

# Creditreform Corporate Rating

Nestlé AG (Group)

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Rating object	Rating information	
<b>Nestlé AG (Group)</b>  Creditreform ID: 406421612 Incorporation: 1866 (Main) industry: Food manufacturer Management: Ulf Schneider, CEO	Rating: <b>AA</b>	Outlook: <b>stable</b>
	Prepared on: Monitoring until: Publication: Rating type: Rating systematic: Rating history:	<b>April 3, 2017</b> withdrawal of the rating April 10, 2017 <b>unsolicited</b> corporate rating www.creditreform-rating.de

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## Abstract

### Company

Nestlé AG ("Nestlé", "Nestlé Group" or "the Group") is the world's leading food company, employing approx. 328,000 people in about 190 countries and manufacturing thousands of nutrition, health and wellness products.

In 2016, Nestlé generated sales of CHF 89.5 billion (2015: CHF 88.8 billion) and a consolidated surplus of CHF 8.9 billion (2015: CHF 9.5 billion). Higher tax expenses caused a palpable drop in the 2016 profits (- 6.2 %) despite a slight increase of revenues (+ 0.8 %). On the operating level, Nestlé managed to compensate higher sales and marketing costs through cost efficiency drives, generating EBIT of CHF 13.2 billion, CHF 0.8 billion more than in 2015. The Group reached an organic growth rate of 3.2 %, better than most comparative industry figures but still lower than the previous year's rate of 4.2 %.

For 2017, Nestlé expects a continuation of the generally positive trend of recent years, re specifically an organic growth rate of 2 to 4 % and an increase of sustainable profits. In the light of its plans to restructure some parts of the business, Nestlé Group expects no more than stable earnings for 2017. We believe that the company will be able to achieve its targets despite the fact that it is operating in a challenging business environment. We also believe that Nestlé is in an excellent position to meet these challenges, due to a strong position on the market and solid balance sheet structures.

### Rating result

This rating attests Nestlé a very high level of financial strength and a very low default risk. We believe that the company will continue to survive on the global market, despite a challenging business environment. One important factor is the highly diversified product portfolio that is firmly entrenched in the market as well as continuously cultivated and developed with a high level of innovative strength. Nestlé is dedicating increasing amounts of energy and resources to the development of therapeutic food and healthcare products that promise rapid growth and high margins. Due to its financial strength and solid balance sheet structures, Nestlé should be well capable of reaching its strategic targets. Nevertheless and despite the company's excellent market position, falling sales and profits in the wake of an economic downturn or geopolitical problems cannot be totally ruled out. Such an adverse development would, however, only temporarily and moderately affect Nestlé's overall business.

### Outlook

The one-year outlook of the rating is stable. It is based on the assumption that the economic environment and the global currency markets will remain relatively stable, without Nestlé being able to derive an outperformance from this. We have also assumed that Nestlé will not make large acquisitions or engage in major share buyback programmes, either activity being liable to involve significant increases of debt. Based on the solid foundations of the business and the determination to continue the pursuit of ambitious efficiency targets, we believe that Nestlé will be capable of

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achieving growth objectives that are in the upper range of what seems possible given the probable development of the industry as a whole.

## Relevant rating factors

Financial ratios' extract <sup>1</sup> Basis: consolidated annual statement per 31.12 (IFRS)	Standardized balance sheet	
	2015	2016
Total assets	CHF 105.4 billion	CHF 112.6 billion
Revenues	CHF 89.1 billion	CHF 89.8 billion
EBITDA	CHF 15.6 billion	CHF 16.3 billion
EBIT	CHF 12.4 billion	CHF 13.2 billion
EAT	CHF 9.5 billion	CHF 8.9 billion
Equity ratio	46.0%	44.9%
Capital lock-up period	69.8 days	75.7 days
Short-term capital lock-up	13.5%	16.7%
Return on investment	9.6%	8.5%
Net debt / EBITDA adj.	3.3	3.2
Ratio of interest expenses to debt	1.3%	1.2%

