Alternative Performance Measures
July 2018 Edition

Nestlé

Good Food, Good Life

Definitions of Alternative Performance Measures

The Annual Report, the Half-Yearly Report and other communication to investors contain certain financial performance measures, which are not defined by IFRS, that are used by management to assess the financial and operational performance of the Group. Management believes that these non-IFRS financial performance measures provide useful information regarding the Group's financial and operating performance. Such measures may not be comparable to similar measures presented by other companies. The main alternative performance measures used by the Group are explained and/or reconciled with our IFRS measures (Consolidated Financial Statements and/or Condensed Interim Financial Statements) in this document.

Foreword

The July 2018 Edition of the Alternative Performance Measures includes the impacts of:

- the restatement of the 2017 figures of the Consolidated Financial Statements of the Nestlé Group 2017 following, among others, the implementation of IFRS 15 Revenue from Contract with Customers and IFRS 16 Leases; and
- other accounting policies and presentation changes of the Consolidated Income statement.

2017 restated figures of the Consolidated Financial Statements of the Nestlé Group 2017 have been published in March 2018 and can be found in the Half-Yearly Report 2018 and as a separate document "Nestlé Group – 2017 Restatements" under www.nestle.com/investors/publications. These represent the new baseline for the 2018 Performance Measures. As the restatement concerns only the 2017 figures (no restatement of 2016 figures), a comparison of the evolution year-over-year of certain Performance Measures between the published 2016 figures and the 2017 restated figures is not possible due to different basis of measurement and presentation. Therefore, year-over-year evolution, as well as published 2016 figures, are presented for information only. Finally, Return on Invested Capital and Working Capital as a % of Sales are presented only on a yearly basis as not relevant at the end of an Interim period.

The July 2018 Edition also considers the impact of the changes in 2018 of:

- Net Financial Debt and Free Cash Flow definitions; and
- Calculation of Return on Invested Capital (ROIC).

Finally, the July 2018 Edition is enhanced with the definition of Working capital as a % of sales.

Organic Growth (OG)

OG combines Real internal growth and Pricing and represents the growth of the business after removing the impact of acquisitions and divestitures and other changes in Group scope of activity, and exchange rate movements. This provides a "like-for-like" comparison with the previous year in constant scope and constant currency, enabling deeper understanding of the business dynamics which contributed to the Evolution of sales from one year to another.

For purposes of calculating OG (a) the sales of an acquired business are excluded for the 12 months following the business combination, but incremental sales generated by post-acquisition expansion of the business are generally included; and (b) sales of a divested business are removed from comparatives for the 12 months prior to the divestiture. Supply agreements related to the divested business are included in acquisitions and divestitures during a transitory period. The pricing impact of changes in the way that a business is transacted in an entire country (e.g. establishing a local operating company instead of exporting to a distributor, or vice versa) are included in acquisitions and divestitures, respectively.

The effects of changes in foreign exchange rates are calculated as the current year sales' values converted at the current year's exchange rates, less the current year's sales converted at the prior year's rates.

Real Internal Growth (RIG)

RIG represents the impact on sales of volume increases or decreases, weighted by the relative value per unit sold. It is calculated at the level of the individual product reference (stock keeping unit) per distribution channel, by comparing the weighted sales (this year's volumes valued at the prior year's prices in local currency) to the prior year's sales. At the product level, it is therefore primarily driven by changes in volume, while when aggregated at operating segments or Group level, it embeds the impact of the evolution of the product mix.

Sales of newly launched products are included from the moment of launch which tends to increase RIG, while products which are discontinued have a negative impact on RIG since the historical sales continue to be included in the prior year comparatives. This reflects in a balanced way the impacts of renovation and innovation and the impact on sales coming from ongoing product rationalisation efforts.

As RIG is a component of OG, it excludes the impact of acquisitions and divestitures, and exchange rates.

Pricing

Pricing is part of OG and represents the portion of sales growth caused by changes in prices over the period. It excludes the impact of RIG, as well as the impact of acquisitions and divestitures, and exchange rates.

Analyzing pricing allows management to assess the degree to which inflationary or deflationary factors have contributed to sales evolution, and the degree to which cost changes have been passed to customers.

Evolution of Sales

The Group uses OG (including RIG and Pricing), exchange rate impacts, and the effects of acquisitions and divestitures in order to understand the Evolution of sales from one year to the prior year (either the increase or the decrease in the current year's sales compared with the prior year's sales, expressed as a percentage).

Total Group

	January–June 2018	January–June 2017 Restated
Sales (in millions of CHF)	43 920	42 926
Evolution vs prior year (in %)	+2.3%	–0.3% *

* Not comparable with 2018 figures and for information only, since computed before application of IFRS 15, see Foreword in page 1.

