Good morning, and welcome to PepsiCo's Second Quarter 2012 Earnings Conference Call. [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, operator, and good morning, everyone. With me today are Indra Nooyi, PepsiCo's Chairman and CEO; and Hugh Johnston, PepsiCo's CFO, as well as a few of our operating executives. We'll lead off today's call with a review of our second quarter performance and our balance-of-year outlook, and then we'll move on to Q&A.

Before we begin, please take note of our cautionary statement. This conference call includes forward-looking statements, including statements regarding 2012 guidance 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 the 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 revenue, EPS and division and total operating profit growth are on a core basis. In addition, references to organic results in this call exclude the impact of acquisitions and divestitures and, beginning with this quarter, foreign exchange translation. To find disclosures and reconciliations of non-GAAP measures we use when discussing PepsiCo's financial results, please refer to the glossary and other attachment to this morning's earnings release and to the Investors section of PepsiCo's website under the Investor Presentations tab.

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

Indra K. Nooyi

Thanks, Jamie, and good morning, everyone. Our second quarter results came in right in line with our expectations. The major economies we do business in, consumer behavior, the competitive landscape and commodities were all in line with our assumptions and expectations. Net revenue in the quarter grew 5% on an organic basis, supported by organic net revenue growth in each of our 4 business units. This is a solid result, reflecting balanced revenue management, which led to a healthy price mix benefit.

Our organic net revenue growth was 5% year-to-date, and we're on track to deliver organic revenue growth of mid-single-digits for full year 2012. Our organic net revenue growth was ahead of our reported revenue growth, owing to structural changes and to the negative impact of translating our international revenues with the strengthened dollar in Q2. The structural changes included refranchising our bottling operations in Mexico in the fourth quarter of last year and, in China, with the transaction with Tingyi at the beginning of Q2.

As a consequence of entering into new franchise agreements with our highly capable partners, we no longer report bottling revenues in these markets. From a strategic standpoint, these transactions strengthen our operations and are expected to improve our operating margins and key efficiency metrics, including revenue and EBIT per employee, improve our returns on capital and reduce the capital intensity of PepsiCo's operations in these markets.

Importantly, in addition to very solid organic top line growth in the quarter, we continue to gain traction on the brand building, innovation, and execution of productivity initiatives that are key elements of our 2012 plan. Before I discuss progress on these initiatives though, let me quickly review the financial highlights for Q2.

Our financial results are right in line with our expectation. Core EPS was $1.12. As I just mentioned, organic net revenue grew 5% and it reflected strong price mix across all of our businesses. Globally, price mix was up 4%, and this pricing helped to offset the impact of about $350 million of commodity cost inflation. We had growth in both global snack revenue and global beverage revenue on an organic basis. In emerging and developing markets, revenue growth was particularly strong, up 9% on an organic basis, led by strong double-digit organic revenue growth in key emerging markets.

Results are generally strong across our 4 business units, and each business unit posted organic revenue growth and achieved solid productivity gains to help offset inflation. Within PepsiCo Americas Foods, Frito-Lay North America executed very deliberate channel and revenue management strategies that drove very good net price realization revenue growth, especially in the C-store and foodservice channels, and positive unit growth overall, while they delivered volume performance that was even with prior year. We could have employed different volume-oriented tactics, particularly in large format channels, but they would have been detrimental to our overall channel mix and net pricing objectives, and we are comfortable with the channel, pricing, unit and volume balance we achieved.

PepsiCo Americas Beverages had another solid quarter of solid net price realization. We remain highly disciplined in the execution of our price/pack and channel strategies, and as a result, we are seeing very good performance in the immediate consumption packages, which led to strong net revenue growth in the C-store channel, and we are seeing good, stable and value share performance relative to our primary competitor in measured channels.

Europe was a terrific story with strong performance, with organic net revenue up 3% and constant currency operating profit up 15%. Zein will comment on Europe in more detail in a few minutes.

In AMEA, we had 10% organic net revenue growth and terrific operating profit performance, reflecting the strength of the top line growth and our productivity programs. Overall, our Q2 results encourage us that we're making good progress, and we're on track to deliver our full year financial targets.

Let me now turn to the progress we are making on our key initiatives for the year. We remain focused on 5 big areas: brand building, innovation, execution, productivity and driving cash returns. Let me talk to each of them.

On brand building. We're on target to increase our investment in advertising and marketing to 5.7% of revenue this year, which is an increase of 50 basis points over our investment level last year. We've made good progress on increasing our consumer-facing A&M investment, focused on 12 global mega brands, to drive greater scale and impact with our spending. Much of this is enabled by having much greater coordination among our operations globally, allowing us to leverage creative and production activities across multiple geographies, which gives us cost leverage and drives greater consistency in our brand messaging.

And we've significantly stepped up our media in key markets. For example, in the United States alone, our media spending was up over 40% in the second quarter and over 30% year-to-date. And we're beginning to gain traction with these efforts. Brand equity scores for our major brands in our key markets are showing improvement in many cases and are stabilizing in the remainder. We will sustain our efforts in this area, and we are confident we will see higher brand equity scores translate into strong top line growth with healthy price premiums.

Our second focus area is innovation, where our goal is to consistently increase the contribution of new products to our total net revenue. Our innovation is targeted on specific channels, cohorts and occasion opportunities and with the balance focused on Fun-for-You, Better-for-You and Good-for-You products.

For example, at Frito-Lay North America, innovation drove incremental sales all across the portfolio. Doritos had double-digit sales growth in the quarter behind innovations such as Doritos JACKED and Doritos Locos Tacos, which continues to drive strong growth at Taco Bell. Ruffles delivered mid-single-digit sales growth, supported by incremental sales from Ruffles Ultimate, which continues to gain distribution during ramp up, with strong retail activations surrounding the launch.

