

Company Name: PepsiCo
 Company Ticker: PEP US
 Date: 2018-04-26
 Event Description: Q1 2018 Earnings Call

Market Cap: 146,997.75
 Current PX: 103.56
 YTD Change(\$): -16.36
 YTD Change(%): -13.642

Bloomberg Estimates - EPS
 Current Quarter: 1.573
 Current Year: 5.707
 Bloomberg Estimates - Sales
 Current Quarter: 16088.600
 Current Year: 65410.000

Q1 2018 Earnings Call

Company Participants

- Jamie Caulfield
- Indra K. Nooyi
- Hugh F. Johnston

Other Participants

- Dara W. Mohsenian
- Lauren R. Lieberman
- Bryan D. Spillane
- Vivien Azer
- Caroline Levy
- Ali Dibadj
- Amit Sharma
- Mark David Swartzberg
- Andrea F. Teixeira
- Robert Ottenstein
- Pablo Zuanic
- Nik Modi
- Bonnie L. Herzog
- Stephen Robert Powers
- Kevin Grundy
- Brett Cooper

MANAGEMENT DISCUSSION SECTION

Jamie Caulfield

GAAP and Non-GAAP Financial Measures

When discussing our financial results on today's call, we will refer to certain non-GAAP measures, which exclude certain items, such as the impact of foreign exchange translation, from our reported results

You should refer to the Glossary and other attachments to this morning's earnings release and to the Investors section of PepsiCo's website under the Events and Presentations tab to find full explanations and reconciliations of these non-GAAP measures

Indra K. Nooyi

Business Highlights

Net Revenue and Core Earnings

- For the quarter, we delivered \$12.6B of net revenue and core earnings of \$0.96 per share

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- Within the P&L, gross margin was impacted by input cost inflation
- Operating margin was further impacted by the front-line bonus we announced earlier this year
- Foreign exchange translation had a positive impact of approximately 2 percentage points to both net revenue and reported EPS
- And below the operating profit line, we benefited from a lower core effective tax rate

Organic Revenue and Operating Profit Growth

- The majority of our businesses performed very well in the quarter, excluding our North American Beverage division
- In fact, excluding NAB, the company generated 4.6% organic revenue growth and 7% core operating profit growth, when excluding the one-time front-line bonus
 - However, our North American Beverages sector continues to work through some challenges

NAB

- So let's start with a discussion of NAB, separating long-term strategy from short-term executional issues
- As you know, we've been transforming the business over many years, to build a product portfolio that meets consumers' desires through a repertoire of great-tasting beverages, especially beverages with fewer or zero calories, and in an assortment of packages that satisfies a broad range of occasions, from immediate personal refreshment, to family meal accompaniment, to social gatherings

Transformation Initiatives

- And our focused and sustained transformation initiatives at NAB have been very successful on multiple dimensions
- We have shifted our product mix to faster-growing subcategories and provided more lower and zero sugar options, including recent innovations under the Mountain Dew, Gatorade, Propel, Lipton Tea House and Starbucks trademarks
 - Since 2010, we have increased our volume mix of non-carbonated beverages by 7 percentage points

CSD Package

- We have established and maintained strong leadership positions in many of the most attractive non-carbonated beverage categories, including ready-to-drink tea, ready-to-drink coffee and sports hydration and in the most recent quarter, grew value share in a number of the fastest growing categories, including tea, enhanced water and sparkling water
- We have increased our CSD package variety, so that our mix of non-traditional packages, that is, everything other than 2-liter and 20-ounce PET and 12-ounce cans, has increased from 14% in 2011 to 21% today

Supply Chain

- We have reconfigured our supply chain to handle increased complexity and greater product assortment

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- For example, we have substantially increased flexible can line capacity
- We expanded our [ph] co-pack (5:01) network to give us greater packaging flexibility in an asset-light model
- And we're approaching having 60% of our route network converted to delivery via our [ph] GeoBox trailers, (5:11) and we have equipped many of our trucks with chillers to expand our chilled DSD network

R&D and Innovation Efforts

- We have brought equipment innovation to market, providing product customization and convenience with our Spire fountain device and made nutritious options more broadly available with our Hello Goodness vending machines
- And we have ramped up our R&D and innovation efforts to launch products that are on-trend with consumers
- For example, this February, we introduced bubly, a new flavored sparkling water with no artificial flavors, sweeteners or calories, and a brand and packaging that convey a playful and upbeat sense of humor

Drinkfinity

- And we recently launched Drinkfinity, now available online in the United States
- This unique beverage system addresses growing consumer demand for customizable nutritious beverages in the most sustainable packaging

Strategy

- We believe our strategy is sound and is positioning us well for the future; however, we are focused on the past three quarters, where our financial results have not lived up to our expectations for the North American Beverage business
- So what is the issue? Simply put, while most parts of the business are performing well, recent losses in cola market share in North America have led to subpar top line and bottom-line performance over the past three quarters
 - We have studied in detail the causes for the share loss across every dimension

New Pepsi Generations Campaign

- The overwhelming driver is that, despite moderately increasing our media on trademark Pepsi over the past three years, our share of voice has fallen dramatically relative to our key competitor, who has substantially stepped up their media spending on colas over the past two years
- To address this, we have allocated increased media to trademark Pepsi
- And we have tightened and elevated our brand communication, beginning with the launch of our new Pepsi Generations campaign

