Consumer Analyst Group of New York Conference

Company Participants

- Hugh F. Johnston, Vice Chairman, Executive VP & CFO
- Jamie Caulfield, SVP of IR
- Vivek Sankaran, President & COO of Frito

Other Participants

- Ali Dibadj, SVP and Senior Analyst, Sanford C. Bernstein & Co., LLC., Research Division
- Brett Young Cooper, Senior Analyst of Beverages & Managing Partner, Consumer Edge Research, LLC
- Bryan Douglass Spillane, MD of Equity Research, BofA Merrill Lynch, Research Division
- Caroline Shan Levy, Senior Analyst, Macquarie Research
- Dara Warren Mohsenian, MD, Morgan Stanley, Research Division
- Eunjoo Hong, MD, Co, Goldman Sachs Group Inc., Research Division
- Lauren Rae Lieberman, MD and Senior Research Analyst, Barclays PLC, Research Division
- Laurent D. Grandet, United States Beverages Lead Analyst, CrÃ©dit Suisse AG, Research Division
- Sunil Harshad Modi, MD of Tobacco, Household Products and Beverages, RBC Capital Markets, LLC, Research Division
- Unidentified Participant, Analyst, Unknown
- Vivien Nicole Azer, MD and Senior Research Analyst, Cowen and Company, LLC, Research Division

Presentation

Bryan Douglass Spillane {BIO 2147799 <GO>}

All right. It's my theme music. We're very excited to have PepsiCo here with us today. And Vivek Sankaran, President and Chief Operating Officer of Frito-Lay North America. Joining Vivek is also VP of Investor Relations, Jamie Caulfield. In an era where many food and beverage companies are dealing with a host of disruptions, Frito just powers on. So we look forward to hearing more about plans to keep up that momentum. Vivek, I'll turn it to you.

Vivek Sankaran {BIO 16613348 <GO>}

Thank you, Bryan. Good afternoon, everyone. Let me just give you a little feel for what we're going to do today. I'm going to take 2 or 3 minutes giving you some context. And then maybe spend 15 minutes or so talking about the Frito-Lay business, the Frito-Lay flywheel, if I can call it that. Then, Jamie and I are here to take questions. And we hope we can spend 15 minutes taking questions, all right?

So the safe harbor statement, please take note of it.

Let me start with just a little bit of context here. In 2017, Frito-Lay contributed 1/4 of PepsiCo's total net revenues and 42% of its operating profit. This was consistent with our contribution in 2016. And we are pleased to play a role. And a big role, in driving PepsiCo's growth and profitability.

I would say Frito-Lay is in a good place. We have a great portfolio of brands, great relationships with consumers and customers, an incredibly effective supply chain and DSD workforce and robust cost management. We have delivered what we believe are top-tier results in our industry. On average, over the past three years, we've delivered 3% net revenue growth, 6% profit growth and have been the #1 dollar growth contributor to the food and beverage market. In fact, our growth contribution has exceeded all our competitors combined over the same period. We continue to gain market share -- it's a big focus for us. And gained 37 basis points of macro snacks share in 2017 versus the prior year, in the total macro snacks segment of about $100 billion.

We are also proud of the fact that in the latest Kantar Retail PoweRanking study, our retail partners voted PepsiCo at the top of the manufacturer list for the second straight year. Our ability to leverage the scale and breadth of our North American business has been pivotal in driving this success. And please note that there are a number of categories on the right, where we were ranked #1.

I'll give you a few examples of how we at PepsiCo bring to life -- bring this to life with retail partners. First, through our demand accelerator, which we formed in 2015. We provide a singular PepsiCo approach to shopper insights, shopper marketing, combining data across categories to drive total basket size and penetration.

Second, through our PepsiCo customer teams, we manage relationships with our largest customers across all our categories to offer a seamless approach to working with us.

And third, we actively cross-promote products to create Better Together consumer solutions. Our most recent example was the successful launch of Doritos Blaze and Dew Ice at Super Bowl, 2 products designed from the ground up to complement each other.

Our customers value the capabilities we've assembled over the last few years across many fronts: consumer insights, digital marketing, supply chain and e-commerce, to just name a few.