The reconciliation of OG to the total Evolution of sales is as follows:

Total Group (In %)

	January–June 2018 vs January–June 2017	January–June 2017 vs January–June 2016 *
Real Internal Growth	+2.5%	+1.4%
Pricing	+0.3%	+0.9%
Organic Growth	**+2.8%**	**+2.3%**
Effect of exchange rates	–0.5%	–0.3%
Effect of acquisitions, divestitures and other changes in Group scope activity	+0.0%	–2.3%
Evolution of sales	**+2.3%**	**–0.3%**

* Not comparable with 2018 figures and for information only, since computed before application of IFRS 15, see Foreword in page 1.

Underlying Trading Operating Profit Margin

Underlying Trading operating profit margin is when Underlying Trading operating profit is calculated as a percentage of sales. Underlying Trading operating profit is Trading operating profit before the impact of Other trading expenses and Other trading income (mainly restructuring costs, impairment of property, plant and equipment, and litigations and onerous contracts). See note 4 of the Consolidated Financial Statements of the Nestlé Group 2017 for more details of Other trading expenses and Other trading income. (https://www.nestle.com/asset-library/Documents/Library/Documents/Financial_Statements/2017-financial-statements-en.pdf)

The exclusion of these items allows tracking and better understanding and prediction of the results due to the day-to-day trading activities under the control of the operational management in the business units. It excludes the impacts of decisions (such as factory closures, disposal of a piece of real estate, or restructuring plans) made in conjunction with Zone or GMB management, or litigations and disputes or events which distort the underlying performance due to their frequency or the unpredictability of the outcome.

The reconciliation of Underlying Trading operating profit to Trading operating profit is as follows:

Total Group

In millions of CHF except for Underlying Trading operating profit margin

	January–June 2018	January–June 2017 Restated
Trading operating profit	**6 391**	**6 472**
Add:		
Other trading income	(19)	(59)
Other trading expenses	691	408
Underlying Trading operating profit	**7 063**	**6 821**
Sales	**43 920**	**42 926**
Underlying Trading operating profit margin	**16.1%**	**15.9%**

Trading Operating Profit Margin

Trading operating profit margin is when Trading operating profit is calculated as a percentage of sales. Trading operating profit is a subtotal in the Consolidated Income statement, appearing above Operating profit. It excludes Other operating income and Other operating expenses. The items excluded from Trading operating profit represent the results of transactions and decisions taken at Group level and are largely out of control of management of the operating segments (such as acquisitions, disposals or strategic alliances), or the impacts of events which are irregular in nature and difficult to predict (such as wars or natural disasters).

Underlying Trading Operating and Trading Operating Profit Margins in Constant Currency

Profit margins in constant currency are calculated as the ratio between profits (see above) and Sales, adjusted to eliminate the impact of changes in exchange rates.

When comparing the year-on-year change in profit margins, it is useful to eliminate the impact of changes in exchange rates in order to isolate the results generated by business operations from the effect of translation of these results into Swiss francs. This is done by converting both Sales and profits of the current year at the exchange rate of the prior year. The resulting profit margins can therefore be compared with the reported profit margins of the prior year to understand fundamental business trends.

The reconciliation of profit margins in constant currency is as follows:

Total Group

In millions of CHF except for Trading operating profit margin

	January–June 2018	January–June 2017 Restated
Sales	**43 920**	**42 926**
Retranslation at prior year rates	188	142
Sales in constant currency	**44 108**	**43 068**
Underlying Trading operating profit	**7 063**	**6 821**
Retranslation at prior year rates	31	71
Underlying Trading operating profit in constant currency	**7 094**	**6 892**
Underlying Trading operating profit margin (as reported)	**16.1%**	**15.9%**
Reported evolution (in basis points)	+20 bps	0 bps *
Underlying Trading operating profit margin in constant currency	**16.1%**	**16.0%**
Evolution in basis points compared to prior year as reported Underlying Trading operating profit margin	+20 bps	+10 bps *
Trading operating profit	**6 391**	**6 472**
Retranslation at prior year rates	42	67
Trading operating profit in constant currency	**6 433**	**6 539**
Trading operating profit margin (as reported)	**14.6%**	**15.1%**
Reported evolution (in basis points)	–50 bps	–30 bps *
Trading operating profit margin in constant currency	**14.6%**	**15.2%**
Evolution in basis points compared to prior year as reported Trading operating profit margin	–50 bps	–20 bps *

* Not comparable with 2018 figures and for information only, since computed before application of IFRS 15, IFRS 16 and other changes. See Foreword in page 1.

