Nestlé

Good Food, Good Life

Half-Yearly Report

January/June 2004

Key figures (consolidated)

In millions of CHF (except for per share data)		January/June 2004	January/June 2003
Sales		42 454	41 437
EBITDA Earnings Before Interest, Taxes, Depreciation and Amortisation of goodwill		6 496	6 415
as % of Sales		*15.3%*	*15.5%*
EBITA Earnings Before Interest, Taxes and Amortisation of goodwill		5 122	5 045
as % of Sales		*12.1%*	*12.2%*
Net profit		2 838	2 780
as % of Sales		*6.7%*	*6.7%*
Capital expenditure		1 270	1 291
Equity, end June		37 519	34 871
Market capitalisation, end June		129 967	108 164
Per share			
Net profit	CHF	7.30	7.19
Underlying net profit [a]	CHF	9.18	9.48
Equity, end June	CHF	96.51	90.18

(a) Net profit before amortisation of goodwill, impairments, restructuring costs, results on disposals and significant one off-items. The above items have been adjusted for tax.

Principal key figures in USD (illustrative)

Income statement figures translated at average exchange rate, balance sheet figures at ending June exchange rate

In millions of USD (except for per share data)		January/June 2004	January/June 2003
Sales		33 534	30 694
EBITDA Earnings Before Interest, Taxes, Depreciation and Amortisation of goodwill		5 131	4 752
EBITA Earnings Before Interest, Taxes and Amortisation of goodwill		4 046	3 737
Net profit		2 241	2 059
Equity, end June		29 542	25 830
Market capitalisation, end June		102 336	80 121
Per share			
Net profit	USD	5.77	5.32
Equity, end June	USD	76.00	66.80

Principal key figures in EUR (illustrative)

Income statement figures translated at average exchange rate, balance sheet figures at ending June exchange rate

In millions of EUR (except for per share data)		January/June 2004	January/June 2003
Sales		27 337	27 791
EBITDA Earnings Before Interest, Taxes, Depreciation and Amortisation of goodwill		4 183	4 302
EBITA Earnings Before Interest, Taxes and Amortisation of goodwill		3 298	3 383
Net profit		1 827	1 864
Equity, end June		24 522	22 497
Market capitalisation, end June		84 946	69 783
Per share			
Net profit	EUR	4.70	4.82
Equity, end June	EUR	63.08	58.18

Overview

Introduction

The first half of 2004 was marked by a reversal in the trend of flat or falling raw material prices, which had lasted several years, with rises in most raw materials, including those which are key cost drivers to Nestlé's business: milk, coffee, sugar and energy, as well as crude oil related costs, such as rigid plastic and flexible packaging. The one exception was cocoa, which did not repeat the price levels experienced in 2003. Otherwise, there was a return to more normal trading conditions in most parts of the world, when seen in the light of the first half of 2003.

For Nestlé, after four years during which we achieved leadership positions in strategic categories through acquisitions, the first half of 2004 has witnessed the announcement or completion of significant disposals of non-strategic businesses. These disposals, in areas such as distribution, culinary and cocoa processing, have been central to our strategy to focus on the manufacture and marketing of high value-added, R&D-driven, food and beverage products.

Internally, the Group has continued to focus on improved efficiency through its Target 2004+ and Project FitNes programmes, facilitated by the GLOBE project which remains on track. These initiatives have enabled the Group to deliver an improved performance in the face of higher raw material and packaging costs and increased investment in brands. The decision to continue investing in brands and market positions in spite of higher raw material and packaging costs reflects the long-term nature of the Company's strategy.

Financial Review

Sales

At constant currencies, sales grew 3.6%, while reported sales increased 2.5% to CHF 42.5 billion. Organic growth was 4.6%, consisting of real internal growth (RIG) of 2.8%, higher than in 2003, and pricing of 1.8%. There was an adverse foreign exchange impact of 1.1%, whilst divestitures, net of acquisitions, reduced sales by 1%.

Profitability

The Group's **EBITA** increased 1.5% to CHF 5.1 billion, but the margin declined 10 basis points to 12.1% of sales. This reflects the net impact of the inclusion in our consolidated results of Dreyer's Grand Ice Cream and the exclusion of divested businesses, including Trinks, as well as the impacts of currency movements and raw material prices. At constant currencies, the EBITA margin would have increased by 10 basis points. If one excludes also the impact of acquisitions and divestitures to reach a like for like comparison, margins improved 20 basis points.

