

Company Name: PepsiCo
 Company Ticker: PEP US
 Date: 2018-07-10
 Event Description: Q2 2018 Earnings Call

Market Cap: 159,662.77
 Current PX: 112.89
 YTD Change(\$): -7.03
 YTD Change(%): -5.862

Bloomberg Estimates - EPS
 Current Quarter: 1.626
 Current Year: 5.671
 Bloomberg Estimates - Sales
 Current Quarter: 16478.733
 Current Year: 65033.136

Q2 2018 Earnings Call

Company Participants

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

Other Participants

- Dara W. Mohsenian
- Andrea F. Teixeira
- Pablo Zuanic
- Bryan D. Spillane
- Ali Dibadj
- Judy Hong
- Lauren R. Lieberman
- Steve Powers
- Bonnie L. Herzog
- Amit Sharma
- Mark David Swartzberg
- Robert Ottenstein
- Nik Modi
- William B. Chappell

MANAGEMENT DISCUSSION SECTION

Jamie Caulfield

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 the U.S. Tax Cuts and Jobs Act and other tax-related items, foreign exchange translation and acquisitions, divestitures, structural and other changes 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

Organic Revenue Growth

- We will start off with an overview of second quarter performance and a discussion of each of the operating sectors in a little more detail, and then Hugh will cover the full year outlook

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- For the quarter, we delivered \$16.1B of net revenue, driven by 2.6% organic revenue growth and core earnings of \$1.61 per share, a 7% increase on a core constant currency basis
- Overall, we are pleased with our operating and financial performance in the quarter, especially given continued commodity inflation and our other headwinds in the quarter such as the Brazil transportation strike
- In the quarter, organic revenue growth accelerated sequentially from Q1

Frito-Lay North America's Performance

- The majority of our business has performed very well with particularly strong performances by Frito-Lay North America and each of the international sectors
- And NAB, North American Beverages, posted another quarter of sequential improvement in both organic revenue and operating profit performance

Marketplace Execution, Innovation and Creative Brand Marketing

- Frito-Lay North America delivered balanced volume growth and net price realization, driven by great marketplace execution, innovation and creative brand marketing
- For example, to address consumers' desire for greater flavor and product variety in single-serve market bags, we launched a 20-count Family Fun Mix that includes an array of products from Lay's to Cheetos to Ruffles with an expanded mix of flavors
 - And this clearly helped drive 10% net revenue growth in our overall variety pack businesses
- We launched Ruffles, Mozzarella and Marinara, our latest barfood inspired flavor to meet the expectations of existing fans and capture the attention of new consumers seeking a unique and fun flavor experience
 - And this contributed to Ruffles' 10% net revenue growth in the quarter
- And Doritos Blaze, launched earlier this year with the most talked about Super Bowl ad, continues to perform well above our initial expectations and contributed to 6% net revenue growth in trademark Doritos in Q2
- So, overall, we're feeling very good about Frito-Lay North America's performance and momentum

North American Beverages

- Turning to North American Beverages
- The marketplace remains highly dynamic, but generally rational
- With this as a backdrop, we're encouraged by the trending improvement in both net revenue and operating profit performance

Net Revenue Growth

- After a slow start in the earlier part of Q2, both for the category and North American Beverages, we saw momentum improve and a return to net revenue growth in the back half of Q2
- Within the business, trademark Pepsi continue to make progress towards more stable performance
- As we mentioned last quarter, we have stepped up media support on trademark Pepsi under the Pepsi Generations campaign

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- As a result, in Q2, we began to see improvements in a number of key brand health metrics that is leading to better net revenue performance as the year progresses

Brand Investment and Robust Innovation

- So we intend to stay the course increasing investment behind brand support in H2 with the aim of driving further top line improvement
- At the same time, we remain laser-focused on higher growth categories with appropriate brand investment and robust innovation
 - For example, bubly, a cleverly marketed new entrant in the fast-growing sparkling water segment, launched earlier this year and it continues to perform exceedingly well
- Gatorade Zero, our latest hydration innovation with zero sugar and all the electrolytes of Gatorade just launched and is off to a great start
- More importantly, trends on overall Gatorade performance have also recently accelerated
- And we're excited about the return of Mtn Dew Baja Blast, our summer limited time offer that just hit the shelves
- So overall, we have seen sequential quarterly improvement at NAB, and we expect to see continued acceleration in top line performance in Q3

Quaker Foods North America

- At Quaker Foods North America, our hot cereal business posted its fourth consecutive quarter of market share gains and delivered mid-single-digit retail sales growth, supported by our new ad campaign highlighting the functional benefits of oatmeal
- In addition, Quaker light snacks had double-digit retail sales growth and our Aunt Jemima pancake business grew both retail sales and market share for the seventh consecutive quarter

