# Q2 2020 Earnings Call

## Company Participants

- Hugh F. Johnston, Vice Chairman and Chief Financial Officer
- Ramon L. Laguarta, Chairman and Chief Executive Office
- Ravi Pamnani, Senior Vice President of Investor Relations

## Presentation

### Ravi Pamnani {BIO 6230658 <GO>}

Good morning everyone and welcome to this pre-recorded management discussion of PepsiCo's second quarter earnings results. My name is Ravi Pamnani and I am the Senior Vice President of Investor Relations at PepsiCo. Joining me today are PepsiCo's Chairman and CEO Ramon Laguarta; and PepsiCo's Vice Chairman and CFO Hugh Johnston.

Before we begin, please take note of our cautionary statement. We will make forward-looking statements on today's call, including about our business plans and outlook and the potential impact of the COVID-19 pandemic on our business. Forward- looking statements inherently involve risks and uncertainties and only reflect our view as of today, July 13th, and we are under no obligation to update. When discussing our results, we refer to non-GAAP measures, which exclude certain items from reported results.

Please refer to today's earnings release and 10-Q, available on pepsico.com, for definitions and reconciliations of non-GAAP measures and additional information regarding our results, including a discussion of factors that could cause actual results to materially differ from forward-looking statements.

As a reminder, our financial results in the United States and Canada, or North America, are reported on a 12-week basis while substantially all of our international operations report on a monthly calendar basis for which the months of March, April and May are reflected in our results for the 12 weeks ended June 13, 2020.

And now, it's my pleasure to introduce our Chairman and CEO, Ramon Laguarta.

### Ramon L. Laguarta {BIO 18967774 <GO>}

Thank you, Ravi, and good morning everyone. I'll spend some time today discussing the current environment, our business performance and then provide thoughts on our expectations going forward given the unprecedented level of volatility that we currently face. I will then turn it over to Hugh for additional color on the financial details.

Our second quarter began during the early stages of the COVID-19 pandemic for most of our markets. As we started the quarter, we set clear, simple priorities to manage the business successfully through the enormous challenges that were happening with the consumer, customer, economy and operating environment. These priorities included: Ensuring the protection and safety of all our associates, especially our critical frontline workers, by providing suitable personal protective equipment and sanitizers, conducting health screenings and implementing contact tracing and social distancing protocols; Providing the best service possible to our customers and competing to win in the marketplace; Ensuring that we have adequate liquidity to run the business; Continuing to invest in capabilities that will drive our longterm success; Supporting the communities that we do business in and the people who live in them; and, Delivering strong financial results while executing against the above priorities.

Based on this clarity of purpose, I'm pleased to report that our business performed relatively well through this unprecedented level of change. Specifically: Our organic revenue increased 3.3% for the first half of this year, while second quarter organic revenue declined 0.3%. During the second quarter, our portfolio worked well as our global snacks business remained very resilient with 5% organic revenue growth, while global beverages declined minus 7% as increased take-home consumption was more than offset by a decline in the convenience and gas and away-from-home channels.

Our core operating margin declined by approximately 200 basis points in the second quarter which included nearly $400 million of incremental COVID-19 related costs to keep our employees safe and ensure business continuity. Excluding these costs, our core operating margin would have increased in the quarter. The months of March and April were particularly challenging as overall global economic growth was contracting and restrictions, closures and the resulting impact on consumer mobility had a significant effect on our performance.

However, we saw an improvement in our business performance and channel dynamics in May and June as population mobility increased after many economies gradually began to reopen both in developed and developing markets.

Now, turning to our business review for the quarter, I will start with North America. Our snacks and food businesses performed Prepared very well, while our beverage business was challenged but continued to improve its competitive positioning. Within snacks and food, we delivered strong organic revenue growth across both Frito-Lay and Quaker, driven by strong category growth and market share gains.

Consumer eating habits continued to evolve, with consumers spending more time at home, which benefits the at-home breakfast, snacking and dinner occasions. Organic revenue at Frito-Lay North America grew 6% and we gained share, market share in salty, savory and macro-snacks in the quarter. Frito's net revenue growth was broad-based across all our major brands, including double-digit growth in Tostitos, Fritos and Cheetos, high-single digit growth in Ruffles and mid-single digit growth in Doritos. Emerging brands such as Bare and Off The Eaten Path also delivered double-digit growth. Our larger pack sizes and multipacks performed very well as consumers' desire for variety continued to grow.

In addition, Frito's performance in large-format channels was strong, which more than offset the declines in the convenience and gas and away from home channels. Frito's core operating margin declined in the quarter due to COVID-related costs, including frontline incentives and higher protective personal equipment and sanitation costs. Excluding these COVID-related costs, Frito's core operating margin would have increased by 185 basis points.