In our Frito-Lay growth ventures business, which is focused on incubating new premium and value products, revenue grew 13% in the quarter, led by double-digit gains in Stacy's and our Smartfood platform.

In North American beverages, Pepsi Next is off to a strong start, and we have just launched 2 new limited-time-only flavors, Pepsi Next Cherry Vanilla and Pepsi Next Paradise Mango, to satisfy the thirst of cola lovers looking for unique fruit flavor blends, both with 60% less sugar than regular colas.

We're also driving growth across the Gatorade portfolio, with additions to the G Series line and introduction of differentiated packaging. One of our most recent introductions is the Prime Chew. The Chews come in 3 flavors and contain 25 grams of carbohydrates, as well as B vitamins, to help your body break down carbs into fuel and helps you maintain your performance throughout your activity.

And at Quaker, we are driving organic sales growth and share gains with innovation like Quaker Real Medleys and Quaker Yogurt Bars. Interestingly, on both Quaker Real Medleys and the Gatorade Chews, we are selling all we have the capacity to make. Year-to-date, our innovation is off to a good start, and it provides a good base to build on.

Let me turn to execution. We are measuring and driving execution across every element of the value chain to increase efficiency, quality and service to best-in-class levels, and we are seeing good results across our functions and businesses. One example is how we've executed our price/pack and channel mix strategies this year, driving strong revenue realization and positive mix. This is evident in North America where our C-store growth remains very strong, with retail sales gaining 8% in both snacks and beverages in the second quarter, making us the #1 contributor to growth in the channel. In fact, PepsiCo was the largest contributor to food and nonalcoholic beverage growth across all measured channels in the United States in the second quarter.

And our businesses are executing well together. We launched our Rock Your Summer campaign, where consumers are encouraged to match, snap and win. Match any Frito-Lay product with any Pepsi beverage product and then snap and submit a picture of the 2 products for a chance to win a variety of prizes. We featured the campaign in 46 of our top 50 retail accounts and increased our Power of One displays on the grocery channel by 13% compared to last summer. Joint promotion merchandising is a key element of our Power of One programming, and it's driving coincidence of purchase of PepsiCo beverages and PepsiCo snacks at a rate well above our fair share.

And our execution focus is especially evident in many of our emerging and developing markets. For example, we had strong double-digit organic revenue growth in beverages in India and Brazil and snacks in Mexico and India, and we are especially pleased with the progress we've made in Eastern Europe.

I'd like to ask Zein to give us a quick update on this business, which had very good results this quarter. Zein?

Zein Abdalla

Thank you, Indra, and good morning, everyone. Despite the well-known challenges in Europe, we continue to build momentum in our business, beginning with a very solid performance in Q1 followed by strong results in Q2. We grew our organic net revenue by 3% and delivered 15% growth in our core constant currency net operating profits. We've done this through a disciplined approach to pricing and mix management, together with terrific execution against an aggressive productivity agenda. A particular highlight this quarter has been our acceleration in Eastern Europe, where our successful integration of Wimm-Bill-Dann and our Power of One initiatives drove outstanding results in Russia.

Our success has really been enabled by the transformation we've made to our business over the last few years, with a strong focus on expanding in the faster-growing Eastern European markets, encompassing a broader set of categories to cater for more consumer needs and day part, a portfolio that is wonderfully balanced across Fun-for-You, Better-for-You and Good-for-You, which is the best way to compete in this region. In 2008, less than 25% of Europe's revenue mix came from the east. And by last year, that figure had increased to well over 50%. And this portfolio transformation is helping us weather the macroeconomic headwinds facing other parts of Europe.

PepsiCo Europe's increasingly diverse category portfolio -- about 40% of net revenue comes from snack, with the remainder well balanced across noncarbonated beverages, DSDs and dairy -- has positioned us to respond to changing consumer preferences and to strengthen our mix.

Central to these changes has been PepsiCo's journey in Russia, one we embarked upon some 50 years ago. Through our recent investments, we've built the largest food and beverage business in Russia, a powerhouse business primed for growth and positioned to capitalize on the market with lots of growth potential. PepsiCo Russia net revenues now represent some 40% of our total sector's revenue, and Russia is growing profit at the fastest rate in Europe.

We have leading positions in multiple categories: savory snacks, juice, tea, water, energy and dairy, with a portfolio of strong global and local brands. In fact, we now have 10 of the top 25 nonalcoholic food and beverage brands in Russia, each with retail sales of more than $250 million.

By building on this strong base, PepsiCo Russia provides a gateway to more than 400 million consumers. It's our base for expanding successfully across Eastern and Central Europe, and we started to see the benefits of this in the quarter with accelerated growth in Ukraine and other CIS markets.

The integration of Wimm-Bill-Dann is progressing very well. Adding this to the Power of One business infrastructure we had already put into place across our Russian businesses, we've been able to drive significant synergies and productivity. We have a fully integrated and low-cost supply chain and back office, delivering substantial cost synergies.

We have tremendous go-to-market advantage with unparalleled reach across the organized and traditional trade channels. We've created a single-sales structure to our top 8 national accounts, enabling us to capitalize on the benefits of scale to enhance customer engagement. We've integrated our foodservice teams in Moscow and St. Petersburg, now delivering dairy, juice, beverages and snacks to on-premise and social channels.

The top line synergies have come in, in the form of convergence and brand building and go-to-market, which is the recent launch of Oats products under Chudo branding and with single-serve kefir, or drinkable yogurt, being distributed through the PepsiCo system. All this is helping us to deliver strong revenue realization through selective pricing, portfolio management and strong, speedy innovation.

We have very strong share positions across our strategic categories in Russia. Highlights include very favorable savory snack share, with 1.9 percentage point value share gains year-to-date, and strong CSD share, with 0.8 percentage point value share gains year-to-date. In short, we are pleased with our results in Europe overall, enabled by a well-architected geographic and product portfolio, with Russia and the balance of Eastern Europe well positioned to be a substantial growth engine, not only for -- in the European sector but for all of PepsiCo.

