Good morning and welcome to PepsiCo's First Quarter 2015 Earnings Conference Call. Your lines have been placed on listen-only until the question-and-answer session. [Operator Instructions]. Today's call is being recorded and will be archived at www.pepsico.com.

It is now my pleasure to introduce Mr. Jamie Caulfield, Senior Vice President of Investor Relations. Mr. Caulfield, you may begin.

Jamie Caulfield

Thank you, Laurie. With me today are Indra Nooyi, PepsiCo's Chairman and CEO; and Hugh Johnston, PepsiCo's CFO. We'll lead off today's call with a review of our first quarter 2015 performance and full year outlook and then we will move on to Q&A. We recognize today is a busy earnings day with a number of other consumer and mega-cap companies reporting. So we've kept our comments brief this morning and intend to conclude the call by 08:45.

Before we begin, please take note of our cautionary statement. This conference call includes forward-looking statements, including statements regarding 2015 guidance and our long-term targets based on currently available information. Forward-looking statements inherently involve risks and uncertainties that could cause our actual results to differ materially from those predicted in such forward-looking statements. Statements made on this conference call should be considered together with cautionary statements and other information contained in today's earnings release and in our most recent periodic reports filed with the SEC.

Unless otherwise indicated, all references to EPS and operating profit growth are on a core constant currency basis. All references to free cash flow exclude certain items. In addition, references to organic revenue results in this call exclude the impact of acquisitions and divestitures, structural changes and foreign exchange translation. To find disclosures and reconciliations of non-GAAP measures that we use when discussing PepsiCo's financial results, you should refer to the glossary and other attachments to this morning's earnings release and to the Investors section of PepsiCo's Web site under the Events & Presentations tab.

As we discuss today's results, please keep in mind that our first quarter comprises the 12 weeks ended March 21 for our North American operations and it is a short quarter for our international business reflecting the two months of January and February for most of our operations outside North America.

And finally, our core Q1 2015 earnings results include a $39 million pre-tax gain related to the refranchise of a portion of our India bottling operations.

We also reported a pre-tax impairment charge of $65 million associated with our dairy joint venture during the quarter. And as you may recall, our Q1 2014 core earnings results included a $31 million pre-tax gain from the sale of certain agricultural assets in Europe.

And now, it's my pleasure to introduce Indra Nooyi.

Indra Nooyi

Thank you, Jamie and good morning everyone. I am pleased with our performance in the first quarter of 2015. Our focus on innovation, brand building and marketplace execution funded in part by productivity initiatives continued to drive fundamental business performance.

In the first quarter, organic revenue grew 4.4% with Global Snacks up 7% and Global Beverages up 1.5%. And core gross margins improved by 150 basis points. Excluding the impairment charge and gains Jamie mentioned, core operating margin improved by 65 basis points. Core constant currency operating profit grew 11% and core constant currency EPS grew 16%. However foreign exchange headwinds persist. We have and will continue to take actions to manage through the current volatile macroeconomic environment by taking responsible pricing actions, tightly controlling costs and optimizing our global sourcing to minimize and mitigate the impacts of the current foreign exchange challenges.

I am particularly pleased with the level of effective pricing we're achieving, especially in Global Beverages where we realized 3 points of effective net pricing. At the same time we will not let cyclical macroeconomic issues divert us from our focus to drive sustainable shareholder value creation. We intend to continue to invest across our markets and brands to generate organic revenue growth, drive greater efficiency and productivity, deliver attractive free cash flow and cash returns to shareholders and enhance our returns on invested capital.

The power of our the portfolio of products and brands and the strength of our geographic footprint have enabled us to consistently meet or exceed our financial goals and more importantly give us confidence in the future prospects of our business.

As you know, in June this year we celebrate the 50th anniversary of PepsiCo which is the coming together of PepsiCo and Frito-Lay. As we celebrate this milestone, we look back on our journey with price. In 1965, our annual revenue was $510 million. Today it stands over $66 billion. A $100 investment in PepsiCo stock in 1965 was worth nearly $43,000 at the end of 2014, a compound annual total shareholder return of over 13%, far outpacing the S&P 500. And the reason we performed so well is that throughout our history, we have delivered short term performance with a keen eye on the long term sustainability of our results. We've done this because throughout the past half century, PepsiCo has made bold move to reshape our portfolio, build new capabilities and broaden our geographic footprint.