Our momentum is very strong. Over the last three years, we've gained 48 basis points of share in the salty category while delivering 30 consecutive periods of share gain in savory. This has been fueled by a strong and broad portfolio of core brands and products as well as some fabulous innovation. My favorite on this page on the top left there is Poppables. We worked on that for three years to get it just right. It's a 3D-shaped chip. It's light and airy in texture. And in essence, it extends the eating enjoyment for the same amount of calories. But that is a lot of our core innovation that you see on that page. When I talk about the Frito flywheel earlier, it's pretty straightforward. You've seen this before. This is not a new framework. We just get better at each of these 4. And we connect each of these 4: brand building, innovation, execution and productivity. And I'll just talk to -- spend some time on each of these 4.

Brands. We have some of the most recognized brands in the world, including Doritos, Cheetos and Lay's. In fact, the top 7 brands in salty are Frito-Lay brands. And we generate almost 90% of our total revenue from brands with either the #1 or #2 market share positions in their respective subcategories.

We also have a phenomenal marketing team that is consistently creating new and innovative ways to connect with our customers and our consumers and keep them engaged with iconic advertising campaigns. We're going to take a look at a Super Bowl spot in just a minute, where you've got a chance to see Peter Dinklage and Morgan Freeman battle it out, okay? Beyond just being creative, this was the first commercial with 2 big brands, back-to-back in a 60-second spot. And you should know that 2 -- and the way this works for us, 2 weeks before the launch, we started sending out digital -- we started digital campaign with teaser ads. It first showed Peter and Morgan in different -- in a duel or at least connecting like you saw earlier. Then we introduced the musicians.

And what's very important is that we tied all of this to what -- to in-store execution and what we call just seamless media-to-shelf execution. Can you play the Doritos Blaze commercial, please?

(presentation)

What do you think? All right, all right. Another thing I want to highlight is we're just launching, as we speak, what we call the Lay's Smile campaign. This is, in addition to just getting consumers to find their own smile. And so these bags are going to have various smiles. It's a program that started out in Asia. And that's rolled around different parts of the world with us. Each of the -- we're also going to -- they're going to donate to Operation Smile with each purchase. So this program is just launching. Another very, very creative program on a core brand to continue to create excitement in the category and to continue to get placement in our retail stores.

The next piece I'll talk about is our innovation. We continue to invigorate our core brands with new and exciting forms and flavors. I mentioned Lay's Poppables earlier. But we have other great examples. On the left on the top, you see Cheetos Paws, which just brings the mischievous nature of Cheetos, the brand positioning of Cheetos, to new fun forms.

Beyond flavor and form, we are innovating across categories. For example, we extended the bold flavor and crunch of Doritos into the nuts category with the launch of Doritos Crunch Nuts. You see that at the bottom in that tall bag there, Doritos Crunch Nuts. These are roasted peanuts wrapped in crunchy Doritos nacho cheese or cool ranch flavored shells. And they are flavorful but also convenient.

And for the launch, we introduced and developed a new packaging, which got the iconic triangular shape of Doritos. But more importantly, it's sturdy. It's something that's convenient for you to just eat while you're driving or something. But also can be closed and resealed and put in your backpack, right? And we see platforms like this coming along that provide different functionality through packaging.

Finally, we're also launching entire new brands. For example, you can expect to see later this year a brand called Red Rock Deli. It's the product on the right, the red and the blue bag, red curry, coconut, tamale and pink salt. Red Rock is a brand we are importing from our Australia business. It's been a big hit in Australia. It's probably the best potato chip ever made with an amazing crunch and artisanal flavors. And it's made in what we call a continuous kettle process, something we are bringing for the first time into the U.S. We expect this one to be a big hit, too.

I mentioned earlier the notion of media to shelf. And I want to give you an example of how this plays out with our innovation and plays out with our DSD system in different ways. On the one end, for a large brand like Doritos Blaze, we went broad and fast and achieved 95% ACV within 3 weeks of the launch before Super Bowl. And in contrast, when it comes to a brand like Red Rock Deli, you're going to see an extremely targeted launch. We are targeting specific markets and even specific stores based on our understanding of the target consumer and where they shop. So it's DSD system that can go from -- go to an extreme scale or be extremely targeted.

We're also growing our Better For You portfolio. And for example, Smartfood, the products you see on the top there. It's the #1 ready-to-eat popcorn brand in the country and has posted double-digit growth for 3 straight years. Consumers we know continue to seek (inaudible) packs that have clean credentials, including USDA Organic, non-GMO and no artificials.

Our Simply portfolio capitalizes on this trend by providing consumers with the brands their families love and the credentials they're looking for. Not surprisingly, Simply has been a top performer over the last few years. And we see it as a major growth driver. Simply is the bag on the bottom, the second from the left, the Simply Cheetos.