Net profit increased 2.1% to CHF 2.8 billion, giving an unchanged net profit margin of 6.7% of sales. An increase in the net financing cost was balanced by a lower tax charge. **Earnings per share** grew 1.5%, in line with EBITA.

Financial position

Nestlé continued to have a strong financial position, underpinned by strong cash flow. **Cash flow** from operations increased from CHF 3.1 billion to CHF 3.3 billion.

Capital expenditure fell slightly as a percentage of sales, whilst cash expenditure on acquisitions, net of divestitures, was significantly reduced.

Net indebtedness fell from CHF 21.1 billion at end of the corresponding period of 2003 to CHF 15.4 billion at 30th June 2004. The ratio of net debt to equity fell from 59% at the end of June 2003 to 40% mid 2004.

Business review

Trading conditions in the three key markets of **Zone Europe,** Germany, France and Great Britain, continued to be challenging, and were further impacted by the poor weather, resulting in organic growth for the Zone of –0.4%. The decline in EBITA margins for the Zone, from 12.2% to 11.4%, is a reflection of a weaker performance in Ice cream due to the poor weather, as well as increased marketing spend and higher raw material costs. Trading conditions in Eastern Europe continued to be dynamic, with near double-digit levels of organic growth achieved in the region.

The reported results of **Zone Americas,** which show a 90 basis point decline, are not comparable to the first half of last year, due to the inclusion in 2004 of Dreyer's. Excluding the US Ice Cream operations from the 2003 and 2004 results, the EBITA margin would have improved by 30 basis points. The Zone's organic growth reached 7.3%, with good performances, in particular, from Mexico and Nestlé Purina PetCare, as well as the smaller Latin American markets. There was also an improvement in trading conditions in Brazil, in spite of the continuing challenging economic conditions.

The trading environment in **Zone Asia, Oceania and Africa** improved over that in the first half of 2003. The Zone delivered organic growth of 7.3%, as well as a 10 basis point improvement in EBITA margins to 17.8%. There were good performances from most areas in the Zone, including such important markets as Oceania, Japan, Greater China, the Philippines and the Middle East.

Nestlé Waters experienced a 20 basis point decline in EBITA margins to 9.4%. This was a resilient performance in view of the weaker RIG than in the first half of 2003 and negative pricing. The business has been held back, in particular, by the poor European weather, as well as by comparisons with last year's European heat wave. The North American market has been somewhat more dynamic than last year, with organic growth above 10%.

There was a strong performance from the **Other activities,** with organic growth of 10.9%, as well as a good improvement in margins. The reported margin improvement includes the positive impact of the disposal of Trinks. Even excluding this, the EBITA margin would have improved 290 basis points, helped particularly by a strong performance by Alcon.

There was a mixed performance from the **product groups,** although the figures were distorted by the disposal of Trinks and the acquisition of Dreyer's, where the integration is proceeding well. The reported 140 basis point decline in EBITA margin in **Milk products, nutrition and ice cream** would have been a 20 basis point increase if the US Ice Cream operations had been excluded from the 2003 and 2004 results. In **Beverages,** meanwhile, the 120 basis point improvement in the reported EBITA margin was entirely accounted for by the sale of Trinks. **PetCare** continued to increase its margins, whilst **Chocolate, confectionery and biscuits** achieved a recovery from the raw material-impacted margins of the first half of 2003. **Prepared dishes and cooking aids** experienced a decline in margins, reflecting primarily difficult trading conditions in North America.

Outlook

The first half of 2004 has seen a deterioration of the general environment for manufacturers due to the rise of raw material and packaging costs. Western Europe has also continued to be a very challenging market, even without the poor weather. On the other hand, trading conditions in Asia, Oceania and Africa and Latin America have improved, and a more positive market sentiment is expected in North America in the second half of the year. Consequently, the Group expects an acceleration in organic growth to its trend target of between 5 and 6 percent for the full year. The Company also expects to deliver a higher constant currency EBITA margin and improved cash flow for the full year.

