Q4 2018 Earnings Call

Company Participants

- Hugh F. Johnston, Chief Financial Officer & Vice Chairman
- Jamie Caulfield, Senior Vice President-Investor Relations
- Ramon Laguarta, Chairman and Chief Executive Officer

Other Participants

- Ali Dibadj, Analyst
- Andrea F. Teixeira, Analyst
- Bonnie Herzog, Analyst
- Bryan D. Spillane, Analyst
- Caroline Levy, Analyst
- Dara W. Mohsenian, Analyst
- Judy Hong, Analyst
- Kevin Grundy, Analyst
- Lauren R. Lieberman, Analyst
- Laurent Grandet, Analyst
- Nik Modi, Analyst
- Steve Powers, Analyst

MANAGEMENT DISCUSSION SECTION

Operator

Good morning, and welcome to PepsiCo's fourth quarter 2018 earnings conference call. Your lines have been placed on listen-only until the question-and-answer session. Today's call is being recorded and will be archived at www.pepsico.com.

It is now my pleasure to introduce Mr. Jamie Caulfield, Senior Vice President of Investor Relations. Mr. Caulfield, you may begin.

Jamie Caulfield {BIO 17051951 <GO>}

Thank you, operator, and good morning, everyone. I'm joined this morning by PepsiCo's Chairman and CEO, Ramon Laguarta, and PepsiCo's Vice Chairman and CFO, Hugh Johnston. We'll begin with approximately 25 minutes of prepared comments from Ramon and Hugh, and then open the call up to your questions.

Before we begin, please take note of our cautionary statement. This conference call includes forward-looking statements, including statements regarding 2019 guidance and long-term targets, based on currently available information. Forward-looking statements inherently involve risks and uncertainties that could cause our actual results to differ materially from those predicted.

Statements made on this conference call should be considered together with cautionary statements and other information contained in today's earnings release and in our most recent periodic reports filed with the SEC. When discussing our financial results on today's call, we will refer to certain non-GAAP measures which exclude certain items from our reported results. Such items include the impacts of certain tax-related matters, foreign exchange translations, acquisitions, divestitures, structural and other changes and restructuring charges. You should refer to the glossary and other attachments to this morning's earnings release and to the Investor section of PepsiCo's website under the Events and Presentations tab to find full explanations and reconciliations of these non-GAAP measures.

And now it's my pleasure to introduce Ramon Laguarta.

Ramon Laguarta {BIO 18967774 <GO>}

Thank you, Jamie, and good morning, everyone. We'll begin this morning's call with a brief recap of 2018 performance, and then move on to a discussion on our go-forward priorities, long-term targets and the financial outlook for 2019. So let's begin with 2018, which was a very successful year. We met or exceeded each of the financial targets we outlined at the beginning of the year. Organic revenue grew 3.7%, which was a meaningful sequential acceleration from 2017, and within the year, we saw the rate of growth accelerate from 2.5% in the first half to 4.7% in the second half. Frito-Lay North America and each one of the international divisions performed very well, and NAB made progress throughout the year with a return to organic revenue growth and improved pricing. At the same time, we continued to make investments in the business and the solid momentum we have as we entered 2019 is a good indication that those investments are working.

Now, on to priorities; as most of you know, I assumed the role of CEO in early October and I'm pleased to report that the transition has gone very well, and I'm fortunate to step into the role at such a well-positioned company. PepsiCo competes in attractive, large and growing categories. We have leading brands and a broad portfolio capable of evolving into new growth spaces. We have a very well-developed geographic footprint with a stronghold positions in our largest markets and very competitive positions in a number of other rapidly-growing markets. We have a suite of strong and very relevant capabilities across the value chain that have been built and strengthened over the years. We have scale that allows us to run our operations very efficiently, and to leverage our capability investments across a large and global business.

We have highly-engaged associates, a strong cohesive management team and deep talent bench, and we have a distinct winning culture that has at its foundation well-embodied values and a strong sense of purpose. These traits have enabled us to perform well in an environment characterized by highly-dynamic retail and competitive landscapes, shifts in consumer habits and preferences and volatile currencies, commodities and geopolitics. Over the past six years, organic revenue growth has averaged 3.8%, core operating margin has expanded by 1.6 percentage points, core constant currency earnings per share growth has averaged 9%, core ROIC has expanded by 9.5 percentage points to 24.8%, dividends per share have grown 9% on a compound basis, and we're returning $45 billion to shareholders through a combination of dividends and share repurchases.

I've spent the past four months deeply engaged in the business, connecting with our consumers, our customers, and associates, as well as spending considerable time together as a senior leadership team having no-holds barred debates, with a goal of focusing on what the opportunities are to make our company even faster, stronger, and better. We looked for opportunities to improve our strategies, our portfolio businesses, the strength and breadth of our capabilities, how we're organized and get work done, how we can take our execution to new heights, and how we can elevate our sense of purpose. And from this review and assessment, we emerged with a set of what I'll call observation and a very clear set of go-forward priorities.

Let me begin with the observations. Fundamentally, we're a highly focused convenient food and beverage company. We compete in very attractive, large, growing, and highly complementary categories that share many common characteristics, including consumers, customers, shoppers and occasions. Our ability to leverage the scale of our business to invest in and deploy new capabilities and technologies is a competitive advantage.