So today our portfolio is positioned well. Our annual net revenue is nearly split evenly between the US and countries outside the US. And just over half of our global revenue is derived from snacks, with the remainder from beverages. In aggregate, carbonated soft drinks comprised less than 25% of our 2014 total global revenue. And while we are proud to have the Pepsi name on the door, coolers represented less than 15% of our total revenue mix, and this speaks exactly to how we've transformed and will continue to transform our portfolio to address ever changing consumer needs and preferences.

And as you know we've also developed new capabilities to compete in a rapidly evolving global business environment. For example, we transformed our operating model to blend global scale leverage with locally focused execution and this has increased our ability to capture efficiencies, live and shift the best ideas and capabilities from PepsiCo teams around the world and win us a point of sale.

We embrace design as a core building block of our new product pipeline with innovation representing over 9% of our net revenue in 2014. We're very proud to report that three PepsiCo products have received the 2015 Nielsen Breakthrough Innovation Award. This award recognizes the most successful and enduring new CPG products launched in the US in 2013 and PepsiCo is also the only company to receive multiple awards this year.

Lastly, productivity is now part of our DNA with $1 billion in annual savings projected through 2019. These savings enable us to maintain or increase necessary investments in the business to drive strong organic revenue growth. And we're always looking to reconceptualize our business to unlock even more productivity.

We are proud of the legacy results we are building this company on. So with that backdrop, let's take a look at how our business has performed. Starting with North America which again delivered strong results in an otherwise sluggish packaged food and beverage environment. In fact, in Q1 2015 PepsiCo was the largest contributor to US retail sales growth among all food and beverage manufacturers with over $300 million of retail sales growth in all major channels. This was nearly three times the next largest contributor to growth and represented more growth than the next 19 largest manufacturers combined. Notably, North American beverages was the key driver of US retail sales growth within PepsiCo and the largest contributor to US retail sales growth on a standalone basis.

Turning now to PepsiCo Americas beverages. We delivered organic revenue and core constant currency operating profit growth while holding US LRB value share. Our strategy has not wavered as we continue to manage the business responsibly with consistent positive price realization across the portfolio. Within the US, we gained value share across important sub-categories, including sports drinks and ready to drink tea. And we grew retail sales in measured channels in the US for regular colas and Mountain Dew in CSDs and for Gatorade Lipton Tea and Naked Juice within our non-carbonated footprint.

We were proud of PepsiCo's execution at this year's Super Bowl. We had over 60,000 integrated food and beverage displays merchandised at retail, up nearly 70% from the prior year. We also continue to invest in R&D to drive sustainable innovation. For example, we rolled out a newly designed Gatorade 20-ounce bottle which is a sleek contemporary design bottle that is built with improved ergonomics informed by athletes' insights. Early results are promising with this package of innovation contributing to double-digit retail sales growth in regions that have converted with the new packaging.

We're also focused on health and wellness innovation. We recently introduced new Naked Juice flavors, including Chia Cherry Lime, Chia Sweet Peach and Bright Beat [ph] which offer delicious food and vegetables movies that pack a nutritional punch. And we launched Tropicana Farmstand Tropical Green, which is a great tasting green juice that has a full serving of fruits and vegetables in each 8-ounce glass with no added sugar.

Additionally we recently launched Mountain Dew Dewshine, a craft premium soda inspired by the brand's roots in the backwoods of Tennessee. It is a clear citrus juice made with real cane sugar and packaged in clear glass bottles. We're also excited to report the new food service partnership with Umami Burger which was a Pepsi-Cola Mountain Dew and Sierra Mist, all made with real sugar at its 24 locations.

In addition, we entered into a new multi-year deal with Live Nation. We are the music company's official carbonated soft drink and bottled water partner and have exclusive pouring rights at 75 of Live Nation's US event spaces. And we're also pleased about our new multi-year food and beverage partnership with the National Basketball Association, Women's National Basketball Association, NBA Development League and USA Basketball beginning next season. As part of this expansive food and beverage partnership with the League, PepsiCo will leverage its Mountain Dew, Aquafina, Brisk, Doritos & Ruffles brands to engage NBA fans through

PepsiCo's world class sports marketing and high-profile activation. The partnership between the NBA and PepsiCo builds upon the League's relationship with Gatorade which is the NBA's longest standing partner.