Latin America

Organic Revenue Growth

- Turning now to our sectors outside of North America
- We are pleased with the more than 6% organic revenue growth we saw in our developing and emerging markets as a group
- Strong marketplace execution combined with stable macro conditions have led to continued solid growth across many of our key international markets, though growth was negatively impacted by the 11-day transportation strike that broadly disrupted commerce in Brazil
- Within Latin America, organic revenue grew 3.5% driven by mid-single-digit growth in Mexico and double-digit growth in Argentina and Colombia
- We estimate the Brazil strike depressed overall net revenue growth for Latin America by approximately 2 percentage points

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Europe Sub-Saharan Africa Sector and AMENA

- In our Europe Sub-Saharan Africa sector, Russia, Poland and South Africa each grew organic revenue high single-digits and Turkey had double-digit organic revenue growth
- Even within the developed markets of Europe, we saw mid-single-digit organic revenue growth in the UK and high single-digit growth in France
- And in AMENA, we had strong double-digit organic revenue growth in China and Egypt, high single-digit organic revenue growth in Pakistan and Australia, and solid mid-single-digit organic revenue growth in India
 - This strong top line performance translated into impressive bottom line results with core constant currency operating profit up 12% in our international divisions as a group, fueled by fundamental operating performance and the gain this year from the Thailand refranchising partially offset by lapping the gain from our sale of Britvic shares in 2017

Latin America

- The international results are in part a reflection of our efforts to increasingly lift and shift successful initiatives from one market to many, and innovating on our big global brands in locally relevant ways
- For instance, in Latin America, we're innovating with Quaker Super Foods, a new premium platform with differentiated ingredients such as oats with rye, amaranth, flaxseed and quinoa

ESSA

- In ESSA, we have lifted and shifted Off the Eaten Path, a premium range of plant-based snacks from the U.S. to the United Kingdom
- And in AMENA, we have taken our successful Sunbites platform from the U.S. to Australia by launching Sunbites Grain Waves Plus with the goodness of Australian whole grain corn, wheat and oats plus beetroot and sweet potato
- At the same time, we've also launched in the U.S., Red Rock Deli, one of our most successful brands in Australia
- Net, we're encouraged by the momentum we're seeing across many of our key international markets

NAB

- NAB is making steady improvement and Frito-Lay North America is performing well
- Importantly, as we manage the business with strong performance today, we're also taking steps to enable it to continue to perform well in the decades ahead
- We are pleased to report that in the coming days, we'll publish our most recent sustainability report, discussing our progress against and commitments to our sustainability goals

Opportunity and Responsibility

- We encourage you to read the full report, but I'd like to take just a few minutes this morning to provide you with the highlights
- We are in millions of pantries and refrigerators worldwide, so we know we have a tremendous opportunity and responsibility to use our scale to make a positive impact on the world

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- Our customers, employees and partners feel good knowing that we're in a shared journey of sustainable transformation making our products more nutritious and more resource efficient, dialing up the taste while reducing our environmental footprint

Performance with Purpose

- Our investors can feel good knowing this makes us a stronger business over the long term and that we can also do well by also doing good
- 12 years ago, we embarked on a journey at PepsiCo as we call Performance with Purpose
 - Since then, much has changed at PepsiCo and around the world, but the underlying principles behind Performance with Purpose remain
- Much of our early work on Performance with Purpose required us to think differently about our business and make the kinds of long-term investments from researching and developing new more nutritious products, to finding ways to reduce water and energy use across plants and farms that will help us deliver on the vision of making our growth, our operations and our impact more sustainable

Sustainability

- Sustainability has been defined as meeting the needs of the present without compromising the ability of future generations to meet their own needs
- Over the last dozen years, we've tried to meet the needs of the present, while strengthening the ability of future generations to meet theirs, integrating that aspiration into our goals for products, planet and people

Products

- Let me briefly comment on each
- When it comes to products, we've built on our legacy as the first company to voluntarily remove trans-fats from our snacks by reducing added sugars, sodium and saturated fat in many of our products launching a revolutionary nutrition-focused vending option, Hello Goodness, and growing our portfolio of what we define as Good for You and Better for You options from about 38% of revenue in 2006 to roughly 50% last year
- We also teamed up with others in our industry to form the Healthy Weight Commitment Foundation removing 6.4 trillion calories from our food and beverage products, surpassing our collective pledge by more than 400%
- And through Food for Good, we've provided 80mm nutritious servings to low-income U.S. families since 2009

Planet

- Regarding planet, we've raised the bar for what it means to be a responsible corporate water steward earning the prestigious Stockholm Industry Water Award
- We've invested more than \$40mm since 2006 to provide safe water access around the world benefiting nearly 16mm people in some of the planet's most water-stressed regions
- We've also made our delivery fleet more energy efficient eliminating the need for over one million gallons of diesel fuel since our electric vehicle initiative began in 2010, the equivalent of keeping more than 2,000 passenger cars off the road for a year while also making our beverage coolers and vending machines 60% more energy efficient

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- And we're one of the world's largest purchasers of recycled PET
- In fact, if more recycled PET were available, we would buy it

