Consumer Analyst Group of New York Conference

Company Participants

- Brian Cornell, CEO PepsiCo Americas Foods
- Hugh Johnston, EVP & CFO

Other Participants

- Unidentified Participant, Analyst, Unknown

Presentation

Unidentified Participant

Before we get started with our next presenter, PepsiCo, just one housekeeping note, we will have a brief -- a bit of Q&A here in this room but there will be no breakout session afterwards; PepsiCo management will be available for a Q&A at lunch. And we want to make sure that we exit this room promptly because Avon needs to come in here during the lunch period to do their rehearsals.

So with that first, please join me in thanking Pepsi for sponsoring lunch today and also beverages this week. And it is an incredibly exciting time at Pepsi. The Company has made significant progress on its strategy to re-accelerate growth. I want to thank Chief Financial Officer, Hugh Johnston, for coming down to spend time with us today. Hugh, I will turn it over to you.

Hugh Johnston {BIO 15089105 <GO>}

Okay. Thank you, Brian. Good morning, everyone; pleasure to be here with you all today. With me are Brian Cornell who leads PepsiAmericas' foods businesses. And Jamie Caulfield known to all of you, our Head of Investor Relations. Brian happened to be in South Florida this week and out in the market and we thought we would take advantage of the opportunity to have him come in and spend some time with you and answer some Q&A both in the session and out at lunch as well.

I'm going to share a short presentation on PepsiCo with you this morning and then we will open it up to your questions from the floor. Once we wrap it up in here, as Brian noted, we will join you for lunch where we will have some time to talk about our business and enjoy some PepsiCo products prepared in what I think you will find to be some really creative ways.

Before I begin please make take note of our safe harbor statement which can also be found on our Investor website under the Investors tab. So let's jump into it.

As we look at PepsiCo today we do feel we are very well positioned. We generate $65 billion in annual revenue, we are the second largest food and beverage business globally, which provides us significant scale advantages. We just completed a year in which we generated 5% organic revenue growth.

We have very attractive operating margins and returns on net invested capital, each of which stand now at about 15%. And our businesses are big cash generators, which enables us to provide attractive cash returns to shareholders through dividends, where our yield today is approximately 3%. And through a healthy share repurchase program.

We compete in categories with attractive growth, margins and returns. Both the snacks and the beverage categories are projected to generate global growth of about 5%.

Our core businesses of convenient food and beverages are fairly evenly balanced with about half our revenue coming from each and our core categories are highly complementary. They not only share common consumers and customers. But they also share resources and capabilities like agri sourcing, R&D capabilities, packaging, flavoring, go-to-market systems and back office functions.

And we are well-positioned within our categories with a clear number one global position in salty snacks and a strong number two global position in beverages with leadership or parity in a number of important markets.

We have a product portfolio that is really quite broad, it cuts across day parts, age groups, need states and occasions providing almost limitless opportunities to address consumers' evolving needs. And our businesses will continue to benefit from global mega trends alike on the go lifestyles, a rapidly growing middle class in emerging and developing markets and consumers seeking a repertoire of products that spans from fun for you all the way to good for you.

We also have a powerful brand portfolio that connects with consumers. 22 of our iconic brands have retail sales surpassing the $1 billion, a number that has doubled over the last 12 years. And like our products, these brands stand for everything from fun for you to good for you.

Our brands typically have the number one or number two position in their respective categories. In fact, Lay's Banner Sun is the number one global food brand overall and Pepsi is the number two global beverage brand in the liquid refreshment beverage category. And we have another 40 or so brands that are between $250 million and $1 billion of retail sales and that provides a great pipeline for the creation of our future $1 billion brands.

To give you some perspective on the power of our brands, let me share with you an interesting chart. Here are the 40 largest CPG brands in the US. So not only for food and brokerage but also for HPC. We have nine of the top 40 trademarks and we have four of the top 10 trademarks. This shows both the importance of the categories we compete in and how well-positioned we are in these important categories. We are an integral partner to our customers because our success is directly linked with their success.

We also have a truly global footprint with presence in more than 200 countries. Over a third of our revenue now comes from fast-growing emerging and developing markets, or over $22 billion. Across our markets from emerging to developed we have tremendous go-to-market reach which is largely enabled by the DSD systems we have developed and optimized over the many decades.

Our systems are uniquely tailored to suit local market dynamics so that we can efficiently and effectively reach millions of points of distribution and billions of consumers every single day. Our geographic diversity also acts as a sort of natural hedge against regional volatility around the world.