Consolidated income statement for the period ended 30th June 2004

In millions of CHF	Notes	January/June 2004	January/June 2003
Sales to customers	2	42 454	41 437
Cost of goods sold		(17 506)	(17 607)
Distribution expenses		(3 676)	(3 323)
Marketing and administration expenses		(15 475)	(14 901)
Research and development costs		(675)	(561)
EBITA Earnings Before Interest, Taxes and Amortisation of goodwill		5 122	5 045
Net other income (expenses)		(94)	(150)
Amortisation and impairment of goodwill		(808)	(727)
Profit before interest and taxes		4 220	4 168
Net financing cost	3	(332)	(191)
Profit before taxes		3 888	3 977
Taxes		(1 190)	(1 301)
Net profit of consolidated companies		2 698	2 676
Share of profit attributable to minority interests		(228)	(190)
Share of results of associates	4	368	294
Net profit		2 838	2 780

As percentages of Sales		
EBITA Earnings Before Interest, Taxes and Amortisation of goodwill	12.1%	12.2%
Net profit	6.7%	6.7%

Earnings per share (in CHF)		
Basic earnings per share	7.30	7.19
Fully diluted earnings per share	7.20	7.11

Consolidated balance sheet as at 30th June 2004

In millions of CHF	Notes		30th June 2004		31st December 2003		30th June 2003
Assets							
Current assets							
Liquid assets							
Cash and cash equivalents		4 800		7 074		5 963	
Other liquid assets		10 213		8 054		6 872	
			15 013		15 128		12 835
Trade and other receivables			12 804		12 851		13 647
Inventories			7 891		6 995		8 038
Derivative assets			529		669		758
Prepayments and accrued income			628		590		567
Total current assets			36 865		36 233		35 845
Non-current assets							
Property, plant and equipment							
Gross value		42 110		41 778		42 837	
Accumulated depreciation		(24 735)		(24 339)		(25 231)	
			17 375		17 439		17 606
Investments in associates			2 857		2 707		2 668
Deferred tax assets			1 527		1 398		1 396
Financial assets			2 536		2 394		2 888
Employee benefits assets			1 123		1 070		1 079
Goodwill			26 619		26 745		29 653
Intangible assets			1 686		1 575		1 379
Total non-current assets			53 723		53 328		56 669
Total assets			90 588		89 561		92 514

In millions of CHF	Notes		30th June 2004		31st December 2003		30th June 2003
Liabilities, minority interests and equity							
Current liabilities							
Trade and other payables			9 358		9 852		10 093
Financial liabilities			16 795		15 419		18 189
Tax payable			750		549		735
Derivative liabilities			678		846		698
Accruals and deferred income			3 706		3 699		3 839
Total current liabilities			31 287		30 365		33 554
Non-current liabilities							
Financial liabilities	5		13 580		14 064		15 725
Employee benefits liabilities			3 434		3 363		3 385
Deferred tax liabilities			466		576		677
Other payables			253		309		273
Provisions			3 015		3 061		3 143
Total non-current liabilities			20 748		21 373		23 203
Total liabilities			52 035		51 738		56 757
Minority interests			1 034		943		886
Equity							
Share capital			404		404		404
Share premium and reserves							
Share premium		5 926		5 926		5 926	
Reserve for treasury shares		2 091		2 458		2 776	
Translation reserve		(5 516)		(5 630)		(3 771)	
Retained earnings		36 757		36 093		31 993	
			39 258		38 847		36 924
			39 662		39 251		37 328
Less:							
Treasury shares			(2 143)		(2 371)		(2 457)
Total equity			37 519		36 880		34 871
Total liabilities, minority interests and equity			90 588		89 561		92 514

Consolidated cash flow statement for the period ended 30th June 2004

In millions of CHF	January/June 2004	January/June 2003
Operating activities		
Net profit of consolidated companies	2 698	2 676
Depreciation of property, plant and equipment	1 244	1 252
Impairment of property, plant and equipment	28	–
Amortisation of goodwill	808	727
Depreciation of intangible assets	130	119
Increase/(decrease) in provisions and deferred taxes	(133)	(14)
Decrease/(increase) in working capital	(1 322)	(1 863)
Other movements	(106)	183
Operating cash flow	3 347	3 080
Investing activities		
Capital expenditure	(1 270)	(1 291)
Expenditure on intangible assets	(252)	(269)
Sale of property, plant and equipment	76	77
Acquisitions [a]	(308)	(1 327)
Disposals	67	14
Income from associates	200	153
Other movements	(20)	8
Cash flow from investing activities	(1 507)	(2 635)

[a] 2003 comparatives exclude the CHF 3.4 billion payable for the Dreyer's acquisition recorded under non-current financial liabilities.