Indra K. Nooyi

Thank you, Zein, and that's a great report out on East Europe and Russia.

Let me now turn to productivity. We're targeting more than $1 billion in productivity this year and $3 billion in total over the next 3 years, which includes the restructuring program we announced earlier this year and our other productivity initiatives that are incremental to our ongoing productivity agenda. Our productivity programs for 2012 are locked in, and we are very confident to deliver these targeted savings.

We made substantial progress against our productivity plans in the first half of the year. The financial benefits of the restructuring accelerated in Q2 and will continue to benefit financial performance as we move through the second half of the year.

In addition to the restructuring programs, we've also accelerated other productivity initiatives. We're driving hard against reducing the capital intensity of our business and improving working capital efficiency, and we are already seeing good results.

Finally, we are doing a better job leveraging global capability and know-how. By sharing best practices and implementing best-in-class processes, we are improving operating performance. So we are encouraged by the pace and progress of our productivity plan.

And finally, we are taking steps to drive higher returns on our invested capital and enhance cash return to shareholders. We have reduced our net capital spending year-to-date by $338 million and reduced our net CapEx as a percentage of sales over the last 4 quarters by more than 100 basis points. We are achieving this, both by driving higher utilization of our assets and by reducing the cost of replacement and growth capacity through value engineering and through enhanced global procurement management.

And we remain committed to returning cash to our shareholders. In the first half, we returned $2.8 billion in cash to our shareholders through dividends and share repurchases, and we expect to return more than $6 billion for the full year, an increase of approximately 12%. Our dividend increased again this June, making 2012 our 40th consecutive year of dividend per share increase. Based on yesterday's closing stock price, our current dividend represents a 3.1% annual dividend yield.

To recap, we are focused on brand building, innovation, execution, productivity and cash return. We are making good progress. We expect momentum to continue to build as the year progresses, and we are confident in achieving our 2012 goals in these areas.

Let me now turn the call over to Hugh Johnston. Hugh?

Hugh F. Johnston

Thanks, Indra, and good morning, everyone. I'd like to start by reviewing the scorecard we introduced at our investor meeting in February. At that time, we shared that we'd review with you on a semiannual basis our performance in 8 key areas, and I'm pleased to share our initial results with you today and look forward to providing another update following Q4.

Let me review the results briefly. We're focused on 4 key input metrics: brand strength, innovation, execution and cost and capital spending; and then 4 key output metrics: value share, EPS, net return on invested capital and operating cash flow. We're making good progress on each of these, and our results were right in line with where we expected to be at this point in the year.

On brand strength, our objectives are to step up the level of investment in A&M and to improve the brand equity for our major brands in our key markets. At the end of Q2, our brand equity scores are stable or improving in 85% of our key brands in strategic markets with sequential improvement from Q1 to Q2, and we're on track to achieve our targeted A&M investment level of 5.7% of sales for the full year.

On innovation, our goal is to increase the contribution of innovation to our overall net sales. Year-to-date, our innovation is currently at 7% of net revenue and is on track with where we want to be. And our expectation is for this number to trend up as we launch products currently in the pipeline.

Turning to execution. As a proxy for overall execution, we're providing share of inventory on display and coincidence of PepsiCo snack and beverage purchases in the United States. Share of inventory on display increased in the second quarter for both snacks and carbonated soft drinks, and we continue to achieve above our fair share of co-purchases of salty snacks and CSDs, which improved from 2011 to 2012.

From a market share perspective, we're gaining or holding LRB value share versus our primary competitor in a majority of our strategic markets. While our value share trends in savory are a bit more mixed, we've shown sequential improvement from Q1 to Q2, and we expect this to continue to improve. This is not an area where we expect to see results overnight because it's partly an outcome of our brand-building efforts, which are just beginning to gain traction. We stay -- we're staying focus on this and expect to continue to see sequential improvement.

And we feel good about our performance against our financial metrics. Cost and CapEx performance are both positive, with CapEx trending at 4.4% of net revenue over the last 4 quarters, and we're projecting to meet our targeted operating cost reduction of 75 basis points of net revenue. And with respect to EPS, ROIC and operating cash flow, as Indra mentioned earlier, we're on track to deliver our EPS and cash flow targets for 2012, and our capital investment in 2012 is in line with our target to begin to see ROIC improvement of 50 basis points per year beginning in 2013. So overall, we're pleased with the progress we're making on our scorecard, and we'll provide another update on our Q4 call.

I'll wrap up now with a quick discussion of the numbers in our outlook, and then we'll turn to Q&A. As Indra mentioned, the quarter came in, in line with what we expected. Organic net revenue increased 5% while our reported net revenue declined, reflecting the structural changes, including Mexico and China, which reduced the reported number by approximately 4 points and by negative currency translation, which was a 3-point drag on the reported net revenue. We realized 4 percentage points of effective net pricing with increases across each of our divisions.

Core gross margins were down 64 basis points, driven by higher commodity costs in the quarter, which is a sequential improvement from the first quarter. And core division operating margins were down by 22 basis points with productivity and SG&A helping to offset a substantial portion of the commodity inflation. All-in, this resulted in a 1% decline in core division operating profit on a constant-currency basis and a 3% decline in core division operating profit on a U.S. dollar basis, reflecting a nearly 3-point drag from currency, in line with our expectations.

Core corporate unallocated expenses increased in the quarter, reflecting higher pension-related costs. Net interest expense was $208 million in the quarter, an increase of approximately $30 million over Q2 of 2011, which is a function of both lower net interest income and higher average debt balances.

