

Nescafe China

From Seed to Cup

President of Nestle Beverage Division

Vevey, Switzerland

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Why are we here?

Nestle SA needs a real-world, implementable strategy to grow production operations in China

You asked?

- ➔ Should we work with farmers at grassroots level? No.
- ➔ Should we keep certifications like Fairtrade? Only Fairtrade.
- ➔ Should we look at backwards integration? Yes.

A solution brewed just right

Backward integration into farming to ensure Created Shared Value to all stakeholders

Benefits

- ➔ Secure supply
- ➔ Improved farmer welfare
- ➔ Improved margins
- ➔ Assured Quality

Executive Summary

Strategy	Micro-Strategy	Details
Lease Land	Farming	-30yr lease of 529 hectares in Pu'er, Yunnan Province (10% supply) -Manage in-line with 4C best practices -Expand by 10% year on year for next 5 years
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Certifications	Fairtrade	-Understood by consumers and adds value (drop others)
Create Shared Value	Best practices	-Implement practices individual farmers resistant too
	Education	-Onsite schools (educate and alternative to child labour)
	Training	-Offer retired farmers and Nestle training
	Environment	-Waste H ₂ O management, No slash & burn practices
	Nutrition	-Ensure staff have access to nutritious meals
	Living wage	-10% higher wage due to our cost savings
Existing supply	Do not cut loose	-Only phase out through attrition



The Robusto Plan

Andrea will grind down to the finer details

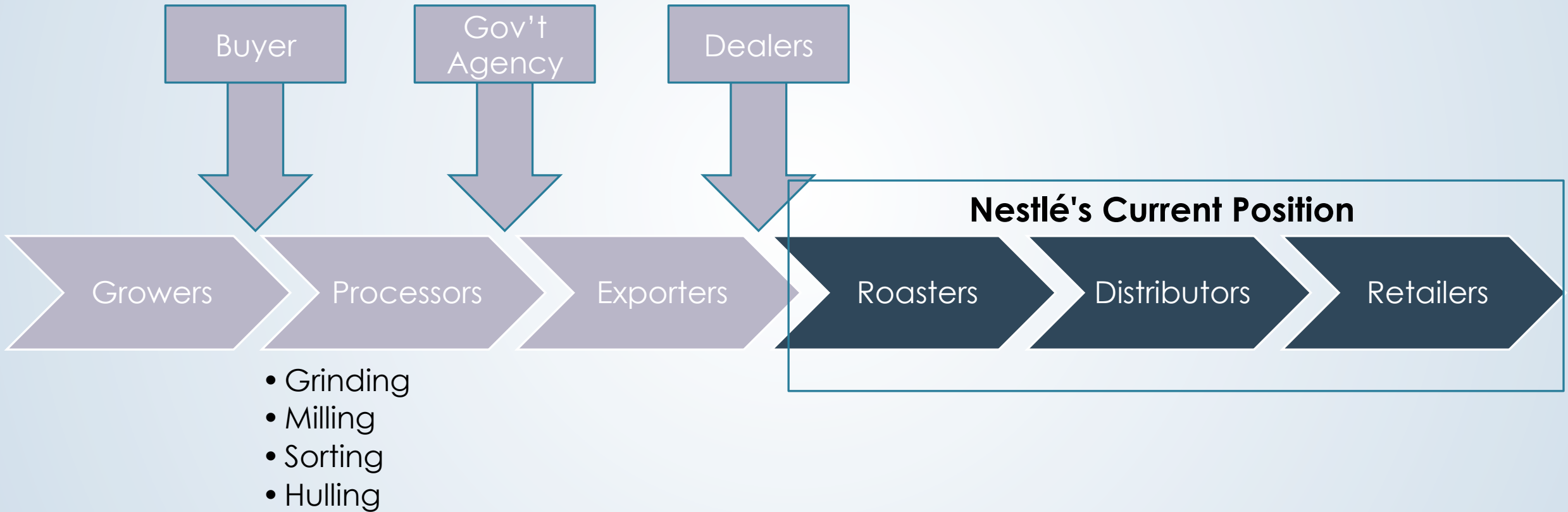
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The Coffee Supply Chain