In millions of CHF		Januar/June 2004		Januar/June 2003
Financing activities				
Dividend for the previous year	(2 800)		(2 705)	
Purchase of treasury shares	(111)		(249)	
Sale of treasury shares and options	497		298	
Premium on warrants issued (repaid)	–		(0)	
Movements in minority interests	(99)		(113)	
Bonds issued	377		2 014	
Bonds repaid	(295)		(40)	
Increase/(decrease) in non-current financial liabilities	(383)		(61)	
Increase/(decrease) in current financial liabilities	841		(1 255)	
Decrease/(increase) in marketable securities and other liquid assets	(2 153)		439	
Decrease/(increase) in short-term investments	16		760	
Cash flow from financing activities		(4 110)		(912)
Translation differences on flows		(68)		80
Increase/(decrease) in cash and cash equivalents		(2 338)		(387)
Cash and cash equivalents retranslated at beginning of year				
Cash and cash equivalents at beginning of year	7 074		6 338	
Effects of exchange rate changes on opening balance	64		12	
		7 138		6 350
Cash and cash equivalents at end of period		4 800		5 963

Consolidated statement of changes in equity

In millions of CHF	Share premium	Reserve for treasury shares	Translation reserve	Retained earnings	**Total reserves**	Share capital	Less: Treasury shares	**Total equity**
Equity as at 31st December 2002	5 926	2 830	(4 070)	32 307	36 993	404	(2 578)	34 819
Gains and losses								
Net profit				2 780	2 780			2 780
Currency retranslation			299		299			299
Taxes on equity items				54	54			54
Fair value adjustments on available-for-sale financial instruments								
– Unrealised results				(38)	(38)			(38)
– Recognition of realised results in the income statement				(9)	(9)			(9)
Fair value adjustments on cash flow hedges and on hedges of net investments in foreign entities								
– Unrealised results				(369)	(369)			(369)
– Recognition of realised results in the income statement				(9)	(9)			(9)
Total gains and losses			299	2 409	2 708			2 708
Distributions to and transactions with shareholders								
Dividend for the previous year				(2 705)	(2 705)			(2 705)
Movement of treasury shares (net)		(54)		54	–		54	54
Result on options and treasury shares held for trading purposes				(72)	(72)		67	(5)
Premium on warrants issued [a]				(0)	(0)			(0)
Total distributions to and transactions with shareholders		(54)		(2 723)	(2 777)		121	(2 656)
Equity as at 30th June 2003	5 926	2 776	(3 771)	31 993	36 924	404	(2 457)	34 871

[a] Partial redemption of the Turbo Zero Equity-Link bond issue

In millions of CHF	Share premium	Reserve for treasury shares	Translation reserve	Retained earnings	**Total reserves**	Share capital	Less: Treasury shares	**Total equity**
Equity as at 31st December 2003	5 926	2 458	(5 630)	36 093[a] [b]	38 847	404	(2 371)	36 880
Gains and losses								
Net profit				2 838	2 838			2 838
Currency retranslation			114		114			114
Taxes on equity items				(9)	(9)			(9)
Fair value adjustments								
on available-for-sale								
financial instruments								
– Unrealised results				80	80			80
– Recognition of realised results								
in the income statement				(2)	(2)			(2)
Fair value adjustments								
on cash flow hedges and								
on hedges of net investments								
in foreign entities								
– Unrealised results				1	1			1
– Recognition of realised results								
in the income statement				31	31			31
Total gains and losses			114	2 939	3 053			3 053
Distributions to and								
transactions with shareholders								
Dividend for the previous year				(2 800)	(2 800)			(2 800)
Movement of treasury shares (net)		(367)		367	–		386	386
Result on options and treasury								
shares held for trading purposes				158	158		(158)	–
Total distributions to and								
transactions with shareholders		(367)		(2 275)	(2 642)		228	(2 414)
Equity as at 30th June 2004	5 926	2 091	(5 516)	36 757[a] [b]	39 258	404	(2 143)	37 519

[a] Includes a negative Hedging Reserve of CHF 5 million (2003: negative CHF 32 million)

[b] In the event of a redemption of the Turbo Zero Equity-Link bond issue, part of the USD 123 million premium received in June 2001 on warrants issued would be repaid, i.e. up to USD 47 million in 2006.