Pepsi Umbrella

- The campaign supports all the brands under the trademark Pepsi umbrella, and this will enable us to more effectively leverage the media investment across our full Pepsi portfolio

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- Importantly, we plan to substantially and sustainably support the campaign throughout the year, while remaining disciplined on pricing
- We are already seeing positive results from the campaign, with research telling us that the campaign is driving higher advertising recall, higher brand recall and higher brand regard with consumers
- And our share performance has also begun to improve
 - These are important first steps
- As we sustain the campaign, we anticipate it will translate to further improving sales and market share results

Tea Portfolio

- Encouragingly, beyond trademark Pepsi, North America Beverages is performing reasonably well in the context of a highly competitive environment
- Our tea portfolio under Lipton and Pure Leaf has over the past 17 quarters grown retail sales in the range of mid-single digits to as high as 21%

Premium LIFEWTR

- Our enhanced water portfolio is performing well, with our premium LIFEWTR continuing to grow nicely as it enters the second year since its initial launch
- And bubly's early results following its 2018 launch are exceeding our expectations
- KeVita, our line of premium organic live probiotic beverages, grew retail sales 50% in Q1, following 66% growth for the full year 2017
- And Starbucks ready-to-drink coffee grew retail sales 3% in Q1, following 4% growth in 2017, despite a number of new competitive entrants in the category
- Furthermore, we are pleased with both the improved trajectories and the outlook for both Mountain Dew and Gatorade
 - Both brands posted improved retail sales performance in the quarter vs H2 last year
- And our positive outlook for these trademarks are underpinned by robust 2018 innovation

MTN DEW ICE

- In January, we launched MTN DEW ICE, a clear lemon-lime flavored DEW made with a splash of real juice with just 100 calories per 12-ounce serving, and it is off to a strong start
- Additionally, we expect our Summer 2018 limited-time offering of MTN DEW BAJA BLAST to perform well, especially relative to our DEW Summer 2017 LTO, which fell short of our expectations

Gatorade Zero

- Also, this summer, we will launch Gatorade Zero
- Gatorade Zero will address the large and growing demand by athletes for additional hydration options
 - We are introducing a Gatorade that provides all the hydration and electrolyte solutions of base Gatorade without the carbohydrates

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- Gatorade Zero will give our athletes more flexibility in combining hydration with other fuel sources to meet their overall sports hydration and nutritional needs
- Taken together, we believe our plans will drive continued improved performance in the business
- Finally, beyond the strategic and execution actions I just mentioned, we continue to consider all available options to drive greater shareholder value from NAB

Frito-Lay North America

- Now moving on to Frito-Lay North America
- We had solid performance, with balanced volume growth and net price utilization and continued strong market share results, driven by great marketplace execution, innovation and creative brand marketing
- For example, building on the success of our 2017 launch of Lay's Poppables, an entirely new growth platform for Frito, we extended the Poppables product line-up with the introduction of new Lay's Poppables Honey Barbecue and a new 12-count multipack of Poppables Sea Salt

Net Revenue Growth

- We continue to drive net revenue growth through increased trial and household penetration, which, when combined with increased purchase frequency from the expanded product line-up and year long media support, should continue to scale up this promising new brand extension
- We have also extended success of our Simply sub-line by introducing new package varieties with the Simply variety pack and a three-flavor lineup of single-serve packages for Simply Lay's, Cheetos and Doritos offerings
- The expanded package variety is enabling us to more fully capitalize on consumers' growing desire for organic non-GMO snacks with no artificial ingredients

U.S. Red Rock Deli

- Demonstrating our focus on lifting and shifting successful ideas around the globe, we recently introduced Red Rock Deli to select markets in the U.S. Red Rock Deli has been a breakout success in Australia that addresses millennials' desire for high-quality food offerings, with credentials like Non-GMO Project Certification and no artificial flavors or colors
- Another example of lift and shift is our launch of the innovative Lay's Smile campaign, a concept that has its roots in a similar campaign we initially ran in China
 - This year, we are harnessing the power of sharing a smile and having a positive impact along the way

Lay's Smiles

- With Lay's Smiles, we put more than 40 unique smiles on Lay's bags
- And with each purchase of a Lay's Smile bag, donated a portion to Operation Smile
- The photogenic and humorous elements of the campaign, combined with a compelling purpose-driven element, have driven terrific exposure for the brand through social media

Quaker Foods North America

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- At Quaker Foods North America, our portfolio of Quaker branded products had mid-single-digit retail sales growth, boosted by the continued success of overnight oats and supported by a new ad campaign highlighting the functional benefits of oatmeal

Organic Revenue Growth

- Let me now turn to our sectors outside of North America
- We are pleased with the 8% organic revenue growth we saw in our developing and emerging markets as a group, which is an acceleration from the 6.5% growth we had in Q4 2017
- Stable to improving macro conditions, combined with strong market execution, have led to very strong growth across many of our key international markets
- Within Latin America, organic revenue grew 10% in Mexico, high teens in Brazil and 20% in Argentina

AMENA

- In AMENA, we had strong double-digit organic revenue growth in China, India, Egypt and Pakistan
- The growth in the sector continues to be diluted somewhat by beverage tax-related declines in Saudi Arabia

Europe Sub-Saharan Africa Sector

- In our Europe Sub-Saharan Africa sector, Turkey and Poland organic revenue grew high teens, while Russia and South Africa grew mid-single digits
- Even within the developed markets of Europe, we saw solid low single-digit growth in the UK and Spain, mid-single-digit growth in France and high single-digit growth in Germany