Our geographic mix also gives us lots of runway to grow because the consumption of our products grows as GDP per capita grows. In fact, there is a sweet spot between $10,000 and $20,000 of GDP per capita where the rate of adoption and frequency and purchase of our products both in snacks and beverages really starts to accelerate. So as we look at our geographic portfolio there are a number of markets that today are in this sweet spot fueling the growth that we see today.

Just as importantly, there are many markets that have yet to enter that sweet spot and they represent tremendous future growth potential for PepsiCo.

To demonstrate, this chart shows salty snack per capita consumption of a number of our key markets with Mexico at the top followed by Brazil, Russia, China and India. Each of these market's per capita consumption is indexed to Mexico's level. So even with a doubling of per caps in India, China, Russia or Brazil, these market's consumption levels will still be far below where Mexico is today.

And just as importantly, we have a strong leadership position in each of these markets which positions us well to capture the lion's share of the growth that will occur in the categories.

On top of these considerable advantages, in 2012 we strengthened our business across a variety of areas by focusing intently on five key priorities -- increasing our brand support; stepping up our innovation; improving our marketplace execution; driving greater productivity and efficiency; and driving cash flow. Let me comment briefly on each of these beginning with brand support.

In 2012 we took a number of important steps to increase our brand support; first we increased the overall level of brand investment by 50 basis points from 5.2% of sales to 5.7% of sales. At the same time we increased the effectiveness and efficiency of our investment. We focused our spend on 12 mega brands leveraging the scale and heft of these biggest brands.

We directed more of our spend activities that are directly consumer facing, shifting money from nonworking to working A&M by rationalizing the number of agency partnerships and by leveraging and coordinating our creative and production costs on a global basis for our global brands.

And finally, we improved the way we measure our return on A&M investment by better tracking our consumer equity scores and how they respond to our marketing activities. We also leverage social media to connect in a deeper way with our consumers.

For example, we continued our highly successful Crash the Super Bowl Doritos campaign, asking our passionate Doritos consumers to submit ads in a competition where consumers also select the finalist spots to air during the Super Bowl. Over the course of the contest history we received more than 22,000 consumer created Doritos ads with winners consistently ranking in the top five of the USA Today's ad meter.

The creator of this year's top ranked entry won the opportunity to work on the next installment of the blockbuster Transformers movie with director Michael Bay. Even in its seventh year Crash the Super Bowl continues to generate tremendous buzz, consumer engagement and great advertising.

We further leveraged social media recently with the highly successful execution of our Do Us a Flavor campaign. This concept actually originated with our UK snacks business. The program invites consumers to submit proposals for new potato chip flavors in the UK under our Walkers brands and in the US under our Lay's brand.

Following its great success in the UK we ran Do Us a Flavor in 17 markets and, as I just mentioned, ran it in the US very recently. The results in the US were well above our expectations. We received more than 3.8 million consumer proposals in the US alone and over the 17 markets we have received 19 million consumer proposals globally.

And we have improved the execution in our global sports properties as well. We have a terrific stable of (league) protein and college sports properties. We are doing more to better leverage these great equities across our stable of brands. A good example was our activation around the Super Bowl with the NFL where we had tie-ins with Pepsi, with Doritos and with Quaker.

The other area to drive execution from national mass media to local in-store presence. So with local team properties we are driving very localized in-store POS to connect our consumers' passions for their favorite teams with our brands. And for brands like Pepsi we are taking it a step further as we are finding interesting intersections between the sports and the music categories, the heart of pop culture.

For example, we coordinated our global partnership with Beyonce with our sponsorship of the Super Bowl half-time show, the perfect linkage of sports and music on a huge platform.

Secondly, we stepped up our game in innovation by bringing to market a broad array of offerings from line extensions that bring additional frequency to our existing products to new product platforms that capture new occasions by meeting previously unmet needs. We've made progress with both the number and breadth of these new product platforms and these typically have greater staying power and offer the opportunity for consistent growth over a number of years.

For example, in just the last year or so we've introduced Doritos Locos Tacos where we sold more than 325 million taco shells -- it's 325 million taco shells -- contributing to the most successful product launch in Taco Bell's 50 year history and expanded our presence in the foodservice channel. We are gearing up for year two of our Doritos partnership with Taco Bell with even more exciting new products.