## General rating factors

- + Global market presence
- + Global market leader with a diversified portfolio of product and brands
- + Continuous growth and stable cash flow
- + Low level of debt
- + High levels of financial provisions, free access to the capital market
- Currency risks (Swiss Franc, emerging markets)
- Raw material prices are highly volatile
- Consumer behaviour can change quickly
- High level of competition
- Reputational risks (quality, food safety, compliance with ethical principles)

## Current factors (rating 2017)

- + Solid financial ratios, e.g. an operating margin of 15 %
- + Large free cash flow
- + The product portfolio is being developed through the addition of healthcare and therapeutic food products
- Weakening global growth
- Organic growth restricted to 2 - 3 %
- Restructuring process will require time and resources

<sup>1</sup> The reported key figures are based on the calculation method of Creditreform Rating. They often differ from the original key figures of the rating object.

### Prospective rating factors

- + Increasing the organic growth rate to more than 5 %
- + Improving the operating margin (currently 15.3 %)
- + Improving the leverage ratio (net debt / adjusted EBITDA) to under 3
- + Retaining the cash flow representing more than 30 % the level of debt
- + A booming global economy
  
- A global economic recession
- Weakening organic growth
- A significant decrease of the cash flow from operating activities
- Image loss or calls for a boycott of certain Nestlé products due to quality issues or allegations of insufficient nutritional value

Best case: AA

Worst case: AA-

#### Note:

The scenarios are based on the information available at the time of the rating. Within the forecast horizon, some circumstances could occur that would lead to a rating change out of the indicated range.

### Best case scenario

We underpinned our best case scenario for Nestlé (time horizon: one year) with revenue and profit growth figures that slightly exceeded their current levels. Given the somewhat uncertain and challenging market conditions in which the Group operates, however, such a development alone would not justify a rating upgrade.

### Worst case scenario

Under a worst case scenario (time horizon: one year), a decline of the rating to a level of AA- would be possible. Such a downgrade could, for example, be triggered by a substantial downturn of the global economy and a deterioration of the geopolitical situation which would in turn adversely affect the business development and the financial ratios, requiring an adjustment of the strategic targets.

## Business development and outlook

In 2016, Nestlé generated sales of CHF 89.5 billion (2015: CHF 88.8 billion) and a consolidated surplus of CHF 8.9 billion (2015: CHF 9.5 billion). The fall in profit was mainly caused by a rise in tax expenses, primarily a result of an adjustment of deferred taxes. On the operating level, Nestlé managed to offset higher sales and marketing costs through cost efficiency drives, increasing its EBIT to CHF 13.2 billion, CHF 0.8 billion more than in 2015.

Nestlé achieved an organic growth rate of 3.2 % (2015: 4.2 %), a higher rate than most of its competitors but failing again – as in previous years – to reach the long-term target organic growth rate of (on average) 5 %. Nestlé defines the “organic growth rate” as the rate of corporate expansion without taking into account acquisitions, disposals and currency fluctuations.

Nestlé Group did not develop evenly across its individual product divisions. While the divisions Beverages, Pet Care and Water registered organic growth rates of approx. 5 %, the divisions Milk Products and Ice Cream, Prepared Dishes and Confectionery grew at a significantly slower pace. The division Nutrition (therapeutic food and healthcare products) equally failed to meet Nestlé’s expectations of generating high revenue growth rates. It did, however, produce an operating margin in excess of 20 %, as did the divisions Pet Care and Beverages, while the other divisions were less profitable (although still generating double-digit earnings).

The individual divisions generated the following results in the business year 2016:

Categories / Segments	2016		
	Revenues (CHF billion)	Organic revenue growth (%)	Operating margin (%)
Powdered and Liquid Beverages	19.8	4.6	20.8
Milk products and Ice cream	14.3	1.6	18.4
Prepared dishes	12.1	2.7	15.0
Nestlé Nutrition	15.0	1.5	22.7
PetCare	12.1	5.3	21.0
Confectionery	8.7	1.8	13.7
Water	7.4	5.0	12.2

For 2017, Nestlé expects a continuation of the generally positive trend of recent years, with an organic growth rate of 2 to 4 % and an increase of sustainable profits. In the light of its plans to make significant investments into the restructuring of certain business segments, Nestlé Group expects no more than stable earnings for 2017. We believe that the company will be able to achieve its targets despite the fact that it is operating in a challenging business environment. We also believe that Nestlé's business is very safe, due to a strong position on the market and solid balance sheet structures.