Initiatives

- Importantly, the strong top line performance translated to impressive bottom-line results, with core constant currency operating profit up 9% in ESSA, 10% in AMENA and 17% in Latin America
- The strong international results are, in part, a reflection of our initiatives to leverage our scale by increasingly coordinating commercial activities across markets and sectors
- Example, with the increased global focus on zero-calorie beverages, we have continued to strengthen and scale our distinctive Pepsi Black under the MAX or Zero Sugar brands, depending on the market, which drove double-digit organic volume growth globally and the United States in 2017

Global Footprint

- We have almost tripled our global footprint from 28 markets at the beginning of 2015 to 77 markets this year
- We are leveraging our Pepsi Generations campaign internationally, airing our This is the Pepsi ad across 55 markets and the soccer-themed copy under the Generations campaign across more than 60 markets
- And we have expanded Lay's Oven Baked to 14 markets, with plans to nearly triple that number in the next two years
- And the Lay's Smiles campaign mentioned earlier has now been launched across markets in each of our sectors and grew retail sales mid-teens in Q1

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Frito-Lay North America

- Net-net, we're encouraged by the momentum we're seeing across many of our key international markets and solid financial performance by Frito-Lay North America
- And although North American Beverages is in the process of a turnaround, we have plans in place that we expect will lead to improving performance

Hugh F. Johnston

Financial Highlights

Macro Perspective

- I'll just provide a quick update on the outlook, and then we'll move to your questions
- From a macro perspective, we remain pretty positive
- We see continued broad-based GDP growth, with developed markets stable and developing and emerging markets accelerating
- And in most of our key markets, including the U.S., the picture is relatively positive, with strong employment, consumer spending and consumer sentiment data
 - However, within this broadly positive picture, there remains a risk of geopolitical volatility in certain markets
- From an industry standpoint, we continue to see pretty challenging conditions, including:
 - Dynamic retail and consumer landscapes
 - A very competitive environment
 - Some currency volatility, most recently, in the Mexican peso, Russian ruble, Turkish lira and Brazilian real, and commodity inflation

NAB's Results

- As Indra mentioned, within our businesses, the majority of our divisions are performing well, and we expect NAB's results to improve as the year progresses
- So putting this all together, our guidance for 2018 remains unchanged
- Specifically, we expect organic revenue growth at least in line with our 2017 growth rate, or 2.3%

Gross Margin

- As we move through the year, our expectation is that we will continue to see some level of gross margin compression from inflationary input costs
- Normally, you would see the gross margin contraction offset with SG&A productivity
- But, as we shared with you in February, with the benefit of a lower effective tax rate in 2018, we are making investments to fortify the business, as well as fund the front-line bonus

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- And these investments will largely offset the productivity-driven margin improvement

Core Effective Tax Rate

- We expect our core effective tax rate to be in the low 20s
- And we expect core EPS of \$5.70 or a 9% increase compared to 2017 core EPS of \$5.23

Cash Flow

- We continue to expect and we continue to generate strong cash flow and to exercise disciplined capital allocation, with prudent reinvestment in the business
- For 2018, we continue to expect FCF of approximately \$6B, which includes approximately \$9B in cash flow from operations, including \$1.4B discretionary pension contribution made in Q1, and net capital spending of approximately \$3.6B

Shareholders and Cash Flow

- We continue to expect to return approximately \$7B to shareholders in 2018, with cash dividends of approximately \$5B, reflecting a 15% increase in the annualized dividend per share starting with the June payment, and share repurchases of approximately \$2B.
- And, as we mentioned on the last conference call, we still see the prospect for even higher cash returns as we begin to fully realize the benefits of greater global cash mobility beyond 2018

Core Constant Currency EPS Growth

- Finally, as you update your models, I'd like to highlight the following
- We continue to expect our core constant currency EPS growth to be higher in H2 than in H1, as we will lap NAB's softer performance and natural disaster-related business disruptions in H2
- And we expect variability in the timing of productivity savings, investments, which includes the accrual of the front-line bonus, and net commodity inflation, to contribute to relatively better performance in H2 2018

QUESTION AND ANSWER SECTION

<Q - Dara W. Mohsenian>: So, Indra, on the Beverage business, obviously a disappointing few quarters, I'd also argue if you go back longer-term, you could argue it's somewhat disappointing a performance, even including the solid results from back in 2015, 2016. And we continue to see this wide dichotomy between the snacks business performance and Beverages. You articulated that with the corporate ex Beverage numbers earlier.

So with all that as context, you mentioned all available options on the call earlier. And, as you think about that, is that more a sort of options and structure maybe that we've seen in the past, perhaps tweaked a bit for today's environment or is that seriously considering more radical changes? And I'm trying to get a sense for the level of sort of discontent within the organization around these Beverage results.

<A - Indra K. Nooyi>: So, Dara, that's a good question. So let me start off by saying, we are talking just about North American Beverages. As I look around the world, given some of the actions in many countries on beverage categories, selected beverage categories, we have actually performed quite well internationally in beverages, not just as PepsiCo, but the PepsiCo system, because our bottlers have their own beverage businesses, too. So if you look at the total, the beverage system of PepsiCo has actually performed extremely competitively.