Furthermore, we have tremendous potential to expand consumption across multiple dimensions. We believe we can capture a greater share of consumption occasions by continuing to broaden our portfolio, to provide greater choice to satisfy consumers' evolving tastes, whether they're seeking for an indulgent treat or a more nutritious snack, hydration or a functional drink, on-the-go convenience or take-home value. And we also see the opportunity to continue to increase consumers' perceived purchase ability of our products as an additional growth avenue.

Relatively, we believe our product and geographic portfolios make sense, and we do not currently see the need to shed or acquire businesses in any significant way. Those businesses are not squarely on strategy, are relatively small, and generate very healthy cash flows, and there's no apparent value-creating path to divest them because of tax consequences and/or transaction complexity.

Let me go now into our individual businesses. Frito-Lay North America, our largest sector by profit, is an extremely strong business that generates consistently attractive top line growth and has industry-leading margins and returns on invested capital. The core of Frito's business remains very strong and growing.

Over the years, Frito has successfully adapted its portfolio to address new demand spaces, mainly in more permissible and premium snacking. We've added new brands and product lines to capitalize on those opportunities with products like Simply, SunChips, SMARTFOOD, Off The Eaten Path, and Imagine, and we expect this approach will enable Frito to continue to compete very effectively across the spectrum of the snacks category. Furthermore, we see more runway to continue to source volume from other macro snacks occasions in ways that play to Frito's strengths.

Operationally, Frito brand has extremely efficient and highly optimized supply chain and go-to-market systems. However, capacity utilization is very high on average, and there are pockets where capacity is overstretched. We believe with added capacity. Frito will be even better positioned to capture new growth opportunities.

Let me move now to North America Beverages. NAB, our largest sector by revenue, is an attractive business. It has many leading brands in growing beverage categories and operates a differentiated, integrated business model. We believe our operating model is a competitive advantage that provides superior customer and system alignment, speed to market, and system-wide efficiency. With that said, in a dynamic market, NAB has faced a number of challenges over the past 18 months. New entrants have come to market in some of our stronghold categories. There are opportunities to improve some of our brand marketing and consumer engagement, and there are areas where we can step up our local marketplace execution.

We have good plans in place to address these opportunities. We've increased both the quality and level of A&M on key core brands, including Pepsi and Mountain Dew. We've increased our innovation to address new category entrants and to drive success in higher growth segments with innovations like LIFEWTR, Bubly, Gatorade Zero, new variants of Propel, and extensions within our successful Starbucks and Pure Leaf Tea (11:10). At the same time, we're having good success with Pepsi Zero Sugar, and this has been a key element in stabilizing the performance of our trademark Pepsi business.

And we're making changes to our NAB organization structure and adding front-line resources to make us more agile in responding to local commercial opportunities and local competitive actions. While there's more work to do, we're very encouraged by the steady sequential improvement we've seen in the business. We're confident that with more well-placed investments we'll see continued improvement in NAB's performance.

Let me talk a bit about international now. We have a very well-developed international footprint, and our international businesses are performing very well. We have strong market positions in snacks globally and within most of our key markets. And in beverages, we have very competitive market positions, either outright or in combination with our bottling partners who provide scale and round out our beverage product portfolio. In most of our key markets, we're the number one or number two overall food and beverage supplier. Our categories travel well, and we have success innovating and marketing in ways that make our products highly relevant at a local level. We have a very well-codified playbook to expand our business in developing and emerging markets by exploiting our global capabilities to grow penetration and frequency.

A key element of the playbook is lifting and shifting our ideas from market-to-market still that we continue to hone. We believe with greater focus on capability deployment, increasing the local relevance of our products and achieving greater scale, our international business, especially in D&E markets can be a source of even greater growth and higher profitability. Underpinning all we do is our commitment to a strong environmental, social and governance agenda. Our sense of purpose is a great inspiration to our associates, and makes us a very attractive place to build a career. Furthermore, we understand that we're an integral member of the communities we operate in.

We embrace the notion that we can and should make big positive impacts in our communities by leveraging our scale and deploying our capabilities to help our communities thrive. We believe a strong ESG agenda is fundamental to long-term value creation, and our dedication to environmental, social and governance leadership will not waver. So with these observations in mind, let me move on to our priorities. Our first set of priorities relates to becoming faster; specifically, accelerating our rate of organic revenue growth. And if there's one thing I'd like you to take from our discussion today is that we view top line acceleration as the single biggest opportunity to create more shareholder value.

To achieve accelerated top line growth, we intend to strengthen and broaden our product portfolio and packaging formats to win locally in convenient foods and beverages, and this means growing our core businesses as we continue to evolve our product portfolio and sharpening our focus on key geographies. Across snacks and beverages, we'll invest to capture a greater share of consumption occasions, from indulgent to functional, social to individual, value to premium and across day-parts from morning to night. We plan to do this by continuing to grow our core brands, which include $22 billion brands, and building and/or acquiring new brands to cover new demand spaces as we have recently done with Bubly, LIFEWTR, Off The Eaten Path, or Bare.