And our core tax rate for the quarter was 27.8%, which is 180 basis points higher than the rate in Q2 of 2011, driven by country mix and the favorable resolution of some tax items in Q2 of last year. And finally, our fully diluted share count was down 1.5% in the quarter compared to the prior-year period, reflecting the impact of our share repurchase program.

So in total, below-the-line items, mainly pension-related expenses we record at the corporate level, interest and tax rate, offset somewhat by the benefit of the reduced share count, drove about 3 points of deleverage from our core constant currency division operating profit decline of 1% to our core constant currency EPS decline of 4%.

Now turning to our outlook. We anticipate continued strong net effective pricing, which will contribute to net revenue growth but expect continued impact from negative currency translation and from the deconsolidation of revenue related to structural changes. We expect continued commodity cost pressures. Our current outlook on commodities is consistent with our previous outlook at about $1.5 billion for the full year.

As Indra mentioned, we're on track to deliver productivity of more than $1 billion this year, which represents a substantial increase versus our historical productivity target. The incremental productivity is largely driven by the restructuring program we announced earlier this year. A majority of the restructuring actions have already taken place, and we expect the remainder will take place over the course of this year. So the productivity benefits should accelerate as we move through the year.

We're investing more in A&M this year to support our brands, and we're making incremental marketplace investments in routes and racks. We expect A&M as a percent of sales to increase by approximately 50 basis points on a full year basis. We began to put more media in the market in the first half, but the increase in A&M expense as a percent of net revenue in the P&L will actually be more pronounced in the back half based on how the accounting curve of the expense works. In fact, we expect A&M as a percent of sales will increase by approximately 100 basis points year-on-year in the second half, so you should model this increase into your operating margin and operating profit growth assumptions with the impact heavier in Q3 than in Q4.

Below the division operating profit line, we expect an increase in corporate unallocated expenses, reflecting higher pension cost related to the change in the discount rate and investments in productivity capability, with Q3 corporate unallocated expected to be a bit higher than what we saw in Q2 based on the timing of expenses.

Full year net interest expense is expected to be higher, driven by higher debt balances and higher rates as we term out some of our debt during the year. And we expect our core tax rate to be approximately 27% for the full year but with some level of variability between the quarters. Based on current ForEx market consensus, currency translation would have approximately 3 points unfavorable impact on our full year core EPS, with a

Q3 impact on both net revenue and operating profit estimated at approximately 5 points.

As you model out the second half, you should be mindful of 3 structural changes we've mentioned, where we will no longer record the revenue. First, we re-franchised our Mexican beverage business in early Q4 of 2011. We adjusted our ownership in our joint venture in Almarai, such that we are now in the minority. And finally, we entered our alliance with Tingyi, which closed on March 31. We estimate the impact of these changes will be an approximately 5-point drag on our reported net revenue in Q3 and approximately 3 points in Q4. The impact abates somewhat in Q4 as we lack the Mexico re-franchising that occurred in Q4 2011.

From a cash flow standpoint, year-to-date reported cash generated by operating activities was $1.2 billion, which includes a $1 billion discretionary pension and retiree medical contribution we made in Q1. Reflecting our capital spending productivity initiatives, net CapEx is down $338 million year-to-date and down more than 100 basis points as a percentage of revenue on a rolling 4 quarters basis. In addition, our working capital also improved year-to-date with net working capital on receivables, inventory, prepaids and payables improving by more than $300 million year-on-year.

Our management operating cash flow, excluding certain items, improved by $28 million to $1.4 billion year-to-date. We returned $2.8 billion to shareholders year-to-date through dividends of $1.6 billion and share repurchases of $1.2 billion. For the full year, we expect to generate more than $6 billion in management operating cash flow, excluding certain items, and return more than $6 billion in dividends and share repurchases, including our previously announced increase in our quarterly dividend that took effect with the June dividend payment.

Finally, from an earnings perspective, consistent with our previous outlook, we expect our core constant currency EPS to decline 5% for the year. Now I realize that the first cap came in a bit ahead of the consensus estimate, but you should not flow that through to the bottom line as you model the full year. As I mentioned, A&M expense, based on how it was curved in last year and in this year, will result in a substantial reported increase in the back half. In addition, if we have upside in areas like commodities, our intention is to reinvest those in the business to support and accelerate our brand building, innovation and productivity initiatives.

Net, the quarter came in as we expected. The pricing picture was positive, and our outlook for the year for earnings, cash flow and cash returns is exactly and completely consistent with what we previously shared with you.

And now we'll open the lines for your questions.

Question-and-Answer Session

Operator

[Operator Instructions] Our first question is coming from John Faucher with JPMorgan.

John A. Faucher - JP Morgan Chase & Co, Research Division

You talked about the convenience store business doing better generally, which would imply, I guess, that the large format store business is probably struggling a little bit. So can you talk a little bit about some of the challenges there? Is it just fundamentally a consumer spending issue, or -- what color can you give us on the large format store business?

Indra K. Nooyi

John, I'm going to toss this over to Brian Cornell, and then maybe Al Carey. So Brian, do you want to take it from here?

Brian C. Cornell

Yes. And John, I think as you've seen, there has been considerable weakness in the core grocery channel, but that's being offset by growth in other channels: foodservice, C-store and, certainly, club. So as we look at our business, we're managing through those channel mixes and making sure we're making profitable investments to grow our business and sustain the volume in those channels.

Indra K. Nooyi

Al, did you want to add anything?

Albert P. Carey

I'll just add one thing. It was mentioned earlier that the discounting for holidays, that's a disproportionate amount of the business, and we need to spread the value throughout the month rather than just during those holiday peak periods. And I think we're doing some work on that right now that I have optimism for in the future.