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The issue is in North America, and the issue is really the last three quarters. We look at the performance of the business constantly. If I look at it post the reinvestment we made in 2012, the business has actually performed quite well, very competitive, but performed quite well. And 2014 coming into 2015, 2016 and even H1 2017 was good. The last three quarters have been worrisome for us.

And let me talk a little bit about this, and I am reflecting back in the last 15 years of looking at North American Beverages, in particular. Whenever we have a competitive situation where somebody is going through a financial transaction with beverages, clearly, that creates room for reinvestment, which starts to perturb the competitive balance. And that's what we are seeing in the last three quarters, because of stepped up investment resulting from business model changes. The question is should we allow this to pass or should we step up and invest along with our competitor and that's a big question we asked ourselves.

For three quarters, we said let it pass, because all of these have a timeframe. And once that temporary investment phase is over, the business comes back to a competitive equilibrium. But we don't want to be a net share donor, especially in CSDs, especially in colas. And so we'll go toe-to-toe and increase our spending in colas, in particular, but we're going to remain very responsible on pricing.

The key thing is this is a business that's highly competitive in North America. There's no question about it. It's a big business. It's a profitable business. Is it the same profile as salty snacks? No, but it generates a lot of U.S. cash, in the mid-teens profitability. I think that's a very, very attractive business in the staples space. And it gives you enormous clout with retailers because the velocity on this categories are phenomenal.

And I will tell you one thing. Anybody who is in the beverage business always wants to be in the salty snack business. And anybody who's in the salty snack business always wishes they had a beverage partner because you can't have a salty snack without a beverage.

So we have the combination together. We just have to keep making sure that our portfolio works. And that's what we are doing. [ph] We like (24:19) the fact that we have to go through these short-term issues with performance, but believe me, our team is maniacally focused on getting this business back to track in H2 this year. And we will, sequentially improving every quarter.

<Q - Lauren R. Lieberman>: I wanted to talk a little bit about productivity. The profitability outside the U.S. really accelerated, and productivity was highlighted kind of ranked first in the description of each businesses in the release. So could you talk a little bit about the balance of kind of productivity savings outside the U.S. vs. within the U.S.? And as we go forward, should we expect more savings to come out of international and perhaps to start to see some margin build or are you still more prioritizing reinvesting, maybe pricing a bit below the rate of inflation to continue consolidating market share internationally? Thanks.

<A - Indra K. Nooyi>: You know, our goal is not to price below inflation. That's not our goal. What we're trying to do is build frequency and penetration. That's all we focus on in every market. And market-by-market is a function of what the nature of the competition is. Because in many of these markets, we have local competitors, too, and we have to think about our pricing architecture vs. local competition.

So at every point in time, Lauren, we are looking across geographies to really figure out how best to grow the businesses. Is it frequency, is it penetration? Do we want to actually create a price umbrella for other local competitors to come in or do we want to remain with a price premium that's reasonable and allows us to build a business?

So while doing this, sometimes, we let productivity flow through. Other times, we reinvest it back in the business. So it's, again, literally a case-by-case basis. The net-net result of all of this is, as a company, overall, we are focused on productivity like you won't believe it.

We think all the digital technologies that are coming, all the new ways we can work to improve agility, improve flexibility, de-layer the company, there's so much we are looking at, is actually going to increase the productivity of our company. It's just that we have to make sure we have enough beta tests done with all the new technologies in the company, that when we roll it out across the company, they actually yield results, as opposed to flopping.

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So we're in the process of doing all the beta tests now to make sure that they actually yield the kind of results that we're looking for. Rest assured, you might see short-term international productivity, but overall, we're looking at global productivity initiatives. Hugh, did you want to add anything?

<A - Hugh F. Johnston>: No. I was just going to comment on that as well. The productivity balance won't change. It will be consistent across the globe.

<A - Indra K. Nooyi>: Yeah.

<Q - Bryan D. Spillane>: So I guess I want to follow-up on Dara's question, just about NAB. And I guess as you think about all the available options to drive greater shareholder value, would that actually include separating or selling NAB? Is the international business still important to have the scale benefits and you'd keep one and not the other or is that really not kind of what you're implying when you talk about all available options?

<A - Indra K. Nooyi>: That's not what we are talking about when we talk about all available options. The beverage business is still a global business. It's very linked, the North America business to the international business. And it's very linked to our snacks business. It provides very important scale in many important international markets and provides us a seat at the table with customers here in the U. S. So I think the beverage business is very important.

The real question we are asking ourselves is how best do we handle the operating aspects of bottling? We've gone back and forth between a separate company, part of PepsiCo. Is it best as a standalone public entity or is it best in the hands of multiple franchisees? The evidence is not clear. And we want to make sure we just don't engage in financial transactions for the sake of financial transactions, but whatever we do is really setting the company on a sustainable path.

So we're looking at what models exist out there. We're looking at what we did in the past. And we are trying to see how best to operate this very attractive, but very competitive beverage business that creates shareholder value and also does not detract from the overall performance of the rest of PepsiCo.

<Q - Vivien Azer>: So, Indra, I was hoping we could touch on Frito-Lay, please. Another solid print from the top line, but I was hoping you could touch on price realization. You did cycle quite a tough compare. But it does also look like in the scanner data, that there might be a slight softening in pricing, driven by competitive promotional activity. So if you just offer any color on that, that would be helpful. Thank you.

<A - Indra K. Nooyi>: So Hugh?