Annex

Accounting policies

The unaudited interim financial statements comply with the recognition criteria and the measurement methods of International Financial Reporting Standards (IFRS) issued by the International Accounting Standards Board (IASB) and with those of the Standing Interpretations issued by the International Financial Reporting Interpretations Committee (IFRIC) of the IASB.

The accounting conventions and accounting policies are the same as those applied in the 2003 Consolidated accounts, with the exception of IFRS 3 on business combinations, which impacts the accounting treatment of all new acquisitions as from 31st March 2004 onwards.

These standards comprise in particular IFRS 2 on share-based payments, IFRS 3 on business combinations together with the consequential changes of IAS 36 on impairment of assets and IAS 38 on intangible assets, IFRS 5 on non-current assets held for sale and discontinued operations as well as the revision of existing IASs such as IAS 16 on property, plant and equipment, and IAS 32 and 39 on financial instruments. The Group is currently working on the implementation of these standards and, at this stage, only the new and/or revised standards covering the repeal of goodwill amortisation, as well as the treatment of employee stock options are likely, once implemented, to have an impact on the Group's reported results.

Consequences from the European Union's IFRS endorsement

As a Swiss company, the Group is not affected by the European Union decision requiring EU-listed companies to present their accounts in accordance with IFRS as from 2005. However the Group has complied with IFRS/IAS since 1989. Therefore the Group will comply from 1st January 2005 onwards with all the new IFRSs and revised IASs that are effective on this date.

Modification of the scope of consolidation

During the interim period, the scope of consolidation has been affected by acquisitions and disposals. The principal businesses are detailed below.

Fully consolidated

Disposal:
Trinks, Germany, distribution business, 51% (January)

Notes

1. Seasonality

The business of the Group does not present pronounced cyclical patterns, seasonal evolutions in some countries or product groups being compensated within the Group.

2. Segmental information

By management responsibility and geographic area

In millions of CHF	January/June 2004	2003	January/June 2004	2003
	Sales		EBITA	
Zone Europe [a]	13 999	13 763	1 596	1 674
Zone Americas	13 058	12 354	1 674	1 698
Zone Asia, Oceania and Africa	7 181	6 834	1 280	1 210
Nestlé Waters	4 128	3 948	387	379
Other activities [a] [b]	4 088	4 538	977	795
	42 454	41 437	5 914	5 756
Unallocated items [c]			(792)	(711)
EBITA Earnings Before Interest, Taxes and Amortisation of goodwill			5 122	5 045

(a) 2003 comparatives restated for Eismann, now reported in Other activities
(b) Mainly Pharmaceutical, Joint Ventures and, in 2003, Trinks
(c) Mainly corporate expenses as well as research and development costs

The analysis of sales by geographic area is stated by customer location. Inter-segment sales are not significant.

In millions of CHF	January/June 2004	2003	January/June 2004	2003
	Impairment of assets		Restructuring costs	
Zone Europe [a]	24	–	128	42
Zone Americas	1	–	7	51
Zone Asia, Oceania and Africa	2	–	9	28
Nestlé Waters	1	–	4	62
Other activities [a] [b]	–	–	3	4
	28	–	151	187

(a) 2003 comparatives restated for Eismann, now reported in Other activities
(b) Mainly Pharmaceutical, Joint Ventures and, in 2003, Trinks

By product group

In millions of CHF	January/June 2004	2003	January/June 2004	2003
	Sales		EBITA	
Beverages	10 847	11 195	2 000	1 924
Milk products, nutrition and ice cream	11 647	11 031	1 253	1 351
Prepared dishes and cooking aids	7 863	7 573	858	877
PetCare	4 865	4 674	674	641
Chocolate, confectionery and biscuits	4 486	4 415	297	272
Pharmaceutical products	2 746	2 549	832	691
	42 454	41 437	5 914	5 756
Unallocated items [a]			(792)	(711)
EBITA Earnings Before Interest, Taxes and Amortisation of goodwill			5 122	5 045

