Good morning and welcome to PepsiCo's first quarter 2014 earnings conference call. (Operator Instructions) It is now my pleasure to introduce Mr. Jamie Caulfield, Senior Vice President of Investor Relations. Mr. Caulfield, you may begin.

Jamie Caulfield

Thanks, Jackie. 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 2014 performance and outlook, and then we'll move on to Q&A.

In an effort to get to as many analyst questions as possible within the hour, we're going to have a one-question limit, so we should be able to get through the full queue of analysts, when we get to the Q&A.

Before we begin, please take note of our cautionary statement. This conference call includes forward-looking statements, including statements regarding 2014 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 basis. 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 website 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 22 for our North American operations and the months of January and February for the vast majority of our operations outside of North America.

Now, it's my pleasure to introduce Indra Nooyi.

Indra Nooyi

Thank you, Jamie, and good morning, everyone. Thank you for joining us this morning. We are very pleased with our first quarter results. Organic revenue grew 4% overall, with global snacks up 5% and global beverages up 3%.

Core gross margins improved by 40 basis points and core operating margins improved by 50 basis points. Core constant currency operating profit grew 7% and core constant currency EPS grew 10%. We achieved our targeted productivity savings in the quarter and remain on track to achieve our full year target of $1 billion.

On a rolling four-quarter basis, our core net ROIC improved by 110 basis points and now stands at 16.5%, and we returned $2.1 billion to shareholders in the form of dividends and share repurchases, a 47% increase versus last year. And as we previously announced, we expect to return $8.7 billion to shareholders in 2014 in the form of dividends and share repurchases, which represents a 35% increase over our 2013 cash return to shareholders.

Now, we all know that the world continues to be a volatile and uncertain place and we certainly saw indications of this in the first quarter. The heavy lifting we've done to transform our portfolio and capability is yielding results. I believe, our results reflect the power of our portfolios of products and brands and the strength of our geographic footprint.

Additionally, the investments we made to strengthen our brand, innovate more effectively, drive better execution and operate more efficiently by leveraging our global scale and portfolio complementarity are all beginning to pay off. As a consequence, we've been consistently meeting or exceeding our financial goals, and more importantly, we have increased confidence in the future prospects for our business.

Today, we believe our business is well-positioned to deliver top-tier return in the current volatile environment, as a result of the very deliberate steps we've taken and the investments we've made over the years.

First, the balance and diversity of our product portfolio, ranging from fun-for-you to good-for-you products across snacks and beverages, gives us the ability to manage through issues in any individual business. Together, these businesses have an attractive growth rate in the mid-single digits.

Second, investments we made to enhance the equity of our $22 billion brand are all translating to success in the marketplace. These powerful brands account for more than 70% of our annual retail sales, in fact our brands hold the number one or number two position in many of our markets, and several of our brands like Mountain Dew, Doritos, Gatorade, Lays and Quaker Oats virtually define their categories.

Looking across our largest markets, we have the leading position among top brands with nine of the top 40 packaged food and beverage trademarks in the U.S., which is most of any CPG company. We have nine of the top 50 packaged food and soft drink brands in Russia, which is again most of any CPG company. We have seven of the top 50 in Mexico and six of the top 50 in the U.K., and again in both countries we are leaders.

The strength of our brands is clear in our ability to achieve consistent net price utilization. In 2013, beverages and snacks each achieved 4 points of net pricing. In the first quarter of 2014, beverages and snacks achieved 2 points and 4 points of net pricing respectively.

Third, we stepped up our focus on differentiated innovation. Our annual R&D investment is up more than 25% since 2011. We have also created unique linkages between consumer and shopper insights and product development, using the signs of our demand space as framework. As a result, 2013 was one of PepsiCo's best years ever for innovation with PepsiCo products accounting for nine of the top 15 new food and beverage introductions across all measured U.S. retail channels.

In the first quarter of 2014, products launched over the past three years made up 8% of our total net revenues. The good news is that our innovation is becoming more incremental and is contributing to positive price mix.

