviously the question is when do you think you're going to get there? I'm sure Wolfgang is listening on this one.

**John Harris - Nestlé Head of European PetCare**

The shrinking of this: these cans are shrinking 9% for the whole category, so Mars' business is shrinking about 9%. Ours is shrinking 9% on the wet cat. On wet dog the category is shrinking about 5%. So you have the shrinking of category but you've got growth happening in the other segments. So that's the details of that. In terms of the profit, getting equal to the average in Europe, it will probably be six years before we get equal to the average of Europe.

**Participant**

And will it be another six to get to the margin of the US?

**John Harris - Nestlé Head of European PetCare**

We will never to the margin of the US. The US has certain inherent competitive advantages that are hard to replicate and one of which is this is the US. It's a little more difficult doing languages, putting eight languages on this package. You can't do it. And we've got I think three or four on this package now. In the US the beauty of it is you have a simple easier

supply chain just by definition. So we'll never get to the point where we're going to be like the US. Complexity in Europe is going to be a lot greater than the US. But we can in fact improve our margins.

**Question #4**

**German pet food market, market share and evolution & Scientific diet type products for Europe**

Two questions. Can you talk a bit about the German market? I think if I'm right Germany is the biggest pet food market in Europe.

**John Harris - Nestlé Head of European PetCare**

No, you're not right.

**Participant**

I'm wrong OK but it's a big market.

**John Harris - Nestlé Head of European PetCare**

It's a big market, it's the number three market in Europe.

**Participant**

And it's a Mars stronghold I think historically. Can you talk about where you are in terms of current market shares and how you see that market evolving vis-à-vis Mars? That's the first one. And the second one is in the US obviously building relationships with vets is very important and Colgate and yourself have developed scientific diet type products which are super premium. Do you think that type of concept could or would take off in Europe and if so what would be a realistic timeframe?

**John Harris - Nestlé Head of European PetCare**

We have a line of veterinary diets that we sell in Europe that's doing quite well and we're slowly but surely making inroads in that vet channel, from a veterinary diet standpoint. What we've done is taken the concepts from the US and applied them as easy as we possibly could to Europe. Some of the concepts are a little more complicated to apply but most of them we've applied so we've got a business from a vet standpoint.

Germany. Germany is a very very interesting pet food market. Germany is not the number one pet food market in Europe, it's not the number two pet food market in Europe. It's the number three pet food market in Europe; this is according to Nielsen. Germany is going through a lot of upheaval. Mars is having some tough times in Germany. We as a company have never been strong in Germany, we've never focused a lot of resources in Germany and it's not in our strategic plan to become a dominant player in Germany. In Germany we want to be a player but we are not willing to invest what is required to be the number one player. So we have a business in Germany, it's based upon these concepts of premium, super premium, they're doing quite well, but it's not a main line brand. Much like in the UK we've

got mainline brands, in France we've got mainline brands, in Italy we've got mainline brands. Germany happens to be a specialist market force. So we've got a focus business in Germany.

### **Participant**

And the market shares? Do you have a rough idea?

### **John Harris - Nestlé Head of European PetCare**

Market share is 15 to 40, somewhere around there. Mars is 40 something and going down.

<b>Question #5</b> <b>1<sup>st</sup> and 2<sup>nd</sup> markets in Europe</b>
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So what's the number one and number two market, that was one question.

### **John Harris - Nestlé Head of European PetCare**

France and the UK. That's easy.

<b>Question #6</b> <b>Benefits of being part of the Nestlé group</b>
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And then what help, if any, are you experiencing from being part of the Nestlé overall group? Is that important? And do you have Nestlé on the packs or is it just Purina?