We also launched a brand called Off the Eaten Path. We incubated this brand over many years and then launched it in Q1 2017 in retail and in e-commerce. Off the Eaten Path delivers uncompromised nutrition. All products in the portfolio are made with real vegetables, no artificial flavors, no preservatives and are non-GMO. The current portfolio consists of pop veggie crisps, hummus crisps and sweet potato crisps. And we have a robust pipeline of future innovation behind this brand. And we expect this to be another strong growth driver for us.

Finally, we retained our commitment to transform our portfolio. On the right of the page, you see our commitments that we made publicly to reduce sodium, reducing sat fat, increasing positive nutrition. Over the last decade, we've removed 12,000 tons of saturated fat, removing highly unhealthy oils, taken 409 tons of sodium out of our portfolio and increased the number of products we have that offer positive nutrition, like Off the Eaten Path and SunChips Veggie Harvest.

The third priority is execution. The heart and soul of Frito-Lay's is our world-class sales frontline organization, nearly 20,000 of us who make over 500,000 service calls and reach nearly 300,000 retail stores every week. While the scale of our system is obvious, it is the reach, consistent quality of service, the precision of assortments, the synchronization with our marketing programs, the often tailored retail theater that you see in stores and the positive impact to the retailer's P&L and cash flow that makes the ultimate difference.

Despite our capabilities today, we believe we have another S-curve of performance with advances in technology in DSD. With the data we are collecting and that digital capabilities we are enabling for the frontline, we believe we can further improve how we plan our business, segment customers and stores and integrate in-store and online, enable on-device activation so that our consumers can find the right Frito-Lay product at the right time in the right store.

For example, we are vastly improving our ordering algorithms to automatically generate the perfect order for that store based on sales histories, counter trends and inventories. We are investing in closed loop technologies that allow managers to assign specific tasks and close the loop on timeliness and quality of execution. We are deploying new label models that allow for more specialization of tasks yet to ensure integration across those tasks, further improving execution and reducing costs.

Now a word on emerging channels. We can't do this without talking about e-commerce. We know that consumer habits are changing, the retail landscape is changing. And we are dedicated to -- dedicated accelerating our growth beyond our traditional retail. In our away-from-home business, we have developed a unique portfolio for K-12 schools, which includes products that have whole grains, are gluten-free and reduced fat. We've also introduced a healthy vending solution called Hello Goodness, which can be placed in schools or offices and leverages the total of PepsiCo Better For You portfolio, ranging from oven-baked Lay's and Sabra hummus to Quaker bars and Naked Juice.

Now let me turn to e-commerce. We as PepsiCo have about $1 billion business in annualized retail sales globally. And we are growing faster than the category. We started investing in this channel three years ago by bringing in talent from the outside. I want you to think tech company like talent. And putting our best and brightest with them and giving them the support as a leadership to break all internal rules they need to so that they can go fast and be agile.

Our business is robust with both our brick-and-mortar e-commerce partners and with our pure-play partners. Though as you know, that line is blurring fast. We do the basics well such as search, content, digital marketing, tweaking our supply chain to sell our everyday portfolio on this channel, things you saw earlier. But we're also pushing the envelope in many ways.

We have been most pleased about how e-commerce has helped our overall brand building. This is true with our co-brands, where we've been able to do programs with brands like Cheetos. Chester on the Dresser is something you see on the right. Those are part of our marketing campaigns. We sell them on e-commerce channels. It's opening up new doors like that for us.

Specific to Frito-Lay, e-commerce has been especially relevant for our Better For You portfolio, several of them over-indexed online and have high subscription rates.

We've also leveraged e-commerce to drive into new spaces, new occasions. As an example, early in our e-commerce journey, one of our insights was that folks were using e-commerce to send care packages to college students, military personnel and as fuel for road trips, long road trips. Using that insight, the team developed a set of packages that comprised of assorted Frito-Lay brands, Lay's, Doritos, Funyuns, nuts, cookies, et cetera. They did this from initial idea to the first shopper delivery within 30 days, which speaks again to the notion of breaking rules so that we can act fast. Anyway, these snack packs, as we call them, have become some of our best sellers online.

The other thing that we've proven time and again here is that our portfolio breadth really works. Shoppers are looking for solutions and the ability to provide convenient, relevant solutions, like the one highlighted here on this page, has really struck a chord, both in e-grocery and in our pure-play e-commerce businesses. Using data and analytics, we have also been able to highlight relevant and contextual affinities online. So if someone buys a Sabra hummus online, suggesting that they add Stacy's Pita Chips to that order has been effective. If you think about it, the friction of having to walk to another part of the aisle -- store and search for an affinity product is completely gone in commerce. And that's working to our advantage. Net-net, we're very pleased with our e-commerce and Frito-Lay, in particular. We doubled the business last year. We'll double it again this year.