<A - Hugh F. Johnston>: Yeah, I'm happy to answer that. Good morning, Vivien. No, I would take the pricing as more temporary in nature. I think when we get to the end of 2018, you're going to see Frito-Lay pricing that's very much in line with what you've seen in the past. I wouldn't expect any dramatic dislocation in that regard. Quarter-to-quarter, price can wiggle a bit, but by the end of the year, you're going to see the same consistent Frito, both from a pricing perspective, as well as from a profit perspective, that you've seen in the past.

<Q - Caroline Levy>: I'm wondering if I got this right, but it looks like your spending on A&M was down in Q1 North American Beverages. If I did get that right, can you just help us, regardless, understand sort of the pacing of the spend behind this business? And which brands in particular, is it really very cola-focused? Are you going to be spending heavily on all your brands? And what the strategy is, just a little more to get us some confidence in a back half recovery.

<A - Indra K. Nooyi>: Hugh, why don't you take it and then I'll follow up.

<A - Hugh F. Johnston>: Yeah, happy to. Hey, Caroline. A couple things on that, number one, we kind of have to separate the accounting from the actual spending in the marketplace. From an accounting perspective, as, of course you know, A&M gets spread out on a curve. As the volume was a little bit softer in Q1 relative to our expectations for the year, less of the spend would have been booked in Q1. And so you're seeing a timing difference in what appears in the books.

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In terms of media spend in the marketplace, we were actually up strong double digits and strong double digits across the big brands. So I wouldn't over-focus on what the A&M showed up in the financial books. That's a product of GAAP convention. In terms of actual advertising in the marketplace behind the big brands, it was up significantly.

<A - Indra K. Nooyi>: And in terms of going forward, Caroline, which is the second part of your question, in most of the brands that we have, we're spending at very competitive levels, and they're all yielding the right results. The only place where we're outspent in the marketplace is in colas. And we were surprised by the extent to which media spending was taken up in colas by competition.

So we're going to step up our advertising behind trademark Pepsi, with a little bit of a focus on Zero Sugar and Diet Pepsi. And at the end of the day, we don't want to be a share donor. We want to be responsible in pricing. We want to be responsible in portfolio management, to go where the consumer is going. At the same time, being a share donor is not our cup of tea.

<Q - Ali Dibadj>: So I wanted to go back to pricing in North America Beverages for a moment. You may remember, we were quite vocal in pushing that price rationality is the best for shareholders in CSDs, at least. And, look, to your credit, you were early adopters of the sustainable price/mix that we've been seeing in CSDs in North America. But actually, now there's a little bit more controversy about it. I think I'd argued it's the biggest investment controversy we are hearing right now, certainly since Coca-Cola reported a couple days ago. And the controversy is whether price/mix will become more competitive or not.

Now to be clear, you reported pricing up in NAB. DPS reported pricing up in NAB, or their equivalent. KO had pricing down. I don't know if you listened to the call or not, but they excused it away with Easter compares and freight [ph] cost, oddly, and (33:26) price, et cetera. But investors are trying to figure out that controversy in particular. What will price/mix look like in North America Beverages for you, for your competitors, in the context of KO's, hopefully, confusion in terms of their pricing and your talk of reinvestment? I get that you're being clear in terms of being responsible on pricing; want to get a better sense of what that is, and how we should think about price/mix in North America Beverages going forward.

<A - Indra K. Nooyi>: Again, mix is very important, because based on the mix, you'll see what the price realization is going to be. But, Ali, I'll tell you something. We've said this for several years now, and I'll repeat it. The message that all our NAB [ph] chaps (34:14) have is make sure that we never return to what happened in 2011, 2012 when there were \$5 cubes. That's not going to happen. We want to make sure that, especially with inflation creeping into the business, we price to cover inflation. I think it's very important with the category growth of about 2%, that we play this market in a very responsible way, so that we don't further depress the category.

Now, here's a challenge. Single-serve clearly has better price realization. And as the mix of single-serve vs. groceries shifts, clearly, you'll see some pricing perturbation. But from our perspective, we are watching grocery pricing very, very carefully. And we want to make sure we don't destroy the pricing architecture across the industry. And that's really the game we are playing. But we're not going to lose the game because of media spending, because at the end of the day, pricing discipline is one thing. But if it's a question of media spending to make sure that the consumer understands that Pepsi is still a strong, vibrant brand, we're going to spend on media.

And we are maniacally focused on making sure we use every opportunity with mini cans, with other packaging formats, to cover inflation to the extent we can, although that's difficult, but inch the pricing up. That's what we're focused on right now.

<Q - Amit Sharma>: Indra, just a clarification for you and one for Hugh. When you talk about increasing spending on the colas in North America, are we talking about taking spending from other segments and putting it behind colas or are you thinking about just raising the overall bucket? And then for Hugh, Hugh, you talked about maybe potentially bringing more cash back. And when you talk about returning it to shareholders, are you thinking more of buyback or raising dividend maybe higher as well? Thanks.

<A - Indra K. Nooyi>: To your question, the first part, I mean, it's a little bit of both. Some of it will be reallocation, but some of it will be additional spending we'll put in. We are working through the details now, but the fact of the

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matter is, we are going to increase spending behind colas. Hugh, on the increased cash?

<A - Hugh F. Johnston>: Yeah. So, Amit, we're still working through plans to bring cash back to the U.S. No change in 2018 guidance, either from a dividend or share repurchase perspective and as regards 2019, obviously, it's too early to talk about that. We'll talk about specifics of that as we get closer to next year.