### **John Harris - Nestlé Head of European PetCare**

Well it says Nestlé Purina some place when the company comes in, but yes it's on there some place. We always debate on that. Some of my nutrition colleagues don't want me to put a big Nestlé on there, they get kind of nervous but we do have Nestlé Purina on the pack and that's on the company and that's on my business card. The leverage that we get from Nestlé is the leverage we try to do with the customer. We have great relationships with Nestlé, with Carrefour, great relationships with some of our customers ASDA, with Tesco, Nestlé has these relationships. What we do is we try to leverage that with our customers and leverage in terms of our trading conditions, in terms of promotional activity, that's basically where the cross fertilisation comes. There's also some savings that comes in the back room which we're working on. By back room I'm talking about accounting, finance, adding the things up. The long term vision for this company is for this company just to be a marketing end, so basically what we're looking at is Nestlé Purina being a marketing end and all the back room, all the services are provided by Nestlé. That's where the synergies comes and the savings come. So we're not looking to create a standalone company that has its own financial operation, chief financial officer, we do have a person we call the chief financial officer, it's not the same. We basically use Nestlé for these services, Nestlé for HR, Nestlé for all our corporate services to lower our cost from a service standpoint and Nestlé from a leverage standpoint with the customer. So that's what we try to do.

**Question #7****Likely impediments to the shift to industrial pet food and to dry pet food**

I wonder if you could just talk about what the main impediments are in terms of stopping the shift towards industrial pet food and from wet to dry? And if you look at the markets which historically have been heavily non-industrial, like Spain and Italy in the European context, are you seeing signs that the trend towards industrial pet food is accelerating?

**John Harris - Nestlé Head of European PetCare**

In the southern part of Europe and also in the eastern part of Europe we're seeing acceleration in the trend, so the market is growing, it's growing at a faster rate so that's a good thing. The impediments are basically disposable income; you have to have a certain amount of disposable income in order to buy pet food, so that's one of the impediments. And also quality. A lot of people have dogs and cats in the other parts of Europe and they feed these dogs and cats table scraps. Now table scraps are pretty good so when we convert people over we have to have superior quality. In the past what has happened is the feeling that we're going to go into Eastern Europe and we've had this in our company. And Eastern Europe is less sophisticated than Western Europe so the quality of products don't have to be as good; in fact the quality of products has to be superior. So we've reoriented ourselves and Mars has too basically to give Eastern Europe top quality products competitive to Western Europe and you're seeing an acceleration of the penetration in the category.

**Question #8****Percentage of business in UK**

You said France and the UK are the biggest markets but I would assume you're the biggest in the UK. What percentage of your business is in it?

**John Harris - Nestlé Head of European PetCare**

No we're not the biggest. You being versus Mars?

**Question #9****Biggest European market**

What is your, what is Ralston's biggest European market? Is it the UK?

**John Harris - Nestlé Head of European PetCare**

It's between UK and France and it's a close, one other thing I have a pet-hate, Ralston disappeared and it's a pet-hate of mine, I see it all the time but Ralston disappeared and Ralston from a business standpoint, Ralston didn't bring us much sales. What Purina bought us was concepts and ideas that were proven brands that we could take and implement in Europe. The sales, the acquisition was pretty much a North American acquisition and I was part of the acquisition team, but from a European standpoint it bought us concepts and what we've been able to do is take those concepts and you saw the improvement. We've been able

to drive those concepts double digit for three years in a row. But UK and France are our two biggest markets and we've focused in on UK and France to make sure that we've been able to grow our share; they've also focused in on Italy to grow our share. As I mentioned Germany is not a focal point for us but those three markets are.

**Question #10**  
**Down trading in dog and cat food**

Could you comment on the down trading phenomenon in dog and cat food? Is the dog the first or the last one to be put on the private label stuff in economic disadvantage? How do you reckon this compares when you swap notes with your food for humans colleagues?