Underlying Earnings Per Share (EPS)

Underlying EPS is calculated by adjusting Net profit attributable to shareholders of the parent to remove the effects of Other trading income and Other trading expenses, Other operating income and Other operating expenses, and related tax effects. An adjustment is also made to eliminate Other trading income and other trading expenses and Other operating income and other operating expenses included in the Income from associates and joint ventures.

Underlying EPS reflects the underlying earnings from trading operations for each share of Nestlé S.A.

Underlying Earnings Per Share (EPS) in Constant Currency

Underlying EPS in constant currency is used when comparing the year-on-year change in Underlying earnings per share to eliminate the impact of changes in exchange rates in order to isolate the results generated by business operations from the effect of translation of these results into Swiss francs. This is done by converting the Underlying EPS of the current year at the exchange rate of the prior year. The resulting figure can therefore be compared with the Underlying EPS of the prior year to understand fundamental business trends.

The reconciliation of Net profit to Underlying EPS in constant currency is as follows:

Total Group

In millions of CHF except for data per share or number of shares

	January–June 2018	January–June 2017 Restated
Net profit attributable to shareholders of the parent	**5 825**	**4 897**
Add:		
Restructuring costs	299	166
Impairment of property, plant and equipment, goodwill and intangible assets	384	120
Net result of disposal of businesses	(1 400)	(25)
Other adjustments in net other income/(expenses)	80	66
Adjustment for income from associates and joint ventures	153	86
Tax effect on above items and adjustment of one-off tax items	311	(78)
Adjustment in non-controlling interests	(7)	(8)
Underlying net profit	**5 645**	**5 224**
Retranslation at prior year rates	(62)	63
Underlying net profit in constant currency	**5 583**	**5 287**
Weighted average number of shares outstanding (in millions of shares)	3 035	3 098
Underlying EPS (as reported)	**1.86**	**1.68**
Underlying EPS in constant currency	**1.84**	**1.70**
Evolution in % compared to prior year as reported Underlying EPS (unrounded)	+9.2%	+3.4% *

* Not comparable with 2018 figures and for information only, since computed before application of IFRS 15, IFRS 16 and other changes, see comment in Foreword in page 1.

Net Financial Debt

Net financial debt represents the net level of financial debt contracted by the Group with external parties (e.g. bonds, commercial papers) after considering cash and investments readily convertible into cash. As per the table below, it is composed of the current and non-current financial debt less cash and cash equivalent and short-term investments. Since 2018 this measure also includes the derivatives hedging financial debt and liquid assets.

Total Group

In millions of CHF

	June 30, 2018	June 30, 2017 Restated
Current financial debt	15 756	14 779
Non-current financial debt	19 847	13 149
Derivatives [(a)]	(77)	785
Cash and cash equivalents	(4 615)	(3 954)
Short-term investments	(2 102)	(1 039)
Net financial debt	**28 809**	**23 720**

(a) Related to Net debt and included in Derivative assets and Derivative liabilities balances of the Consolidated balance sheet.

The reconciliation of the year-on-year Net financial debt evolution as published (see comment in Foreword in page 1) is disclosed in Note 16.6 of the Consolidated Financial Statements of the Nestlé Group 2017. (https://www.nestle.com/asset-library/Documents/Library/Documents/Financial_Statements/2017-financial-statements-en.pdf)

See Note 12.2e of the Consolidated Financial Statements of the Nestlé Group 2017, for more details on the monitoring of the Net financial debt. (https://www.nestle.com/asset-library/Documents/Library/Documents/Financial_Statements/2017-financial-statements-en.pdf)

Adjusted Earnings Before Interest, Tax, Depreciation and Amortization (Adjusted EBITDA)

Adjusted EBITDA is used as a measure of the ability of the Group to generate enough cash from earnings to repay its net financial debt. It is computed as follows:

Total Group

In millions of CHF

	January–June 2018	January–June 2017 Restated
Trading operating profit	**6 391**	**6 472**
Add:		
Net other trading income/(expenses)	672	349
Depreciation and amortisation	1 943	1 945
Adjusted EBITDA	**9 006**	**8 766**

When Net financial debt is divided by Adjusted EBITDA, this yields a ratio which is used to monitor the Group's financing capacity.

Free Cash Flow

Free cash flow represents the cash generating capability of the Group to pay dividends, repay providers of capital, or carry out acquisitions, if any. As per the table below, it equals Operating cash flow less capital expenditure, expenditure on intangible assets and other investing activities. Since 2018 the investments (net of divestments) in associates and joint ventures are excluded from the definition of the Free cash flow.