Turning now to Frito-Lay North America, delivered another quarter of very strong results. Organic revenue grew 4% and core constant currency operating profit rose 7%. The US salty snacks category continued to show solid growth and Frito market share again posted steady sequential improvement supported by both volume growth and price realization. Our key brands had revenue growth, including particularly good performance from Lays, Doritos and Cheetos. And we continue to innovate.

We launched Cheetos Sweetos, the first ever sweet Cheetos in the US as well as Cheetos appetizers, Doritos Jacked 3D and [indiscernible]. Additionally our Lays Do Us A Flavor win in 2014, Lays Kettle Wasabi Ginger return to the shelves. We're also excited about the return of a highly successful Lays Do Us A Flavor consumer contest. Fans nationwide have submitted their ideas for the next great potato chip flavor for a chance to win $1 million grand prize and we will announce the four delicious finalist flavors this summer.

Quaker Food North America delivered commendable results despite continued challenges across central store food categories. During the quarter we gained or held value share in the US in all three of our key categories, Hot, Ready-To-Eat Cereal and Snack Bars while expanding gross margin at the same time. These value share gains are driven by innovation which includes the launch of Quaker 3 minutes Steel Cut Oats in the quarter. This product has the same hottie texture and nutty flavor as traditional steel cut oats but caters to the consumers' needs for convenient products as the cook time is cut from 30 minutes to just 3 minutes. We also launched gluten free varieties of Quaker Popped Rice Crisps.

And then turning to developing and emerging markets. Our business has delivered 10% organic revenue growth in the quarter despite all of the ongoing volatility in many regions of the world. Looking across some of our key DNA [ph] markets, our business continued to proved resilient with double-digit organic revenue growth in China and Turkey and mid single digit organic revenue growth in Mexico, Egypt and India.

So before I turn it over to Hugh, I want to highlight a few key points. As an operating company, we absolutely manage the things that are within our control: marketing, innovation, marketplace execution and productivity and we expect to continue to perform well in these areas. However we expect to face continued headwinds related to macros, in particular weak currencies in a number of our key markets and the impact of low oil prices in countries whose economies are highly dependent on energy. Obviously these are all products and sold but we adjust the business to weather through the challenges as best as we can by controlling costs, adjusting our raw material sourcing and executing pricing actions, and these steps contributed to our strong fundamental performance in Q1.

So with that, let me turn the call over to Hugh. Hugh?

Hugh Johnston

Thank you, Indra and good morning everyone. Turning to guidance. For the full year 2015 we expect mid-single-digit organic revenue growth, core operating margin expansion as organic topline growth and productivity should offset negative geographic mix and commodity inflation, which incorporates the impact of higher than previously expected transaction related foreign-exchange headwinds and approximately $1 billion of productivity servings.

Below the division operating profit line, we continue to expect corporate cost to be lower, a core tax rate of approximately 25% and to reduce share count. As a result, we continue to expect 7% core constant currency earnings-per-share growth in 2015.

However given the continued strength in the US dollar, we now expect foreign-exchange translation to negatively impact net revenue and core earnings-per-share growth by approximately 10 and 11 percentage points respectively based on current consensus market rates. That compares to our initial outlook of 7 percentage points for each back in February. Keep in mind that while spot rates have shown improvement we use consensus rates in calculating our expected foreign-exchange impact and consensus rates have worsened for all of our key foreign currencies, including the Russian ruble, the Brazilian real, the Canadian dollar, the Mexican peso and the British pound.

Our outlook for the year assumes continued translation of our Venezuela results at the SICAD rate of 12 Bolivars per US dollar. Should circumstances dictate use of a higher rate this would also negatively impact our US dollar results.

Taking our 2014 core EPS of $4.63 and applying our guidance and current market consensus of foreign-exchange impact implies 2015 core EPS of approximately $4.44. As you model out the second quarter, I'd ask you to consider the following: Foreign-exchange translation should have an approximate 11 point unfavorable impact on the second quarter net revenue and approximate 12 point unfavorable impact on second-quarter core EPS based on current market consensus rates and we expect a profit decline in

Europe driven by the volatility associated with transaction and translation currency related headwinds.

Below the division operating profit line, net interest expense is expected to increase in the second quarter versus last year, primarily reflecting increased debt balances. And our tax rate in the second quarter is expected to be sequentially higher than the first quarter of 2015.