Productivity is a very important pillar. This is what funds everything else we do. It continues to be robust across 4 different planks. Within our supply chain, we continue to reap the benefits of our GES expansion. We've been talking about GES for a while. It continues to provide us unlock more SKU capacity for us and continues to allow us to increase our breadth of portfolio. This has generated cost savings, too, that reinforces and funds the growth in our system.

Expanded SKU capacity will also help offer the right customized portfolio in every market, especially in diverse urban markets, ultimately in every store.

We're also accelerating our automation agenda across the entire value chain. For example, we have installed robotic truck loaders and automated picking for individual small bags, eaches, in some of our facilities to allow fully automated mixed cases for delivery to small-format stores. This is something we never thought possible five years ago. Technology advances. And now we can pick eaches with robots.

At the same time, we're investing in digital capabilities for our frontline to enable better execution of custom assortment and displays at a very granular store level. We have an app called Store Facts on Demand. We can walk into a store and see immediately detailed trends at the outlet level and the store level for pack, flavor or brand, all of it, which is updated daily. And as many others are doing, we are also pushing for automation in all of the back-office tasks that we have.

We also reap benefits from the sustainability agenda. This not only delivers benefits for our planet and will reduce energy and waste. But also generates additional cost savings for the entire organization.

These 4 planks of productivity continue to yield for us. And technology allows us to continue to push the state-of-the-art in each of these 4.

So let me just close by coming back to our model. These 4 things that I've talked about, we've talked about before, continue to produce for us. We continue to be confident that our growth model will deliver and that in 2018, our customers, consumers and shareholders will be as pleased with Frito-Lay as they have been in the past.

Thank you very much. And we'll take questions from any of you. Jamie?

Questions And Answers

A - Jamie Caulfield {BIO 17051951 <GO>}

Let's start with Laurent.

Q - Laurent D. Grandet {BIO 19930531 <GO>}

I'd like to (inaudible) Frito-Lay has been delivering, I mean, more than 3% in organic growth for the last few years. I mean, now you're well above, I mean, 31% EBIT margin. So -- and the beverage business needs you and needs your number. So is that sustainable? I mean, how long do see, I mean, Frito-Lay, I mean, continue to grow that fast and with that level of margin?

A - Vivek Sankaran {BIO 16613348 <GO>}

So we've averaged about 3% over the last three years. And that 3%, we think, is very sustainable. There is an inherent growth in the marketplace for the population. And that population supports snacks. So there's a fundamental volume growth in the business. With strong innovation, I think innovation is essential. With strong innovation and smart price -- package mixes, you get an additional pricing on top of that, which is what that 3% is. And so we continue to see that. And as long as we can keep this category vibrant with the innovation and marketing that you see, we feel comfortable with that growth trajectory.

A - Jamie Caulfield {BIO 17051951 <GO>}

So Dara?

Q - Dara Warren Mohsenian {BIO 3017577 <GO>}

So just following up on the margin side, obviously, your level of margins at 31% here is sort of the envy of almost all the CPG companies here today. So as you look going forward, can you talk a little bit about what the key building blocks are that drive further margin expansion, how high a level do you think you can get to? Or are you getting to a point where you're reaching sort of the ceiling on the margins? And there's been some investor concern recently that you've needed to sort of lean on Frito-Lay North America profit, given some of the beverage weakness. So can you talk a little bit about the level of investment behind the business over the last few quarters also?

A - Vivek Sankaran {BIO 16613348 <GO>}

Okay. So first on the margin point, I'll tell you how we think about it, Dara. We are -- there are 2 things we are maniacally focused on, right, which I think are enduring. One is you always want to focus on finding a way to get better price per pound. And that comes based on innovation, excitement with the category. In our category, you're also finding people going for smaller bag sizes. And so the mix helps on that front, too. So better price per pound. The other thing we maniacally focus on is cost per pound, right? And every year, if you look out five years ago, you go, Boy, there's going to be a limit to that. But every so many years, technologies come around. And I'll give you this example. And I talked about eaches picking. We have people going up and down a bay, picking a bag of Lay's and a bag of Doritos and a bag of Smartfood, putting it in a box and filling up that box because one particular c-store needed a particular assortment. Rather than sending cases, we pick eaches. That was manual labor. Now we figured out a way to automate that with a robot, okay? We didn't imagine that five years ago. So technology always keeps giving you new avenues to get that kind of productivity and cost per margin -- cost per pound. And as long as we can keep these 2 engines going, the notion of expansion continues. Now I recognize it cannot go on forever. But as of now, we continue to see opportunities on both of those fronts. And we're not -- to your other point, no, Frito continues to deliver what we deliver because of the opportunity within Frito, not so much because of pressure or lack of pressure from another business.