Fourth, the investments we made to expand our footprint in developing and emerging market are fueling our growth. As a group, D&E markets grew organic revenue 9% in the first quarter, following 10% growth for the full year in 2013.

In the first quarter, Russia and Brazil led the way with double-digit organic revenue growth, followed by India which delivered high-single digit organic revenue growth. Our broad array of food and beverage products range from value to premium-priced products and enabling us to earn sales from consumers across the economic spectrum.

Fifth, we are delivering on all our productivity targets and significantly lowering the cost base of the company. By leveraging our global scale, eliminating duplication and deploying new technologies, we are driving the highest level of productivity in our company's history.

We are on track to achieve our three-year $3 billion productivity program in 2014 and we are poised to begin executing on our next major productivity program, targeting $5 billion over five years, beginning in 2015, focused on increasing automation, deploying more shared services model, optimizing our manufacturing footprint and optimizing our go-to-market systems.

Since 2011 we've increased our core net revenue per employee by 9%, increased our core EBIT per employee by 5%, reduced net capital spending as a percentage of net revenue by 80 basis points from 4.9% for full year 2011 to 4.1% over the past four quarters, and improved our average cash conversion cycle by 33% to 24 days in 2013 from 36 days in 2011 and we continue to look in every area of our business for sensible ways to do even more.

And finally, we are executing better, faster and more efficiently within our operating segments and then further benefiting through increased coordination across our product and geographic portfolios. And let me just give you a few recent examples of our complementary portfolio and our execution capabilities at work.

Our Super Bowl execution demonstrated outstanding delivery of print, outdoor, mobile, digital and in-store programming. PepsiCo delivered a united effort to leverage our NFL partnership and drove unprecedented national and local impact with both consumers and customers.

Each business executed the property very effectively and PepsiCo's combined activation was one of our most compelling expressions of better together, with coordinated advertising, promotions and merchandizing across our snacks and beverage portfolios, which helps drive incremental sales and share gains.

Second, building on the growing consumer appetite for ridged cut chips and the strong performance of Lay's Deep Ridged chips in the U.S., U.K. and Spain in 2013, we'll offer versions of Lay's Deep Ridged potato chips in over 20 markets around the globe in 2014 with additional markets planned for 2015.

Our global execution leverage is common product specifications, branding, hedged graphics and ad copy. At the same time, we've built on our beverage partnership with Buffalo Wild Wings by introducing Ruffles Deep Ridged Classic Hot Wings flavored potato chips inspired by Buffalo Wild Wings. So what we are doing is leveraging our global category structure and getting new products to market faster across more geographies, more cost effectively and in more channels.

Third, during the quarter we kicked off the 2014 Pepsi soccer campaign, our largest global football marketing effort to date. Over 100 markets will be executing and locally adapting the campaign around the world. Our global superstar football squad brings together an unprecedented wealth of international talent that spans five continents and includes 19 of the world's greatest players, including the great Lionel Messi.

The campaign unites the worlds of football, music and art, reaching fans with distinctive packaging, point of sale, out-of-home communication and engaging content. This program drives higher consumer awareness and regard, allows us to leverage our global scale of product complementarity and gives us the flexibility for targeted local execution.

Next, our highly successful Lay's Do Us A Flavor campaign represents a great blend of global brand building elements. This campaign now expands more than 15 countries and is an excellent example of how we lived and shift best practices around the world. Breakthrough digital and mobile engagement is embedded in every single touchpoint, all the way to shelf.

This year in the U.S., we've increased consumer engagement by inviting consumer to choose both flavor and type of chip. As part of this year's contest, a judging panel will narrow down the contest submissions to four finalist flavors and then these four finalist flavors will be fully developed at Frito-Lay culinary experts and unveil this summer.

The winning flavor is determined by fan votes, will be revealed in November with a grand prize winner taking home $1 million. This program has driven high levels of consumer engagement and is an extremely efficient marketing tool because of the massive earned media benefit that begun on each of the markets where we launched it. And finally, we have accelerated productivity best practices across the organization.