Finally, our stepped-up share repurchase activity will occur throughout the year but it's expected to have a more pronounced impact in the second half of 2015.

From a cash flow perspective, we continue to expect full year free cash flow of more than $7 billion. I want to emphasize that despite the expected incremental foreign-exchange headwinds this year, our original $7 billion free cash flow target remains intact. This is the result of stringent working capital management and capital spending discipline. We've shortened our cash conversion cycle by over 50% since Q1 2012 and continue to manage capital spending with great efficiency, holding capital spending below 5% of sales.

We expect our capital allocation discipline to continue to drive core ROIC improvement. This is building on the steady progress we've made in ROIC over the past two years with core net ROIC up 220 basis points to 17.5% from 2012 to 2014. And we expect to return between approximately $8.5 billion and $9 billion to shareholders in 2015 through both dividends and share repurchases, again consistent with our original target.

As a reminder, our previously announced 7% dividend per share increase will commence with the June payment. This represents the 43rd consecutive year of annual dividend increases and an approximate 60% payout ratio based on 2014 core EPS. And our annualized dividends per share grew at low double-digit compound annual growth rate over the past 10 years.

To summarize, our core constant currency outlook for 2015 is unchanged from our last call and free cash flow, disciplined capital allocation and returning cash to our shareholders remain top priorities for the company.

With that operator, we will take the first question.

Question-and-Answer Session

Operator

[Operator Instructions] The first question comes from the line of Dara Mohsenian of Morgan Stanley.

Dara Mohsenian

Can you discuss demand elasticity so far from the higher pricing you've taken? It looks like it's been pretty muted with the solid organic sales growth. So I am just wondering where demand elasticities are coming in versus your expectations particularly in Latin America and Russia given some of the macro difficulties there. And then as we look going forward as FX pressure continues to worsen do you plan to take incremental pricing internationally because I imagine at some point you don't want to push too far from a consumer standpoint? And then last just a detail question, the pricing number was very strong in Latin American foods and I suspect in the Latin piece of PAB how much of that was driven by Venezuela versus other geographies?

Indra Nooyi

Dara, overall I tell you demand elasticity in these times when you’ve got high inflation and you’ve got translation FX in countries which required us to take pricing. The challenge is to balance volume and revenue and what we do in most cases is that we try to push through as much of the inflation as we can, and raw material inflation as we can through pricing. In many cases we cannot cover all of it but we try to price through about 75% of the inflation and then we manage very judiciously the revenue output and make sure that our volume decline is not significant. For example, let me take Russia. In Russia, we have pushed through a lot of pricing and we’ve managed it up with a lot of productivity also. And so our results in Russia and our business is doing very well. The real issue is yes, there is some volume drop-off but I think in these times we have to judiciously manage revenue and volume and then as the economies recover, go back to volume growth. If we don't push pricing through now, it will be very hard to push it all through later on to cover all of these costs. So at every point in time in each of these countries that’s what we do.

And in terms of ongoing FX, spots rates are slightly better than consensus. We have to watch and see how this thing evolves but in every country -- again every country is not moving exactly the same way but country by country as FX moves, especially transactional FX impacts country performance, we do take pricing at least to cover 75% of that and the rest of it we try to cover through productivity. And as far as Venezuela is concerned, I mean the footnotes in the Q will indicate exactly the impact of Venezuela and I think it will speak for itself.

Operator

Your next question comes from the line of Bryan Spillane of Bank of America.

Bryan Spillane

First, just a comment, a lot of companies reporting this morning, you put out a pretty efficient press release that was easy to read. So thank you for that. I guess my question is and somewhat related to Dara's question is, if we kind of look out over the balance of the year, there's certainly some volatility still, I guess, we could expect in Russia and potentially Venezuela. And so if you could just talk to – you've maintained your currency neutral guidance and you've also maintained your free cash flow guidance in the context still of having that type of volatility. So could you talk just about what some of the factors that you're watching for that might drive some variances to those forecasts and even specifically on free cash flow, what other actions can you take if you still have – you're still compromised on foreign exchange moving against you?