Vertical Integration:

➤ Farming

- Lease 529 hectares of government land to establish Nestle coffee bean farms
- Traditional farming practices are not environmentally sustainable
 - Difficult to change the mindset of family farmers
- Future generations do not want to take over the labor intensive family farm
 - But, they may be interested in farming with new technologies
 - Nestle farms opens employment to anyone who wants to work, not just successors
- By vertically integrating and removing intermediaries, can maintain margins on farming
- Allows Nestle to introduce technology and ensure stable supply

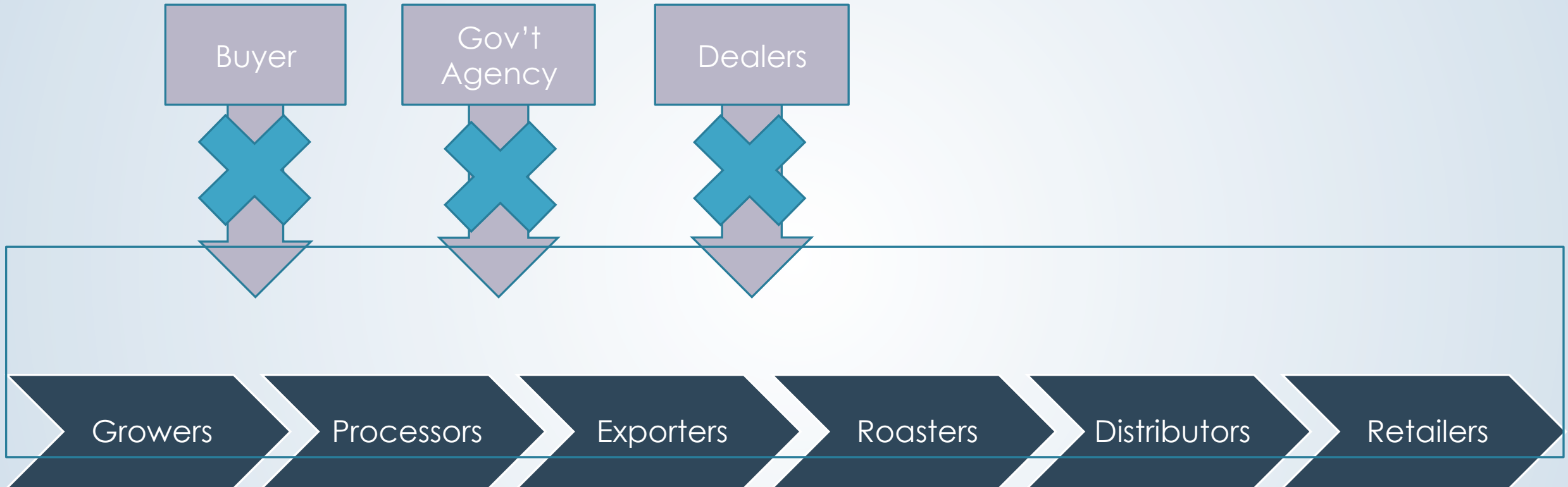
Vertically integrating into farming allows Nestle to ensure stable supply and remove intermediaries.

► Production Facilities:

- Build a production facility at the leased farm for grinding, milling, sorting, and hulling
- Control quality
- Can implement manufacturing best practices
 - Low water and power usage, safety standards
- Reduce costs by removing the intermediaries

Vertically integrating into production allows Nestle to better control quality, implement best practices, and lower costs.

Nestlé's Vertically Integrated Supply Chain



By vertically integrating, Nestle can remove the intermediary middle men and use increased profits towards creating shared value for farmers.