For example, as our global enterprise system or GES continues to rollout across Frito-Lay North America, we are beginning to apply the same concepts and tools to our North American beverage business and in some international markets. And these initiatives will maximize asset utilization by reducing distribution centers, leveraging automation, deploying fleet and route trucks more efficiently, and reducing inventory, while improving service and product freshness.

So with all this as a backdrop, let's take a look at how the business has performed, starting with our North American businesses. Frito-Lay North America delivered another quarter of very strong results. Organic revenue grew 4% and core constant currency operating profit grew 6%. The U.S. salty snacks category continues to grow retail sales at a mid-single digit rate and Frito-Lay's delivering a good balance between volume growth and price realization.

Revenue growth in the quarter was led by good performance across our five largest brands, Lay's, Tostitos, Doritos, Cheetos and Ruffles, and each grew between low and mid-single digits. We continue to execute product and packaging innovation, targeted incremental macro snack occasions, including the launches of Rold Gold Pretzel Thins, Twistos Snack Bites, Lay's Air Pops, Lay's Kettle Cooked Lattice Cut Chips and our ready-to-go market pack that offers a broad assortment of macro snacks.

Quaker Foods North America delivered positive organic topline in the quarter and gained value share at retail in each of its core categories, hot cereals, ready-to-eat cereals and snack bars.

Turning to North American Beverages. We are really encouraged with the continued progress we are making. In the quarter, we held U.S. liquid refreshment beverage value share and achieved positive net price realization at retail, ahead of the category and our primary competitor.

Notably, PepsiCo has held or gained relative U.S. LRB value share in measured channel versus our closest competitor in each of the last four quarters. And we continue to manage the business responsibly with consistent pricing across carbonated and non-carbonated beverages.

Within the LRB category, we held or gained value share across a number of important subcategories, including CSD, sports drinks and ready-to-drink tea and coffee. And we grew retail sales in measured channels in the U.S. for regular colas and Mountain Dew, both within CSD and for Gatorade, Lipton Tea, Starbucks Coffee and Naked Juice within our non-carb portfolio.

We are investing in R&D to drive sustainable innovation and we are off to a good start, beginning with the first quarter launches of Brisk Half and Half, Gatorade Fierce Blue Cherry, and Kickstart Black Cherry and Limeade to name a few. In addition, we continue to expand our package offerings and we are seeing good success with strong double-digit growth in mini cans and we have more than doubled the sales of our 12 ounce glass bottles in Q1.

These practices enable us to realize new price-packed revenue benefits, while providing flexibility to maintain price competitiveness. So that's the North American story. Our other developed markets in Western Europe also performed well, but organic revenue for these markets are up 3.5% in the first quarter.

Let me now turn to developing and emerging markets. In Mexico, we are managing through the new taxes on certain foods and beverages that were enacted recently. We've taken pricing in snacks and our bottle has taken pricing in beverages to pass the taxes through to the consumer.

In the quarter, the elasticities and volume declines in Mexico was in line with what we expected. And we have been dealing with the situation throughout the year and expected to continue to depress consumer demands, but results so far are consistent with our planned assumptions.

In Venezuela, we are managing through high inflation, political unrest, supply chain disruptions and continued uncertainty regarding the applicable exchange rate. But given all these challenges our businesses in Venezuela performed well in the quarter with organic revenue up strong double-digits across both snacks and beverages.

Brazil delivered double-digit organic growth, revenue growth, led by organic revenue growth in snacks. In Russia, organic revenue rose double digits, and double-digit growth in snacks and high-single digit growth in beverages. And we saw strong organic growth in a number of other East European markets, including double-digit organic revenue growth in Poland, high-single digit organic revenue growth in Turkey.

Moving across to our Asia, Middle East, Africa businesses. Organic revenue growth was led by Pakistan, a strong double-digit organic revenue growth, followed by Egypt and the Philippines, which also grew double-digits and India which grew high-single digits.