Indra Nooyi

Yes, I am going to let Hugh talk about cash flow but I will just make an overall comment. Russia, the business is doing very well, Bryan. Retail, dairy products, juice products, basic snacks, the business is doing very well. We have an excellent team in Russia, great productivity programs, putting the pricing through in very judicious ways, doing very good revenue management. I am very proud of the Russia team. And so they are managing through this volatility very well. And Venezuela, the business is doing exceedingly well in Venezuela. The issue is the currency. So let's hear Huge now talk about what he is doing on the free cash flow to make sure that as a company we deliver on our commitment on free cash flow. Go ahead, Hugh.

Hugh Johnston

Yes, happy to. Morning Bryan. Real a couple things. Number one, we do continue to localize this even more aggressively than we have in the past and obviously that helps us manage from a currency perspective which helps us manage from a free cash flow perspective. Number two, we are managing CapEx very tightly. You've seen us over the last few years come down from the mid-fives in terms of CapEx a percent of revenue to we've been operating in the low fours. And then third, we've managed working capital from what had previously been about 21 days down to about three days. In all condor, I still think we have more opportunity in that regard particularly on inventory and we're going to continue to work that as quickly as we can in order to mitigate if there are further downsides. Right now we've given you market consensus, it’s our best guess. So definitionally that's 50:50 as to which way it’s going to do. But I do think we can continue to do more from an inventory perspective in order to continue to cover if we have further downsides from an FX perspective.

Indra Nooyi

And our new operating model is also allowing us to come up with more productivity ideas across the company. That we will be working as the company against.

Operator

Our next question comes from the line of Bill Schmitz of Deutsche Bank.

Bill Schmitz

Hey I know it’s something like a random question but are you guys going to close down Muller as far as big impairment charge in the quarter? So is that just a write-down at the fair value now and is that still going to be in the midst that they’re going to work through?

Indra Nooyi

We’re not closing down Muller. The business is still running and doing well but I think it just didn’t meet our expectations and we have to go through some retooling. I know that business is alive and kicking.

Operator

Your next question comes from the line of Judy Hong of Goldman Sachs.

Judy Hong

So I guess my question is more on the PAB margin performance in the quarter, Hugh. I guess it’s the first quarter in the last few quarters that margin did decline year-over-year. I know in the press release you did cite lapping some of the one-time items. So can you just walk through the margin performance in PAB and how much is timing versus just really some of the spending that you’re doing to drive the business to grow up from a top line perspective?

Hugh Johnston

Yes, couple of elements there, Judy. First of all, the pricing environment is quite healthy. We felt terrific about pricing in the quarter and we expect that to continue going forward. Two other drivers, obviously advertising and marketing was up a bit in that for the quarter and that's timing of the curve. That's one of the elements. The other elements are some of the timing on spending with our Latin American bottlers that drove that number. So – but we certainly expect PAB margins to continue to grow over time as they have been.

Operator

Your next question comes from the line of Caroline Levy of CLSA.

Caroline Levy

Just one quick one. Why did you leave the charge in the Quaker operating income? Is there a good reason for that? And then it would be great if you could just tell us what it's like on the ground in Russia and Brazil right now, possibly even Mexico because there is a sense that things are deteriorating in Brazil for example. So it'd just be great to hear from you.

Indra Nooyi

We left the charge in the Quaker operating income because it's managed as Quaker Muller.

Hugh Johnston

Yes, that's the accounting on the line of business.

Indra Nooyi

On the ground in Russia, as Hugh just mentioned, we were localizing costs and we have a very, very good team that's doing all the right things, productivity, taking pricing, adjusting the product lines to make sure it's suited for Russian consumer, they're shopping differently now. And so I'd say that on the ground in Russia, the business is doing well. And I think it's also giving an opportunity for all companies operating in Russia to look and see how to tighten their belts and work with each other to lower each other's cost. So except for the overall macro geopolitical issues in Russia on the ground the business in Russia looks okay.

In terms of Mexico again, we've operated in Mexico for decades and we've operated through massive volatility. At this point we're not seeing the kind of volatility at all in Mexico, we have pockets of security issues but overall Mexico is just fine. Brazil did see a slowdown, coming off the real weakening and then on top of that the graft issues happening in Brazil. Yes, we did see some turmoil in Brazil, and our business is still holding, Caroline but I'd say of the three countries that you mentioned probably in the last quarter, Brazil is where we saw some on the ground action that we're watching very carefully at this point.

Operator

Your next question comes from the line of Ali Dibadj of Bernstein.