At Quaker Foods, organic revenue increased 23% in the quarter with strong share performance across multiple categories and most brands posting net revenue growth despite supply constraints across a range of our products. Many categories within the Quaker business delivered double-digit revenue growth driven by increased breakfast occasions, in-home dinners, and baking occasions.

Quaker was also able to increase household penetration during the quarter and many of Quaker's categories have grown even as economies reopened during the latter parts of the quarter with consumers purchasing and incorporating these products into their repertoire of food consumption. We also have strong plans in place to retain incremental households with marketing and activation plans across the Quaker portfolio during the balance of this year, including the launch of Cheetos Mac 'n Cheese this coming Fall.

From a profitability perspective, Quaker's operating profit increased 55% in the quarter as strong operating leverage drove a 600 basis point improvement in its operating margin.

Now, I will turn to our North America Beverage business which had a challenging quarter as we had expected. Organic revenue declined 7% due to declines in the convenience and gas and foodservice channels, which more than offset good growth in other channels such as grocery, mass and dollar stores.

However, our revenue management initiatives enabled strong pricing gains across the business and within key categories such as carbonated soft drinks and sports drinks. Both Pepsi Zero Sugar and Bubly continued to deliver strong double-digit net revenue growth, while our ready-to-drink coffee products delivered high-single digit net revenue growth in the quarter. In addition, we gained market share in ready-to-drink coffee, tea and enhanced waters during the quarter while our market share trends improved in carbonated soft drinks, sports drinks, and juices as the quarter progressed.

Core operating profit declined due to higher COVID-19 related costs, including expenses for employee safety, sanitization and frontline incentives, lower volume and unfavorable channel mix dynamics. Before I conclude on beverages, I am also pleased to note that our transition and integration process with Rockstar and the distribution of Bang Energy is nearly complete. We have very strong growth and market share ambitions with respect to this highly profitable category and intend to use the depth and breadth of our portfolio and distribution capabilities to improve our execution and store presence.

Our energy strategy will consist of three elements. Specifically: We will look to accelerate the performance of Rockstar, which has further room for growth; We will expand the distribution of Bang and improve execution in the marketplace; and we will unlock the potential for Mountain Dew to expand in the energy category.

Now, as we look ahead for North America, we expect our overall business to perform well, assuming there is no large-scale disruption in economic activity or population mobility as a result of the recent surge in COVID-19 infections in many markets. With this in mind, we expect our snacks and foods businesses to remain resilient, albeit with some moderation in growth, while our beverages business should deliver better performance during the second half of this year.

From a channel perspective, we have seen an improvement in the performance of the convenience and gas channel since the latter part of the second quarter. Foodservice trends have also improved, but this channel continues to be in decline and will likely take a bit more time to recover. Most of our remaining traditional channels have continued to perform well while our ecommerce US retail sales doubled in the quarter.

Now, moving on to our international businesses, our second quarter results, which incorporated the months of March, April and May were significantly impacted by the timing of COVID-19 restrictions and closures, which varied by country and by region. As we saw in North America, our international snacks and food businesses proved to be more resilient than beverages, with an increase in organic revenue of 2% in snacks, versus a decline of 5% in beverages.

Across our developed markets, organic revenue increased 18% in Germany, 9% in Australia and 3% in the United Kingdom. And in developing and emerging markets, organic revenue increased 30% in China, 8% in South Africa, 7% in Brazil and 3% in Mexico. Our SodaStream business also posted another quarter of strong double-digit net revenue growth as consumers are increasingly enjoying this environmentally friendly, at-home platform.

With respect to our competitive position, we improved our year-to-date market share of snacks in Mexico, China, Brazil, UK, France and Spain, while we held or improved our market share of beverages in the United Kingdom, Germany, Poland, Mexico, Brazil and Thailand. Much like in North America, our international business trends began to improve during the month of May as some businesses and economies reopened.

In addition, our snacks business has remained very resilient. However, we do expect an uneven recovery in international markets as a greater level of macroeconomic uncertainty will likely persist due to: Varying responses and measures by country to address pandemic-related impacts and population mobility; Greater volatility in travel and tourism trends; and, Greater differences in disposable income and affordability. These are two metrics we will be keeping a very close eye on as and when we consider surgical adjustments to offer great value in lower income markets.

To summarize, we are pleased with our overall results in what was a very difficult environment. We remain committed to leveraging our strengths and principles -- what we call The PepsiCo Way to help guide our business leaders and associates in both good and difficult times. This includes reinforcing our culture in a manner that encourages our associates to act like owners with integrity, and get things done quickly. We believe acting on these principles will enhance our standing with customers, with communities and employees.