- Maintain supplier relationships with family farmers
- Where they are willing, educate them and assist them to implement sustainable farming practices
- There is demand for both Nestle farms and family farms
 - In the first 6 months of 2013, you procured as many beans from family farmers as you did in all of 2012
 - The Nestle farm will only supply 10% of next years demand
- **But, with aging farmers, we expect supply from this channel to decrease, and it is important to start your own farms now.**

There is enough demand to support family farms and a Nestle farm.

Certification: Fair Trade

- Become Fair Trade Certified
- It is well recognized by the consumer and therefore commands a premium in the market
- This premium can cover the cost of certification and the annual renewal fee and be used to create programs for healthy living conditions on the farm
- The goal of safeguarding the interests of marginalized farmers and their families aligns with Nestles values (nutrition, health, and wellness)
- Can drop other certifications: Not valued by consumer
 - Rain Forest alliance
 - C4 (but maintain best practices without cost of regulation)

Initiatives that increase the wellbeing of your employees and the sustainability of the land to increase productivity

1. Training

- Utilize training academy
- Farming best practices
- Safety

2. Education

- build a school in the local community of the Nestle farm
- Do not employ children on our farm
- Will allow children to attend school
- Will need to ensure employees receive a living wage to support their family

Initiatives that increase the wellbeing of your employees and the sustainability of the land to increase productivity

3. Nutrition

- Allocate land on the farming to other agriculture to feed your employees nutritious food

4. Rural Development

- Health Clinics

Nescafe Plan Metrics

- # of farmers trained: YES
- % of suppliers compliant with company sourcing policy: YES
- % purchased volume is compliant of the Nestle Supplier Code: YES



Brewing the Numbers

China Market Share

Coffee Market in China (2012)	
Chinese Market Value	1.14BN
Market Share in china	72.70%
Value (MN)	828.78
China share @ % of Coffee Sales (2012)	
Total Coffee Sales (Nestle)	11.35BN USD
China % Share	7%

Assumptions

- ▶ Chinese coffee production to grow by 30%
- ▶ Nestle market Share in china to increase by 3% annual
- ▶ Improvement in productivity to increase by 2%
- ▶ Average coffee price/tonne : USD 2200

Production Estimates

Coffee production Estimates	2012	2013	2014	2015	2016	2017
China production (tonnes) (Raw Beans)	80000	104000	135200	175760	228488	297034
Nestle market Share	72.70%	74.15%	75.64%	77.15%	78.69%	80.27%
Nestle Production	58160	77120	102261	135599	179804	238420
Productivity	50%	51%	52%	53%	54%	55%
Saleable coffee beans	29080	39331	53196	71949	97313	131617
Without Integration	29080	38560	51130	67799	89901	119209
Increase in production by productivity Improvement (tonnes)	0	771	2066	4150	7411	12407
Increase in Production Value MN \$	0.00	1.70	4.54	9.13	16.30	27.30

Potential to increase production worth 27.3 MN (USD)
in 2017

Costs

Cost of Acquiring Leases	
Yield/hectare (Comparable Analysis)	11 tonne/hectare
Annual Nestle demand (Raw Coffee) tonnes	58160
Total Land needed (hectares)	5287
10% own production	529
Cost /hectare (USD)	13000
Cost of lease USD MN	6.87

Other Costs

- ▶ New processing Plant (Capacity 15000 tones): 8-9 USD M
- ▶ New Employees : 220
- ▶ Cost/employee 2500 USD/P.a.
- ▶ Total Expected employee costs: .55 USD M
- ▶ School & other development activity : 1% of NI or actual

Increase in value Chain for Nestle

- ▶ Coffee Millers/Exporters/roasters : \$.175
- ▶ Coffee Growers : \$.035
- Total Increase : \$.210

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Alternatives: Do not pay Higher Prices

25

- ➔ Higher prices may not convert into production improvement
- ➔ Ensuring the proper utilization of excess money would be difficult
- ➔ Difficult to sustain high prices as coffee prices very volatile



Alternatives: Do not lease small farms

- ➔ Difficult to manage high number of individual leases
- ➔ Will not align with overall strategy of Creating Shared Value



STOP

Alternatives: Do not invest elsewhere

- ▶ China production growing strongly
- ▶ Nescafe has a strong market presence
- ▶ Show consumers we invest in China





What goes into a cup?