### Structural risks

Nestlé is the largest food company in the world, generating annual revenues of approx. CHF 90 billion through sales in nearly all countries (190). The group's parent company is Nestlé AG, which is domiciled in the Swiss town of Vevey. Most of the stock capital is owned by domestic and foreign institutional investors (79 %), with private investors accounting for the remaining 21 %. The majority of Nestlé's shares is held by investors in Switzerland (36 %) and the USA (30 %), followed by the UK, Germany and Belgium with contingents of 4 to 5 % each.

Nestlé's operations have been divided into the following three geographical regions ("Zones") and globally managed business units, so-called reportable operative segments:

- Zone Europe, Middle East and Northern Africa (EMENA)
- Zone North and South America (AMS)
- Zone Asia, Oceania and sub-Saharan Africa (AOA)
- Nestlé Water
- Nestlé Nutrition
- Other business activities

Including its globally managed business units, Nestlé generates 45 % of its revenues through sales of food and beverages (from a total of seven categories) in AMS, 30 % in EMENA and 25 % in AOA.

Nestlé operates a comprehensive research and development system to ensure that its product portfolio remains aligned with the changing requirements of the market. Through a process of "renovation and innovation" in the company's traditional product segment of food and beverages, this R&D unit also identifies markets with specifically high levels of potential growth (such as, currently, the health and wellness sector) and develops suitable products for them, always striving to ensure a sustainable corporate development.

Earlier this year, Nestlé hired a new CEO, Ulf Schneider, the former Chairman of the healthcare group Fresenius. It is planned that his predecessor will succeed the current Chairman (the supreme supervisory and executive organ of Swiss stock companies) in April 2017, upholding Nestlé's tradition of continuity on the highest managerial levels.

By the end of 2015, Nestlé employed approx. 328,000 people worldwide, 7,000 fewer than twelve months before (a fall of 2.1 %), continuing the downward trend of previous years. The AOA region accounted for a disproportionately large share (33 %) of this headcount.

We believe that its well-established structures and global market presence will enable Nestlé to ensure its survival on the market for the foreseeable future.

### Business risks

One key business risk for Nestlé is a possible loss of consumer trust, in the wake of a hypothetical non-compliance with safety rules and quality standards in the production and processing of food. Any disregard for environmental policies and ethical principles might equally cause a sustained damage to the corporate image and reputation. Nestlé operates a strict system of controls, carefully supervising all processes and activities that are concerned, in order to prevent any such event or at least to limit the damage it can cause.

Nestlé's business model largely depends on the company's ability to anticipate changes in consumer behaviour and to provide products that reflect current trends. Any loss in the company's ability to anticipate and react to such trends might adversely affect its future business development. Nestlé is also dependent on a sustained supply of raw materials and services. Natural catastrophes and radical changes of the global trade system or the flow of goods could interrupt its supply chain and cause shortages or disproportionate rises in purchase prices. Nestlé's highly diversified infrastructure has been designed to avoid and bypass any such problems or to restrict their consequences. Finally, there are the risks to which Nestlé is exposed due to the international footprint of its business activities: country risks, the risk of climate change, the uncertain development of the currency and raw material markets. These risks must be seen in the perspective of Nestlé's large and diversified product portfolio and its diversified (in effect global) operating base.

Based on its well-established structures, Nestlé is aiming for a sustained organic growth rate of roughly 5 %, exceeding the long-term average expectations of the industry. The strategic focus is placed on the core competence portfolio of nutrition, health and wellness products. Nestlé intends to enhance this portfolio through innovation, a commitment to high quality and improvements of the nutritional value profiles and to develop new high-margin business segments with good prospects for further growth, following the exemplary and successful expansion of Nestlé's therapeutic food and medical skin care businesses. Over the past few years, this strategy was responsible for the disposals of L'Oréal (cosmetics) and Davigel (frozen products) as well as the acquisition of Galderma (pharmaceuticals). The 2016 joint venture with the UK-based ice cream manufacturer R&R, one of the world's leading companies within the industry, can also be seen in this context.