Within snacks, we intend to further capitalize on the consumer trends of convenience and on-the-go in locally relevant ways. Here, we see themes of convenient mini meals, local street foods and local recipes as just a few inspirations to evolve our portfolio in very locally-relevant ways. We intend to rapidly scale our beyond-the-bottle initiative, building on the foundations of our recent acquisition of SodaStream and our internally-developed Spire, Drinkfinity and Aquafina Water Station platforms to offer consumers even greater variety and choice in beverage formats. From a geographic perspective, our priorities are clear. Number one, invest to sustain Frito-Lay North America's growth and leadership; number two, strengthen North America beverages to grow sustainably with the market; and third, accelerate our international expansion with a disciplined focus on right-to-win markets.

Across each of these initiatives, we'll deploy a simple, clear and very effective growth model that's highly focused on the consumer. That is providing the consumer four key benefits; variety, that is what I want; ubiquity, what I wanted; desirability, from a brand I trust; and value, with the benefits or affordability that appeals to me. Our entire commercial agenda is centered on delivering these four benefits to the consumer. Our second set of priorities relates to becoming stronger. This involves becoming more capable, leaner, more agile and less bureaucratic. In doing so we will drive down cost and that enables us to plow the savings back into the business to develop scale and sharpen core capabilities that drive even greater efficiency and effectiveness, creating a virtuous cycle.

Our productivity programs will be guided by a set of universally-applied principles, namely, achieving local affordability, simplifying and standardizing processes, collaborating across functions rather than optimizing within functions to achieve lowest-cost end-to-end processes, relentlessly automating and merging the best of our optimized business models with the best new thinking and technologies. Just as importantly, we're also adopting a philosophy that recognizes that not all the capabilities or costs are equal. So we'll be very discriminating in where we need to pay for best-in-class or we should pay for just good enough. These principles will be applied across the entire cost structure from labor to discretionary costs and advertising and marketing to fixed assets. The savings from our productivity programs will be substantially reinvested to develop and scale a set of core capabilities that we believe are necessary to deliver the consumer benefits I mentioned earlier.

These capabilities are indispensable brand-building, science and design-led innovation, point-of-choice excellence across all channels whether traditional or emerging, consumer intimacy, that is leveraging technology and connecting data to deepen our relationships with consumers, moving from relationships with groups of consumers to relationships with individual consumers. This enables a number of benefits from individually-based media and marketing engagement to personalized pricing. And finally, supply chain agility, where we deploy integrated and more robust data to improve demand forecasting and automation, advanced robotics, and other technology to make our manufacturing assets and go-to-market systems much more flexible to satisfy that demand with greater speed, precision and efficiency.

And of course, executing this aggressive agenda of top-line acceleration, productivity and capability building will require fostering a high-performance culture, one that is aligned on a common set of leadership behaviors and is supported by the right incentive systems. Among the values we're emphasizing throughout the organization are being more centered on the consumer, acting like owners and moving with focus and speed. And finally, we're examining ways to refine our incentive and pay systems to encourage local empowerment and accountability, as well as even greater alignment between management and our shareholders.

And our third and final objective relates to being a better company, by being purpose-led. Performance with Purpose has been a cornerstone of PepsiCo for 12 years. It's guided our strategy and has been a point of differentiation. We're very proud of the progress we've made to-date and equally excited about the continued evolution of our purpose agenda. With this in mind, our organization is committing to winning with purpose, which marks a new chapter in our purpose agenda. It acknowledges PepsiCo's leadership in integrating sustainability with a strategy for more than a decade, that conveys our belief that sustainability can be an even greater contributor to our success in the marketplace.

Central to our winning with purpose agenda will be a sharpened focus on advances to sustainable agricultural practices, a holistic strategy to support the creation of a circular plastic economy, striving for positive water impact and continuing to make our products more permissible to consumers. As we work to execute each one of these priorities, our overarching goal is to accelerate the rate of top-line growth to enable us to deliver balanced, sustainable, financial performance that creates greater long-term shareholder value.

With that, now, let me hand it over to Hugh to cover the financial goals in more detail.

Hugh F. Johnston {BIO 15089105 <GO>}

Great. Thank you, Ramon, and good morning, everyone. T

he plans Ramon just laid out are intended to create durable, attractive, long-term financial performance and total shareholder returns, driven by organic revenue growth of 4% to 6%, 20 to 30 basis points of average annual core operating margin expansion, high single-digit core constant currency EPS growth, growing core net returns on invested capital, and attractive free cash flow and cash returns to shareholders.

To support our free cash flow and core net ROIC goals, we remain committed to disciplined capital allocation with our existing priorities intact namely, number one, investing in the business; number two, paying the dividend; number three, tuck-in acquisitions; and number four, returning residual cash to shareholders through share repurchases.

Productivity is a key component of our go-forward plans, providing both fuel for reinvestment and improving our operating margins. We're extending our productivity savings target of more than $1 billion annually through 2023. Contributing to this goal are savings we expect from restructuring actions we announced in this morning's release. We intend to make substantial investments in the business in 2019 in A&M, manufacturing and go-to-market capacity, end-to-end supply chain transformation and global systems harmonization and standardization. While there are investments in each category in each operating sector in terms of emphasis in Frito-Lay North America and in our international sectors, there is relatively greater emphasis on adding manufacturing and go-to-market capacity and supply chain transformation.