Quaker Real Medleys was a convenient high-quality oatmeal with real fruit and real nuts which was just named the breakfast product of the year for 2012.

Another example, Pepsi Next which delivers real cola taste with 60% less sugar and achieved nearly $150 million in estimated retail sales in its first year.

Starbucks Refreshers, a 60 calorie sparkling beverage that provides the delicious boost of natural energy from green coffee extract and real fruit juice.

Tropicana 50, with 50% less calories, continues to perform well in the US when it was launched in 2011. And we just recently launched it in the UK and are slowly taking it around the globe.

And Gatorade Chews, a convenient form of carb energy to fuel athletes prior to athletic competition.

So as we look at our innovation we feel very good about the new products that we launched in 2012 and we are encouraged by the pipeline of innovation that we have for 2013 and beyond.

The third area we have strengthened is our execution. For example, in North America we continue to drive cross category in-store programs to increase the frequency with which our snack and beverage products are purchased in the same basket. And these numbers continue to improve. As a result we widened our salty snack advantage in co-purchases from 2 points in 2011 to 4 points in 2012 and our advantage in beverages from 2 points in 2011 to 3 points in 2012.

The fourth area, an area of tremendous focus for us in 2012, was productivity. We executed a comprehensive restructuring program and accelerated our productivity efforts across the value chain -- how we make, move and sell our products. We delayered the organization and improved efficiency. We reduced our headcount and we rationalized our supply chain to reduce cost and investment in fixed assets.

As a result of these efforts we delivered in excess of $1 billion in productivity in 2012, double our previous rate. And we will continue to drive productivity across the entire value chain for all of our businesses.

We have a robust pipeline of projects from leveraging best-in-class supply-chain activities around the world to increasing automation across the value chain, from raw materials handling through to the route truck to implementing new processing technologies that enable us to both increase asset utilization and reduce input costs.

Much of our productivity initiative is enabled by the IT investments that we've made over the last several years giving us greater visibility into our performance metrics across the globe. The sum of these changes from small actions repeated millions of times to utilizing new technology that substantively changes the overall cost of key processes gives us high confidence that we will achieve our three-year $3 billion productivity target through to 2014.

That said we are not stopping with the $3 billion current productivity program. We have a deeply embedded productivity culture and we are already beginning to work by to identify the next big tranche of productivity for all of our businesses.

And our fifth focus in 2012 was cash flow and returns; we delivered very strong cash performance for the year. We reduced our cash conversion cycle by nine days. We managed capital spending to 4% of sales, well within our long-term target and 20% below our 2011 level. We delivered management operating cash flow excluding certain items of $7.4 billion a 20% increase over prior year. And we returned $6.5 billion to shareholders through dividends and share repurchases.

Over the past five years our management operating cash flow per share, excluding certain items, has grown at a compound rate of 11% and we have returned $30 billion to shareholders through a combination of share repurchases and dividends.

So how does this all translate to future results? It begins with the balance of our portfolio across both categories and geographies. We spoke earlier about the attractive growth profile for snacks and beverages globally for companies that are well positioned. From a geographic perspective each market type plays an important role in our portfolio.

The emerging markets are primarily top-line growth drivers with some potential for margin improvement in the short-term. Developing markets drive balanced top-line growth and margin and ROIC improvement. And developed markets contribute relatively less to top-line growth but also have very attractive absolute margins and returns.

Taken together the market portfolio provides for balanced growth, margin and return improvement, attractive current returns and sustainable future growth opportunities.

Our financial model is driven by mid-single-digit constant currency revenue growth and from a category perspective we expect our global beverage business to grow in the low; to mid-single-digits. From a market perspective we expect developed markets to grow in a low; to mid-single-digits and our developing and emerging markets to grow in the high-single; to low-double-digits.

With this growth profile we expect about two-thirds of our growth to come from snacks and from a geographic perspective about two-thirds of our growth to come from developing and emerging markets. As a result our business mix will gradually shift to be more heavily weighted towards snacks and more heavily weighted toward developing and emerging markets than we are today. This revenue growth profile supports our long-term growth model.

We expect mid-single-digit revenue growth, mostly organic, balanced between good for you, better for you and fun for you with emerging and developing markets contributing disproportionately to the growth. We also expect that margins in ROIC will continue to improve reflecting scale and productivity and EPS will grow high-single-digits.

And management operating cash flow driven by earnings growth and CapEx and working capital efficiency is expected to grow in line with net income, generating attractive cash flow available for shareholders.