China organic revenue declined low-single digits in line with our expectations. Performance was muted, given strong high-single digit comparisons from Q1 of 2013 and some business disruption related to our bottlers restructuring in Q1 of 2014 to drive increase efficiency through greater integration.

We expect the business to return to its normal trajectory as we enter Q3. We remain committed to the developing and emerging markets as they have a long runway for growth, driven by increasing demand for a convenient, on trend affordable products, supported by a rapidly growing middle-class and we are well-positioned to capitalize on these opportunities.

Let me conclude my comments by saying we are off to a good start in 2014, with the pieces of our portfolio working together to generate healthy topline and bottomline performance. Clearly, there are a number of challenges around the globe, but the shape and resilience of our portfolio combined with strong execution and aggressive productivity should enable us to navigate successfully through the current environment.

So with this, let me turn the call over to Hugh Johnston.

Hugh Johnston

Thank you, Indra, and good morning, everyone. Let me spend a few minutes discussing the quarter and our outlook for 2014, which is in line with the full year guidance issued in mid-February. Overall, the quarter came in largely as expected with pricing actions, commodity inflation and productivity, all in line with our expectations.

For Q1, organic volume grew 2% in snacks and was even versus the prior-year quarter in beverages. Organic revenue grew 4%. On a reported basis, net revenue was even versus year ago, reflecting 3 points of unfavorable foreign exchange translation and nearly 0.5 point negative impact, primarily from the franchising of our Vietnam bottling operation.

Commodity inflation was up low-single digits. Our core gross margins improved about 40 basis points and core operating margins increased 50 basis points. Core constant currency operating profit grew 7% in the quarter. Our core effective tax rate was 23.7%, approximately 80 basis points below Q1 2013.

Our fully diluted share count declined 1.5%, reflecting the benefits of our ongoing share repurchase program and core constant currency EPS grew 10%.

So between the core constant currency operating profit growth of 7% and core constant currency EPS growth of 10%, we achieved about 3 points of leverage, driven by lower interest expense or lower tax rate and share repurchases. And we returned $2.1 billion to shareholders year-to-date in the form of dividends and share repurchases during the quarter, which is 47% above year ago levels and reflective of our commitment to return cash to shareholders.

Turning to guidance. The world does remain a volatile place as evidenced in places like Mexico, Venezuela and Eastern Europe. So even with the strength that we saw in the first quarter, our full year guidance remains unchanged.

Consistent with what we said back in February, for the full year 2014 we expect mid-single digit organic revenue growth and core constant currency EPS growth of 7% and we expect low-single digit commodity inflation and productivity savings of approximately $1 billion.

Below the division operating profit line, we expect corporate cost efficiency driven by our productivity initiatives, a core tax rate of approximately 25% and a reduced share count from our share repurchase program.

Foreign exchange is expected to negatively impact net revenue and core earnings per share for the full year 2014 by approximately 3% and 4% respectively, based on current market consensus rates. Taking our 2013 core EPS of $4.37 and applying our guidance implies 2014 core EPS of approximately $4.50, consistent with our prior guidance.

As many of you know, the foreign exchange picture in Venezuela is very dynamic at the moment. Our first quarter results were translated to U.S. dollars at 6.3 bolivars to the U.S. dollar. Our current FX forecast, which is based on current market consensus rates assumes a blended rate of approximately 9 bolivars to the U.S. dollar for the balance of the year.

To help you with the FX sensitivities on Venezuela, for the full year 2013, Venezuela generated approximately 1% of our net revenues and 2% of our operating profit.

In addition, as of the end of our international Q1, which includes January and February, we have approximately $380 million of net monetary assets in Venezuela, valued at 6.3 bolivars to the U.S. dollar, which would be subject to revaluation, if there is a change in the exchange rate we use. As we did in 2013, we would expect to treat any revaluation of the net monetary assets as a non-core charge.

As you model out the second quarter, I'd ask you to consider the following. First, our EMEA division will face very difficult operating profit comparison due to the following: A, a $137 million gain recorded in Q2 2013 related to the re-franchising of the company's bottling operation in Vietnam; and B, 27% year-over-year core constant currency operating profit growth in Q2 2013, when excluding the above mentioned gain.