In the case of North America Beverages, there is relatively greater emphasis on investing to support the core brands, ramped up innovation and adding and redirecting resources to drive enhanced local marketplace execution. And across all the sectors as well as at the corporate center, we're investing to drive global systems harmonization and standardization. These investments are being made with the aim of building the capabilities and implementing the processes that will support the achievement of the strategic priorities Ramon just reviewed, especially the achievement of sustained accelerated top line performance. We deeply analyze and assess each of the planned investments. We've established detailed guideposts to measure our progress and success against each one, and we're confident that the investments will return meaningful value to investors over time.

Beyond the stepped-up investments, our 2019 core earnings performance will be impacted by three other factors. First, we're lapping a number of strategic asset sale and re-franchising gains and insurance recoveries net of a front-line bonus that contributed approximately $0.17 to earnings in 2018. Second, we expect the core tax rate to increase to approximately 21% in 2019 from a rate of 18.8% in 2018. And third, we expect foreign exchange translation to be an approximate 2 percentage point headwind to both revenue and EPS performance in 2019. Taking all of this together, for 2019 we expect organic revenue growth of 4% and core EPS of approximately $5.50.

Importantly, we expect to see a return to high single-digit core constant currency EPS growth in 2020. For 2019, we also expect free cash flow of approximately $5 billion, reflecting a step up in CapEx to approximately $4.5 billion. Most of the increased capital spending is associated with accelerating progress on our strategic priorities. Following 2019, we expect our capital spending to moderate and to return to approximately 5% of revenue by 2022. We expect total cash returns to shareholders of approximately $8 billion in 2019, comprised of dividends of approximately $5 billion and share repurchases of approximately $3 billion.

With that, we'll now open it up to your questions. Operator, we'll take the first question.

Q&A

Operator

Thank you. Our first question comes from the line of Dara Mohsenian of Morgan Stanley.

Q - Dara W. Mohsenian {BIO 3017577 <GO>}

Hey, guys.

A - Ramon Laguarta {BIO 18967774 <GO>}

Good morning.

Q - Dara W. Mohsenian {BIO 3017577 <GO>}

So, Ramon and Hugh, your 2019 guidance clearly implies some substantial reinvestment both from a P&L standpoint and on the CapEx line. Just at a high level, how did the organization come to that decision under new leadership? Is this more sort of underutilized opportunities under a new CEO you're looking at, as you highlighted maybe on the Frito capacity side, or is it more need to re-boost the coffers after a tough external environment the last few years that may have pressured spend a bit? Because you do appear to be leaving 2018 with some nice momentum from a top line perspective, so just trying to better understand the decision at a high level.

And then also, it would be helpful if you could give us some more granular detail on which product categories or geographies that incremental spend is particularly focused on, both from a P&L and CapEx standpoint, and what gives you confidence around the

ROI behind that spend as you look out getting it back to that high single-digit algorithm beyond 2019. Thanks.

A - Ramon Laguarta {BIO 18967774 <GO>}

Great. Let me start, Dara. The process was, say, a 4-month process that we've been together as a management team over a series of meetings. trying to define what would be the next chapter of PepsiCo. And we came to the realization that we have a good company, we can be a great company. And there is say an aligned vision to be a much faster growing company, because we see that our categories are very healthy, large, growing across the world, and we have been performing okay against the categories but there is further growth and further opportunities for us to grow share in those categories.

And the process started with, let's see how we can refocus the discretionary funds that we have in each one of our business against the growth opportunities. So we're doing that as part of the AOP [Annual Operating Plan] for 2019. And then we came to the realization there are even further opportunities for us to invest and grow our top line in a very competitive way and profitable way. So that's where we are.

In terms of the areas of spend, you should think about we're investing across all the businesses, from our North America business to our international businesses, and we're investing in brand-building, selling capacity, and supply chain capacity. Those are the big areas. And also, we've been building capabilities for the last few years and we're going to continue to in areas like away-from-home, e-commerce, some of the large channels that are driving a lot of growth for the categories.

Operator

Your next question comes from the line of Bryan Spillane of Bank of America.

Q - Bryan D. Spillane {BIO 2147799 <GO>}

Hey. Good morning, everyone.

A - Ramon Laguarta {BIO 18967774 <GO>}

Good morning.

Q - Bryan D. Spillane {BIO 2147799 <GO>}

So just two questions related to the investments this year. One, is it $1 billion of incremental productivity also in 2019?

And then second, I guess as we look at – there was some investment that went into the business in 2018 and then some incremental investment that goes into the business in 2019. So in trying to understand how much of that goes in and stays in the business, the relative size of that, back-of-the-envelope, I was getting to about $500 million. So if you can, give us any sense as to whether that's close to the ballpark in terms of the size of the reinvestment. Thank you.

A - Hugh F. Johnston {BIO 15089105 <GO>}

Hey, Bryan. It's Hugh. So in terms of the size of the reinvestment, we haven't gotten overly specific with the numbers. But if you think about what our normal EPS is versus what we're doing this year, I would think about somewhere between 40% and 50% of it being reinvestment. And then the other factors, we mentioned the tax rate and one-timer lapping being the other parts of it.