Hugh F. Johnston

John, this is Hugh. The only thing I'd add to that is, one of the things that's important to us in large format is that we have consistency in our pricing across the channels, and that's been a real point of emphasis for us. So to the degree that, that has something of an impact on volumes, particularly in areas like bottled water where we're not electing to go chase that type of volume, we don't view that as detrimental to the performance of the business nor do we do it as value creating by chasing those things. So from our standpoint, we're trying to maintain consistent levels of pricing discipline across large format channels.

Operator

Your next question comes from the line of Dara Mohsenian with Morgan Stanley.

Dara W. Mohsenian - Morgan Stanley, Research Division

I was hoping for more color on trends in the gas-convenience channel, post quarter end, over the last month or so here in the U.S. Have you seen any type of slowdown, or is the momentum continuing there? And what are your thoughts around the sustainability of some of the year-to-date strength, just given we saw weather boost first half results?

Brian C. Cornell

This is Brian Cornell. We're seeing very consistent performance trends in both the convenience and gas channels. Their traffic trends remain strong. They're seeing broad growth across regions, but very, very consistent traffic and revenue gains. So it's a channel that's performing very consistently across the country with strong traffic and revenue gain.

Indra K. Nooyi

And we have not seen a slowdown. Not seeing that at all.

Brian C. Cornell

We've not seen any signs of slowdown in the C&G channel.

Albert P. Carey

I'd add to that, and say that sometime ago, the convenience business was losing a fair amount of their volume for cigarettes, and they have done a pretty good job of offering food service that I think has picked up their business. So our trends are very solid in the convenience business.

Indra K. Nooyi

Go ahead, John.

John C. Compton

Dara, the other thing that the teams are doing is their more coordinated effort across Power of One snacks and beverages. And I think particularly in the convenience and gas channel, that's a benefit to PepsiCo.

Indra K. Nooyi

And, what is it? We have 11 of the 15 top-selling SKUs in C-stores?

John C. Compton

Yes, 11 of the 15 top-selling SKUs. And as Hugh and Indra both mentioned in their comments, I mean, we're far and away the largest contributor of growth to the C-store channel.

Albert P. Carey

Our Mountain Dew and Gatorade business is very strong in the small format.

Indra K. Nooyi

And I think we have innovation and good execution of the DSD system. We were able to drive growth in this channel. Traffic still seems to be okay, Dara.

Dara W. Mohsenian - Morgan Stanley, Research Division

Okay, that's helpful. And then, Al, at the Deutsche Bank conference, you seemed to be more focused on using mix to drive CSD pricing longer term than we've heard from Pepsi in the past. So is that an increased area of focus, and can you discuss how much tangible incremental benefit we could expect from that focus over the next few years? And then also, you mentioned managing the highs and lows from a pricing standpoint in terms of everyday versus holiday pricing more over time and mentioned it again here today. It sounds great in theory, but it's often hard to execute day-to-day. So in your mind, is that also a significant opportunity or something which takes a long time to play out?

Albert P. Carey

Well, I think 2 areas that will help us improve in the future, and this is balancing out the value across the month in the large format. And we're working on that, but it's tricky. It'll take us a little bit of time to get there. And the second thing is to offer flexible package opportunities in that channel as well, which we're putting capacity and capability in our system right now, so that in 2013, you'll see us offer more flex packaging, different packages that will be variety packs and those kinds of things in the marketplace.

Operator

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

Bryan D. Spillane - BofA Merrill Lynch, Research Division

Just 2 questions related to the Europe and AMEA segments and profitability, specifically. First, in AMEA, just what effect did the implementation of the Tingyi relationship have on the profitability in the quarter? I guess what I'm trying to drive at is, was there a profit lift that we realized in the quarter because of the structural change? And then second, in Europe. Just in Russia -- the margin expansion there or the profit growth there, how much of that is a function of your pricing and maybe some improvement in the consumer, and how much of it is still structural benefits? So integration benefits from Wimm-Bill-Dann. And I'm just trying to understand how much more runway we have in terms of margin growth there.

Hugh F. Johnston

Bryan, it's Hugh. Regarding Tingyi, we haven't disclosed specifics on the bottom line on that. It sufficed to say, in the context of the overall AMEA business, that we clearly got a bit of a benefit but it was not, by any stretch of the imagination, the big driver. The big driver was the organic performance of the business. Russia.

Zein Abdalla

Bryan, on Russia, I'd say the performance is just very balanced across top line initiatives and management of the cost [indiscernible] to productivity initiatives. Clearly, as we put these businesses together, we have tremendous scale benefits as we drive supply chain consolidation, and that, obviously, is helping -- they're helping margin expansions. But equally, we're able to drive now a much more positive mix as we drive our brands into the convenience channel, and also, we build out innovation that is highly accretive, highly accretive to the margin mix. So it's a very good balance across both.

Bryan D. Spillane - BofA Merrill Lynch, Research Division

Has the nature of the competition in Russia changed at all? You've got so many more multinationals now operating in that market. Has that affected the competitive landscape at all?

Zein Abdalla

Clearly. I mean, Russia is an attractive market across all -- for all of the multinationals. But we enjoy considerable scale and considerable operating history in Russia. What it's allowed us to do is to build a talented management team and a capability across many years. So I mean, our sources of competitive advantage are both scale and the -- of the development of the capability of our business over time.

Operator

Your next question comes from the line of Kaumil Gajrawala with UBS.

Kaumil S. Gajrawala - UBS Investment Bank, Research Division

I know you maintained your guidance on COGS inflation and such. But I just want to ask, given the drought situation, if there's something we need to be thinking about -- perhaps about next year or maybe even perhaps from a supply chain standpoint, maybe there's not enough supply.