<Q - Mark David Swartzberg>: Also NAB; I know we're spending a lot of time on that, but it's important. Firstly, a clarification response to your response to Bryan's question, are you also saying refranchising is not on the table when you say you're not interested in hiving off beverage? And then also, Hugh, you mentioned strong double-digit increases on the big brands. Why do you think the volume didn't respond better to those increases?

<A - Indra K. Nooyi>: On refranchising or any other option, Mark, I didn't say no to anything. I didn't say yes to anything. All that I said was we're studying all of the options, because we have gone back and forth with the bottling business over the last decade or two.

And I don't believe just doing a financial transaction for the sake of short-term financial results is the optimal way to create shareholder value. What we are trying to see is, given the dynamics of this business going forward, given that the mix of products is likely to change, with more hot fill, more non-carbonated, more nutritious beverages coming on to the marketplace, how best do we manage the concentrate business vs. the bottling business, so that we don't have to engage in a financial transaction every five or 10 years. That's what we are trying to do.

We are looking at structures that exists today to see whether they are operationally easy to execute or do they sound good in the short term, but they're very, very, complex and operationally a nightmare to operate. We're studying that. We're also looking at other structures, because I've always told you, the bottling business is a utility, low earnings growth, lots of cash. How do you operate the bottling business like a utility? What's the best structure to do that? That's what we are thinking through, stay tuned.

<A - Hugh F. Johnston>: And, Mark, as regards to the increase in media spending, certain marketing levers work very quickly, distribution and price being the chief among them. Advertising and marketing, there is a building effect over the course of several quarters. So I think you actually did see some responsiveness in Dew, and even Pepsi improved a bit, but it's going to take a few quarters for the Pepsi business to fully respond to the increased advertising in the marketplace.

<Q - Andrea F. Teixeira>: Could you please comment on the cadence, I guess, I want to move back to the numbers, if we can, the cadence of the impacts of the commodities and transportation, and also, obviously the employee bonus, which I understand is a one-time effect and probably behind us. So and correct me if I'm wrong. So if you can help us reconcile as we go through the year against the \$1B productivity per year, so if you can share some of what you're tracking YTD against that objective? Thank you.

<A - Hugh F. Johnston>: Yeah, happy, Andrea, to talk a little bit to that, and certainly, you can follow up with Investor Relations to get into more of the details. Specific to your question, number one, the front-line bonus was entirely booked in Q1, so you see that in the numbers already. Number two, in terms of the commodity inflation, that'll be pretty consistent over the course of the year. And the productivity will equally be consistent relative to prior year over the course of the year. Of course, productivity always builds during the year, but prior year productivity also built. So that shouldn't be a dramatic difference.

<Q - Robert Ottenstein>: I was just wondering if you could give us a little bit of help, and sorry to go back on North American beverages. But is it really as easy as just spending more money and driving share of voice or is it quality of the share of voice? And I'm just wondering if you can just kind of give us some metrics or some evidence of the work that you've done that it's purely a question of share of voice, that you have the right message. You just need to get it out more, and that the brands are essentially healthy. It's just you're being outspent.

<A - Indra K. Nooyi>: Robert, we look at this all the time. Clearly, the quality of voice is important. You cannot just spend with a poor message. The message that we had the last two years, I don't think resonated as much. But the new Pepsi Generations campaign is resonating exceedingly well. It's scoring very high. The recall, the regard numbers are

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all extremely high. And as we go through the summer, you'll see more advertising for Pepsi Zero Sugar, Diet Pepsi as new products come in. You will see a trademark campaign, augmented with some specific additional messaging on Pepsi Zero Sugar and Diet Pepsi. And believe me, we are maniacally focused on the quality of the message to see if it's resonating with the traditional users, which tend to be more the boomers, and then recruiting the new people, which is the millennials.

And we are watching all of these cohort groups to make sure that the message is getting through, that Pepsi is a refreshing drink. It's great for fun times together, and it's great with food. And the recent campaign with Aaron Judge is gaining a lot of attention. And we feel good about the messaging. But at the end of the day, having a great message, but not conveying that regularly, especially with a competitor who is on air all the time, is not the right approach. And so we are going to step up the advertising, and we will constantly look at how it's resonating with consumers. And if we have to make a little tweak here and there, we'll do it.

<Q - Pablo Zuanic>: Look, just to follow-up on this North American Beverage commentary you've made, I mean, obviously, investment bankers listening on this call will be knocking on your door and giving you plenty of ideas and suggestions. But I want to make two questions. One, why do you really think that beverages, whether the concentrate, with or without bottling, gives you greater strength in terms of having a seat at the table? I could argue the opposite, right? That the poor performance in beverages maybe dilutes that seat when you're having discussions about Frito and all the great innovation you are putting through there. So maybe just remind us and convince us, why really having beverages, whether concentrate, with or without bottling, really helps.

And the second question, which is related to that, in the hypothetical scenario that you did not have beverages, tell us what do you think you could do better? I mean, I could argue that the relationship with Tingyi could be expanded. I could argue that you could be a lot more aggressive overseas in expanding your snacks footprint. And I could maybe argue in that you could do a lot more without beverages, but if you can comment on that. I mean, you have opened the door to these questions, of course, with the commentary that you made today. Thanks.