A - Jamie Caulfield {BIO 17051951 <GO>}

Brett. We'll just come across upon here and I'll get to the next row.

Q - Brett Young Cooper {BIO 17398526 <GO>}

As we sit back and hear all the companies here talk about categories that used to be healthy, that used to deliver growth and no longer there, how do guys stay in front of the curve in terms of making sure that your portfolio meets where the consumer is going to be in five years so that you're not one playing from behind? Then just what are your thoughts -- as center store continues to decelerate, we're seeing more and more people wanting into get to the snacks business.

A - Vivek Sankaran {BIO 16613348 <GO>}

Can you say that part again?

Q - Brett Young Cooper {BIO 17398526 <GO>}

As the center store decelerates, more and more food companies are getting into snacks because that's where the growth is, either organic innovation or M&A. So what's your view on that and your ability to stay competitive?

A - Vivek Sankaran {BIO 16613348 <GO>}

Yes, okay. Just remind me what your first question was, the first part of it? Sorry, Brett.

Q - Brett Young Cooper {BIO 17398526 <GO>}

So the first question was just on how do you guys stay in front of the consumer -- stay in front of the curve?

A - Vivek Sankaran {BIO 16613348 <GO>}

Got it, got it. Yes. Look, we are -- wow, I've been at Frito since 2011. And about 2011, we started focusing maniacally on consumers, okay. And what consumers care for. And one of the decisions we made is rather than predict where consumers are going to go, we're going to give consumers choice. And so you can go to a store today and you can get an organic Dorito and you can get a regular Dorito and you can get a Doritos Blaze, if you want, right? We started -- we give consumers choice. And when you give consumers choice, you start seeing which ones resonate. And so we are always thinking -- and our portfolio is always two years ahead. So early last year, we knew what we're launching in 2019. So we try to stay ahead and just keep giving consumers choice. And rather than trying to predict, rather than trying to hold ourselves in one area or another. And second, with others trying to get into snacks, I hope all of you see that as a very positive thing for the category we're at, okay, that others want to put money into this category. And I think it will be good for the consumer. I think it will just make us even better competitors. So I think it's a good thing for the category.

Q - Brett Young Cooper {BIO 17398526 <GO>}

Right. So maybe just a related question to that. One of the -- one good thing that's been consistent about the food companies that are now kind of getting into this snacks business is they feel they're going to bring capabilities to the snack world that maybe these existing businesses didn't have. So as you think about Campbell's it's going to have a big snack business now. Hershey's is ramping into savory snacks. Kellogg, right, has talked about being a snacking company. How do you sort of evaluate the competition now and maybe what are potential competitor threats? Do you do any sort of internal, sort of looking at how the competitors are changing and how you might have to adapt to that?

A - Vivek Sankaran {BIO 16613348 <GO>}

Bryan (sic) (Brett), we are always looking at the competitive environment. We're always looking at how that might change, how -- what different alternatives others might take and paths they may take. But the one thing that we are -- we have got better and better at is reacting, right? So if you go back 7, eight years, people used to use this notion of ankle biters, right. And there were a lot of snacks coming in that would take away pieces of share. And that was, I think, a bit of a wake-up call for us. And so now we've become much smarter at seeing what's happening in the marketplace, reacting very quickly. But also being smart that some of these things are just fads. They come and go. Knowing which ones are sticking and which ones are not sticking and then reacting very quickly. Popcorn would be one such an example, if you display the math over several years. So that's how we play. We -- again, we are -- our philosophy is, we don't -- we can't predict everything. But we can prepare for everything. And that's what we do.

A - Jamie Caulfield {BIO 17051951 <GO>}

Okay. Ali?

Q - Ali Dibadj {BIO 15328592 <GO>}

So 2 questions. One is just back on just margin. So I understand that you think that it's good for the category that others are coming into it. But you have a very kind of juicy margin target for others to get to. And actually, they're all either acquiring things or investing in the category. So I guess, I'm surprised that you're not a little bit more concerned that everybody has seen snacking as an opportunity and they're now aggressively going after it with your margins being so high. So that's the first question. I'll come back with the second one.