For 2013 we expect core constant currency EPS growth of 7% off a core 2012 base of $4.10. We expect organic revenue growth of mid-single-digits, core constant currency operating profit growth of approximately 6% and approximately 1 point of leverage below the line driven by share repurchases offset somewhat by higher net interest expense of approximately $90 million from higher debt balances. We expect our core effective tax rate to be approximately 27% for the full year.

Within these expectations we assume positive price mix, low-single-digit commodity inflation, productivity of $900 million and A&M growing at least in line with our net revenue growth.

We continue to manage our commodities using a systematic hedging program and at this point we have more than half of our commodities' exposures covered for the year with more coverage in the close in quarters and the level of coverage will ramp up as we move further into the year.

We expect the rate of inflation to be fairly consistent across the quarters in total and that rate of inflation will be a bit more pronounced in foods than in beverages.

Our productivity assumption is completely in line with the three-year $3 billion program that we launched last year and the savings will be used to help offset inflation as well as to provide funding for investment back into the business.

One of our key investment areas is supporting our brands with advertising and marketing where we will grow our A&M investment at least in line with net sales, meaning you should expect A&M spending of a least 5.7% of sales which was our 2012 baseline investment.

In addition, we're also accelerating our investments in research and development and in innovation. We do anticipate foreign exchange translation to have up to 1 point of negative impact on our net revenue, operating profit and EPS for the year. And this includes the impact of last week's Venezuelan devaluation.

We also expect an approximate $100 million non-core charge related to the devaluation of our monetary assets in Venezuela in Q1. We anticipate structural changes, primarily bottle refranchisings, will have a negative impact on our full-year net revenue growth of approximately 1 point. And as you model out the First Quarter we expect foreign exchange translation to have a negative 2 point impact on EPS.

Revenue in the First Quarter will have an estimated 3 point negative impact from structural changes and a negative 1 point impact from foreign exchange translation. From a cash flow perspective we expect management operating cash flow excluding certain items of more than $7 billion. We continue to drive cash flow through even more efficient working capital management and continued tight controls over capital spending.

For 2013 we expect to see continued improvement in our key working capital metrics and to manage net capital spending to $3 billion which is well within our long-term target of less than or equal to 5% of net revenue.

From an M&A perspective, consistent with our past comments, we believe the portfolio is largely where it needs to be and consequently we do not -- do not see the need for any large-scale M&A. As a result we will plan to continue to return the strong cash flow to our shareholders. We just approved a new three-year $10 billion share repurchase program to succeed the current program that expires in June of this year.

And our Board has approved a 5.6% quarterly dividend increase beginning with our June payment. In total, we expect to return approximately $6.4 billion to shareholders in 2013, $3.4 billion in dividends and $3 billion in share repurchases. Net our outlook for 2013 is consistent with our long-term targets for net revenue, operating profit and EPS. We expect to drive improved margins and improved net ROIC. And we expect to generate and return cash flow to shareholders and that remains a top priority for PepsiCo.

To wrap up, we feel good about where the business is, we have sizable structural advantages and took actions to strengthen our business in 2012. As a result we believe we are back in a virtuous circle.

We have a business capable of generating healthy, mid-single-digit organic revenue growth, enabling us to capture and leverage productivity savings that can be reinvested in brand building, innovation and extending our go-to-market advantages which, as a consequence, reinforce and fuel our top-line growth for the future. With that I would be happy to take any of your questions from the audience.

Questions And Answers

A - Hugh Johnston {BIO 15089105 <GO>}

Yes, Brian.

Q - Unidentified Participant

Thanks, Hugh. I guess I wanted to get back to just talk a little bit about international scale and the importance of the specialty developing markets as part of the algorithm going forward and appreciate the comments about the contribution to revenue.

But if you could talk a little bit more about the path to how specially developing markets will contribute to profit growth going forward. And what is required -- do you have enough scale today or will you need to build more scale, tuck-in acquisitions -- just kind of what that pathway would be? And also if you could also comment just on the importance of having both a food and beverage business in those markets and how that plays into it.

A - Hugh Johnston {BIO 15089105 <GO>}

Sure, happy to. A couple of questions there so let me parse it a bit. In terms of whether we need to do M&A and those types of things, we may occasionally choose to do a tuck-in acquisition. And we have talked about those in the past. They are typically a few hundred million dollar size, they are accounted for in our cash flow expectations. And the decision we'll make on whether we choose to do a small acquisition or whether we will build purely organically will really be driven by what is the right value creation move.