**John Harris - Nestlé Head of European PetCare**

There is no homogeneous dog or pet owner, there is a diversion of dog and pet owners, they're different segments and how you perceive yourself and how you relate to that dog determines what you do. I had a conversation last night and one of your colleagues openly admitted that the dog was sleeping in the bed. The dog is sleeping in the bed but the dog gets anything it wants and the dog changes his diet every three or four weeks looking for something more, something better, something different. So it depends on your relationship. So what we're finding out is that we've done segmentation studies, we've got a phenomenal global segmentation study that drives our consumer insight. We've targeted our brands to people who have an emotional bond to their dogs. We don't try to sell our dog and cat food to everybody; if you don't love your dog we don't want to talk to you. If your dog is tied up in the back yard with a rope around its neck, we don't want to talk to you. But if you go to a French café or you go to a café down the street and your dog is in the restaurant we want you. So what's happening is we've got polarisation taking place; we've got consumers over here who don't care about their dogs and they'll feed it the cheapest thing they can. And we've got consumers over here that will pay €1 for 85 grams of product. That's the people we want. And that's how we're going after it, and that's a fundamental shift for us because when we came together in the past we were part of acquisitions, we were based on volume, let's get the volume, the bigger the cans the better. And we were selling a lot of cans but fundamentally we did not have a value strategy. In North America Nestlé always had a value strategy, in North America Purina always had a value strategy, it's a fundamental shift in Europe, we've got a value strategy and we've been able to grow the business. But the casualty has been that can. But there's a polarisation taking place, those who love their dogs and those who don't. And we want the people who love them.

**Question #11**  
**Effect of shift in portfolio on asset base & Capacity utilisation for super premium products & Future facility closures**

With such a sharp shift occurring in your portfolio, how's your asset base going to cope with it? Are you comfortable with the capacity utilisation for your super premium products? And also have you got further closures that you need to make on your wet facilities?

## **John Harris - Nestlé Head of European PetCare**

We're always evaluating our asset base. We have some assets that we need to get rid of and we still have some. And we're always looking at that and we will over time, because of the markets declining, they will dictate that we do that. We're also making investments in our assets in terms of increasing the capacity of these small cans, the pouches and the super premium. So we're doing a little bit of both but we've tremendously reduced our asset base. When you shut down nine factories over three years it's a big jump. But we're always looking at it; that's one of the key things that make your money in this business. In terms of utilisation we have a concept that we believe in and it's called 'sweat' asset. In pet food we make money when you're running at 80% utilisation of the assets. You make a lot of money and so that's how we're running the business. We want high utilisation of assets. It depends on where you look at it. In terms of the wet cat, in terms of these cats, it's not there. In terms of the pouches, in terms of the dry we're in the 90%.

### **Question #12**

#### **Other business beyond the seven key brands & Double digit growth in Europe**

Looking at your seven key brands, they're all growing double digit but overall your European business is still pretty much flat. Could you give us an insight about first what is the other part of the business that is not part of the seven leading brands? And secondly, when will the growth pick up in Europe and we'll see double digit growth overall?

## **John Harris - Nestlé Head of European PetCare**

We decided from a strategic standpoint we were not going to make a dramatic change and exit these businesses all at one time. So fundamentally systematically we've decided that we're going to milk these brands down. So what you see in the portfolio are these cans and if you look at the category, Nielsen share will tell you that these cans are going down 9% on the cat and 5% on the dog. 10, 9 whatever, so that part's going down and it will continue to go down probably for the next three years. But our goal is not to have a big dramatic change, a big drop, we want to manage the business so that fundamentally long term we are able to maintain our market share. We don't want to have a dramatic loss of market share. But these cans are going down and we're trying to take as much cash as we can out of them.

### **Participant**

So basically overall in Europe you'll still have relatively flat sales for the next three years?

## **John Harris - Nestlé Head of European PetCare**

Well our growth this year being 2005 will be equal to or better than our growth in 2004. So our growth will be equal to or better than last year and we had growth last year overall.