A - Vivek Sankaran {BIO 16613348 <GO>}

I'm sorry if you're reading that I'm not concerned. Of course, I'm concerned when others get into the marketplace. But we've competed with all of these players before. So nobody here is new, right? We have a good sense for how to play in this market. We have a good sense for the things that people do when they get into the business early. We often find that those things are not sustainable, right? And we continue to focus on 2 things. We know -- we think we know more than anybody what goes through a consumer's mind when they think about snacks. We try to stay ahead on innovation. We try to stay ahead on execution. And all of those, we still have a lot of others things that we haven't yet brought to the market, right, in terms of capabilities. That's why I mentioned I think we have another S-curve of performance left. And we'll just have to see.

Q - Ali Dibadj {BIO 15328592 <GO>}

Then the other one is on NAV. So I guess, (inaudible) not a lot of representation for NAV for some reason. But on the last conference call, Hugh made a point around the pricing discussion that, gosh, Pepsi beverage just isn't selling as much as we like on regular price and really selling a lot of velocity on promo, not that we're promoting more. It's just a lot more is sold on promo than is sold on regular. And that has gone a lot of play in the industry. So a lot of people are asking, "Gosh, that's worrisome, what does that mean?" How do you know that the incremental investment you're making and the investment that you're increasing going forward is going to be enough to fix that or at least improve that challenge that the brand is facing, right? We're not selling stuff on regular price and we're only selling on promo. But that suggests that there's brand damage that has been done.

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

Fair enough. So this goes back to the comments we made in Q3. And when it comes to a few of the key core brands, Pepsi, DEW, to a lesser extent, Gatorade have its own issues in the Third Quarter. We allocated M&A -- or not the M&A, A&M away from those brands into some of these next-generation brands. And basically think of it as just our relative share of voice versus our key competitors. It went down a lot. We know what the brands do when we're closer to parity on the share of voice when it comes to media. And so that's the gap we're trying to close. Now there's no guarantee that fixes it. But we have plenty of past experience that in looking at these metrics, that it does tend to improve brand health and then that it translates to better full revenue performance in the market.

A - Jamie Caulfield {BIO 17051951 <GO>}

I'm going to go, Lauren?

Q - Lauren Rae Lieberman {BIO 4832525 <GO>}

So you're talking about you've been at Fritos since 2011, right? And since that time, you (made) what is consumer choice, let's give them choice, let's give them choice. But the challenge to that, of course, is how do you give them choice but still invest in your big core brands while you do small, right? So you've done an increasingly good job of doing that. And even with today, you mentioned the nuanced strategy of different distribution model for small brands versus big Doritos, like the spicy hot thing, whatever it's called.

A - Vivek Sankaran {BIO 16613348 <GO>}

Doritos Blaze, Doritos Blaze.

Q - Lauren Rae Lieberman {BIO 4832525 <GO>}

It's really not targeted for me. But I was just curious, one, in how much of that was really a conscious decision over the last 6 or seven years to figure out how you allocate those investment dollars across big, small, new line extension? And to what degree can that sort of deleverage internally across other parts of the business, for instance, the North America Beverages, to maybe do a little bit of a better job balancing that mix of provide choice but not sacrifice investment in the big core?

A - Vivek Sankaran {BIO 16613348 <GO>}

Yes, I think the key word is patience. And remember, in our brand portfolio, we have 2 types of brands. We have 2 types of choices for consumers when we go into the Better For You world. One is the core brand carries the name but provides a Better For You alternative. So it is, say, organic Tostitos. So you go to the nature's market section of a store. You will find a portfolio of our Simply line with brands that are familiar to you but that provide a different set of ingredients, okay? Then, there are the other ones that are brands like Off the Eaten Path that we're introducing or Red Rock Deli that we're introducing. What we have learned to do there is to be surgical and patient, right? We don't expect that Off the Eaten Path is going to be a big, big number any time soon. But we know that it's powerful enough that we can build it over time. So that's the way we're playing it. And a lot of -- and in some cases, we're using the DSD system. In some cases, we're not using it. Red Rock Deli, we use the DSD system. In other cases, we won't use the DSD system. We're playing that also carefully so that we don't stress any part of our system down as we go forward, right? And look, we're continuing to learn that in North America. We learned to play that game steadily and patiently in North America.

Q - Lauren Rae Lieberman {BIO 4832525 <GO>}

And can you help your partners in beverages in learning that?