As to the other part of your question, as you know, even in late 2017 and into 2018, we did start making some reinvestments back into the business because with the tax cut and other things, we had the opportunity to do that in 2018. The thing that gives us a lot of confidence and gives us a belief that the ROIs are going to be good is the money that we've invested so far, we have actually seen good payback. The reason for that is obviously, we participate in two great categories, convenient foods and beverages. And when we invest money in those businesses, there is good consumer and customer response to it. So the fact that we have put money into the businesses and we've seen such good response is what gives us confidence that going forward we should continue to do that into 2019.

The one thing I do want to stress in all of this is we started with making the internal cost structure of the company more efficient and have done everything we can do with that, and the restructuring is part of doing that. The incremental portion of it obviously is what we're talking to you about as investors. But I want to assure you all that we've worked hard to make sure PepsiCo is as efficient as it can possibly be, and we'll continue to strive to do that as well.

Operator

Your next question comes from the line of Lauren Lieberman of Barclays.

Q - Lauren R. Lieberman {BIO 4832525 <GO>}

Thanks, good morning. I know that you very specifically talked about 2020 earnings growth coming back to kind of high single-digit range. But in the long-term guidance, you did lower the long-term operating margin target to like 20 basis points to 30 basis points from something more like 30 basis points to 50 basis points. So can you just talk a little bit about what's driving that view of the long-term margin in the business? Is it a change in what's possible from a gross margin perspective, because it sounds like a lot of the productivity and restructuring that you're doing should be yielding a more efficient cost structure for the long-term? So I was curious why there's sort of less operating leverage in the long-term model. Thanks.

A - Ramon Laguarta {BIO 18967774 <GO>}

Let me start and then Hugh can give you a few more details. If you think about the three things we're trying to do, which is become faster, stronger and better. We want to first invest in the business in opportunities that we see ahead of us, and that's going to make us faster, and there are investments we put in the business last year. As Hugh said, we've optimized, we've seen the ROIs and we're deploying again this year with some incremental investments.

The second concept of being stronger goes to the question that you're posing here, which is, we're trying to look at adapting technology and data much more in our business in the way we do business. That will drive a lot of savings that we'll be reinvesting in the new capabilities we've been talking about that we believe that will give us a sustained competitive advantage over the long term. These are capabilities in the areas of basically consumer customer and supply chain agility. So yes, you will see I think a virtuous cycle of additional savings being both brought to the bottom line in what we think is a 0.2% – 0.3% margin expansion every year. But very importantly we want to make sure that the business gets the reinvestment required to become – to stay as a very competitive business long term.

Operator

Your next question comes from the line of Ali Dibadj of Bernstein.

Q - Ali Dibadj {BIO 15328592 <GO>}

Welcome, Ramon. So I have actually three questions and all under the umbrella of your philosophy, Ramon. One is that you mentioned you met with clients and consumers and employees, but it doesn't seem like you've done a lot of meetings with shareholders in informing your observations and priorities and I just want to understand why, clearly a lot of folks on this call are your owners. Secondly, your philosophy on reinvestment, how does that apply to your philosophy on price mix rationality, for a lack of a better term, i.e. kind of measured increases in pricing over the past years? And beverages has taken that industry out of the penalty box for investors, so I'd love to hear your philosophy there. And lastly, your level of confidence that one year of reinvestment is enough to get back to your accelerated long-term growth algorithm 2020 and beyond. Thank you so much.

A - Ramon Laguarta {BIO 18967774 <GO>}

Thank you, Ali. Let me start from the last one, I think it's the core, since that's what we're trying to do. As Hugh said, we started investing in 2018, back in the business, the tax reduction helped us there and we saw areas where we had very high ROIs, which are areas where we didn't have so much high ROIs.

So at the beginning of this year, we went through what I think is a pretty rigorous process of filtering the investments and saying, okay, these are areas where we need to double-down, and we're adding some more resources to those areas, and it's across, what I said, branding, selling capacity, manufacturing capacity, supply chain capacity, and some of the new capabilities. But again, the essence of the model is not this one-year effort that we're trying to make with additional resources. The essence is how we're transforming the machine, the operating machine of PepsiCo with technology and data, and really looking very hard at our cost structures to drive sustained savings that we'll reinvest in these new capabilities that we need for the future. That is really the essence of the model.

Don't think of a one-year investment, which would be a 2-year investment, because 2018 we already started investing, but think of this as an acceleration and then a very clear transformation of capabilities that will make the acceleration sustainable. And it's a virtuous cycle of adopting technologies, driving savings, and pre-investing those savings into what we think are the things that will make us best-in-class in our industry and is doubling-down on consumer intimacy, doubling-down on innovation, doubling-down in brand-building, multichannel go-to-market capabilities, and then flexible supply chain. That's how we see the long-term trend and the long-term momentum.

A - Hugh F. Johnston {BIO 15089105 <GO>}

And, Ali, to follow up on your question on price rationality, we do think there's price rationality in the market right now, and a part of our long-term algorithm is continued price rationality in the marketplace.

Q - Ali Dibadj {BIO 15328592 <GO>}

Thank you.

Operator

Your next question comes from the line of Judy Hong of Goldman Sachs.