Hugh F. Johnston

Kaumil, this is Hugh. I'll handle that -- this one. From the perspective of 2012, because of the forward buying or the hedging program that we have in place, really, nothing to discuss in that regard. Obviously, and I talked about this in the past, we're out about 9 months. So we were also starting to buy into 2013, given that it's already -- it was already June before the drought situation really started to hit and before prices started to pop in the last couple of weeks. The thing I would tell you in that regard is while grains are certainly up, remember that there is no individual commodity that accounts for even 10% of PepsiCo's overall commodity buy. So grains are up. Aluminum's obviously moved in the other direction. Oil and all of the things that flow out of energy move in the other direction. So really nothing to report in terms of 2013 at this point, because we're not going to get into that until we get into pricing and get into more of the details of 2013. I do, though, just want to remind you that our basket of commodities is pretty broad. So I know corn's certainly been in the news, but we buy an awful lot of other commodities as well. And the commodities numbers are moving both up and down depending on the individual commodity.

Kaumil S. Gajrawala - UBS Investment Bank, Research Division

Okay, got it. And then if I can -- if I can ask you, maybe this is a softer answer, is operationally, obviously, earnings were a little bit ahead of expectations. You'll be spending that back behind the business. Is that in incremental spend? Are you stepping up -- are you further stepping up how much you're going to be spending on marketing versus what your initial plan was, or is this part of the original plan?

Indra K. Nooyi

Go ahead.

Hugh F. Johnston

Yes. Right now, Kaumil, we're still basically saying we're going to spend 5.7%, which was the number that we originally put out for the year. But we'll obviously continue as the year evolves to look at opportunities. And as the overall margin mix of the business comes in to the degree that we do have upsides, we will look to invest it behind -- behind brand-building activities. So -- but no, the 5.7% is still the number that we're talking to right now. The one thing to keep in mind in that regard, though, is there is marketing that we spend in the A&M line, which shows up through SG&A. There's also marketing in joint ventures that gets reported just in the consolidated joint venture line. And then there is marketing that is -- it comes in the form of bottler support, but it's bottler support that is clearly A&M that occurs between gross and net revenue. Where we talked about 5.2% to 5.7%, we were talking specifically about the SG&A, and that's the number that we're still saying is going to be consistent. But to the degree that we choose to do some more marketing through bottlers, you could see some of those numbers change as well. We'll talk about that in Q4 as to where all of the numbers came out, but the one thing I want to emphasize is there's no change in the 5.7% number. That's the number that we are managing to, and that's the number we'll look to hit. And as the business presents more opportunities, we'll evaluate what types of brand-building investment opportunities are before us at that time.

Operator

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

Judy E. Hong - Goldman Sachs Group Inc., Research Division

I just wanted to drill into Frito-Lay a little bit. So from a share perspective, I know you talked about, sequentially, maybe getting a little bit better, and it looks like the C-stores and non-measured channels are doing a little bit better. But just sort of taking a step back, if you can just tell us kind of what you're seeing from a competitive perspective and just what's holding back from Frito's -- from getting better more quickly? And then on the profit side in the quarter, I'm just wondering how much of the margin decline was commodities. They're still -- they're not being fully offset by pricing. And then how much of that was marketing spending step-up?

Indra K. Nooyi

Go ahead, Brian.

Brian C. Cornell

Yes. As Indra mentioned, we took a very disciplined approach to managing revenue and our channel mix during the quarter. We're really focused on investing in brand building, in innovation and continuing to deliver the productivity initiatives at Frito. I expect that's going to serve us well as we go into Q3 and Q4, and you're starting to see evidence of that in our P4 share result, particularly during the important 4th of July period where we grow -- we grew share at Frito. So I think we're well positioned right now to continue to see performance improvement in Q3 and Q4. We're going to continue to focus on being very disciplined in our revenue management and channel management mix and continue to invest in our brands and innovation to make sure that we can continue to deliver sustainable growth at Frito.

Indra K. Nooyi

Yes. Judy, if you recall, I think it was at CAGNY when John Compton presented, he talked about the Frito-Lay business growing at the 2 ends, the value and the premium side, and we had a very, very, very strong position in the middle. The middle continues to grow. We were looking for the right model to compete against the value segment of the business and the premium segment. The premium segment, we started to compete with our growth ventures business, and that's doing very well. Again, also for small base. But it's doing well, and that growth will continue. Our challenge is to figure out the right model to play against the value players without impacting the middle, and we wanted to make sure we did it the right way and not take down the pricing level of the middle. And that's why when Brian talked about playing the channels and the portfolio very carefully, we want to make sure that we keep the pricing in place and don't take it down, because getting pricing back in the market is much harder than tweaking the product portfolio to go against specific consumer needs. So as the year goes on, you see improvement in Frito-Lay because we are fine-tuning the model and doing better as the quarters go on.

Judy E. Hong - Goldman Sachs Group Inc., Research Division

Okay. And then, Hugh, when you put up the slide with the brand strength, the equity scorecard?

Hugh F. Johnston

Yes.

Judy E. Hong - Goldman Sachs Group Inc., Research Division

Basically, that 85% of your core brands are showing improvement, up from 81%. Can you give us a little bit more color just in terms of what brands you're actually seeing maybe a better improvement versus what are the 15% that's not showing improvement?

Hugh F. Johnston

Yes. I mean, to talk to the ones that are doing better, Lay's was notably strong in the quarter. We really saw terrific results on Lay's, and Gatorade, we also saw terrific results on. The Lemon-Lime, still a little bit more work to do.

Judy E. Hong - Goldman Sachs Group Inc., Research Division

That's the brand equity scores or the share scores?

Hugh F. Johnston

Those are the equity scores.

Operator

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

Caroline S. Levy - Credit Agricole Securities (USA) Inc., Research Division

I just wanted to follow up on Judy's question. If you could talk about brand Pepsi, which is the centerpiece of everything you're doing, just in terms of what we can look for, what you've seen so far. I know it's very, very early, but it's such a huge brand that -- within the total company. And I'd like to also understand what we can look for as progress measures in the Tingyi JV going forward now.