Second, foreign exchange translation should have an approximate 4 point unfavorable impact in the second quarter revenue and approximate 5 point unfavorable impact on second quarter EPS, based on current market consensus rates. Revenue in the second quarter will have an estimated 15 basis point of negative impact from structural changes due to the Vietnam re-franchising.

Below the net operating profit line, net interest expense is expected to increase in the second quarter versus last year, primarily reflecting higher debt balances and higher rates. And our tax rate is expected to be higher in the second quarter of 2014 versus both, the second quarter of 2013 and the first quarter of 2014.

Finally, our stepped up share repurchase activity will occur throughout the year, but is expected to have a more pronounced impact in the second half of 2014 and into 2013. From a cash flow perspective, we continue to expect full year free cash flow excluding certain items of more than $7 billion. We'll continue to drive cash flow-through efficient working capital management and continued tight controls over capital spending.

Net capital spending should approximate $3 billion, which is well within our long-term target of less than or equal to 5% of net revenue. We expect to return approximately $8.7 billion for shareholders in 2014, a 35% increase over 2013, through a combination of $3.7 billion in dividends and a $5 billion share repurchase program.

And as a reminder, our previously announced 15% dividend per share increase will commence with the June payment. This represents the 42 consecutive year of an annual dividend increase and an approximate 60% payout ratio based on 2013 core EPS. At yesterday's closing stock price, it represents a 3.1% yield and will bring our 10-year annualized dividend per share compound annual growth to 11%.

So to summarize, our 2014 outlook is unchanged from our last call. We expect to drive improved full year margins and net ROIC and discipline capital allocation and returning cash to shareholders remain top priorities for the company.

With that operator, we'll take the first question.

Question-and-Answer Session

Operator

(Operator Instructions) Our first question is coming from Bryan Spillane of Bank of America.

Bryan Spillane - Bank of America

Just wanted to talk a little bit further about Russia and maybe just the way we should think about modeling it going forward. So if you could maybe parse out for us on the double-digit growth, how much was pricing? And then maybe how the performance was snacks versus dairy? And then finally just as we're looking forward, given the exchange rate volatility, the increase in input cost there, just how we should think about modeling profitability in Russia, kind of over the next couple of quarters?

Indra Nooyi

Bryan, I'm going to provide some overall comments on Russia and then I'll transfer to Hugh to provide you more detail. Let me just say, our business in Russia is a good one. Both in Russia and Ukraine businesses are doing well. The climate there has been very friendly to business and we have great relationships with the government, the local retailers. So the business is a very good business.

Clearly, the current geopolitical issues are impacting more the ruble and the Russian [indiscernible] as opposed to basic consumer demand, because they've devalued, input cost have gone up, and therefore consumer prices have had to go up. The consumer is extremely resilient in both countries at this point, so we have to watch and wait and see how things evolve. But those, as overall comment, let me just toss it to Hugh to give you some more color in details.

Hugh Johnston

For Russia in the first quarter, we had 10% revenue growth. Volume did grow across the businesses. You are calling out one of the questions that we wrestle with, which is the dairy inflation we faced in the business. The good news from that perspective is because we have such strong brands across the dairy category and as a leader there in many of those brands, we do have the ability to take pricing successful and that's where the consumer has been quite resilient against that pricing.

So I would expect to see some level of volume growth and then we will continue to take pricing to cover the vast majority of our inflation in the country. And we expect that we're going to see continued profit growth coming out of Russia. And that's true across all of the businesses, snacks and beverages.

Operator

Our next question comes from the line of John Faucher with JPMorgan.

John Faucher - JPMorgan

Just want to talk a little bit about the pricing environment in North America in CSDs. You guys are reporting solid pricing. Coke, mean to say, Cokes had the pricing for carbonated soft drinks was up. We're not really seeing that in the market in terms of looking at the syndicated data. So could you talk a little bit about what you're seeing in the category? Whether some of the discounting we've seen has been able to stabilize demand a little bit? And then how you see the pricing going as we look into the summer selling season.