We also continue to prioritize and invest behind our Faster, Stronger and Better framework which encompasses our brands, supply chain and go-to-market systems, manufacturing capacity, capabilities and culture, and our society by integrating purpose into everything we do. To continue our journey in becoming faster, and best position ourselves to navigate in the current environment, we have instituted an even greater focus on: Capturing more opportunities in the marketplace and improving value share; Rethinking what value and affordability means for our consumers and rapidly adjusting our offerings when necessary; Simplifying our portfolio and commercial programs and making resource allocation adjustments to win with our customers and our consumers; and also, Making calculated growth investments in priority markets that can enable us to emerge even stronger after the crisis.

As it relates to becoming stronger, we are putting an even greater emphasis on our businesses to have a zero-based spending mindset in which we must earn our budgets. In doing so, we continually identified savings and use them to fund new investments; prioritizing critical initiatives that will transform the operating capabilities of the company for the future, such as accelerating the digital transformation of the company; and finally, Re-evaluating and stress testing other less critical investments, always seeking to optimize the investment portfolio for higher returns.

And then becoming better involves raising our ambitions to become planet positive, continuing to integrate purpose into our business strategy and brands; and Supporting and strengthening our local communities and promoting social justice -- two topics that I will briefly expand on today.

With respect to our communities, we have announced more than $60 million in investments to help communities around the world stay healthy and safe during COVID-19, which includes initiatives to help feed families and seniors, increase medical care and testing, expand access to government support, and provide technology for remote education and work. To promote social and economic progress, we have also announced a more than $400 million set of initiatives over five years to support Black communities and increase Black representation at all levels of PepsiCo and amongst our partners and our suppliers.

We believe these initiatives comprise a holistic effort for PepsiCo to walk the talk of a leading corporation and help address the need for meaningful, longterm change in our society.

To conclude, we believe that PepsiCo is well-positioned to adapt and succeed over the long-term. We will continue to collaborate and leverage learnings across our entire organization to build on our strengths, many of which have been advantageous for us both pre-and post-pandemic, including large, well-known brands that consumers love, and most importantly, that consumers trust. Strong positions in growing categories with expandable consumption traits. An agile supply chain with strong local sourcing networks, a flexible and advantaged direct store delivery go-to-market system and, a highly experienced set of global business leaders who have the empowerment, the knowledge and agility to make rapid, decentralized decisions to meet the needs of their local businesses.

Before I turn it over to Hugh, I want to again acknowledge the hard work of all our employees throughout this year. They have worked tirelessly to satisfy our customers and consumers and I am extremely proud of the dedication and efforts.

With that, let me now turn it over to Hugh.

## Hugh F. Johnston {BIO 15089105 <GO>}

Thank you, Ramon. And good morning, everyone. As Ramon mentioned earlier, our second quarter results were impacted by disruptions due to retail closures and other restrictions put in place as a result of COVID-19. In addition, our business experienced higher labor, personal protective equipment, logistics and service costs associated with COVID-19. These costs coupled with an adverse channel mix shift in key markets impacted our operating margin in the second quarter. We expect some of these costs to persist and remain committed to making the necessary, long-term investments to support our employees and customers, while also investing in capabilities that drive competitive advantages for our business.

To mitigate some of these challenges, we have accelerated our efforts to control what we can. This includes tightly managing our discretionary expenses, reducing non-essential advertising and marketing spend to reflect the realities of the current environment and optimizing our pricing wherever possible. We have also reduced the complexity of our product offerings by prioritizing high-velocity SKUs to maximize production capacity. However, it remains difficult to predict exactly how consumer habits and macroeconomic conditions will evolve for the balance of this year. Based on what we can currently project for the full-year 2020, we continue to expect our annual core effective tax rate to be approximately 21% total cash returns to shareholders of approximately $7.5 billion, comprised of dividends of $5.5 billion and share repurchases of $2 billion; and we now expect foreign exchange translation to negatively impact our reported revenue and core EPS by 3 percentage points based on current market consensus rates. Our expected cash returns reflect a 7% increase in the annualized dividend per share that began in June. This represented the Company's 48th consecutive annual dividend per share increase.



With respect to our liquidity and balance sheet, we believe that we have ample flexibility to meet the investment needs of our business and return cash to shareholders. Now, as we look ahead to our third quarter, we expect our organic revenue to increase within a low-single digit range, which incorporates the geographic perspectives and channel dynamics that Ramon referenced earlier. We expect our core operating margin to contract, albeit at a less severe rate than what we experienced during the second quarter, as greater costs associated with keeping our employees safe persist; and, we expect foreign exchange translation headwinds to negatively impact our net revenue and core earnings per share performance by 3 percentage points.

With that, we conclude our prepared remarks for today. We thank you for your time and the confidence you've placed in us with your investment. I invite you to listen to our live question and answer webcast, which will begin today at 8:15 a.m. Eastern Time and will be available at pepsico.com. Thank you.