Q - Judy Hong {BIO 3773182 <GO>}

Thank you. Good morning. So I guess, I wanted to actually ask about Frito-Lay North America, Ramon. So clearly, that business has been on a pretty solid footing. You talked about the potential opportunities to grow that business further. A lot of the growth in the last few years has come from price mix. So I'm just wondering if you can elaborate on more specific programs to really drive consumption and volume increases in Frito-Lay. And then separately, Ramon, I think you talked about being happy with the portfolio and not really making big changes to your portfolio either acquisition or divestiture. I know you guys have been looking at North America Beverage business from a re-franchising perspective. Is that now off the table as you kind of went through the review in the last 4 months? Thank you.

A - Ramon Laguarta {BIO 18967774 <GO>}

Okay. Let me start with Frito. Frito is probably one of the, I would say, best consumer companies in the world, I would say, and we continue to find ways to transform ourselves both on the portfolio and on the capabilities and infrastructure of the business. So the way we're thinking about Frito is, you think our share of market is about 65% of salty, about 39% of what we call savory and only 19% of micro snacks. We see great opportunities for Frito to grow into new day-parts, into new channels into even grow within existing channels and within existing consumer occasions. So the growth opportunities for Frito are multiple. I think the team has done a great job in keeping a very healthy core.

Our Doritos, Cheetos, Lays, Ruffles, Tostitos brands are growing very healthy and build additional brands that cover new spaces, either cohorts or day parts. We see a very strong growth model from the brand perspective, from the channel perspective. And what we're trying to do is make sure Frito is well-funded to go after all these opportunities, both from the P&L and from the CapEx point of view because the ROIC on those investments is unbeatable, and I believe we have an amazing team that is syndicatable, proves it every day in the marketplace, and is very rigorous in how they manage the investments. So empowering that team with the right resources and given them the higher vision of grow even faster and gain more share in the U.S. snack business I think is the right thing to do for the core PepsiCo.

Operator

Your next question comes from the line of Andrea Teixeira of JPMorgan.

Q - Andrea F. Teixeira {BIO 1941397 <GO>}

Thank you. So, Ramon, best of luck as the CEO.

A - Ramon Laguarta {BIO 18967774 <GO>}

Thanks, Andrea.

Q - Andrea F. Teixeira {BIO 1941397 <GO>}

Thanks. And I just wanted to ask you about the company's long-term organic revenue growth, a target of 4% to 6%. So could you maybe help us decompose this target between your expectations for snacks and beverages globally, as well as in developed and developing markets? And just a clarification on Judy's second question I think about re-franchising. Have you decided not to re-franchise any at this time or is it still on the table? Thank you.

A - Ramon Laguarta {BIO 18967774 <GO>}

Okay. Let me address both. The way you should think, Andrea, about our 4% to 6% is we have a great portfolio of geographies and categories around the world, and we see this as a more cycle of opportunities where we'll invest to drive growth and be more competitive short-term and long-term, and should be thinking about the overall portfolio delivering this number of between 4% to 6%. So we won't go into the details of how we're going to grow in each one of these categories. You will see us as we unfold the results going forward. With regards to NAB, yes, I think – sorry, I forgot to answer the question before.

Yes, we spend a lot of time as a management team, obviously studying NAB and the different options we have there. We love NAB business. We think it's a great business that will play a very important role in the future of PepsiCo, and we're convinced it will drive very good results for us. And we believe that the key areas of success, I think, for NAB going forward, will be around having the very strong brands in the different spaces and cohorts. And we think we have the brands, and we may have to strengthen some of the brands, or we have those brands, and we'll be able to create new brands as we've proven with Bubly or LIFEWTR or some of our new innovations.

Second will be our ability to execute in the marketplace, both with the very large customers and also in the local up and down the street. I think we can do that, we are a great operating company, and we know we can do this without re-franchising. Third point, we'll be having a very flexible and cost competitive supply chain, and the third will be having the right high-performance culture in the business. All of those four success factors to me are not related to re-franchising. Plus re-franchising per se would be a very complex and disruptive event for us as a company. So yes, you should assume that we're going to compete very hard in this business. We're going to invest sustainably and rationally. We keep building a very strong company that I'm convinced will do great for us in the near future.

Operator

Your next question comes from the line of Steve Powers of Deutsche Bank.

Q - Steve Powers {BIO 20734688 <GO>}

Thanks so much. Congrats from me as well, Ramon.

A - Ramon Laguarta {BIO 18967774 <GO>}

Thank you.

Q - Steve Powers {BIO 20734688 <GO>}

And I was hoping we could just dig a little bit further into your strategic outlook. If we think about PepsiCo in 2025, what does being the great company that you mentioned at the outset really look like? How would you describe it? And how important is it to you that you can arrive at that destination without the need for another side step or effective algorithm reset somewhere between?

And maybe as you just talk about that future vision, just going to the prior conversation, I'd just love some more color on what role you think the longstanding Better Together, Power of One strategy plays within that. It sounds like something you remain committed to. So do you think maybe it can be strengthened further? But I'd just love it if you could expand on that as well. Thanks.

A - Ramon Laguarta {BIO 18967774 <GO>}

You should think of PepsiCo, as I said, a company that plays in two huge, large categories that globally have a lot of tailwind. And our ability to perform at a very high competitive level in those two categories globally gives us the ability to be a top-performing investment for you guys in the consumer goods space. So I think you should be thinking about a company that has a long-term value creation model centered around accelerated growth and sustained growth and gaining share consistently in our two large categories. That's how I would envision it.