Indra Nooyi

I think at this point, I'd say we have been extremely disciplined in pricing across all parts of the LRB portfolio in all channels. Now and then we see some interesting pricing behavior in one retail channel or in one category, but as far as PepsiCo is concerned, John, we have, as we've communicated with you, decided to be extremely responsible and take pricing up both in carbs and non-carbs and that's what we've been doing in all channels.

Going to the summer selling season, that's going to be our strategy going forward, I think especially in the category like CSDs, taking down pricing is not going to drive up demand too much. So I think we have to play the overall LRB portfolio very, very carefully and balance pricing between CSDs and non-carbs and figure out a way to grow the whole pie very, very carefully. That's what we are doing and that's what we hope to see in the marketplace going into the year, but we can only talk about ourselves.

Operator

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

Judy Hong - Goldman Sachs

I was hoping to just get a little bit more color on Mexico. You talked about the elasticity being pretty in line with your expectation. Can you talk about how much volume was down in beverages and snacks? Any major differences you're seeing from a consumer reaction perspective across both categories? And then a key be, is it profit decline that we saw in the first quarter, can you just talk about how much that was with Mexico?

Indra Nooyi

Judi, I mean the details on the volume decline in Mexico, things like that, we're not going to give you that level of detail, but overall I'll tell you, we've modeled out a trend that have elasticity. And interestingly, it's coming in exactly as we modeled out.

But let's be careful here. It's only about three months into the year after the taxes have gone into effect and it's going to effect on multiple, multiple, multiple categories, but the Mexican consumer is trying to figure out how to rebalance their basket. So I think we're going to let this thing play out another month or two, because our first quarter was just two month, so let's wait and see how this plays out in the next three or four months.

And I think we'll get a much better read as to what this taxation is going to do in Mexico and also what strategies we can deploy in terms of revenue management to really address price points for the consumer -- that would attract the consumer. So I'll tell you as an economy, Mexico remains robust and we still believe enormously in the Mexican economy. I think we have to give it time to allow this taxation to play through.

Operator

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

Dara Mohsenian - Morgan Stanley

Hugh, the international profit results were very strong even against the tough comp and excluding the gain and better than expected FX. From a margin perspective, should we view the Q1 strength as an aberration in a light seasonal quarter? Do you think the strong performance can continue in the balance of the year? And then also, can you give us update on the potential for emerging markets margins to expand longer-term as you gain scale and if we should expect an inflection point in emerging markets margins any time soon?

Indra Nooyi

Go ahead, Hugh.

Hugh Johnston

A couple of things on that. Yes, you're right. The emerging or the international margins expanded probably more than you're going to consistently see across the board in the first quarter. The productivity programs are kicking into the place and obviously that's helping us. In addition to that, some of the new pricing that we putted in is helping as well, but Q1 was probably a bit better than what you would expect over the course of the year.

The balancing act, of course, in developing and emerging markets as we have talked about before is one of how rapidly do you increase margins versus pricing a bit below your commodity inflation, in order to increase consumer adoption of our products and our categories, and also frankly to build competitive strength for ourselves through scaling and gaining market share across the businesses. I do think that by virtue of the scale gains, we will see natural margin accretion over time. To some degree, given the investments that we've made in brands, we can control how quickly we increase the margins in those businesses.

But frankly, what we're trying to do is build great competitive fortresses around the rest of the world, in places like Brazil and places like Russia and in places like India and China, in order to frankly generate lots of long-term value for shareholders. So the strategy we're following is to capture sufficient short-term financial gains in those markets, yet at the same time build great fortresses like we have here in North America for the long haul, in both the snacks and the beverage business.

Operator

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

Bill Schmitz - Deutsche Bank

Couple of quick ones. Just in terms of cash flow in the quarter, I mean it looked like there were some working capital anomalies, and I know you've maintained your cash flow guidance for the year. So could you just explain kind of what happened there? And then I just have a really quick follow-up.

