Dear Investor:

Third Point currently owns roughly 40 million shares of Nestlé. We hold this stake in our funds and in a special purpose vehicle raised for this opportunity. Our investment, including options, currently amounts to over $3.5 billion.

Nestlé, with an over $250 billion market capitalization, is the largest food business in the world and home to some of the world’s greatest brands. Its portfolio, including 34 brands that generate more than CHF 1 billion in sales annually, had roughly CHF 90 billion in total sales last year. The company operates across a number of advantaged categories including coffee, infant formula, pet food, and bottled water. Nestlé also has a strong footprint in emerging markets. The category and geographic mix of the portfolio is excellent and offers the company a long runway for growth as emerging market customers increase consumption and developed market consumers trade up.

However, despite having arguably the best positioned portfolio in the consumer packaged goods industry, Nestlé shares have significantly underperformed most of their US and European consumer staples peers on a three year, five year, and ten year total shareholder return basis. One year returns have been driven largely by the market’s anticipation that with a newly appointed CEO, Nestlé will improve.
Exhibit A: One, Three, Five and Ten Year Consumer Industry TSR’s

Nestlé has fallen behind over the past decade in an environment where growth has slowed due to changes in consumer tastes and shopping habits, as well as an influx of new competition from smaller, local brands. While its peers have adapted to this lower growth world, Nestlé has remained stuck in its old ways, making it impossible to deliver on the once reliable “Nestlé model” that called for 5-6% organic sales growth annually and continuous margin improvement. As a result, earnings per share have not grown in five years. This has had a knock-on effect on dividend growth, which has slowed to low single digits in recent years, and Nestlé’s payout ratio now stands at the upper end of the peer group range at 66%. Without addressing the company’s stalled earnings, further dividend increases will be unsustainable at historical rates. While Nestlé has stood still, its peers have pursued productivity increases aggressively and made other changes in order to deliver earnings growth and create shareholder value in a slower sales growth world.

Third Point invested in Nestlé because we recognized a familiar set of conditions that make it ripe for improvement and change: a conglomerate with unrealized potential for margin
improvement and innovation in its core businesses, an unoptimized balance sheet, a number of non-core assets, and a recent history of meaningful under-performance versus peers. It is rare to find a business of Nestlé’s quality with so many avenues for improvement.

Like other investors, we are also confident that Nestlé is prepared for change because of the company’s wise decision last year to hire a new Chief Executive with a high caliber pedigree from outside its ranks for the first time in nearly a century. Nestlé’s new leader, Dr. Ulf Mark Schneider, had an impressive track record of value creation as the CEO of Fresenius, a German medical supply company, from 2003 until he joined Nestlé. He delivered strong organic sales growth and executed well on transformational M&A, and shares appreciated at a roughly 20% CAGR during his tenure. As he settles into his role at Nestlé, we think he has the ability to execute on the kinds of new initiatives the company must pursue. However, we feel strongly that in order to succeed, Dr. Schneider will need to articulate a decisive and bold action plan that addresses the staid culture and tendency towards incrementalism that has typified the company’s prior leadership and resulted in its long-term underperformance.

Our observations and insights about the company have been bolstered by Jan Bennink, one of the world’s recognized leaders in the packaged goods space, who we have retained to advise us on this investment. Among other roles, Jan was a successful CEO of Royal Numico, which was the largest baby food company in Europe when he became its chief executive. At Numico, Jan divested non-core assets and cut costs in order to reinvest in the core business. His actions helped dramatically reaccelerate organic sales growth and expand margins before the company was sold to Danone for a huge premium. He then became the Executive Chairman of Sara Lee, where he oversaw its separation into two “pure play” companies: a North American branded meat company called Hillshire Brands, and a global tea & coffee company called DE Master Blenders 1753. He then led Master Blenders until it was sold to the Joh. A. Benckiser group.
Jan has direct operating experience in four of Nestlé’s key categories: coffee, baby food, medical nutrition, and dairy, as well as an unimpeachable record of substantial shareholder value creation. He brings deep expertise in packaged goods, which greatly enhanced our due diligence process and gives greater credibility to our investment thesis. Mr. Bennink has also invested a significant personal sum in the Third Point - Nestlé SPV.

Third Point intends to play a constructive role to encourage management to pursue change with a greater sense of urgency. We have offered our views in productive conversations with management, which we expect will continue. We believe Nestlé is positioned to create enormous value for shareholders over the next several years if the company focuses on: 1) Improving Productivity; 2) Returning Capital to Shareholders; 3) Re-shaping the Portfolio; and, 4) Monetizing its L’Oréal Stake. We discuss each of these in more detail below.