Compostable Chip Bag

- We've also launched the first 100% compostable chip bag in test markets while diverting more and more of our waste from landfill, approximately 95% as of 2017
- And for people, we have reimagined what it means to support our associates from ushering on-site and near site childcare campuses around the world to expanding PepsiCo University's online course offerings to help associates upgrade their skills to navigate a rapidly changing world

Disaster Relief Efforts

- We've also helped lift up the communities we serve, playing a critical role in disaster relief efforts from Texas to Florida and Puerto Rico, Mexico to Ecuador and China to the Philippines
- While we still have work to do in certain areas, we're incredibly proud of the progress we've made
- Our aspiration of being a good company, good ethically and good commercially continues to come to fruition, yielding a broader, more lasting impact than we ever imagined and setting a standard that companies across our industry and beyond aspire to meet

Outlook

Looking ahead, we will continue viewing our work through both the microscope and the telescope, focusing on the most granular details, grams of saturated fat, parts per billion of greenhouse gas, the number of women in management roles as well as the larger ambition of building a business and acts in accordance with our values, each of us striving to do what's right for the company and what is right for our communities because at the end of the day there is no separating the two

Hugh F. Johnston

Financial Highlights

Opening Remarks

- I will just provide a quick update on the outlook and then we'll move to your questions
- From a macro perspective, we maintain a fairly positive view overall
- However, within this broadly positive picture, there remains risk of volatility both in geographic markets as we saw in Brazil in the most recent quarter and in currencies as witnessed by the recent sharp rise in the strength of the U.S. dollar
- From an industry standpoint, we continue to see pretty challenging conditions, including a dynamic retail and consumer landscape, a very competitive environment, and ongoing commodity inflation
- So, putting this altogether and considering our YTD performance, our guidance for 2018 remains unchanged

Organic Revenue Growth, Gross Margin, SG&A and Tax Rate

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- Specifically, we expect organic revenue growth at least in line with our 2017 growth rate or 2.3%
- As we move through the year, our expectation is that we will continue to see some levels of gross margin compression from inflationary input costs
- Normally, you would expect to see the gross margin contraction offset with SG&A productivity, but as we have stated previously, with the benefit of a lower effective tax rate in 2018, we are making investments to fortify the business as well as having funded the U.S. frontline bonus and these investments will largely offset productivity-driven margin improvement

EPS, Cash Flow, Dividends and Share Repurchase

- We expect our core effective tax rate to be in the low-20% and we expect core EPS of \$5.70, or a 9% increase compared to 2017 core EPS of \$5.23. We expect to continue to generate strong cash flow and to exercise disciplined capital allocation with prudent reinvestment into 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
- 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 that began with the June payment and share repurchases of approximately \$2B

Earnings Growth

- Finally, as you update your models, I'd like to highlight the following
- We expect our rate of earnings growth to be substantially higher in the fourth than in Q3
 - This is due to the timing of investments and the lapse associated with last year's natural disasters
- In addition, we expect the previously announced refranchising of our Czech Republic, Hungary and Slovakia business operations to benefit our fourth quarter earnings and, finally, based on market consensus forecasts, we expect foreign exchange translation to negatively impact both net revenue and operating profit in H2 reversing the ForEx benefits that we had in H1

QUESTION AND ANSWER SECTION

<Q - Dara W. Mohsenian>: Indra, clearly there has been a lot of investor focus around a number of pressure points in the CPG industry in terms of pricing power, brand demand, fragmentation, et cetera, et cetera, and basically that some of the traditional advantages of larger CPG companies are breaking down. In that context, I was hoping you could give us some perspective on if there are areas of significant investment or operational changes at Pepsi going forward beyond what you've already done to help position the company vs. some of those industry challenges and how realistic or long-term, high single-digit earnings growth algorithm beyond 2018 is if you need to reinvest against some of those pressure points?

And within that answer, I was hoping specifically you could touch on price/mix. You've obviously had strong pricing realization in the last few years with the inflationary commodities and the trade and tariff risks. I'd love some updated thoughts on price/mix also within that. Thanks.

<A - Indra K. Nooyi>: Thanks, Dara. And first of all, I think you asked me about 10 questions within one question. But given that we had this technical difficulty, I guess you're entitled to ask these 10 questions.

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I think you asked a set of very, very interesting questions. I think the changes we're seeing in the industry are quite interesting. And I think the changes that we're seeing benefit companies that have already invested to build scale, build an international footprint and have the right partnerships around the world. I think now is not the time for companies to go and plant flags in new countries and try to start up businesses. So I'd actually observe that the advantage CPG companies are small, niche, single country companies with small brands who grow to a certain level and then flip it, or very large established scale companies who've built businesses in multiple geographies, and I don't mean just planting the flag, actually build scale.