Ali Dibadj

I actually had two questions. One is just assuming on cost a little bit, please. I want to understand a little bit more what's driving on the commodity inflation being higher for the year, why for FLNA and PAB, you had an operating cost inflation. Is that wages? And then importantly also just continue to cut the billion dollars of cost a few years of that, but what happens after that? So that's the cost question. And the other one is, I know it's early days but you're seeing Coca-Cola refranchise more and more of its US bottling operations. Are you seeing anything that shows the change in pattern of their activity in the marketplace?

Indra Nooyi

I am going to answer two parts and I am going to turn it to Hugh on commodity inflation. And as I mentioned in my script, Ali, we talked about the billion-dollar per year for the next five years. But when we announced the billion-dollar a year for the next five years, we started working on the next round of ideas to think about even more productivity opportunities. And we will come back and talk to you about it when we are ready to talk about it but believe me once we change the operating model of the company to really look across the company as opposed to allowing each country and regions just operate independently. There are more opportunities for efficiency. So that's what we are working on.

And in terms of the Coke refranchising its bottling operations, let's not forget why we bought back the bottling access. We bought it back because we wanted to improve efficiency in the system and most importantly we wanted to serve our customers in a seamless way and be able to put in a lot of innovation through a bottling system which had to move from huge monolithic products to a highly segmented set of products. That original proposition has not changed. What we are seeing today is disciplined pricing in the market and from our perspective the integrated operating system is very valuable and we intend to continue to operate that way. So on commodity inflation, Hugh, quickly.

Hugh Johnston

Yes, very briefly, it's almost entirely driven by foreign-exchange, ex foreign exchange their commodity inflation is almost flattish.

Operator

Your next question comes from the line of Bill Marshall of Barclays.

Bill Marshall

I actually have a high level kind of strategic question for you. Indra, in your prepared remarks you mentioned the challenges in center of the store food recently. And I think a couple of years ago you labeled these businesses as not necessarily core to the mission, even though nice cash flow generating assets. I am kind of wondering how you are thinking about those businesses in the current environment, especially with everything we've seen going on with food and the interest rate environment that we are seeing now.

Indra Nooyi

I think there's two kinds of businesses, I said, were not core to the mission. Quaker is very core to the mission. What we were talking about is sort of the peripheral businesses we got as part of the Quaker Oaks acquisition, the Golden Grain and the Aunt Jemima. Those businesses are center of the store. They are not core to our portfolio, but today they are doing fine. They are holding their ground, sometimes even gaining share. They are generating very valuable US cash flow and these are businesses with fantastic margins. So at this point it's more dilutive to get rid of them than to keep them. And so, what we are going to do is just manage those businesses steadily as long as they don't distract us from our core mission of growing the rest of the portfolio. That's what we are focused on.

And lastly, they also provide scale to our warehouse sales operation. So at this point just steady management of those businesses, don't distract ourselves from the core, enjoy the US cash, the good margins and that's all we are doing.

Operator

Your next question comes from the line of John Faucher of JPMorgan.

John Faucher

Indra, I wanted to talk about sort of your old sort of buckets that the business has had in terms of Fun for You, Better for You and Good for You. It seems as though we are seeing a change in the consumer dynamic particularly in the Better for You bucket, if you look at something like diet soft drinks, what have you. So I guess as we look at this what do you think has changed in terms of those buckets and what are you doing differently to respond as the consumers maybe seem less interested in what you guys had traditionally discussed is Better for You?

Indra Nooyi

That's a wonderful question, John, and I tell you something. We've never seen the consumer as confused as they are today. And I use the word confused in a neutral way, not a negative way. If you had asked me a few years ago people were moving to diet sodas. Now they view real sugar as Good for You. They are willing to go to organic non-GMO products even if it has high salt, high sugar, high-fat. So I think we have a challenge these days to really think about what is the definition of Good for You from a consumer perspective. And this is unprecedented and the old definition of Good for You is being challenged right now. So I think the best way to think about this is to think about the fruit and vegetable corridor, a protein corridor, a grains corridor and then sort of a predominantly carb corridor.

And then within that just vary our strategy based on what the consumer is thinking about. Because especially millennials today have got very different definitions of Good for You versus Fun for You. They don't really make the definition in the difference, that they're looking much more to ingredients. So we are also going through a little change in our thinking. The good news is whatever the segmentation is our portfolio is still balanced and we can actually flex to either definition. So, we are managing the business by watching both.