In its current state, Nestlé already owns a broad and highly diversified portfolio of brands and products with a relatively low susceptibility to fluctuations of external factors. This wide-ranging portfolio includes items such as frozen products, beverages (coffee, tea, mineral water), dairy products and confectionery as well as pharmaceutical products, special food products, baby products and pet supplies. It features well-known brands such as Nescafé, Nesquik, Maggi, KitKat, Smarties, Alete, Bübchen, Felix and many more.

In our view, it is reasonable and plausible to expect a continuously stable and positive business development of Nestlé, based on the company's product policies and its well-established, future-oriented market positioning strategies.

### Financial risks

Nestlé's financial structures are highly solid. Our structured analysis of the annual statement for 2016 revealed an equity ratio of 44.9 % (2015: 46.0 %), far above the average, and net debt (as per the cutoff day) of only CHF 13.9 billion, equivalent to 1.2 times the generated EBITDA. The ratio of net debt and adjusted EBITDA is similarly low with a multiple of 3.2. The debtor structure appears

sufficiently diversified. The debt – mainly bonds and commercial papers – is almost evenly split between short-term and long-term liabilities.

As per the cutoff day for the 2016 annual statement, Nestlé had access to unused credit facilities with a total volume of USD 7.1 billion and € 4.1 billion in addition to liquid and cash equivalents with a total volume of CHF 9.3 billion, providing additional reassurance for the company's ability to meet its payment obligations. On top of that, Nestlé owns a range of mid-term to long-term investments (bonds, shares, equity funds, commercial papers) with a total value of approx. 10 billion that could be monetized if necessary, and a non-core business interest in L'Oréal, the leading company on the global market for cosmetics, which was valued (as per the cutoff day of the 2016 annual statement) at approx. CHF 24 billion. Nestlé Group also benefits from a well-developed cash flow that (in 2016) exceeded the total volume of the company's net debt. In the light of these figures, Nestlé appears to operate from a highly secure financial base.

## Financial ration analysis

### Key ratios

Vermögensstruktur	2013	2014	2015	2016
Fixed asset intensity (%)	70,46	69,97	71,94	71,44
Asset turnover	0,88	0,86	0,86	0,83
Asset coverage ratio (%)	71,18	73,40	67,31	66,12
Liquid funds to total assets (%)	6,90	7,82	5,51	8,26
Kapitalstruktur				
Equity ratio (%)	47,50	48,57	45,96	44,89
Short-term-debt ratio (%)	32,21	28,98	31,62	33,86
Long-term-debt ratio (%)	2,66	2,78	2,47	2,34
Capital lock-up period (in days)	63,51	69,28	69,81	75,73
Short-term capital lock-up (%)	14,22	11,98	13,52	16,73
Gearing	0,96	0,90	1,06	1,04
Finanzkraft				
Cash flow margin (%)	14,56	20,10	13,92	13,46
Cash flow ROI (%)	13,16	16,27	11,77	10,73
Debt / EBITDA adj.	3,31	4,18	3,65	3,81
Net Debt / EBITDA adj.	2,87	3,54	3,28	3,24
ROCE (%)	21,68	17,02	20,42	21,63
Rentabilität				
EBIT interest coverage	15,37	14,13	17,11	17,37
EBITDA interest coverage	19,10	18,09	21,50	21,50
Ratio of interest expenses to debt (%)	1,58	1,32	1,27	1,22
Return on investment (%)	10,84	13,69	9,58	8,45
Return on equity (%)	22,11	29,03	19,30	18,04
Net profit margin (%)	11,31	16,22	10,63	9,89
Interest burden (%)	104,84	167,55	102,93	101,01
Operating margin (%)	14,15	11,87	13,93	14,66
Liquidität				
Cash ratio (%)	19,49	22,64	14,66	20,96
Quick ratio (%)	65,87	75,36	63,87	62,01
Current ratio (%)	91,72	103,63	88,72	84,34

## Regulatory requirements

The present rating is an unsolicited corporate rating. Creditreform Rating AG was not commissioned by the company with the preparation of the rating. The present analysis was prepared on a voluntary basis.