To Brew Over: Future Ideas

- ▶ These are a few ideas that we are NOT recommending right now however they could be worth looking into in the future:
 - ▶ Encourage farm workers to contribute to R&D- can Nestle extract value in recipe generation from how the farmers mix their coffee beverages?
 - ▶ Encourage farmers to sell a percentage of crops, or crops that don't meet the grade, for local fundraising efforts.


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Served Hot: Recommendation



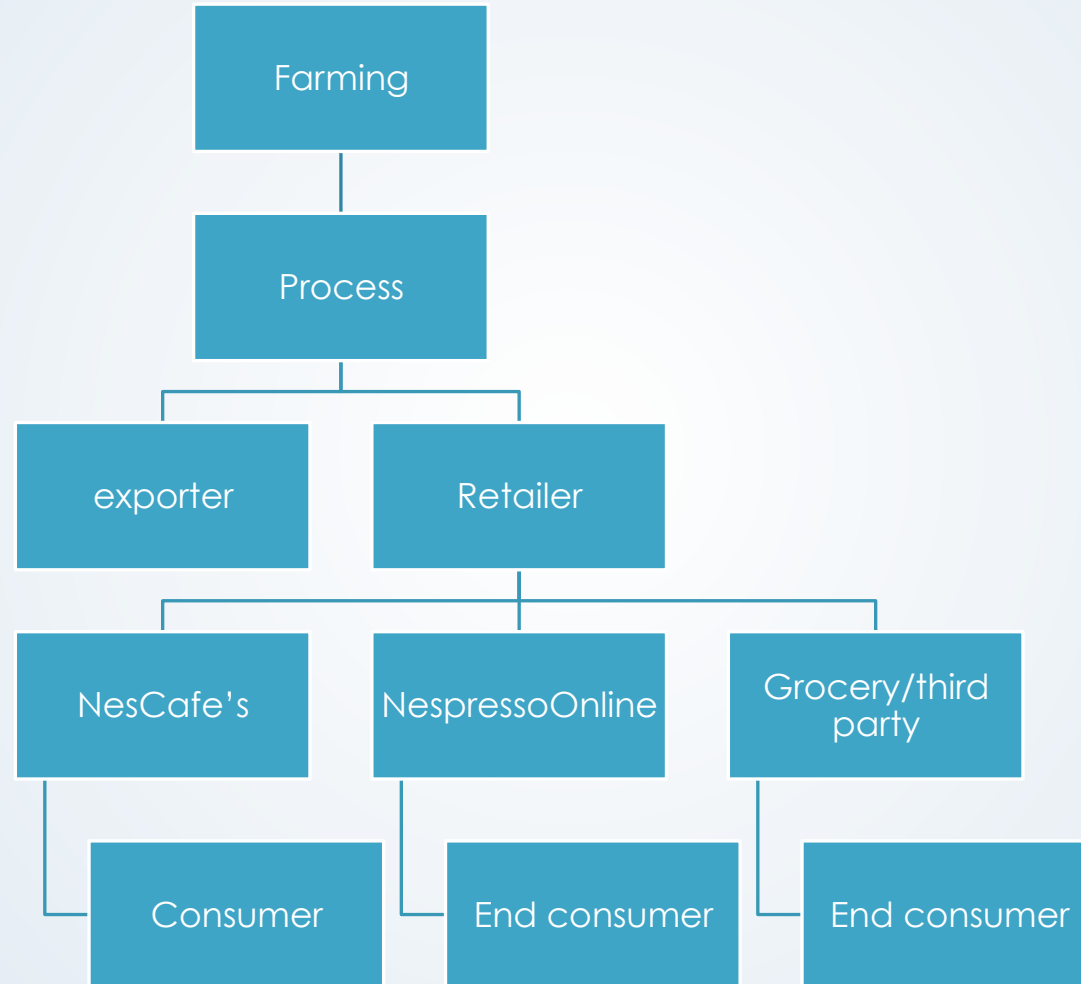
Our recommendation is for Nestle is to implement backward implementation to ensure that Nestle can create shared value for both the farmers and Nestle global.