How we do it, I think we painted the picture on how we're thinking about our portfolio and how we're going to look very holistically at the opportunities in each one of our categories. And there are multiple demands; spaces, there's a lot of coffers, there's a lot of different day parts in those categories that provide for immense opportunities for us to innovate and build brands and continue to grow.

Geographically, you should be thinking about a company that is, I would say, skewed to developed markets, Western Europe and the U.S. And obviously, long term we would like to be stronger in some of our developing markets where we have strong positions to build on top. And so we have strong talent. We have strong market positions in some of those markets. And you should think about us growing very fast in those geographies and adding to how we'll reach consumers around the world.

Think of us, we sell 1.5 billion servings a day, so we touch conceptually 1.5 billion people around the world every day. So our ambition is to become at least – touch at least 2 billion people every day. That's some of the aspiration we have as a management team. So you should be thinking around the vectors of how many people we serve every day, and around what do we offer people in terms of both the convenient foods and the beverage categories.

Operator

Your next question comes from the line of Caroline Levy of Macquarie.

Q - Caroline Levy {BIO 1494597 <GO>}

Thank you. Good morning and best of luck, Ramon.

A - Ramon Laguarta {BIO 18967774 <GO>}

Thank you.

Q - Caroline Levy {BIO 1494597 <GO>}

My question is around – I'm just hoping you can actually elaborate on what you can do in the route-to-market field. Just a little more detail because if I think about the beverage business, it feels like you have some catch-up, particularly in North America. In snacks, you're already really, really good. So taking the two different sides, are you going to focus more on the small channels where brands are often built and nurtured? And how do you manage an online business when you're shipping heavy beverages? So just touching on that range of opportunity.

A - Ramon Laguarta {BIO 18967774 <GO>}

Listen, thanks for the question. The value creation of categories is proportionate in the impulse part of our business. So obviously, we want to maximize our go-to-market where we can generate impulse occasions, we capture much more value for our – I think we provide more value to the consumer and we capture more profit as a company. So obviously, as you think about the areas where we'll be investing money to become much more of a great customer service company, we will invest against the large customers, and they are critical for us to serve a lot of households. And there, I think the opportunity to put all our categories together, to serve customers like Walmart, Amazon, et cetera is a big idea.

Then in terms of the capillarity and the ubiquity of distribution of our categories, I don't think we're satisfied with NAB or we're satisfied with Frito or we're satisfied with any of our companies. There are almost unlimited numbers of point-of-sale for our categories. And our strategic intent is to be everywhere where there could be an occasion to serve a consumer to buy a snack or a beverage. And it's not only the conventional points of sale that you're thinking about, it could be endless numbers. So how do we make money in servicing those stores is the biggest strategic idea, and we have a lot of technology to unlock this. We're playing obviously across non-conventional ways to get to those points of sale, and that's a core capability of the company.

Operator

Your next question comes from the line of Nik Modi of RBC.

Q - Nik Modi {BIO 7351672 <GO>}

Good morning, everyone. Ramon, you talked about the reinvestment and you talked about front-line, putting more investment in front-line. Can you maybe help us understand in terms of the percentages you're allocating or your thinking about it in terms of increases in advertising, and then also the in-store execution portion in NAB?

And then the second question is, you also talked about perhaps adding more capacity in the Frito business. So does that mean you're going to reduce your alliance on co-packers? Thank you.

A - Ramon Laguarta {BIO 18967774 <GO>}

I'll start with Frito. Yes, with the growth of the business, we're stretched on some of our technologies, which impacts our ability to service the demand on some of our products. So we'll be investing in additional capacity. In Fritos we're actually investing, and you should see it I would assume in additional share of market gains from us in the coming years.

With regards to NAB investments, obviously, I cannot give you details. This is a very sensitive information of where we're going to invest in our S&B money, but you should think about us adding selling capacity across the U.S. for both our foodservice and our small format elements.

Operator

Your next question comes from the line of Bonnie Herzog of Wells Fargo.

Q - Bonnie Herzog {BIO 1840179 <GO>}

All right, thank you. Good morning, everyone. I certainly sensed an overall level of urgency from you based on your comments this morning. And specifically on NAB, you mentioned you're stepping up innovation investment to reignite growth. So I guess I've got a couple of questions. First, how much of a lag do you anticipate before you anticipate seeing improvements on your top line? And then, in general, how do you think about balancing this higher level of spending with your ability to drive profitability growth, and then more importantly your ability to expand margins in NAB specifically, again, over the long term? Thanks.

A - Ramon Laguarta {BIO 18967774 <GO>}

Yes, we've been investing in NAB now for a year or so, especially in our brands, but also in some of our execution capabilities. And we're seeing good returns on some of those investments and not-so-good returns in some others. So what we're doing is clearly optimizing our investments against the areas where we see we're getting more overall return. The performance of the company as you saw in our Q4 numbers is improving. So we had a good 2.5% in Q3. We grew 2% in Q4. So we'll keep investing in the business to stay positive, and our ultimate ambition is to grow with the market and the timeline we're aspiring to do that is by the end of this year. It might take us a bit longer.