**Question #13****P&G Iams market share loss & ONE success & Expected response from Mars**

Could you talk further about the slide that you have on taking share from P&G Iams business and premium dry cat food? That's a big progress and it looks like maybe it's in the UK, I can't tell where that slide was from. And then also the success you had in Switzerland with the ONE dry cat that grew so sharply. And then weave those answers back into an analysis of what might be the response from Mars as they've lost so much share; what do you expect from them? And then certainly P&G to see those kinds of out performances by Nestlé must also lead to some possible response. So firstly how did you succeed and then what might you expect?

**John Harris - Nestlé Head of European PetCare**

We've been able to succeed based upon a couple of things. One being product quality; our product from a performance standpoint is better than Mars. The palatability is better than Iams and better than Mars, so we've been able to succeed there. We've also been able to succeed in that we've got a lot more focus in our organisation in terms of selling super premium. Our communications, you saw the commercials, we're spending a little bit more money in terms of PFME, in terms of communications. And also last year this gentleman here gave me little extra funds to spend to drive some of these businesses. We always debate on that and we focused some of that money. So basically we've been driving those brands. So from an investment standpoint, a communications standpoint and a quality standpoint and an organisation standpoint.

The reaction from Mars ? I don't know what Mars will do so I'm not going to tell you what they're going to do. But I know their industrial structure is based on this. This is their industrial structure (big cans). They announced, first in the year they were shutting down one of their factories. I know their volume is going down 10% on these cans. I know they've got a problem. Their first reaction has tried to prop this can up and then they stopped trying to prop the can up. In Germany, someone mentioned Germany, their biggest market they have, they took a price decline on these cans. We didn't follow them on those cans because we're trying to get as much money as we can out of it. But they took a price decline on these cans. Then they raised the price back up because the price decline didn't generate any more revenue. So I don't know what Mars is going to do but I do know Mars is a good competitor, they'll compete. I know that Iams is trying to figure out, or P&G is trying to figure out what is going to be the role of Iams. Since the Iams' acquisition they've made a lot of other acquisitions, all of which have been in health and beauty aid and the Iams, from my perspective is getting quite fit. But they've got a great brand, the rumour is they're looking to expand that brand. They're looking to introduce the Iams product in France, they currently have no presence in France now, they're looking to go in France and try to build the business but we'll see. But all that is rumours and we've been hearing these rumours for a number of years. But P&G since the new CEO took over has taken a "wait and see" attitude in terms of expanding the Iams' business. So we'll see what they do. I can't tell you what they do.

<b>Question #14</b> <b>Global consumers in pet care</b>
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OK and lastly Peter Brabeck talks about the fact that there are no global consumers on the food side. What's your sense about the pet side in terms of the ability to go across our markets?

**John Harris - Nestlé Head of European PetCare**

I used to be head of the worldwide SBU for PetCare. The attitude that people have about their dogs is universal. We've done a segmentation study about attitudes about pets and we've identified these five consumers. Now the number of consumers or how big these consumers will vary depending on the market, but they're people that have a great love for their dogs and cats and they are people that the dog and cat is a companion and there's people that believe the dog and cat are just obstacles. But fundamentally it's universal so we do have in our opinion a universal consumer for pet care. And that's why we've taken the brand and tried to make these brands global; our objective is to make these brands global and make these concepts global and it's worked for us because we've taken concepts right off North America. The ads you saw in terms of Beneful, that's the North American ad. We've dubbed the French in or dubbed whatever language in and we ran it; we ran it in Holland with great results. We're doing well with it in France now. So the concepts we believe are universal.

**Participant**

*(Unable to hear)*

**John Harris - Nestlé Head of European PetCare**

Yes, isn't that nice? There's two, it's actually two per household that has them, there's 2.3 households that have them.

