

(as at May 31, 2020)

Business Description:

Nestlé S.A. is a nutrition, health and wellness company which engages in the manufacture, supply and production of prepared dishes and cooking aids, milk-based products, pharmaceuticals and ophthalmic goods, baby foods and cereals. The company's products portfolio includes powdered and liquid beverages, water, milk products and ice cream, nutrition and health science, prepared dishes and cooking aids, confectionery and pet care. The company was founded by Henri Nestlé in 1866 and is headquartered in Vevey, Switzerland.

Investment Thesis:

- **Shift to Premiumization:** Nestlé's portfolio has become significantly more focused on premium products over time. This is backstopped by key customer trends including demand for more natural products, organic products, vegan/plant-based foods and sustainable packaging. Customers have shown a willingness to spend a larger percentage of income on products with the above attributes, thus enhancing revenue opportunities for Nestlé.
- **Disciplined Mergers and Acquisitions Strategy:** Before deploying capital on a merger, the target must meet the following criteria:
 - **Strategic fit:** Targets must provide a degree of synergistic benefits to Nestlé. So the company generally seeks smaller food, beverage and nutrition operators. Targets must also be engaged in high growth markets or have an e-business presence.
 - **Financial return:** Management is prudent with investor capital. Prior to an acquisition, management will only consider a target that will immediately add growth or margin benefits as well as generate a return on invested capital above Nestlé's cost of capital in 5-7 years time.
 - **Cultural fit:** Nestlé will not consider an acquisition if integration of cultures proves to be too challenging.
- Mergers are a key pillar of Nestlé's value-creation strategy, and a disciplined acquisition approach is crucial to the long-term success for us as investors.
- **Portfolio Management:** Nestlé is focused on optimizing its product portfolio. This includes divesting any business that underperforms and using that excess capital to deploy into its more successful business segments.
- **History of Dividend Growth:** Nestlé (in Swiss francs) has grown its dividend for over 20 consecutive years. Moreover, it has bought back over CHF 67 billion in stock since 2005, an indication that management is dedicated to enhancing shareholder value over time.
- **Starbucks Integration:** One of Nestlé's most notable and recent acquisitions was the purchase of Starbucks' brand license. Nestlé was able to "plug in" Starbucks branded coffee products into their vast global network far more efficiently than Starbucks would have been able to as a stand-alone entity. Nestlé has recently rolled out Starbucks branded packaged coffee, Nespresso pods, coffee creamers and cold brew products across the globe.
- **Digital Transformation:** Nestlé is investing in digital transformation across marketing, social media, e-commerce, manufacturing and supply chains. This helps it become data-powered, develop new business models, and deliver more personalized products, messages and services for its consumers. During 2019, the company also became the first major food and beverage company to pilot open blockchain technology. This allows consumers to track their food right back to the farm. This is part of Nestlé's journey toward full supply chain transparency and traceability.
- **Net-Zero Emissions:** In 2019, Nestlé announced its ambition to achieve zero net greenhouse gas emissions by 2050. Some of its specific steps include speeding up the transformation of products to lower its environmental footprint, scaling up initiatives in agriculture to absorb more carbon and using 100% renewable electricity in Nestlé sites. During 2021, the company will lay out a time-bound plan including interim targets consistent with the 1.5°C path.

Industry Growth/Drivers:

- **Capturing Geographical Opportunities:** Nestlé sees key growth opportunities in the following markets:
 - **Greater China:** China currently comprises 30% of current sales in the Asia, Middle East, Africa and Oceania regions, but offers an attractive long-term growth profile as the middle class continues to grow.
 - **Sub Saharan Africa:** Nestlé is focused on increased product penetration and providing affordable, accessible nutrition for the entire region.
- **Seizing Digital Opportunities:** As consumers are becoming increasingly hyper-connected, the digitalization of retail has emerged as an attractive growth market for Nestlé. The company is focused on building out 'mobile first' markets, which include cross border e-commerce, product personalization and establishing a global digital platform/presence to reach more consumers.

NESTLÉ S.A.



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Major Competitors:

- The Hershey Company
- Mondelez International Inc.
- The Kraft Heinz Company
- Pepsico, Inc.
- Unilever PLC
- Danone
- Mars

Barriers to Entry:

- **Iconic Global Brands:** Nestlé manufactures some of the most recognizable products in the world. Some of these brands include: KitKat, Nescafe, Nespresso, San Pellegrino and Coffee Mate.
- **Scale:** In a hyper competitive food and beverage market, scale advantage is critical to reduce corporate costs and maintain healthy margins over time. Nestlé's global distribution network is one of the best in the world and would be near impossible to replicate for a new entrant.

- **Distribution Network:** Nestlé operates a highly sophisticated global logistics network that would be difficult for new entrants to replicate.
- **Shelf Space:** Due to Nestlé's long operating history and portfolio of iconic brands, new entrants would be unable to capture the amount of shelf space that Nestlé currently occupies.

Officers & Directors:

Paul Bulcke, Chairman of the Board; **Mark Schneider**, Chief Executive Officer; **Francois-Xavier Roger**, Chief Financial Officer; **Stefan Palzer**, Chief Technology Officer; **Leanne Geale**, General Counsel

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Financial Summary:**Income Statement (CHF millions, years ended December 31st)**

	2015	2016	2017	2018	2019
Revenue	89,083	89,786	89,922	91,750	92,865
COGS	44,730	44,199	45,571	46,070	46,647
Gross Profit	44,353	45,587	44,351	45,680	46,218
Net Profit	9,066	8,531	7,156	10,135	12,609
Earnings per Share	3	3	2	3	4

Balance Sheet

Total assets	123,992	131,901	133,210	137,015	127,940
Long-term debt	9,629	12,118	11,211	14,694	14,032
Total equity	63,986	65,981	62,229	58,403	52,862

Statement of Cash Flow

Cash from operations	14,302	15,582	14,199	15,398	15,850
Cash from investing	(4,153)	(6,123)	(4,950)	(14,266)	8,356
Cash from financing	(12,235)	(6,184)	(9,084)	(4,117)	(21,156)
Dividends paid	(6,950)	(6,937)	(7,126)	(7,124)	(7,230)

Key Ratios and Figures (%)

Gross profit margin	49.8%	50.8%	49.3%	49.8%	49.8%
Return on assets	7.3%	6.5%	5.4%	7.4%	9.9%
Long-term debt / equity	15.0%	18.4%	18.0%	25.2%	26.5%

Source: MorningStar



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