The rating is based on the analysis of published information and on internal evaluation factors. The quantitative analysis is primarily based on the annual report for 2016 and on press releases of the company. The information and documents meet the requirements and are in accordance with the published Creditreform Rating AG's rating methodology. An electronic version of our rating methodology can be found on our website [www.creditreform-rating.de](http://www.creditreform-rating.de).

The rating was prepared by analysts Klaus Geukes ([k.geukes@creditreform-rating.de](mailto:k.geukes@creditreform-rating.de)) and Christian Konieczny ([c.konieczny@creditreform-rating.de](mailto:c.konieczny@creditreform-rating.de)).

A Rating Committee of highly qualified analysts of Creditreform Rating AG was called on March 29, 2017. The analysts presented the results of the quantitative and qualitative analyses and provided the Committee with a recommendation for the rating decision. After the discussion of the relevant risk factors, the Rating Committee arrived at a unanimous rating decision.

The rating result and a draft of the present rating report were communicated to Nestlé on April 4, 2017. The final version of the rating report has been sent to Nestlé on April 3, 2017.

The rating will be monitored as long as CRA removed the rating and set it to non-rated (n.r.).

In 2011 Creditreform Rating AG was registered within the European Union according to EU Regulation 1060/2009 (CRA-Regulation). Based on the registration Creditreform Rating AG (CRAG) is allowed to issue credit ratings within the EU and is bound to comply with the provisions of the CRA-Regulation.

## Conflict of Interests

No conflicts of interest were identified during the rating process that might influence the analyses and judgements of the rating analysts involved or any other natural person whose services are placed at the disposal or under the control of Creditreform Rating AG and who are directly involved in credit rating activities or approving credit ratings and rating outlooks.

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## Rules on the Presentation of Credit Ratings and Rating Outlooks

The approval of credit ratings and rating outlooks follows our internal policies and procedures. In line with our policy "Rating Committee," all credit ratings and rating outlooks are approved by a rating committee based on the principle of unanimity.

To prepare this credit rating, CRAG has used following substantially material sources:

1. Annual Report
2. Website
3. Internet research.

There are no other attributes and limitations of the credit rating or rating outlook other than displayed on the CRAG website. Furthermore CRAG considers satisfactory the quality and extent of information available on the rated entity. In regard to the rated entity Creditreform Rating AG regarded available historical data as sufficient.

Between the disclosure of the credit rating to the rated entity and the public disclosure no amendments were made to the credit rating.

The "Basic data" information card indicates the principal methodology or version of methodology that was used in determining the rating, with a reference to its comprehensive description.

In case where the credit rating is based on more than one methodology or where reference only to the principal methodology might cause investors to overlook other important aspects of the credit rating, including any significant adjustments and deviations, Creditreform Rating AG explains this fact in the credit rating and indicates how the different methodologies or these other aspects are taken into account in the credit rating. This information is integrated in the credit rating report.

The meaning of each rating category, the definition of default or recovery and any appropriate risk warning, including a sensitivity analysis of the relevant key rating assumptions, such as mathematical or correlation assumptions, accompanied by worst-case scenario credit ratings as well as best-case scenario credit ratings are explained.

The date at which the credit rating was released for distribution for the first time and when it was last updated including any rating outlooks is indicated clearly and prominently in the "Basic data" card as a "Rating action"; first release is indicated as "initial rating", other updates are indicated as an "update", "upgrade or downgrade", "not rated", "confirmed", "selective default" or "default".

In the case of a rating outlook, the time horizon is provided during which a change in the credit rating is expected. This information is available within „Basic data“ information card.

In accordance to Article 11 (2) EU-Regulation (EC) No 1060/2009 registered or certified credit rating agency shall make available in a central repository established by ESMA information on its historical performance data, including the ratings transition frequency, and information about credit ratings issued in the past and on their changes. Requested data are available at the ESMA website: <https://cerep.esma.europa.eu/cerep-web/statistics/defaults.xhtml>.

An explanatory statement of the meaning of Creditreform`s default rates are available in the credit rating methodologies disclosed on the website.

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