And I think PepsiCo is one of those few companies that have actually, over the years, invested to build scale, put the right partnerships in place, built a diversified portfolio and actually solidified our presence, and we made all the investments over the years. So, that part of the investment is behind us. This next tranche of investments relate to digitalization, thinking through more automation in our plants, in our go-to-market systems, figuring out how we can unleash more productivity, but more efficiency and effectiveness, not just efficiency, efficiency and effectiveness, so that we can serve the changing retail world in more efficient and productive ways.

Because retailers are going to go through their own changes, and they're going to look at a few players to be the anchor suppliers to them while they handle with all kinds of changes with a large portion of the CPG world. And I think PepsiCo with its DSD systems and with its high velocity categories, its brand portfolio and, most importantly, innovation, becomes a very valuable partner across the world.

I mean, I've often said this to you. When we had just snacks or beverages going to large European retailers, we were like 37 in a number of 50 on the list. Now, with our combined approach and a Power of One approach, we're in the top five or top seven suppliers, driving a lot of the growth. So they look at us and say, there are these large companies that drive a lot of growth and our anchor suppliers that we should just have great relationships with, leave them aside while we focus on all of the other players that we need to either prune the portfolio or figure out how to make them more efficient.

So, we're making investments in digitalization, more automation in plants, rethinking our innovation process, and making sure that we fragment or segment our innovation between premium, mid, and value, and deal with each country and each marketplace with that sort of an architecture. And then we're getting better and better at lifting and shifting across the world.

So then I don't think there are big bursts of innovation required. All that we are doing is investing as we go along. And I think Hugh talked about the fact that we've been making investments in the business. We've been doing that deliberately and carefully over the years. And we're going to continue to do that. We're going to look for ways to unleash productivity and every time we have productivity, we're going to see how we judiciously reinvest in the business so that we can keep this engine going.

And in terms of price/mix, innovation is a big driver of price/mix, as is revenue management. And we're improving our revenue management skills all the time, applying more digital tools. When it comes to innovation, we're thinking more and more about segmenting our innovation, and we're also thinking about how to incubate a niche company within our big company, and that's what we're focused on in every big region of the world. So, overall, we feel very comfortable with our overall strategy.

<Q - Andrea F. Teixeira>: I was hoping if you can update us on your outlook for NAB since the last call as you're considering strategic alternatives. Any light of this combined approach with technology you just mentioned using the European example? I would appreciate if you can elaborate. Thank you.

<A - Indra K. Nooyi>: I'll provide some opening comments, Andrea, and then toss it to Hugh to give more color. What we told you in the last call is that you should expect to see sequential improvement in North American Beverage performance. That's exactly what we're focused on and that's what we're delivering. Every part of the business in North American Beverages is showing sequential improvement. And in the second part of Q2, we saw significant improvement in performance and, as we go into Q3, we feel good about the trend rate. We are playing a very responsible game in terms of advertising and pricing. And with commodity inflation, we will continue to take a

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responsible position in this marketplace by pushing through pricing.

So, at the end of the day, our North American Beverage business, which participates in a highly competitive category, needs to be managed very, very carefully, especially at a time when there are changes in the marketplace from lots of competitive activity. And, look, there's always going to be short-term perturbations when competitors go through major changes in their business models. Our challenge is to maintain a very steady hand and make the PepsiCo portfolio work for us, and that's what we've been doing.

I don't know, Hugh, if you want to add anything to this.

<A - Hugh F. Johnston>: The only thing I would add, Indra, is hopefully you all have seen that this management team is always focused on creating value both in the short term and in the long term and achieving the right balance between the two. And as we look at all of the businesses, that is our most significant focus. And I think we will continue to do that just as we have.

<Q - Pablo Zuanic>: Look, two quick questions. One, I understand that you're [ph] reinvesting really the (00:30:39) tax benefit, but can you clarify whether that's more heavily geared to reinvesting in beverages, or is it pretty much evenly across the business?

And the second question which is related to that, when you see a success that Coca-Cola has had with the Diet Coke and new products and with Coca-Cola Zero Sugar, any thoughts in terms of how things would be done different on the Pepsi side of things? And the reason I ask that is that if the brands themselves haven't been improved in terms of innovation, how much is reinvestment and more marketing going to help? Thanks.

<A - Indra K. Nooyi>: Pablo, we reinvested tax benefits on additional media for NAB and wherever the businesses needed investment, we put it in. The idea is not just to invest, it's to reinvest judiciously, so that we get a return from the investments. And we also reinvested some of the tax benefits in our frontline bonus, so that especially people in the United States where the tax benefits really accrued can benefit from the upside.

Now when it comes to our North American Beverage business, we're investing in CSDs, especially trademark Pepsi. And we're investing more in trademark Pepsi because we saw stepped up investment in media from our competition, so we're doing that. When it comes to the Zero Sugar portfolio both between Diet Pepsi and Pepsi Zero Sugar, Pepsi Zero Sugar is growing extremely well, extremely well. I mean, it's a – I hate to use the word flying off the shelves, but it's doing exceedingly well.