<A - Indra K. Nooyi>: Pablo, first of all, the investment bankers have been knocking on our door forever. They have lots of great ideas. But at the end of the day, as I said, the ideas have got to make sense. They've got to make business sense and shareholder value sense. And we've been thinking through all of this a lot. Hugh, why don't you take the first part of the question and I'll come back and add to it?

<A - Hugh F. Johnston>: Yeah, happy to. Good morning, Pablo. I would respectfully disagree with you on the notion that not having beverages would increase our sway or our influence with retailers. The fact is we're the number one food and beverage company in North America. We're the number two food and beverage company globally. We have impulse categories and expandable consumption. And we've consistently driven growth for our retailers because of the fact that we have impulse categories and strong brands, and they've been well marketed over time. So as our retailers are looking for growth, they inevitably come first to PepsiCo because of the size of the two businesses. It's not to say either one of them isn't a terrific business alone. We just think the two of them are better together, and I have a lot of evidence to support that. So I do think that the retailers value what we bring to the table in their entirety.

<A - Indra K. Nooyi>: Again, Hugh, adding to your comment, in North America, if you take the biggest retailers, they do top-to-top meetings and a joint business plan session, maybe with three companies. And PepsiCo is a company that is a must do a top-to-top with because we are such a big part of the store, such a big part of the growth. And most large retailers will say, if PepsiCo doesn't grow, we can't grow because it's such a big part of the high velocity categories.

So our joint business plan, top-to-top meetings, may be one of the few where the senior-most leaders of the big retailers attend these meetings. Second, I go over to Europe, and individually, our businesses may be 37th or 50th in importance to a retailer. But together, we are in the top 10, but not just in the top 10, we are the fastest growing. And very often, we end up with top-to-top meetings with European retailers, and I attend many of them. And the reason that they ask for the top-to-top is because together, we drive a lot of the sales growth of the retailer, and we are high-velocity categories and bring the traffic in. And we are very innovative across both categories.

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So I think that what we are looking at right now is a short-term performance issue with North American Beverages. We know exactly what needs to get done and we are off doing it. And we have come off three, four years of terrific performance. So we've got three quarters of performance miss and we are going to fix it, period.

<Q - Nik Modi>: I guess a lot of your commentary on the Beverage business has been around just stepping up marketing. But we haven't really talked about much on execution. And I'm just wondering, because if you're in the marketplace and you look at a refranchised Coke territory vs. a Pepsi territory, you can see a very stark difference in terms of pre and post a refranchising for Coke. And so I'm just wondering. How can you compete in that type of situation where you have these independent franchisees just spending a lot more of their own capital in improving execution at retail vs. a company-owned bottling operation? So I just was hoping you can give me some context around that as we think about some of the options you might have in the future.

<A - Indra K. Nooyi>: You're right, Nik. You know what? And this is just our observation, because we've studied all these in great detail. In the first couple of years of refranchising, when the parent company gives you a bit of a break, you're spending the parent company's money. After the first 18 months, it's your money that you have to spend. And right now, those independent bottlers are operating on very, very low margins. So the real challenge is going to be after the first 18 months after refranchising, are they going to be spending their own money off of lower margins already to do what they've been doing in the first 18 months post-refranchising where they got some breaks from the parent company.

I don't know. The jury is out. All that I tell you is, the evidence in a couple of cases where we've seen the first 12 months pass after refranchising, we are already seeing execution drop off significantly. Again, I'm not passing any judgment, I'm just giving you an observation. Believe me, what we are doing is studying their model in great detail. And if we believe their model makes sense, and if we believe that it's a model that can be executed without having to buy back the bottlers again in a few years down the road, the advantage is we can follow it easily. We are in studying mode at this point, along with all other options.

<Q - Bonnie L. Herzog>: I have a follow-on to an earlier question on price/mix, specifically on channel mix. Could you guys drill down a little on what you're seeing in terms of your businesses in the different channels in the quarter and then, your outlook for the rest of the year, and how that may positively or negatively impact your mix? And then, just to clarify, you do expect your price/mix to be positive this year, correct?

<A - Indra K. Nooyi>: Go ahead, Hugh.

<A - Hugh F. Johnston>: Yeah, good morning, Bonnie. First, we're seeing pretty consistent positive pricing across all of the channels. So nothing that you see in the IRI or Nielsen data is different than what we're seeing overall. Second, as regards the year, yeah, we absolutely expect pricing that's consistent with what we've seen in the past couple of years. The business pricing performance has been kind of in the 1% to 2% range; price/mix, it's typically been around 2%. I think that's probably a reasonable assumption for us. Again, all subject to what happens in the marketplace, but that's, I think, what you can reasonably expect.

<Q - Stephen Robert Powers>: Building further on the discussion of snacks and beverages belonging together, as you think about the path to improvement in NAB, I'm just wondering what the role, the relationship with Frito-Lay is expected to play in that improvement. Because as I listened earlier to the plans for NAB improvement, there definitely seem to be many NAB-specific initiatives underway. But in the context of a broader better together Power of One strategy, I guess I continue to be somewhat surprised there aren't more joint snacks and beverages efforts being prioritized, such that Frito's enduring strength can theoretically lift Beverages. Is that just a misconception on my part, that there aren't more or there isn't more explicit cooperation between the two businesses or is there evidence that joint beverages vs. snacks execution still remains elusive? Thanks.