The way I see this is, and this is my experience with businesses, large business that need to turn around is, you need to agree on long-term objectives. In our case, it's growing with the market and eventually growing share. And then empower the team with the right resources, make them feel that you support them and give them very clear milestones to go after those, the turnaround. That's what we're doing with NAB. The team is responding. We're having very clear process internally to monitor progress, and we feel good, and we feel fortunate to have the rest of the company portfolio that we can still deliver a very good performance to company, and invest in what is going to be a very powerful business for us in the future.

Operator

Your next question comes from the line of Kevin Grundy of Jefferies.

Q - Kevin Grundy {BIO 16423871 <GO>}

Thanks. Good morning, everyone. So I wanted to come back to portfolio considerations with beverages and snacks. So particularly, Ramon, the ability to drive more consumption occasions, so under sort of the thinking of the two are better together, and it sounds like you two are of the view that the beverage and snacks did belong together. But I think there have been some questions on how successful the company has been in that pursuit of cross-selling over the years, particularly given some of the notable challenges in beverages. So do you see it that way? Is that an unfair assessment that the company has not done as well as it possibly could in terms of cross-selling and utilizing the strength of both of these businesses? And as you're thinking about the priorities of how to reaccelerate growth at NAB, is there greater cohesiveness with Frito that could be part of that strategy? So any comments there would be helpful. Thank you.

A - Ramon Laguarta {BIO 18967774 <GO>}

Listen, as you guys know, I've been in Europe for a few years, and there we have this kind of what we call Power of One model in some countries, in a lot of countries actually. So I understand the value of where the scale makes sense and where the focus makes sense, or more or less, I mean, it is not a science, it's almost an art on where does the scale give you a competitive advantage, and where the scale defocuses you. And so listen, I don't know if you guys walk around the stores for the Super Bowl, but if you see the displays we're able to build together as an organization, the amount of traffic we build for our customers because of those displays and the combined consumption that was between our two categories because of those displays, you would see that there is a very clear opportunity for us to dial up that as an opportunity.

Also on the cost side, we're doing a lot of things together. So if you think about freight, for example, it's a great area where we're in a lot of productivities because of combined freight. And as you think about future capabilities, we're trying to build them as a combined company. So our e-commerce capabilities, some of the ones I referred to this morning, consumer intimacy, so our ability to attract talent, special talent, retain talent and challenge talent, is much – we have a much higher likelihood to succeed if we do it as a full PepsiCo. So we see many areas of value for Power of One. But we also see areas where Power of One could derail the performance of each one of the businesses. So you will see, yes, there are opportunities but we have to address them very carefully and with trial and error. We'll make mistakes in some areas, we'll get better in others. So that's how you should think. But yes, of course, for us it's a competitive advantage, and we'd not be doing the best for our shareholders if we didn't explore this area to the maximum.

Operator

Your next question comes from the line of Laurent Grandet of Guggenheim.

Q - Laurent Grandet {BIO 19930531 <GO>}

Yes. Good morning, Ramon and Hugh. And Ramon, great speaking with you.

A - Ramon Laguarta {BIO 18967774 <GO>}

Hi, Laurent. Nice to see you again. Nice to talk to you again.

Q - Laurent Grandet {BIO 19930531 <GO>}

Lots of questions about NAB and Frito-Lay. I would be interesting in having your perspective on the Quaker business and the role of Quaker in PepsiCo's portfolio in the near or long-term future. EBIT margin now is at a relatively high-level, especially in corporation to other sales businesses. Now, it has not been growing for a while, and it seems like it's not really at the center of the impulse occasion, you said it was the strength of PepsiCo. So really would like to have your perspective on the Quaker business going forward.

A - Ramon Laguarta {BIO 18967774 <GO>}

Okay, thank you, Laurent. Listen, we love our Quaker business. I think it complements our portfolio, and it makes us strong in a day part where we are weaker otherwise. Now, we need to be better at exploiting some of the opportunities of that brand internationally. So we have a very strong business in Europe, and it's doing very well. Here, domestically, you could think – of the more we see clearly breakfast becoming an on-the-go occasion, people are rushing for to get to work early in the morning. There is a huge opportunity for us to play with Quaker in that, I would say, higher-value to consumer demand moment of breakfast on-the-go. You're going to see us innovating in that space, and you will see again another vector of Power of One as we leverage some of our go-to-market strength to deliver on the convenience on-the-go for Quaker. So I think it plays a role in our portfolio apart from obviously the cash flow it generates and the great returns we get from that business. But we see it as part of our broader strategic opportunity of capturing demand moments we're not very strong in right now.

Operator

Your next question...

A - Ramon Laguarta {BIO 18967774 <GO>}

Okay. I think we ran out of time. So thank you all for your time and participation in this morning's call. To conclude, I'd like to leave you with just three key thoughts. First, our overarching objective, as you saw, is to accelerate in a sustainable way our top-line growth. Secondly, we're investing to lift performance across the business, making our best businesses better and our productively lower performing businesses stronger. And third, respect that the investments we're making will not only benefit 2019 with accelerated top-line growth, but will provide us a solid foundation for sustainable, attractive marketplace and financial performance for the years to come. We look forward to updating you on the progress throughout the year, and we thank you for the confidence you've placed in us with your investments. Thank you.

Operator

Thank you. That does conclude today's PepsiCo's Fourth Quarter 2018 Earnings Conference Call. You may now disconnect your lines, and have a wonderful day.