When it comes to Diet Pepsi, Diet Pepsi is also back to good performance. And I have to tell you, the flavor portfolio on Diet Pepsi and whatever competition launched, you might want to look at the numbers in a little bit more detail, because I think it's a mixed bag. We have to be careful not to draw too much innovation to this marketplace and sort of obfuscate the numbers. From our perspective, our Zero Sugar portfolio between Diet and Zero Sugar is doing well. And it's doing well on a sustained consistent basis.

And we're playing the long game, Pablo, in terms of overall liquid refreshment beverages. And we think that that's the right way to play this beverage game, and we feel good about where we're headed.

<Q - Bryan D. Spillane>: I just wanted to pick up on – you made a comment in terms of the forward guidance about gross margin still being under pressure in H2. So, I guess, couple of questions. And I guess that implies, we should expect the gross margins might be down in H2. And then maybe what some of the pressure points are what sort of inflation and I guess also maybe transactional effect. If you could just kind of walk us through what's going to drive that pressure in gross margins in H2 and maybe what mitigation you might have as we look forward into 2019?

<A - Hugh F. Johnston>: Yeah, Bryan, happy to do that. So, a couple of comments. When I say gross margins under pressure, I'm talking about relatively nominal pressure as we've seen over the last several quarters. A combination of a couple of factors on gross margin: number one, obviously commodity inflation has picked up a bit. Certainly we've seen a bit more in oil and in addition to that in aluminum.

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Second, transport costs have also been under some pressure with the driver shortage in the United States. And then, third, in international markets, as you know, where we have seen some inflation, we do tend to price a bit behind in inflation and try to drive productivity in order to offset that. And then, obviously we're reinvesting the tax benefit in the form of new capabilities, so you don't see the productivity flow through as you normally might in SG&A.

So, those are the several factors that are driving it. Overall, as I said, we expect full year to be on the 9% that we originally committed to, and we're balancing the internal workings of the P&L to make that happen.

<Q - Ali Dibadj>: So, just wanted to ask a little bit more about the sustainability of your results going forward along three dimensions. First, is the sustainability of one-timers like Thailand and Britvic and coming up on Czech Republic here in your core results? Should we continue to expect things like that to be a consistent part of your algorithm going forward? How much more of those types of things do you have to sell?

Second, in terms of pricing, it continues to be a big driver, obviously, for Latin America, and you're willing to continue to sacrifice a little bit of volume there again. How much longer do you think that's sustainable?

And then, third, on NAB improvements, very pleased that they're on track, both you and I. If you can give us more about whether you believe that was actually driven by advertising increases, was there an advertising increase in particular in NAB overall as opposed to just Pepsi – because you call it Pepsi, but I don't see it in the release for the segment NAB or is there something else that drove that improvement. And so, will that improvement, you guys, believe continue not just going to this quarter but going forward?

<A - Indra K. Nooyi>: I'm going to take the third one. And then, Hugh, I'm going to toss it to you to talk about the first two, okay? NAB improvement, again, Ali, as I mentioned, we are playing the LRB game. We are looking to improve our position in the liquid refreshment beverage category because we play in pretty much every category in LRB, most of them, but with very, very strong brands.

And in terms of A&M spending, we increased A&M spending on trademark Pepsi as we mentioned we were going to do and because the A&M gets curved in, you'll see the benefits flowing through in Q3 and Q4 more as we go through, and we are seeing the improvement in brand health metrics and we're seeing a sequential improvement in the performance of the business.

So, believe me, we are focused maniacally on tracking the performance and the results of all of our increased spending, and what we're seeing in the results that gives us confidence to tell you what we told you on the call today. So, on balance, we are feeling good about the NAB performance trends.

Now, let me turn it to Hugh to talk about the one-timers and pricing, especially in countries like – regions like Latin America.

<A - Hugh F. Johnston>: Happy to, Ali. In terms of one-timers, if you look at our record over the last four or five years, we've always had some one-timers and whether it's refranchising of businesses or sales of businesses or assets. So that's going to continue to be a factor as it has been.

In terms of Latin America, without a doubt, where you have high inflation environments, we've tended to price through the vast majority of that inflation and, as a result, it's improved our revenue results sometimes at the expense of volume. As you see, the inflation rates come down in those countries. Obviously our pricing will diminish, but we do expect that our volume will pick up as a result of that and we expect to continue to see strong results out of Latin America and other places that have historically had high inflation where the numbers have come down a bit.

<A - Indra K. Nooyi>: I think the most important thing of one-timers, Hugh, we don't do one-timers to deliver earnings, we do one-timers because we think it's the right business model for those countries. And what we're trying to do is to strengthen the core business so that we have the right partner to boost the performance of that beverage business in certain markets. We'll franchise it to them. And if we think we are better off operating it, we'll do that. So, I think we use one-timers in a very judicious, strategic way to improve the overall performance of the company.