<A - Indra K. Nooyi>: Oh, great question, Steve. I'd say that there's stuff that happens together behind the scenes and stuff that happens that's visible to all the consumers. For the big holidays, you do see joint promotions. The idea of Power of One is not to force joint activity, even if it [ph] doesn't (51:58) make sense, because, sometimes, just based on the marketing calendar with various retailers, Frito and Pepsi may be on deal at different times. So we have to be

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very, very careful that we don't force deal activity when it doesn't make sense. But Super Bowl was an example where the two came together in a significant way.

But let me speak behind the scenes. We talked about the joint business planning. We talked about technology transfer. Frito-Lay had GES. NAB had [ph] GeoBox. (52:26) They're all the same technology. So we negotiate with suppliers in one place. We have the same chassis for both Beverages and Frito-Lay. The go-to-market system shares all the best practices between the two entities.

When we think about customer management, customer databases, how you think about managing the whole customer relationship, we have Power of One customer teams. Our Walmart team is one team. And so behind the scenes, in dealing with the customers, we are one company. From a execution and a shelf perspective, we do displays and joint activity when it makes sense. Foodservice, we go together as much as possible. We do have joint programs between beverages and snacks. That gives us a much better seat at the table for many foodservice negotiations.

Then our Hello Goodness vending machine, which we're now rolling out pretty fast, that's got both beverage and snack better-for-you, good-for-you options in the machine. And that's what's allowing us to win university accounts because they love the fact that we're putting in good-for-you, better-for-you products in machines. And there's both snacks and beverages, and we take care of fulfilling it.

And so I think there's lots going on behind the scenes. Your question sounds like music to my ears because I'd like to do more and more and more. But you've got to be a little bit careful that you don't do Power of One for the sake of Power of One. You do it because it makes sense, in terms of driving sales or lowering costs.

Then talent, one thing I shouldn't forget. The great thing with NAB is, because it's so competitive, if you take a Frito-Lay person, put them in North American Beverages and send them back to Frito-Lay, they're much better executives because they now really learned what it is to be in a dogfight. And so from a talent development, we actually like NAB as a wonderful talent development area where you really earn your stripes for playing in a highly competitive sort of not just large competitors, but a whole bunch of small competitors, and how you navigate that whole minefield.

<Q - Kevin Grundy>: Quick points of clarification and then a broader question on sports drinks, but the clarification is on NAB and the strategic considerations. So, Indra, is there a timeline here that will govern the process? In other words, will investors know next quarter, by year-end, et cetera? So if you could just build on that, I think that would be helpful for people.

The broader question I have, though, is on the Gatorade business and your view for the sports drink category. Trends have slowed there, seemingly on health and wellness concerns. Gatorade's lost some market share, despite higher levels of investment. Can you discuss, Indra, your outlook for the Gatorade business now, how that possibly may have changed over the past year or two, and your level of confidence that new product innovation can improve your trends? Thank you.

<A - Indra K. Nooyi>: The first question – and, Hugh, I'll make some comments. If you want to add something, please do. Look, looking at the best way to operate North American Beverages is not something new. We've been talking about it for the last two years on the call. So we always look at it and say, hey, what's the best way to create value. And that's something we're maniacally focused on. And we've studied other companies' activities. We've looked at creative options on our side.

But, again, we have to make sure whatever we do does not take us back to the old system of having problems between the bottling company and the concentrate company, because this is a big, attractive category. And so there is no timeframe, Kevin. When we get to a place where we think it makes sense to do something, we'll share it with you. But at this point, we're not going to give you any date because we don't know. We haven't come up with the solutions yet. We're still studying.

In terms of Gatorade, the business is still very, very strong. This is like the ready-to-drink coffee business. When some new competitor comes in and decides to drop the pricing substantially and take some share from distribution, the

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leader, especially the leader like Gatorade, has to be very judicious in not trying to compete on pricing. And so what happens is, we allow some distribution build to happen. Then we watch to see what happens to velocities of that product. And right now, what we are seeing is, there is some competition in sports drinks.

But after the first distribution build, velocities are dropping off. And if some of these companies are actually preparing for sale, you do see them taking on some actions that are not sustainable in the long term. In those cases, Gatorade just has to be very responsible and very careful in its response. It's got to be surgical, and that's what we are doing. We are watching Gatorade shares like a hawk. And whenever we have a competitor that's trying to build distribution through pricing, there's a point or two that we might lose, but we always gain it back. It's still the strongest franchise in sports nutrition, bar none.

<Q - Brett Cooper>: A quick question for you, I mean, as the retail environment changes, consumer evolve, is there greater room for collaboration on distribution, both from an efficiency standpoint and potential environmental benefits? I'm thinking specifically within the U.S. or North America? Thanks.

<A - Indra K. Nooyi>: Go ahead, Hugh.

<A - Hugh F. Johnston>: Yeah, Brett, this is Hugh. I think there is always opportunities to do that within the boundaries of competitiveness. So if nothing else, hopefully, this management team has convinced you that we're always looking for avenues for growth that provides good returns. And to the degree that those opportunities present themselves or to the degree that we're able to turn over rocks and ferret them out, rest assured, we'll take advantage of them as quickly as we can.

Indra K. Nooyi

Summary

We are hyper-focused on improving the financial performance of North American Beverages, but in a responsible and sustainable way

We are very pleased with the very strong performance we are seeing across the balance of the business

And we are on track to deliver our full year financial targets.

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