The Farmer


- Most farmers live in poverty
- Highly labour intensive
- Average age of farmer is 62, little interest from younger generations
- Women performed more that 70% of the manual labour.

From Farm to Cup



Tall, Coffee: Vertical Integration

- ▶ The process of coffee beans can be done at the farm at the processing facility
 - ▶ Roasted coffee can then be shipped directly to packaging facilities
 - ▶ Packaged products can be shipped to the warehouse and then to the end user or retailer
- ▶ Nestle has a great subscription model with Nespresso
 - ▶ End consumer is top of the pyramid, mostly female, and willing to pay premium for Fairtrade and best practices.
 - ▶ By vertically integrating Nestle will reduce intermediary costs, this cost savings can be a passed on as an added value to farmers
 - ▶ Through social media campaigns, and a Track My Cup imitative consumer in North America can see where and how their coffee was made.



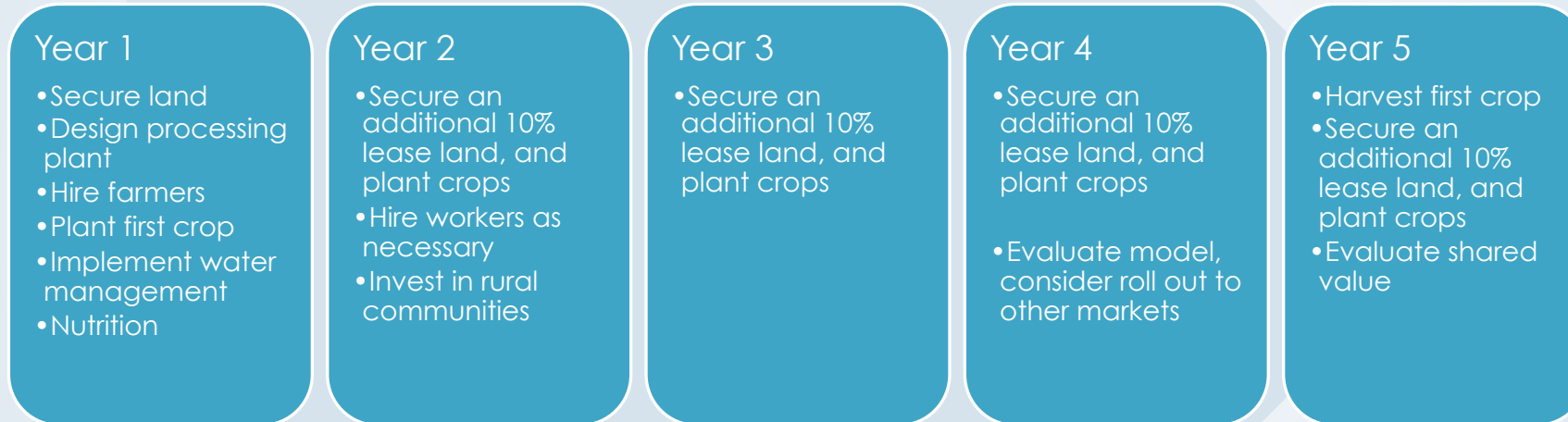
Good Coffee + Good Lives

Implementation

Crop Cycle: Year 1



Crop Cycle: 5 year



Creating Shared Value: Results

- Nutrition
 - Farming and sharing of excess production
- Water
 - Water management, smart farming
- Rural Development
 - Invested in schools

Drought: Risk and Mitigation

Risk	Mitigation	Likelihood	Impact
Future Prices	Hedge commodities	M	I
Decline labor market	Provide better way of life	L	L
Government	Hire local agencies	M	M
Water	Use environmental Best Practices	L	L



Good Life + Good Business = Shared Value

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