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 Event Description: Q2 2018 Earnings Call

Market Cap: 159,662.77
 Current PX: 112.89
 YTD Change(\$): -7.03
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<Q - Judy Hong>: So, Indra, I guess I just wanted to get a little bit more color on the Gatorade performance. Trends have gotten a little bit better recently, the comps are getting easier, so maybe that's also helping. But just wanted to also get a better sense of maybe some of the brand, health metrics that you talked about as it relates to maybe that was, I think, more of a Pepsi trademark comment, but on Gatorade specifically. And then, as you think about Gatorade Zero, a little bit more color just in terms of the positioning of that particular line and how much marketing investments that you're making on that line. Thanks.

<A - Indra K. Nooyi>: Gatorade is actually doing very well. And this weather is helping for sure, but the underline Gatorade trademark is very, very strong. And Gatorade always attracts new players into the marketplace, and they come in with either lower prices or they try to come in and build distribution and they might take a few share points in any quarter or two. But then, over time, if you look at it over a period of five or seven years, the Gatorade franchise has been extremely resilient and has basically held on to its leadership position. We've innovated to build shoulders with the Gatorade recovery drinks, the Gatorade [ph] juice (00:40:24) before you start exercising, and then we have segmented along flavors and then across different sports.

Many of our consumers wanted a Gatorade Zero for the light exerciser who didn't want the carbohydrates that real athletes needed. And so, we launched Gatorade Zero even though there's Propel also, they wanted to be seen with the Gatorade, so we launched Gatorade Zero. And we keep advertising along the entire trademark, and we have never wavered from advertising to athletes and to active exercisers, and that's going to be the continuous focus of Gatorade. It's a very strong, resilient franchise. And we feel good about where it is and where it's headed.

<Q - Lauren R. Lieberman>: I was curious you mentioned sort of two different types of comments around brands and innovation. So, one bucket was sort of the discussion of lift and shift, continuing to support and build your biggest franchises. And then, Indra, you also mentioned the idea of incubating niche brands or companies within markets. So, I was curious if you could kind of put those two together, and in particular what I have been most curious about is how PepsiCo is thinking about a small brand strategy, if you want or need to have one in the beverage business. Because when I look at some of the work you've done in the last two years, LIFEWTR, bubly, it's very much a strategy of drive a blockbuster win, not build something slowly and patiently through single-serve and discovery. So, I was curious to your thoughts around the viability of a small brand strategy within PepsiCo and if that was something you were focusing on. Thanks.

<A - Indra K. Nooyi>: Actually it's a great question, Lauren. If I look back especially the last five years of beverages, we've had some spectacular new products, which for any small start-up company would have been a blockbuster. But for PepsiCo, because we put it through DSD system, unless it reaches the scale of a LIFEWTR or bubly in the first 12 months to 18 months, we can't support it, because many times the space has to come out of the core cooler or the core aisle, and so we look at differential velocities, and then the DSD system tends to kill it.

And if I look at products like Lemon Lemon from last year, it was rated the best new product launch of last year. It reached a pretty impressive level of sales, yet on the DSD system, it didn't do that well because it was cannibalizing space from a core CSD category. So what we've created now is this new entity within PepsiCo called The Hive. It's a separate group, just like we did with e-commerce, we've taken it out of the core headquarters. It's going to be an entrepreneurial group. That's going to take some of the best new products that we launched and reached a certain size, but we never really allowed it to thrive in the DSD system.

We're going to nurture it and incubate it in whatever distribution system they think is the best for it. And when it reaches a certain size, we can decide whether it should come into the DSD system or not. And this group is also going to look at other venturing brands they can bring in. And we want to create an environment where we have a business within a business, a small entrepreneurial sort of agile group that's thinking about the new age consumer that loves discovery brands, while allowing the big brands to thrive in the overall mothership.

And this is not new to PepsiCo North America, we're doing something like this in Europe also. It's a very local business. So we have to be careful not to make it global. It's a very local business. And we're going to play with these businesses, because there is a consumer that is willing to pay for discovery brands, and they can reach a decent level of growth. And so, we're going to go off and see how to make it happen. We're feeling excited about what we've just

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launched. Let's see what happens the next few months and years.

<Q - Steve Powers>: So going back to North American Beverages for a minute, it does indeed look like we're on track for a return to growth in H2, which is great. I just want a little bit more context about what you might feel the top success factors in that path, whether it's a key launch like Gatorade Zero, better realized price/mix as inflation builds more of an inflection in core Pepsi or just – are there one or two priorities on your scorecard that you could call out for us, that'd be great.

And then, secondly, as you've been open about your ongoing assessment of strategic options for the bottling utility, as you've called it, whether that's constituting a standalone entity or putting in the hands of multiple franchisees or keeping it as part of PepsiCo. I'm just curious as to whether or not you've narrowed in on any subset of those options, or what the timeframe might be for you being in a position to communicate your path forward to the market? Thanks.

<A - Indra K. Nooyi>: Hugh?