So in some markets we may say, you know what, we believe we can do this entirely on our own as we have done in India. In some markets we may choose to do some tuck-ins as we have done in Brazil. So I think it is going to be a balancing act. But I think we have got that all captured in the financial guidance that we've shared.

Regarding the pathway to improve margins, really many of the things that we do in emerging and developing markets, it's a matter of choice as to how quickly we want to move the margins up. Because our market positions are as strong as they are we could choose to move margins up more quickly by taking more pricing. But that will slow the rate of category development and it will slow the rate of competitive advantage that we can build particularly in the snack food businesses.

Typically when we put ourselves in a position where we build a relatively high market share position and we develop the margin improvement more slowly we build a stronger, sturdier business for the long haul.

Probably the best example I can point to on that is our Mexico business where we slowly but surely over the course of really a decade or two built a tremendous franchise there and a franchise that has quite high market share. And while we don't disclose and margins explicitly, if you look at developed markets snacks businesses they would be right in that similar type of range.

We think that is the right pathway to growth. The choice that management has. And frankly as we communicated our guidance to all of you, is we need to make choices around how quickly we want to develop the margins versus how quickly we want to develop the category. And as portfolio managers that is very much our job.

I would expect though to see continued margin improvement across all the sectors. It doesn't have to be rapid margin improvement to make all of these numbers work. But I would expect to see across all of our sectors continued margin improvement.

Q - Unidentified Participant

(Inaudible; microphone inaccessible)?

A - Hugh Johnston {BIO 15089105 <GO>}

So yes, food and beverage together, the last piece of that. We do think that actually, particularly in developing and emerging markets, food and beverage together is an important characteristic of the portfolio. If you think about the way these markets tend to develop, beverages just develop first partly because they are relatively inexpensive, partly because of the terrific marketing.

And by virtue of doing that they actually provide scale benefit that the snack beverage -- the snack business can leverage off of. So it enables -- it is an enabler to competing in beverages and then it's also an enabler to getting snacks businesses developed earlier which allows for us, again, to build those share advantages which allow for us to build the competitive barriers to build stronger businesses over time.

We have said in the past that we think the benefit of having the global snack and beverage business together is north of $800 million. So $800 million to $1 billion of synergies created by virtue of having those two together and that is purely based on the cost side of it, it doesn't account for any -- the revenue in the longer-term, strategic benefits as well.

So as we think about these things, same consumer, same customer, shared R&D, oftentimes shared elements of the supply chain. We think there is real tangible advantage in the short term and we think there is significant strategic advantage to the complementarity of the portfolio over the longer-term.

Q - Unidentified Participant

Hugh, just over a year ago you held a meeting and embarked basically on a beverage business review. You said you would get back to us in 12 to 18 months and obviously you have pushed that out to early 2014. Could you maybe take us through in more depth what kind of fundamental or strategic thinking has changed that you have decided to push that out?

And Brian, also a year ago at CAGNY you talked a lot about Frito-Lay North America increasing its penetration on the more premium end of the business. Could you maybe bring us up to date on how you would scorecard yourself so far and what you expect to see this year?

A - Hugh Johnston {BIO 15089105 <GO>}

So why don't I handle the beverage piece first, Brian and --

A - Brian Cornell {BIO 1841158 <GO>}

Sure.

A - Hugh Johnston {BIO 15089105 <GO>}

--kick the snacks piece over to do? Yes. So, Mike, we talked about 12 to 18 months last year. We indicated on the call last week that we felt like it was more likely to be a year from now. So that would be about 24 months out. A couple of things have evolved.

Number one. And we referenced this on our earnings call last week. Sweetener development that we think can fundamentally change some of the elements of the core product offering in carbonated soft drinks. Some things are happening that are a bit closer in.

And you will understand if I don't go any further in terms of answering specific questions on what is happening specifically with sweeteners because we do view that as competitively -- competitive information that sharing with all of you probably wouldn't be good for the shareholders right now.

But we do think the sweetener piece is developing more rapidly and we need to see that play out before we make a decision on exactly what the optimal structure would be for the beverage business going forward. So that is number one.

Number two. And we want to see how the beverage business plays out this year. We think we have got the business on the right track. We did see it sequentially improve over the course of the year and we want to give it a bit more time with some of the strategies that we implemented around brand building, some of the strategies that we implemented around revenue management, price pack architecture, some of the things we have done on productivity. And we want give the operational side of the business a bit more time to play its way out.