**Participant**

*(Unable to hear)*

**John Harris - Nestlé Head of European PetCare**

Yes. In North America about half the people have a dog or a cat and the people that have a dog or a cat tend to have more than one. And particularly cats. And it's amazing, you guys don't have dogs or cats, but I have a dog. And I had two dogs but they died and then I bought another dog. I got a dog, a great dog, the dog's a year old. My daughter who is 10 years old came up to me and said it's time for us to get a second dog. I said why do we need a second dog? The other dog is lonely in the daytime. And in my house now there's a rebellion going on because I don't want a second dog. In my house there's a rebellion going on which I'm going to lose to get two dogs. And fundamentally the people who like animals, one oh that's no problem, two it's almost like having kids, we'll have two. And that's what happens. It's kind of like I'll talk to my mother, you went to school to get an MBA to spend all your time talking about dog and cat food. But the emotional attachment that people have with dogs and cats are incredible. The bond is incredible. And they will talk forever about them and it's love. And two is good and they'll have two. And some places you'll read stories where they



have 19 cats in a house; they'll make the news. But fundamentally people that have it have an emotional attachment and the key thing from a marketing standpoint is targeting and finding those consumers. For us the internet, being focused on the internet is key, focusing in on those consumers and once we get those consumers to work with them, we send them blankets, we send them dog bowls, we send them Christmas cards, we send them birthday cards. It is an infinity business; it's much like you would do if you were selling Louis Vuitton bags or Four Seasons Hotels, you send birthday cards and Christmas cards. That's how we run the business. And that's what makes it a fascinating business and that's what makes it a very profitable business to us too. Those consumers will spend.

## **Participant**

*(Unable to hear)* don't cost that much so what's the value to them ????

## **John Harris - Nestlé Head of European PetCare**

Well the canning lines do cost but didn't cost that much, it does cost, and they're shifting to pouches, they're shifting to smaller cans too. They're shifting. But they have so much embedded in this and then they don't have the know-how in dry. They're not a dry company. Mars is a wet company. We are a dry company. Their whole strategy is based on getting consumers to buy more wet. Fundamentally we believe that dry is the most efficient way to feed an animal, not only from a cost standpoint but from a nutrition standpoint so it's a bet. Our bet is on dry, their bet is on wet. Our bet is on Super Premium, they're betting on Super Premium too, they see the trend there and they're participating in trading consumers up also.

<b>Question #15</b> <b>Opinion leaders</b>
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Can you talk a bit about what sort of effort you put into reaching out to the opinion formers like the vets etc? And how in Europe does that compare with the US? And I don't know, could you give us an insight as to how much of your marketing budget would be dedicated to that sort of area?

## **John Harris - Nestlé Head of European PetCare**

I don't know the specifics in the marketing budget but we do quite a few vet conferences where we actually send out to the vets. We do a lot of work with the breeders and dog shows and for example Crufts which is the biggest dog show in the world, the last two winners at Crufts were Pro Plan dogs; dogs who were fed our product. And also, it happened to be for the first time the winner in North America and the winner in Europe were the same dog and they were all Pro Plan dogs. So fundamentally we work with the breeders, we work with the vets, we send lots of publications, we have symposiums, we have all kinds of conferences and meetings to try to bring that group together. I can't tell you the exact, how much money we spend but we do focus a lot of resources. We have a whole team that works on that. And it's done quite well. If you go to Crufts in the UK you'll see a big Purina stand.

## **Participant**

*(Unable to hear)*

## **John Harris - Nestlé Head of European PetCare**

Yes and we tend to co-ordinate this business from a global perspective so we sit down every three months and share best practice across the whole category. So Pat McGinnis (Head of Nestlé Purina PetCare Americas), myself and the guy from AOA, we'll get in a room and talk about how do we deal with vets; how do we deal with pet speciality stores; how our organisation looks; how shall we spend our R&D money; what's giving us the best bang for the buck so to speak; what's working and what's not working. And we take those ideas and we implement them in the markets as quickly as we possibly can. But there's a lot of interaction between the regions.