A - Vivek Sankaran {BIO 16613348 <GO>}

We're always working together in North America.

A - Jamie Caulfield {BIO 17051951 <GO>}

I want to go to Caroline and Vivien and then we'll go back to Nik.

Q - Caroline Shan Levy {BIO 22683565 <GO>}

I'm also going to ask about beverages. Because it's just -- it's a little confusing as to how you can have a spectacular 30-plus years of growth top line, margin expansion at Frito, all the great productivity work you're doing, which you lay out very, very clearly in the (pre-pack) and the improvement. And you're not at a granular level seeing anything. So it seems like they're 2 different companies completely. Is there something structural in beverages? Is it because Coke has a dominant share? Is it the nature of the product? What is it that makes it so much harder to win definitively in beverages on a consistent basis the way you have in snacks?

A - Jamie Caulfield {BIO 17051951 <GO>}

I'm going to go back to Vivek's slide that shows that we have the 7 top brands in salty snacks. When you have the 7 top brands in salty snacks, it's a different game.

A - Vivek Sankaran {BIO 16613348 <GO>}

But Caroline, you go back. Frito has had its moments, too, tough days too, right? It's not always been that. We've gone through our cycle. Just go back 10, 15 years. We've gone through that cycle, too. I just think that's a combination of those brands, the steadiness and the execution. And there's -- so I think it's going through a phase where it's been a little better.

Q - Caroline Shan Levy {BIO 22683565 <GO>}

And just to push it a little bit further, though, is it more dependent on a handful of very big brands -- Pepsi Diet Pepsi? Is that the problem whereas you've got so many SKUs? Is that part of the issue in snacks? Flexibility you have in snacks?

A - Vivek Sankaran {BIO 16613348 <GO>}

What I can tell you in Frito, too, is that if we lose momentum on the core brand, it's difficult to make the numbers work. And the same issue holds. The same issue holds. The core brands have to work for the math to work at Frito, too.

Q - Vivien Nicole Azer {BIO 16513330 <GO>}

To follow up on that theme, it seems like that your innovation plan for 2018 are perhaps are little bit more weighted to Better For You than we have seen historically. Giving Pepsi full credit, you guys have been way ahead of the curve on Better For You across your portfolio. But it does raise a question about the Third Quarter misstep on beverages, where my understanding was there was a little bit too much emphasis on low, no cal in beverages, where the consumer was still more inclined to full calorie. So as you put up together your launch plan on salty snacks with a lot of new innovation on Better For You, what did you learn from what happened in NAV in the Third Quarter and how does that inform kind of the balance of emphasis across your portfolio?

A - Vivek Sankaran {BIO 16613348 <GO>}

With the DSD system, one of the -- one of the powerful things about the DSD system, as I told you, we can get to 95 ACV with the Doritos Blaze in 3 weeks. One of the powerful things about the DSD system is if I emphasize something else, we have 95 ACV on Simply, okay? And so we've just got to be really careful about what we emphasize with that frontline and make sure that we are always building what I'd call the new things around the core portfolio and the perimeter. So that's why you see us launching the Lay's Smile campaign, right, as a big prominent engine. That's why you see us launching Doritos Blaze. But you won't see a big commercial like that on Off the Eaten Path or on Simply. You will find placement of Simply and off the Eaten Path that complements it. What we're trying to do there is either attract a different shopper or expand the basket with something. And that's -- that's part of the trick with the DSD system.

Q - Vivien Nicole Azer {BIO 16513330 <GO>}

And if I could just follow up. And I apologize if you commented on this, on an unpromoted basis, what kind of...

A - Vivek Sankaran {BIO 16613348 <GO>}

On an un-what, sorry?

Q - Vivien Nicole Azer {BIO 16513330 <GO>}

On an unpromoted basis post-launch, how should we think about price gaps on your core versus your Simply line extension?

A - Vivek Sankaran {BIO 16613348 <GO>}

It's about 20% to 30% higher on the Simply lines, yes.

A - Jamie Caulfield {BIO 17051951 <GO>}

Nik?

Q - Sunil Harshad Modi {BIO 7557463 <GO>}

Vivek, maybe you can help us. When you think longer term about the DSD system and the rising emergence of click-and-collect and e-commerce, how do you think about that, just the kind of polarizing? Because obviously, DSD is a very expensive network to run, (importance) of spot merchandising. But obviously, we're going into an environment where consumers aren't even walking into the store.