So the combination of there could be significant value creation as the sweetener situation continues to evolve and having a better sense of exactly how quickly that is going to evolve and how evolutionary versus revolutionary it is going to be. And by the way, we do see it as more evolutionary than revolutionary. We think giving that a bit more time is probably the right answer for shareholders in terms of realizing the maximum value creation out of that business.

A - Brian Cornell {BIO 1841158 <GO>}

Mike, if I turn to Frito-Lay, let me start with a look at the broader scorecard. And I think across the year you saw solid progress in Frito-Lay leading up to a very solid Fourth Quarter. So sequential improvement in our performance throughout the year and I really think it demonstrates that the strategy and the playbook that Tom Greco and the Frito-Lay team have in place right now is gaining traction with both our customers and with consumers.

The investments we are making in our brands clearly are improving brand equity. You talked about the tremendous response we had to the Lay's Do Us a Flavor contest. 3.8 million consumers providing us with recipes; very strong engagement. We have had a very solid pipeline of innovation that is consumer led in place for Frito-Lay and you are starting to see some of that unfold as we move into the first half of the year.

Solid progress from a productivity standpoint as we look at ways to drive greater efficiencies in our supply chain and go-to-market system. Then from an execution standpoint a real focus on making sure we've got the right products, packs and price in place channel by channel, customer by customer, including as it pertains to that important premium segment where we have demonstrated solid mid-teen growth in line with the category.

We feel very good about the progress we are making with the big brands like Stacy's, the progress we have demonstrated in the new Sabra categories with our hummus products. And we still see that as a very important part of our future at Frito-Lay. But within that we don't want to lose focus on that important mainstream portfolio which is the heart and soul of our Company.

We want to continue to accelerate our entry into the premium space and then continue to look at selective ways to compete in value. But overall good progress against the scorecard, sequential improvement throughout the year and I think it sets us up for continued solid progress as we move into 2013.

A - Hugh Johnston {BIO 15089105 <GO>}

John.

Q - Unidentified Participant

Thanks. Brian, two questions here. The first would be -- and we have heard from a number of companies and also directly from Walmart last week about a tough start to February. So can you just give an idea in terms of what you think we are seeing out there from consumers?

Then I wanted to follow up on GES which is something that came out with a little bit of fanfare a couple years ago and since has -- sort of we haven't heard as much about it. So can you tell us where you stand on that? Is that still something that can be a big breakthrough? And as you look at that how much of that is the bottom-line savings versus potentially greater top-line from SKU availability?

A - Brian Cornell {BIO 1841158 <GO>}

John, let me start with the start of the start of the year. And as you have heard us say before during our earnings call, January is a very difficult month to read. The weather overlaps year on year. This year we had the additional challenge of changes in tax, the refund changes that took place. So it's a difficult month to read.

But as you look at a measured channel performance, the month of January started out very much like the Fourth Quarter finished. So pretty stable food and beverage trends and we would expect that to continue throughout the year. So as we look at it, January is a tough month to read.

But I think we see generally consumer stability right now, the trends in food and beverage being very consistent in measured channels from what we saw in the back half of last year as we started this year and that is the environment that we are planning for in 2013.

From a GES standpoint we remain very committed to that initiative. We have continued to roll that out throughout 2012, we have got plans for expansion in 2013. But it is going to be a long runway as we balance both the need for capital and the human capital investment to do that right.

So we are still very committed to the initiative, we are very pleased with the returns it is generating, it provides us much greater flexibility in our go-to-market system, ability to tailor our offering customer by customer. But it is going to be a four or five year runway until we (hit the brakes).

A - Hugh Johnston {BIO 15089105 <GO>}

Then from a financial perspective, John, just let me add on on the GES initiative. You will recall we talked about the fact that early implementations would in effect fund the next one, right. So we get the productivity in the P&L but there is an investment on these markets.

So somewhere around the 2014-2015 time frame is when we start to tip over where we have got more markets in than we have left to go so you have enough critical mass so that it starts to show through in margin accretion within Frito-Lay. So that is still the time frame we are working against.

If anything the returns are at or equal -- are equal to or better than what we have talked about in the past and what we had originally scoped out for the project. So GES still very much on track and, again, the capital for GES very much captured within all of our guidance as well. So there won't be anything disruptive from that perspective. So Ollie?