Indra K. Nooyi

Al, you want to talk about brand Pepsi?

Albert P. Carey

Yes. Brand Pepsi, the campaign began in about April, and it's very early to try to indicate whether or not we've seen a result. But the thing that I like to look at is our single-serve business, which will be a first indicator, and that's usually not impacted by these holiday discounting overlaps. So we see growth in brand Pepsi on single serve for the first time in a very long time, and our brand equity scores have improved for the second quarter. So some improvement. We have Pepsi Next in the marketplace that is delivering about what we expected, very happy with it. And in the just recent few weeks, we've just launched the -- a new TV campaign and also 2 new flavors of the product. So let's say, cautiously optimistic on that brand.

Indra K. Nooyi

And on China, Saad, you want to give some color on Tingyi?

Saad Abdul-Latif

Yes. Caroline, we really feel good about the progress of our transitioning our business in China to Tingyi. As you know, we've got the approval in the end of March, and we've spent the months of April and May and big part of June transitioning our business into our partner. We've moved upwards of 20 plants and about 20,000 employees into that. Now I think the transition is complete, that we're going to see sequential improvement into our volumes. And basically, there are 3 areas where we will see huge improvement as we go Q3, Q4 and for next year. One, a new area is white areas we will have accessible to us that we would not have before. Two, we will have production availability for water and other products, such as the Gatorade and that. And thirdly, we will benefit a huge deal from the distribution strength of Tingyi. So we really feel good about that alliance, and we're going to start bearing the fruit Q3 and going forward.

Caroline S. Levy - Credit Agricole Securities (USA) Inc., Research Division

That's very helpful. Can I also just clarify? I think you said you did raise your efficiency target for the total company. Can you just remind us how much you've increased that now?

Hugh F. Johnston

This is Hugh. No -- I'm sorry, we didn't raise the efficiency target. So we said $1 billion -- $1 billion plus this year, $3 billion over 3 years. And that's exactly where we are. No change on that at all.

Operator

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

William Schmitz - Deutsche Bank AG, Research Division

I have a long question. So I'm sort of confused on some of the numbers. So I think you said U.S. media spend was up 40%, and then you looked at sort of the year-over-year SG&A and that was down. And then I think you said 100 basis points increase in that ad ratio on the back half of the year, which sort of implies that there was sort of flat advertising ratio on the front half. And then let's kind of take it a step forward. I was looking at the Pepsi Americas Beverages margins and given that shift away from the center store and towards the C-stores, you would have thought you would've seen a little bigger uptick in the margin structure. Can you sort of square this for me? I know it's a long question.

Hugh F. Johnston

Yes. Bill, why don't I take a shot at that, because that's a big causal chain you just laid out. The thing that -- first and foremost, the thing to keep in mind is, the way we talk about media is that's publicly reported media data. Okay? And that's based on the actual spending that's going into the marketplace. At the same time, when we talk about advertising and marketing expense, which is obviously inside of SG&A, that's curved over the volume curve during the course of the year. And you have to consider those numbers from 2 perspectives: number one, what's happening this year with the curve; and then number two, what's happened last year with the curve. And the way our spending -- or the way our curve worked last year was, you saw the A&M number fall off during the latter portion of the year. So we had, from an expense standpoint, more of the spending in the first half of the year, relatively speaking, compared to the 2012 timing of the spend. So it's almost impossible to connect the media number to the A&M expense in the P&L. I wouldn't spend a whole lot of time doing that. And what I wanted to do when I gave you the A&M expense timing comments was not so much to tie to the media spend, but rather to connect the fact that the year-over-year impact in H1 versus the year-over-year of impact in H2, it's much more substantial in H2. So hopefully, that kind of addresses your A&M question. Regarding the bottling or the beverage -- PAB business and the impact on margins, there's 2 things to keep in mind there that are also important to balance out. On the one hand, the convenience store business performance was strong. On the other hand, the inflation that we have inside of PepsiCo, particularly in beverages, is much more front loaded than it is back loaded. So those 2 are probably having something of an offsetting effect, and therefore, in the back half of the year, you should see the margin impacts start to improve really in the PAB business in the back half of the year, due to the commodities overlap timing muting, while we certainly expect the C-store business to continue to perform well.

William Schmitz - Deutsche Bank AG, Research Division

Great, thanks. And then just to quickly follow up, did you see a benefit from the PET deflation? Because I think that's one of the few commodities you can't hedge out 9 months, and I think a lot of your competitors have talked about some relief there.

Hugh F. Johnston

Yes. Bill, we actually can hedge out PET pretty well because of the nature of the relationships that our global procurement team has created. You're right in saying there's no market to do that. But through suppliers, we've been pretty successful in moving our PET buy further and further out over the last couple of years. So in terms of your question on any benefit, the answer is basically no. From our perspective, the commodities for this year have been largely hedged out for a couple of months now. So not a whole lot of change is going be coming in the balance of the year on that.

Operator

Your final question comes from the line of Ali Dibadj with Sanford Bernstein.

Ali Dibadj - Sanford C. Bernstein & Co., LLC., Research Division

I want to follow up on a couple of things and ask a slightly different question. Just to follow up on Frito-Lay North America. In February, and I think since then, we've also heard you guys still expect flat volumes, flat margins. Now that's a little bit better than what we've seen in the first half of the year. It sounds like you're expecting an inflection as you go into the back half of the year for Frito to maintain that flat margin-flat volume expectation for the year. Is that the right way to interpret your comments today?

Indra K. Nooyi

Brian?

Brian C. Cornell

Ali, it would be. I think we expect to see improved performance in the third and fourth quarter. The benefits of our investments in brand, the continued focus on innovation and productivity should show improvements in our third and fourth quarter results.