[a] Mainly corporate expenses as well as research and development costs

In millions of CHF	January/June 2004	2003	January/June 2004	2003
	Impairment of assets		Restructuring costs	
Beverages	5	–	21	86
Milk products, nutrition and ice cream	23	–	39	56
Prepared dishes and cooking aids	–	–	23	16
PetCare	–	–	29	1
Chocolate, confectionery and biscuits	–	–	36	28
	28	–	148	187
Administration, distribution, research and development			3	–
			151	187

3. Net financing cost

In millions of CHF	January/June 2004	January/June 2003
Interest income	236	421
Interest expense	(568)	(612)
	(332)	(191)

4. Share of results of associates

This item includes mainly our share of the estimated results of L'Oréal.

5. Bonds

The following bonds have been issued, repaid or partially repaid during the period:

Face value in millions	Interest rates Nominal	Effective	Year of issue/ maturity		January/June 2004 In millions of CHF
New issues					
Nestlé Finance-France S.A., France					
AUD 200	6.00%	6.03%	2004-2008	Subject to an interest rate and currency swap that creates	
				a EUR liability at floating rates.	175
USD 100	3.00%	2.25%	2004-2006	Increasing the USD 500 million bond issued in 2002.	
				Subject to an interest rate and currency swap that creates	
				a EUR liability at floating rates.	127
EUR 50	2.50%	2.95%	2004-2007	Increasing the EUR 100 million bond issued in 2003.	
				Subject to an interest rate swap that creates a liability at floating rates.	75
Total new issues					377
Full repayment					
Nestlé Capital Canada Ltd, Canada					
USD 200	5.50%	5.47%	1999-2004	Was subject to an interest rate and currency swap that created	
				a CAD liability at floating rates.	(249)
Partial repayment					
Nestlé Finance-France S.A., France					
EUR 30	4.75%	3.22%	2002-2007	Decreasing the EUR 400 million bond issued in 2002.	
				The interest rate swap that creates a liability at floating rates	
				was adjusted accordingly.	(46)
Total repayments					(295)

6. Dividends

The Company pays only one dividend in each financial year and does not pay interim dividends. The following dividend related to 2003 has been paid on 28th April 2004 in conformity with the decision taken at the Ordinary General Meeting on 22nd April 2004.

Dividend per share	CHF	7.20
resulting in a total dividend of [a]	CHF	2 800 482 012

[a] On 388 955 835 shares with right to dividend

7. Events after the balance sheet date

Garoto
The antitrust agency of Brazil (Administrative Council of Economic Defence or CADE) issued a ruling in February 2004 requesting Nestlé Brasil Limitada to sell the chocolate confectionery business, assets and intellectual property it acquired from the Meyerfreund Group when the purchase of 100% shares of Chocolates Garoto S.A. was completed in 2002. CADE said the combined operations of Nestlé and Garoto were a threat to fair competition. Nestlé is considering various options to resolve this matter with CADE. CADE has accepted to review the case in July 2004. The final outcome is expected by the end of the year.

Other subsequent events
After the date of the closing the Group had no subsequent adjusting events that warrant a modification of the value of the assets and liabilities.

Principal exchange rates

CHF per		June 2004	December 2003	June 2003	January/June 2004	January/June 2003
			Ending rates			Average rates
1 US Dollar	USD	1.27	1.24	1.35	1.266	1.350
1 Euro	EUR	1.53	1.56	1.55	1.553	1.491
1 Pound Sterling	GBP	2.28	2.20	2.24	2.307	2.174
100 Brazilian Reais	BRL	40.70	42.60	47.00	42.670	41.690
100 Japanese Yen	JPY	1.16	1.16	1.13	1.169	1.137
100 Mexican Pesos	MXN	11.00	11.00	13.00	11.340	12.730
1 Canadian Dollar	CAD	0.94	0.96	1.00	0.944	0.934
1 Australian Dollar	AUD	0.87	0.93	0.90	0.934	0.834
100 Philippine Pesos	PHP	2.25	2.23	2.53	2.262	2.526

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