Reconciliation of Operating cash flow to Free cash flow is a follows:

Total Group
In millions of CHF

	June 30, 2018	June 30, 2017 Restated
Operating cash flow	4 399	3 384
Capital expenditure	(1 158)	(1 024)
Expenditure on intangible assets	(251)	(354)
Other investing activities	(106)	(112)
Free cash flow	**2 884**	**1 894**

Working Capital

The Group monitors average Working capital to evaluate how efficient it is at managing its operating cash conversion cycle.

Working capital is the sum of Trade Net Working capital, composed of inventories, trade receivables and trade payables, and other components such as some other receivables and other payables, some prepayments and accrued income, and some accruals and deferred income.

The average of Working capital for the last five quarters (that is, from the end of the prior year through each calendar quarter to the end of the current year) is divided by sales to determine the average Working capital as a % of Sales. Due to the fact that working capital as a percentage of sales is not meaningful when measured over less than 12 months, the Group generally calculates the Working capital as a percent of sales on a yearly basis.

Working Capital (continued)

The average Working capital as a percentage of sales is determined as follows:

Total Group

In millions of CHF

	5-quarters average 2017	5-quarters average 2016 *
Trade receivables	9 370	9 582
Inventories	9 397	8 617
Trade payables	(11 914)	(10 981)
Average Trade Working capital	**6 853**	**7 218**
Other receivables	2 435	2 541
Other payables	(4 593)	(4 450)
Other elements of Working capital (a)	(3 226)	(2 799)
Average of other elements of Working capital	**(5 384)**	**(4 708)**
Average of Working capital	**1 469**	**2 510**
Sales	**89 590**	**89 469**
Average Working capital as a % of Sales	**1.6%**	**2.8%**

* Not comparable with 2018 figures and for information only, since computed before application of IFRS 15, IFRS 16 and other changes, see comment in Foreword in page 1.

(a) Mainly composed of prepayments and accrued income (assets) and accruals and deferred income (liabilities).

Return on Invested Capital (ROIC)

Return on invested capital is a measure of performance which integrates both measures of profitability and measures of capital efficiency.

The numerator is Trading operating profit before Litigations and miscellaneous trading income/(expenses), net of tax. This figure is divided by average Invested capital during the year. Invested capital is a measure of the operational assets used to generate the results of the business, excluding financing, tax and cash-management activities. Further details of the definition of Invested capital can be found on Note 3 of the Consolidated Financial Statements of the Nestlé Group 2017.

(https://www.nestle.com/asset-library/Documents/Library/Documents/Financial_Statements/2017-financial-statements-en.pdf)

Return on Invested Capital before Goodwill and Intangible Assets

Return on invested capital before Goodwill (GW) and Intangible assets (IA) is used to eliminate the distortions caused by the different treatments of goodwill in the past and internally and externally generated intangible assets. This removes from the analysis the impact of varying acquisition activities over time.

This measure is calculated by removing the average goodwill and intangible assets value from the average invested capital (see above).

The calculation of Return on invested capital is shown below:

Total Group

In millions of CHF

	January–December 31, 2017 Restated		January–December 31, 2016 *	
	Before GW & IA	After GW & IA	Before GW & IA	After GW & IA
Trading operating profit	**13 277**	**13 277**	**13 693**	**13 693**
Add:				
Net other trading income/(expenses)	1 494	1 494	614	614
Underlying Trading operating profit	**14 771**	**14 771**	**14 307**	**14 307**
Less:				
Impairment of property, plant and equipment	(391)	(391)	(157)	(157)
Restructuring costs	(673)	(673)	(300)	(300)
Impairment of intangible assets (excluding goodwill and non-commercialized intangible assets)		(152)		(44)
Impairment of goodwill and non-commercialized intangible assets		(3 039)		(439)
Trading operating profit before litigations and miscellaneous trading income/(expenses)	**13 707**	**10 516**	**13 850**	**13 367**
Tax rate [(a)]	(3 701)	(2 839)	(4 155)	(4 010)
Trading operating profit before litigations and miscellaneous trading income/(expenses), net of tax	**10 006**	**7 677**	**9 695**	**9 357**
Average Invested capital (Note 3.2)	32 654	32 654	30 596	30 596
Average goodwill and intangible assets (Note 3.2)		51 931		52 592
Average Invested capital, goodwill and intangible assets		84 585		83 188
ROIC	**30.6%**	**9.1%**	**31.7%**	**11.2%**

* Not comparable with 2018 figures and for information only, since computed before application of IFRS 15, IFRS 16 and other changes, see comment in Foreword in page 1.

(a) 2017 restated figures based on the Group Underlying Tax Rate (UTR) of 27%.
2016 figures based on theoretical tax rate of 30%.

Notes