<A - Hugh F. Johnston>: Yes. Steve, happy to answer those questions. First, in terms of the priorities, if nothing else, what we saw last year and we've certainly seen in this year, we need to be able to both make sure the big businesses are on track in North America Beverages. Those big businesses obviously are Pepsi, Mountain Dew and Gatorade. What we've seen over the last couple of quarters is certainly a strengthening in the Mountain Dew business, both the core green bottle business as well as the innovation with Ice, and now the return of Baja Blast, which has always been a Mountain Dew fan favorite.

Second obviously is Gatorade. Gatorade certainly is a business that's now back on track, and we're very excited about the innovation. Gatorade Zero really meets, I think, a very unmet need for the [ph] lapsed (46:42) Gatorade user because, as Indra pointed out earlier, they just don't want the calories but they want the Gatorade brand.

And then, Pepsi, where we knew we needed to increase the advertising, we knew we needed to have a good campaign this year. That obviously takes longer to do. The quantity is easier to turn on, but just getting in into consumers' minds takes a period of time. So, for sure, the big priority is making sure the big businesses are doing well.

Second is continue to execute against the innovations in the newer categories, whether it's bubbly or continuing to execute LIFEWTR or continuing to make sure newer brands like KeVita do well. That's the additive that sort of creates the growth in the business. The core brands grow at a certain rate and all of those new innovations create the incremental growth. So, I think we need to be able to do both. North America Beverage is obviously a big nuanced complex business and we need to do more than one or two things well. We need to do most things well for that business to perform. And that's what you see happening.

Regarding strategic options, nothing new to report on that. We'll continue to look at options to create value not only in that business, but across all of our businesses.

<Q - Bonnie L. Herzog>: So, I wanted to talk about Frito-Lay North America. Your growth really has been impressive both on the top and bottom line, so how sustainable is this from a long-term perspective? And then, could you guys walk through for us any productivity initiative that you specifically implemented in Frito-Lay that you possibly could implement across the rest of your businesses? Thanks.

<A - Indra K. Nooyi>: I think, Frito-Lay, the reason the growth is impressive is because Frito-Lay plays in salty snacks and the entire macro snack space is there for the taking. And so, Frito-Lay, focus is on the core and then inches out of the core by taking occasions from the rest of macro snacks, and innovation engine is very geared to going on and building both frequency and penetration and picking up more and more snacking occasions. And as long as they keep doing that, they should be able to deliver the growth. The DSD apparatus is an extremely impressive machine and that actually helps sustain Frito-Lay's growth.

In terms of productivity initiatives, we've talked about GES, Bonnie. GES is now rolling out to multiple locations. It's doing two things. One is delivering more productivity, but more importantly is debottlenecking the system because it's allowing us to put more SKUs and be more customer specific in our picking. And so, GES has actually been a big benefit for us. And then, deploying more digital technologies across Frito-Lay is actually delivering more productivity.

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The good news is, as North America, tools that North American Beverages develops goes to Frito-Lay and what Frito-Lay develops comes to North America. And so, we have a wonderful transfer of knowledge and tests that's happening between the two businesses, and so we can take the customer base, both traditional trade often down the Street and big organized accounts, and figure out how to serve them better with whether you call it GeoBox at our beverage business, or GES in Frito-Lay, there's a lot of information exchange going on.

And overall, I think both businesses are high velocity businesses, and they're able to unleash productivity to reinvest to keep this growth engine going.

Do you want to add anything, Hugh?

<A - Hugh F. Johnston>: No, I think you've captured it very well.

<Q - Amit Sharma>: A quick clarification, you did say you expect to take pricing in NAB CSDs. Can you talk about how quickly we should expect you to roll out pricing and to what extent? And then, another one, gas prices are now multi-year high. Are you seeing any change in consumer behavior, especially in the C-store channel?

<A - Hugh F. Johnston>: Yeah, to answer your first question first. I think you'll see incremental pricing benefit in Q3 and then you'll see more in Q4. Regarding gas prices, convenience channel was up about 3%, I believe, overall for Q2. So, I think given the healthiness of the overall economy, that's more than offsetting the gas price increases.

<Q - Mark David Swartzberg>: Hugh, just for you, on CapEx, could you remind us why the \$3.6B is higher than it's been historically, and how representative you think that is of future CapEx either in absolute terms or relative to sales?

<A - Hugh F. Johnston>: Yeah. So, our previously discussed long-term guidance is equal to or less than 5% of net revenue. No update on that right now. Bigger investments in a couple of places, Latin America, we've seen capital spending go up as we've implemented some of the GES solutions that Indra has mentioned on the previous questions. Number two, we're investing more in Frito-Lay because we're identifying projects to drive continued growth and productivity. And number three, North America Beverage, as the single-serve strategy has continued to be successful, we're adding capacity in certain places.

<Q - Robert Ottenstein>: Indra, in the past, you've given us a little bit more color in terms of market share gains and value share gains. And clearly you're doing very well outside of the U.S. Can you perhaps give us a little bit of a sense of where you're gaining share in important international markets and where things are more challenging?