Q - Unidentified Participant

Thanks. So I want to push a little bit on this margin discussion that you started a little bit earlier because your long-term targets have to have margin expansion in them. But if you look at your track record 2002 to 2009 your margins were essentially flat, 18% operating margins (ish). And all of your EPS growth was FX and M&A and a better marketplace than you certainly have today.

And right now you are starting from a lower margin base, right, because a reinvestment year and because of the M&A on the bottlers. So what can you tell us that gives us confidence that you will actually start to see margins go up in a tougher environment, right?

And you said, look, we expect all of our business segments, to an earlier question, to go up. But we know there are difficulties in PAB. We know that Frito is maxed out at least in North America in terms of margins in some sense. And there is an inherent margin -- negative margin mix for the time being in the emerging markets and you're going to have to investment. So what can you point to that gives us a little bit more confidence in that trajectory?

A - Hugh Johnston {BIO 15089105 <GO>}

Sure, happy to. Really a couple of pieces to it. Number one is the global operations organization that we have set up. The reality of it is we do fairly similar things in markets around the world. How you run a pay the chip 50 line in the US probably shouldn't be that different than the way you run it in India, the way you run it in Brazil, the way you run it in Mexico.

The reality is because we have been operating in the past as such a decentralized company with such limited coordination that they do run differently. And part of the reason we brought in the head of Frito-Lay operations from the past to run global operations for us was to essentially established basically the data, the benchmarks and then to work across the organizations to say, look, there is one way to run these lines and you will have X many people running these lines and that is the way we do it.

Now, we are not insensitive to the different labor capital trade-offs that occur in different markets, obviously, we have lower cost labor you may make different choices. But there is a best practice element to this that we see as very near in, very straightforward productivity opportunities that are highly reliable in terms of their realization. And that is different. We just -- should we have had it? You could make the case for that. But we didn't have it in the 2002 to 2010, 2011 timeframe. We do have that now.

The second piece of it is as we have built the R&D function we actually are applying new processing technologies that we haven't applied in the past, again, particularly in the snack food business in terms of the types of things that we can do on the line to make the lines more efficient using less commodities. Using acceleration line speeds to again provide essentially a lower cost structure or even a change to a process that is just a lower cost process than the one that we have been working through right now.

And that takes a bit longer time and as the best practice types of opportunity start to tail off over the couple of years those types of technology improvements that these are things that -- we know how to do them right now, it will take a while to basically prove them out completely, roll them across the globe in different markets. But those opportunities are well understood and within our grasp.

Then the third piece of it is, there are two elements to the developing and emerging market piece. There is the piece that says those are lower margins. So as they grow faster it is a drag and we know that. But at the same time those are businesses and there are big scalable elements across those businesses that as they grow their margins individually will improve.

And when I referenced in terms of Brian's question the choices that we make, the choices that we are oftentimes making are how quickly do we want to acceleration margins? Because you are making a choice to some degree between developing the category more quickly or taking your margins up more quickly. And that is the portfolio role, frankly, that management plays in all of this.

I think the sum total of all those three should give you a level of confidence that we in fact do have the capability, we do have the ideas sitting there to go and realize the types of productivity that we haven't in the past. Step one of that was 2012. So we literally doubled our annual rate of productivity in 2012 and that was masked because we had a lot of commodity inflation and pension cost issues.

We made an A&M investment. But there was a legitimate doubling of the rate of productivity in 2012. And that is the data point I would point to to say it is not as if I am saying we are going to do it, we have already embarked on that journey with a great sense of urgency and we did it in 2012.

Q - Unidentified Participant

To follow up on that, Brian, can you talk about the expansion opportunity from a margin perspective in the Frito-Lay North America business over time? And given you had such a high level versus the peer set is there room to continue to expand margins and what would be the key drivers behind it?

A - Brian Cornell {BIO 1841158 <GO>}

I will build off of Hugh's comments, I think as I look at the Frito-Lay business. But really I look across our whole portfolio. I think there are two important areas that allow us to continue to increase margins. One is just enhancing the value of our brands.

And that starts with enhancing brand equity, making sure we have got great differentiation in our innovation pipeline, continue to improve the quality of the products we offer, enhancing and tailoring our go-to-market offering channel by channel so that we really match that up with the shopper needs.

So on one hand we have got to continue to make sure we improve and enhance the value of our brands. The second part is really leveraging those global best practices. How do we make sure that we are leveraging in Mexico and Brazil and Canada some of the same best practices that we have in the US and really taking up those standards.