Indra K. Nooyi

And, Ali, we started the year across all of PepsiCo saying, "Don't chase volume for the sake of volume, chase share in a very responsible way." So we've tried to balance volume, pricing, revenue and profit in a very, very balanced way through the first half of the year.

Ali Dibadj - Sanford C. Bernstein & Co., LLC., Research Division

Okay. So still sticking to flat margins, flat volume for the year for Frito?

Indra K. Nooyi

Yes.

Ali Dibadj - Sanford C. Bernstein & Co., LLC., Research Division

Okay. And then on PAB, the volumes, whether it be negative 1% or negative 1.4%, were I guess a little bit lower than I'm hearing some folks expected. Can you help us disaggregate that? I know you're going to do it in your Q, but disaggregate that between North America and the rest of PAB, Latin America. And then also between CSDs and fill, just to give us a sense of where the volumes were looking for each of those segments.

Hugh F. Johnston

Yes. Ali, this is Hugh. From the standpoint of CSDs, again, we -- our focus was, first and foremost, on let's make sure that we get the right place -- pricing into the marketplace and let's make sure we maintain the consistent funding behind the brands and behind the innovation that we've launched this year. So as you know, because you've been around the consumer space for a while, when you're doing brand building and innovation types of build, it takes a bit longer for those things to get traction. But when they get traction, they are more advantaged than simply dropping price, and that's the strategy that we've chosen to follow. And frankly, the expectations that we had for the volumes in the business are basically right on where we would have expected them to come out, both from a volume perspective and from a market share perspective, in terms of the reported market share numbers that are out there. Regarding the other piece, the non-carbs in the overall volumes, I think the other factor that you have to consider is around this whole area of water and, in particular, case-packed water. We're in the business. We promoted sufficiently to stay in the business, but we're not interested in chasing case-packed water pricing down. We just don't think that's the right strategy for us. We do think it's an important part of the overall Aquafina business, but we do -- we promote it just enough to really maintain our relevance. On the other hand, the single-serve side of water is -- obviously, it's a great business. It's a profitable business. We like that business quite a bit, but we're not interested in chasing volume just by promoting case-packed water at the end of the quarter.

Indra K. Nooyi

Ali, the other thing, too, is we don't have as much of a tailwind on the distribution of energy drinks as anybody else might have. And second, our foodservice business is substantially different. As you know, our footprint is very different, and therefore, our foodservice volume uplift is overall lower than it might be for other people. So if you take into account these fundamental structural differences in our respective businesses, between us and competition, you'd see that we held value share, which is what we are focused on, in the measured channel business, and on foodservice, we gained share but from a very, very small base. And the energy drink is the big wildcard and something we distribute but we not -- we don't get as much tailwind as the market does.

Ali Dibadj - Sanford C. Bernstein & Co., LLC., Research Division

Okay. So that makes sense from the spirit of the answer. But would you care to offer numbers on North America CSD volume growth, Latin America fill, especially. So if you broke that down, would you care to offer those? I think a lot of that will be in your Q, but I was trying to get a head start on that.

Hugh F. Johnston

Yes. So basically, the way the numbers came in, North America volumes were down 2; North America volumes on CSDs were down 4; and non-carbs were up 1.

Ali Dibadj - Sanford C. Bernstein & Co., LLC., Research Division

Okay, cool. And then just the last thing, if you would indulge me. So I guess we do appreciate -- you've heard this from others as well. But we appreciate the change to how you're disclosing things like organic growth. And that -- for us, at least, that's been very helpful in understanding how you actually are operating. If we could push for another potential change or, at least, some clarity is -- within SG&A. So I think it might help answer some part of Bill's question a little while ago as well. So in your SG&A, obviously, you put your JVs. So there's a bunch of income with no revenue attached to it, whether it'd be Lipton or -- Tea, in your Starbucks or Muller or Almarai, I'm probably missing a few. So it's difficult for us, at least for me and maybe I'm just missing something, to figure out what your real SG&A productivity is or what your real level of improvement is at the overall company level, but also at the -- perhaps even more importantly, the operating segment level. So is there consideration to split that out as you go forward, given it's become a big chunk, number one? And number two is to the question part. Can you help us understand what were the actual operating leverage on SG&A if you excluded those JV incomes that you report through that line item?

Hugh F. Johnston

Yes. Ali, this is Hugh. I hear your feedback on that one. And one of the things that we do every year is we both look at the disclosure to ensure that we're maintaining the right level of transparency without, obviously, giving away anything that would be competitively sensitive. Now SG&A would be less concerning in that regard, although I'm not crazy about the idea of breaking out JV profitability. I hear your feedback on that. We, at the same time, also look at other big multinationals, and we're trying to position ourselves where we're certainly at or better than most in terms of disclosure. But at a certain point, it also makes sense to limit the amount of disclosure based on, frankly, not giving away competitive information. So I appreciate the perspective. We're going to take a look at it again during the course of the fall as we think about 2013, and perhaps we can talk off-line a little bit more about some of the detailed thoughts that you have on that. It'd be helpful to get your point of view.

Indra K. Nooyi

But, Ali, I'll tell you one thing. When we look at productivity, we look at every item of the cost structure, including G&A: what's the corporate unallocated, what's the infrastructure running to the sectors and are we actually making that bucket more and more efficient over time? And so, from an internal management of the cost structure, believe me, we are maniacally focused on any sort of overhead structure to run this company. And based on all of our benchmarks, our core G&As around the company is among the lowest of any multinational company. So we feel good about the way we're managing G&A.

So let me just close by saying Q2 marked good progress against a clear, focused game plan that's allowing us to compete effectively today while positioning us for sustainable, long-term growth and shareholder value creation. And you have my and our entire leadership team's commitment that we'll continue to act with great urgency to deliver against our 2012 targets and our strategic objectives.

So let me close by thanking you all for joining us and for the confidence you place in us with your investment. Have a great day.