### **Question #16**

#### **GLOBE implementation in UK Nestlé Purina & Overall benefits of GLOBE**

I note that the GLOBE systems implementation occurred in the UK Nestlé Purina business last year. Can you talk about how that went from your perspective, the roll out? And secondly from your perspective what the benefits of operating under the GLOBE system are?

## **John Harris - Nestlé Head of European PetCare**

The GLOBE system is basically SAP based, a lot of discipline, a very disciplined system. And sometimes our manufacturing processes or how we manufacture items or how we schedule our factories didn't have a discipline. The GLOBE system bought us a whole lot of discipline and it's bought us a whole lot of transparency in terms of our manufacturing operation. We can see what's going on in the factories and we can look at it daily if need be. We can see what the ingredients are, what's going in, what's going out, what are the issues we're having. So from that standpoint, from a manufacturing standpoint it's been incredible. We've got a lot of reports in terms of customers from input, how we're doing with the customers. The implementation of GLOBE itself was hard because it required a lot of people to change the way they do business; to change their lifestyle on how they approach business, to be more disciplined. And I think from a business standpoint it's going to pay off because what we have now I think is a more disciplined organisation, particularly in the area of cost. So I'm looking for a positive result there, I'm seeing it in the factories already. I anticipate I'll see it in the way we look at our marketing synergies too, but discipline and cost and focus is what GLOBE brings.

### **Question #17**

#### **Timescale to perceive GLOBE benefits**

In what sort of time horizon do you perceive that the GLOBE benefits will really start to come through? My understanding of your answer is that you can see that they're potentially there but they're not happening at the moment.

## **John Harris - Nestlé Head of European PetCare**

I can see the cost things right away. I can see managing the supply chain right away. I know what's going on in the factories in the UK. Unfortunately I only have a couple of factories in the UK but I understand what's going on in the factories in the UK, the cost structures right

away. That comes through right away. The marketing end in terms of leveraging the customer, better understanding what's going on there, that probably will take some time but the cost structure should come right away.

<b>Question #18</b> <b>Risks to objectives</b>
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You've naturally enough focused on the opportunities and spelt those out pretty clearly. From your point of view, what would you say the main risks would be to your ambitions to grow the margin and the share? Is it private label? Is it Mars? Is it changes in consumer behaviour which you may not have anticipated? Could you just sort of look at it from that angle?

**John Harris - Nestlé Head of European PetCare**

For us we spend a lot of time looking at potential threats to our business. We go through and we look at it, we've analysed. Mars is a fantastic company, they're doing some fantastic things, they're a threat and we've got to watch them. But the way we watch them is not by looking backwards. The way we watch them is by looking forwards. The same thing with private label, we look forward. And by that I mean we focus on renovation, innovation to be best in class. To make sure our products all have 60/40, that we're at the cutting edge. If we're able to do that we think we can drive the business ahead and that's what's worked for us. And so we are concerned, yes I'm concerned about private label, yes I'm concerned about Mars but what I'm betting on and the big bet is on our R&D facility having the ability to provide us with the innovation and the renovation that will put us way ahead of our competition. And that's why when I showed you the palatability in terms of where we are on the 60/40, we spend a lot of time and a lot of research to be ahead at 60/40. I talked about the relationships that we have with the US taking the best ideas and the best practices and implementing them as quickly as we can into Europe. So the key is innovation, not looking back and worrying about them. We're conscious of them but we've got to innovate. We've got to improve the quality of our products. If we do that we'll be able to increase or still improve our market share. But I respect Iams, I respect Mars, I respect the private label guys. And the categories where we stand, where the businesses stand or sit still, this is a 14 ounce can, these big cans, that's where private label's caught us. But they've not caught us where we've innovated, and that's the key. We've got to innovate, we've got to have the 60/40, we've got to have nutrition on it, we've got to promise and deliver against a longer life. We can't stand still, that's the whole thing. And these cans sit still a little bit too long.

**Roddy Child-Villiers - Nestlé Head of Investor Relations**

John thank you very much.

*END OF CONFERENCE*