Operator

Your next question comes from the line of Mark Swartzberg of Stifel Financial.

Mark Swartzberg

Indra, Hugh, a question about FX from a transactional standpoint. Obviously you have some major productivity programs underway and we are a couple of years into this. But when you look at specifically the countries of Mexico and China, are these higher transactional costs that are dollar-related -- are they impacting you to the scope or the phasing of some of your productivity programs in those particular countries?

Hugh Johnston

Mark, I would say no. It really doesn't affect us a great deal. We obviously have got to be cognizant of what's happening with transactional ForEx. To the degree that we are experiencing that in a particular market, as Indra mentioned earlier, we are tending to price through about 75% of it. But in terms of if transactional ForEx is affecting capital that we would put in to drive productivity, it really isn't impacting us a great deal. It's not slowing down the rate because the returns on those initiatives tend to be pretty solid and we can overcome the FX impact.

Operator

Your next question comes from the line of Amit Sharma of BMO Capital Markets.

Amit Sharma

Just a quick clarification first. The 75% rule that you're talking about, is that just to cover underlying inflation or should we expect that to cover the transactional FX as well?

Indra Nooyi

I mean, transactional FX is what drives some of the inflation. And so they are all related. I have given you 75% of what we're doing today, it varies around that number. Sometimes we can do more, sometimes we can do less, but as a basket it's around 75%. The thing, Amit, is that globally we have been through in some country of the world hyperinflation, inflation, extraordinary inflation, geopolitical crises, we have been through that. And across PepsiCo exists a lot of playbooks on how to manage through these sorts of issues. So when we have a problem like this in a country we bring the experts in, we use one of these playbooks and then we use our extraordinary teams in these countries, then we judiciously manage through pricing, productivity, revenue management to see how best to insulate the portfolio.

And I think the good news about the portfolio is that the portfolio serves as a good hedge when you have a mix of countries, mix of businesses. That’s what allows us to deliver the 7% constant currency growth, reiterate that guidance and the free cash flow guidance.

Hugh Johnston

To be clear on that, I would think of the 75% as a rough modeling guideline, not an internal principle as to how we execute market by market. We vary market by market based on the opportunities in front of us.

Operator

Your final question comes from the line of Steve Powers of UBS.

Steve Powers

Maybe just a couple of final clarifications. First on pricing specifically in Europe. Clearly it's difficult to realize in Western Europe, but the 6% price this quarter is falling well short of sort of the currency headwinds. So was there additional pricing that maybe you took after the quarter in Eastern Europe and Russia or do you still expect to take to catch up with currency? And if so what type of elasticity should we kind of think about around that incremental pricing? That's first. And then second, maybe, Hugh, just some clarification and sensitivities around that updated FX guidance, understanding you use consensus rates. If we benchmark to today's spot rates can you give us some sense of what that outlook would look like at spot rates and how it might improve? And then conversely, if you did move to the latest rates in Venezuela, some sensitivities around the magnitude of that impact in the other direction?

Hugh Johnston

Okay, Steve. That's multiple questions, but let me try to address it efficiently. Number one, you will see more pricing in Eastern Europe that will come through. To date the elasticities in Russia have been less than one. So as we put incremental pricing we will see how it looks going forward. But to date the elasticity has been less than one. So obviously that's been favorable to us.

Number two, in terms of the overall FX, spot numbers are moving around so much, I actually don't pay as much attention to spot as I do to market consensus. So not clear to me, it might be a little bit favorable at this point. But I would just stay focused on the guidance that we have given you rather than trying to anticipate it, it's awfully complex. And then the last question was around – I think that was it. Anyway, Steve, if you have another question you can give Jamie and the team a call.

End of Q&A

Indra Nooyi

Yes. Thank you all for your questions. And in closing I just want to say that we have taken the necessary steps to position ourselves for sustainable long-term growth. I believe we are off to a good start in 2015, and we are navigating well through an uncertain and volatile environment. And I believe the first quarter of 2015 is a good example of how a well constructed portfolio, appropriate investment and disciplined execution can drive strong constant currency top- and bottom-line results. Our first quarter results give me confidence that our plans are working and that we are on track to deliver on our financial goals in 2015.

I thank you for your time this very busy morning and for the confidence you have placed in us with your investments. Have a great day.