**Improving Productivity**

We believe Nestlé should adopt a formal margin target. While management has recently talked publicly about accelerating organic sales growth and delivering a better balance between growth and margin improvement, investors are skeptical. The company has highlighted over CHF 7.5 billion of cost savings since 2012 but these savings have not fueled faster organic sales or earnings growth, leaving shareholders to wonder what benefit Nestlé has gotten from them. Nestlé’s CY16 EBIT margin 15.3% (16% ex-items) is at the low end of its peers, nearly all of which are now targeting high-teens to low 20’s margins.
Exhibit B: 2017 Consensus Operating Margin Estimates

Our work suggests Nestlé should be able to improve margins by as much as 400 basis points over the next several years. We are not alone in our view, as well-respected analysts at investment banks including Goldman Sachs and Bank of America have identified a similar opportunity. As a result, we believe it would be appropriate for the company to set a formal margin target range of 18-20% by 2020. We are highly confident that this is achievable since Nestlé has already scoped out significant cost savings for the next few years via its ongoing “Continuous Excellence” productivity initiatives and a separate CHF 1.8 billion plan announced in 2016. Adopting a formal target range would remove uncertainty around reinvestment and give management the flexibility needed to meet their goals.

**Capital Return**

We believe capital return in conjunction with a formal leverage target makes sense as well. Nestlé’s remarkably low leverage of less than 1.0x net debt to EBITDA serves no real business purpose for a non-cyclical business with such strong cash flow and contrasts unfavorably with most peers, which fall within a leverage range of 2.0x to 4.0x. We believe
Nestlé should set a target of at least 2.0x, which would better optimize the company’s cost of capital. Getting to 2.0x and staying there would also produce enormous capacity for share buybacks over time. Share repurchase is a particularly attractive option at the moment since the company has the potential to grow earnings considerably over the next few years as sales growth reaccelerates and margins expand. Finally, buybacks offer an attractive alternative to M&A given the high multiples in Nestlé’s sector, offering similar EPS uplift with none of the integration risk.

**Re-Shaping the Portfolio**

It is past time for Nestlé to undergo a comprehensive portfolio review. The company operates today with over 2,000 brands in Food & Beverage and Health Science. Management must determine which of these businesses are key pillars of growth for the future and then strategically reduce exposure to those that are not. We were encouraged by management’s recent disclosure that they are considering a sale of the US confectionary business. Given large synergies to potential acquirers, we believe these kinds of businesses could fetch above-market multiples. Separating them could also help accelerate organic growth and free up internal resources (both time and money) to increase focus on priority areas. We also think it makes sense for Nestlé to consider accretive, bolt-on acquisitions in high growth and advantaged categories.

**Monetizing the L’Oréal Stake**

It is also time for Nestlé to sell its stake in L’Oréal. The company acquired 29% of L’Oréal, the global leader in beauty products, in 1974 and sold 6% in 2014. This has been a superb investment, and the remaining 23% stake is equivalent to more than $25 billion, or roughly 10%, of Nestlé’s market capitalization today. However, having L’Oréal in the portfolio is not strategic and shareholders should be free to choose whether they want to invest in Nestlé or some combination of Nestlé and L’Oréal. Current conditions make this the right time to exit the remainder and we believe the stake can be monetized with limited tax or other consequences. We also believe that the L’Oréal stake could be divested via an exchange offer for Nestlé shares that would accelerate efforts to optimize its capital return.
policies, immediately enhance the company’s return on equity, and meaningfully increase its share value in the long run as earnings improve over a reduced share count.

**Conclusion**

As demonstrated by our significant capital commitment, we are enthusiastic about Nestlé’s prospects. The situation reminds us of similar conditions that existed when we first invested in Baxter in 2015. Some market observers scratched their heads, as they thought the company looked “expensive” and thus underestimated the uplift that is possible when a new leader dedicates himself to better capital allocation, portfolio optimization, and margin improvement with strong shareholder support.

We believe our recommendations to Nestlé management, if taken together, would dramatically improve both the growth profile and earnings power of the company. Portfolio re-shaping and productivity investments should help to re-accelerate organic sales growth from 2-4% this year to something in the mid-single digit range over the next few years. A formal margin and leverage target (with debt capacity used to repurchase shares) should help drive EPS from CHF 3.40 last year to CHF 5.00-6.00 by 2020. At that point, a more focused, faster growing Nestlé, with earnings per share more than 50% higher than today, would command a premium not just to the market but also to the broader staples group, generating attractive returns for shareholders. Importantly, improved earnings power will also bring the dividend payout ratio back in line, allowing Nestlé to reward shareholders with continued dividend increases and make the necessary investments in its business for the future.

We recognize that even with new leadership and clear options for value creation, change at a company like Nestlé can be complex. It is for this reason that Third Point intends to be an engaged, long-term shareholder and offer our assistance to the management team and Board as they pursue improved performance for all stakeholders. We are confident that by following the path we have outlined, Nestlé will be able to revive its iconic slogan, with a twist: *Nestlé makes the very best* returns for its shareholders.
Investor Relations is available to answer further questions about this new investment at 212.715.6707 or ir@thirdpoint.com. Thank you for your partnership.

Sincerely,

Third Point LLC

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