The other lever is the use of technology. And there are technology solutions in front of us that I think are going to allow us to run our business more efficiently, run our go-to-market systems more efficiently and service our customers more efficiently.

So between improving the value that consumers place behind our brands, leveraging best practices around the world and leveraging new technology breakthroughs both from a productivity and R&D standpoint, I think that is where we will find the opportunities for margin enhancement.

A - Hugh Johnston {BIO 15089105 <GO>}

Yes.

Q - Unidentified Participant

I had a question about -- for North American CSD's, the promotional environment. To me it really doesn't seem like the depth or the frequencies of promotions have really moderated a whole lot. And running three for $10 doesn't seem to really do much for building brand equity, for building the category growth, for improving your channel mix.

And for the retailers I don't think there is really evidence that it really builds long-term consumer share wins. So it is kind of a net loss for everybody. So just how do we get to a lower level of frequency? Or have you considered doing something radical and going to say a small market like Hawaii or Alaska and just materially cutting out the amount of promotion? Thanks.

A - Hugh Johnston {BIO 15089105 <GO>}

Yes. It's a good question and high/low pricing in CSDs has been a challenge for a long time. You almost have to step back and look a little bit at some of the historical drivers on it. When you had a separate concentrate and bottling company that tended to create more of that behavior because concentrate companies are oriented towards volume and bottling companies are oriented towards price. And that was a US phenomenon. There is better alignment internationally in all of that.

The second piece is retailers tended to use it as a traffic driver and they are doing less of that now. And have been gradually doing less of that over the course of the last decade.

A couple of the things that we have done and in particular Al Carey talked about it about six months ago I think at the Deutsche conference. Implementing what we call a hybrid everyday value program. We don't think an everyday low price strategy is the right strategy for the category. We do think that when -- it is still an impulse buy, when it gets on the floor it tends to get more consumer traction.

That said, your point that the pricing environment just got way too high/low over the course of maybe five or six years. And what we started to do last year and we are doing with a couple of very significant customers this year is to essentially have higher pricing on the holidays and lower pricing every day to start to level out some of those kind of steep peaks and valleys.

We did it last year with one customer, it was very successful. As I mentioned, we are doing it with more customers. We do think it sends the right message from a brand building perspective, to your point. We actually think it cuts a lot of cost out because when you're basically selling 50% of your business in nine weeks of the year you wind up renting extra warehouse space, you wind up incurring extra labor charges and that -- we started to diminish that last year; we think we will diminish it a whole lot more this year.

So you lower your supply-chain costs as well. And frankly you also get the consumer not expecting the deep, deep price cuts around the holiday time frame. So again, put it in place last year with the one customer, went well, got it in place with some big customers this year. We think it is going to be successful this year.

The industry structure now doesn't suffer from all of this noise around pricing that I think tended to lead to some behavior in the past that wasn't good for the category. So I think we are structured well and I think we have got the right initiatives to basically see a -- CSD pricing environment that I would characterize as rational.

Q - Unidentified Participant

Hugh, you have got time for one more.

A - Hugh Johnston {BIO 15089105 <GO>}

Okay, Mark?

Q - Unidentified Participant

Hugh, a question on the balance sheet. How open are you to increasing leverage? You've got a number of peers in the two, two and a half times EBITDA level range. It doesn't hurt their investment grade credit rating. You have re-based earnings, you have reiterated that you are not focused on big M&A. So obviously you're not going to say you are going to do it today. But how open are you to that kind of approach in order to increase the return to shareholders in terms of cash going back to them?

A - Hugh Johnston {BIO 15089105 <GO>}

Yes. In terms of analyzing it, I analyze it every year. And at least for the last several years the answer that we got to was we think we are at the right spot in terms of leverage and the rating that falls out of the leverage that we have.

So I don't think that it would be a value creating move to take as any further on the leverage scale. If you look at where our leverage is relative to our rating, we are in I think a highly productive spot, a pretty fair sweet spot in terms of cost of financing.

But it is not something that we continue with as an ongoing assumption. We look at it every single year and the conclusion we came to as recently as just in the last couple of months this year was we think we are in the right spot from a leverage perspective.

Q - Unidentified Participant

Okay. With that PepsiCo. First want to thank you, Brian, Jamie, for spending time with us today. Thanks again for sponsoring lunch. And remember, management will be available at lunch so there is no breakout session, we'll be available for lunch. Thanks.