A - Vivek Sankaran {BIO 16613348 <GO>}

Yes, Nik. I always thought of it as a very profitable system to run, okay? Yes.

Q - Sunil Harshad Modi {BIO 7557463 <GO>}

True.

A - Vivek Sankaran {BIO 16613348 <GO>}

It's true. So these are early days. And one of the things that we are observing, first, you have to take e-commerce and parse it out into 2 types. One is there's the e-commerce, which is fulfilled from a store, okay? Then there's the e-commerce that is shipped from a location. The first thing about our system is recognize that our product fundamentally doesn't transport well. And because of that, we designed a big network where we have plants closest to consumption. So our product is already closer to the home, first thing you should note, right? And so when it comes to something that's picked up from a store, it is the DSD system that is still enabling the transaction closest to the store. On the part -- on those parts of the business where you have something going from a DC, from some dot-com or from a dot-com provider going from a DC, a DSD system is not as valuable. But that today is. And in our forecast, still a smaller chunk of the total business. I suspect what's going to happen is you're going to have an integrated system, where people are picking up from store, delivering from there. And that network is going to combine. So we still see a lot of promise. And recognize that a huge part of our DSD system's advantage is to reach those stores that you and I don't talk about. You don't see it in a report. It's up and down the street. It's a liquor store. It's a gas station that's owned by an independent. And that's where we make more of our money.

A - Jamie Caulfield {BIO 17051951 <GO>}

We'll take 2 very quick. So (Amit) and Judy.

Q - Unidentified Participant

Vivek, just a quick question on e-commerce and another one. Is your share advantage just as large in e-commerce as it is in the brick-and-mortars? Then the second one, you answered all the tough questions very well. So in your words, what are some of the things that keep you up at night? Is there anything to worry about this business at this time?

A - Vivek Sankaran {BIO 16613348 <GO>}

Of course. Yes, of course. Well let me answer that first. Yes. We worry about the whole change in the retail environment, clearly. We worry about potential continued deflation in the retail environment, which is why this notion of innovation, price mix, all of those become so important to ensure you can get the pricing in this retail environment. We worry about -- as much as I seem to have conveyed that I'm not concerned, we worry about others getting into our category, right? And we want to be watchful. And so those are some of the things. I would have said some years ago that I'm worried about the health and wellness. But I think we have made tremendous progress. So I feel like we have learned how to play that game and we've learned how to provide consumers with a choice on a variety of that portfolio. And you had an e-commerce question, too?

Q - Unidentified Participant

Yes. Your relative share advantage so far.

A - Vivek Sankaran {BIO 16613348 <GO>}

Yes. The relative share advantage. Let me put it this way. It is clearly -- we're surprised how strong the basket is. The basket tends to be equal to or better when there's a transaction online in the brick-and-mortar e-tailer space, okay? And the other one, in the pure-plays, it varies by category. There are some categories -- or product types where it is significantly -- I know some of that is lower. But we're happy about the ones where it's higher.

A - Jamie Caulfield {BIO 17051951 <GO>}

Then, Judy?

Q - Eunjoo Hong {BIO 17927278 <GO>}

So I guess, my question is just around your desire to maybe expand your portfolio more broadly to some of the adjacent snacking categories. I know in the past, you talked about chocolate-covered ruffles and really using core brands to go into adjacent categories. Is that still the strategy? Do you have to develop more new brands? Can you deploy more of a venture capital model to take investments in some of the smaller start-ups that are really popping up here and there?

A - Vivek Sankaran {BIO 16613348 <GO>}

Judy, we're doing all of that. So we are looking at -- as Indra said in the call, we are always looking at potential tuck-ins that can expand our portfolio. We are so strong on -- if you think of 2 bases, the potato chip and the corn, we're so strong. So we're always looking at ways of getting into other snacks. When you think of chocolate-covered Lay's, that's more of a novelty, okay? That's nice around Christmas but not something that you're going to consume enough often. So we're trying to get into things that can provide other benefits. So this Off the Eaten Path, the fundamental -- that for us is going to be a platform where we can bring other benefits to you, the snacks that are -- that might provide you a wonderful eating experience and some protein, as an example. You'll see more of that coming later this year and next year.

Q - Bryan Douglass Spillane {BIO 2147799 <GO>}

Okay. With that, I think we're ready to move into the breakout. Vivek, Jamie, thanks again for spending your time with us.

A - Vivek Sankaran {BIO 16613348 <GO>}

Thank you, I'd like to thank you all.

A - Jamie Caulfield {BIO 17051951 <GO>}

Thank you.