And then, secondly, bubbly, off to a great start. Perhaps if you could maybe stand back a little bit and give us a sense of where you see yourself taking your water strategy and what percentage of the business it is right now? Thank you.

<A - Indra K. Nooyi>: In terms of share gains internationally, I think, overall, salty snacks globally, I think, in 75% of the markets, we are holding or gaining share. Remember, internationally, we also have a lot of local low-cost competitors. In spite of that, I think 70%, 75% of the markets we hold or gain share. I think in 60% of the markets, we're gaining share and about 75%, we either hold or gain.

I'm giving you rough numbers, Robert. In terms of beverages, again, in many of the markets that we participate, as PepsiCo, about 50% or 60% of markets, we're actually holding or gaining share. And in the other markets, we go in and out, one quarter we may gain share, one quarter local competitor or a global competitor may gain share. So, we trade shares on a quarterly basis based on what we're lapping or what specific blockbuster marketing initiative is being implemented at that time.

But overall, what we are focused on is, on an annual basis, how do we make sure that we don't do anything crazy just to gain share. We participate in a very responsible way. And somewhere between 60% and 75% of our markets, if we can hold or gain share, that's a very sustainable, deliberate strategy. And that's really what we're focused on globally both in the snacks and beverages, and now more and more in our nutrition businesses, which we are trying to figure out what the relevant marketplace is and how do we calculate a fair market share number. So that's roughly speaking where we are on share.

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<A - **Hugh F. Johnston**>: On water, Indra, just....

<A - **Indra K. Nooyi**>: Oh, water, yeah.

<A - **Hugh F. Johnston**>: ...I'll finish Robert's question. It's about 12% of our volume, Robert, round numbers. And in terms of water strategy, obviously we have a case-pack water business that provides base load volume. And then, we are increasingly segmenting that business, whether it be with flavored still waters, whether it be with flavored sparkling waters in the form of bubbly, whether it be in the form of LIFEWTR, which obviously appeals to a large consumer segment and one that continues to grow well for us. So, I think you'll continue to see us segment the water category into profitable niches to go along with the large scale case-pack water business.

<Q - **Nik Modi**>: Indra, I was hoping you could provide some of the logic behind the various refranchising initiatives PepsiCo has undertaken in the international markets, and how any early learnings could inform the beverage strategy in the U.S. And I guess, the main question is, is it even translatable? That would be really helpful to understand.

<A - **Indra K. Nooyi**>: You know, Nik, I'll tell you, that's a good question, and let me just offer some points. When we refranchise, it's usually to somebody who already has a portfolio of beverages, because Pepsi internationally in many markets we don't have a full line of beverages. We participate only in a small lineup. We partner with somebody who has their own LRB products, and together we cover the entire line.

An example would be somebody like Postobón in Colombia that has their own line of non-carbs. And then, we come in with our portfolio and, together, we have a fantastic leadership position in Colombia. What we're looking at, and Hugh talked about our Czech Republic, Hungary and Slovakia beverage operations, we're refranchising it to our partner who already has a lineup of LRB and we complete the portfolio. So, our system actually is much more robust than people realize because as a system we are much stronger than just PepsiCo in the international beverage business. And that's why we feel good about the beverage business.

And the early learnings are, make sure if you're going to refranchise, refranchise to somebody who knows how to run the beverage business and they have a portfolio that together the one plus one is a three, not detracting from our own performance. So that's all we are going to focus on going forward, and those are the learnings from our beverage refranchising.

<Q - **William B. Chappell**>: Question on just a momentum in NAB that you talked about as it kind of started slow and had good momentum at the end, I mean, that tracks with kind of what we saw in North America weather in terms of cold and wet late March, April, early May and then came back roaring and then very hot. So, trying to understand what you see that makes you feel that it's beyond weather, I mean, the whole – lifting the whole category? Are you seeing kind of market share? Especially in CSDs, are you seeing something stabilize? Or what gives you so much confidence that carries through as we get to kind of more normal weather albeit easier comps in the back half?

<A - **Indra K. Nooyi**>: Weather is clearly a factor. I mean, I would be lying if I didn't tell you that hot weather helps the beverage business. But I think on top of that our brand helps metrics that are all trending the right way. The business is trending the right way. And pretty much all of our franchises, we are seeing sequential improvement in performance. And so, even businesses have had difficult lapse, we are seeing sequential improvement in performance. So, I think if this continues, this bodes well for NAB

Indra K. Nooyi

Closing Remarks

Let me summarize

The business overall is performing well in a highly dynamic environment, and we remain on track to deliver our financial goals for the year

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We remain highly focused on driving better operating performance from North American Beverages, and we are encouraged by the sequential improvements that we have seen in NAB

Just as important, even as we remained highly focused on performing well in the current and coming quarters, we remain committed to continuing to transform the business, to strengthen its sustainability and durability, to perform well far into the future

Thank you for joining us this morning, and thank you for the confidence you've placed in us with your investment

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