Hugh Johnston

Yes, Bill, you're right. This is Hugh. We had some timing on payments and a few timing items on inventory as well. Those are correct. In fact, they're already correcting through margin. And as we get to the full year, you will see the cash flow come in exactly as we expected.

As you try to manage cash flow, managing on a quarterly basis our cash flow is a little bit trickier than earnings on a quarterly basis. You're going to see some more bumps and it will be a bit more inconsistent, but I would expect the cash flow to come in as we expected for the year. And working capital will improve strongly during the year.

Bill Schmitz - Deutsche Bank

And then just, maybe it's too early, but can you just give us some early reads on the Pepsi next launch in Canada and kind of what you guys are thinking so far?

Indra Nooyi

I think it's hardly a couple of weeks since the launch, so let's wait and see. It's too early to call any results from that, because typically it takes about three to four months before you can get a first read. So let's wait and see how it evolves.

Operator

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

Caroline Levy - CLSA

Just wondering, there is a huge disconnect between the results, topline that Coke put up in Europe and you. And obviously Russia is a huge part of your Europe business, but in Western Europe and the U.K. in particular, which is a big business for you, could you talk about how your European beverage business performed? And what you're seeing in that market, please?

Indra Nooyi

I just think, our European business again, investments in brands, investments in stepped-up execution is all beginning to payoff. And our bottling partners are also performing very well. And I'd say across the board, pretty much in every country in Western Europe and parts of Eastern Europe, whether it's a company-own bottling operation or a franchise operation, first, our bottlers are healthy, which helps. And on top of that, they are executing exceeding well.

And I think the portfolio plays in our favor too. Pepsi MAX, for example, is a wonderful, wonderful product and is doing very well in the U.K., in the Nordic countries. So the choice of the portfolio works. The fact that we have financially strong bottlers helps. And third, I think businesses like Tropicana doing exceedingly well in France and the U.K.

So we have on target products, healthy bottlers and great execution, and together they're all beginning to work in Europe. So we're feeling good about the shape of the portfolio. And what I'd say is, what we can control, we're doing well. When it comes to geopolitics or macroeconomic turmoil, we try to navigate through it. But what we can control, we are doing a very job with it.

Operator

Our next question comes from the line of Steve Powers with UBS.

Steve Powers - UBS

Indra, I thought maybe we could just talk a little bit about the productivity programs, $8 billion effectively over eight years is clearly impressive, and about a $1 billion per year run rate its about 10% less to EBITDA or is equal. Obviously that's not the expected flow-through, so can you give us just a little bit more sense of where the productivity is going from, in terms of reinvestments

And how you're measuring return on that investment, and then also in terms of where the productivity is being sourced from? It sounded like from some of your comments that there is a shift going on, changes of focus perhaps between Frito-Lay in North America to beverages, but is that correct, and perhaps maybe some quantification around the productivity opportunities there?

Indra Nooyi

Hugh wants to take it and then I'll add to it.

Hugh Johnston

First, in order to understand all these numbers, it maybe helpful to give a bit of context on the overall environment they're operating within. The cost base that we're drawing productivity from is what we refer to is operating expense. What's important is what that excludes. That excludes A&M, that excludes any financing cost below the line, and tax and things like that, that also excludes commodity. So it's really kind of the operating expense of the company, including corporate expenses. So that's point number one.

It's about $28 billion, $29 billion in terms of the overall size of that bucket. So when you're talking about $1 billion a year of productivity, you're talking about somewhere between 3.5% and 4% productivity out of that bucket. For a company that's a growth company, that's really quite strong productivity. We benchmark that against other companies that grow the revenues in mid single-digits and we do feel quite confident about that strong productivity.

Now, to your question around where does it go? That question is really a margin question, which is a bit more complex. But let me share a few thoughts that may help you bottle it and also just give you a little bit of an understanding of how it works.

Number one, based on our mix of countries, of course, there is operating expense inflation inside of those operating cost. The operating expense inflation inside of that bucket is also going to run in the 3% to 4% range depending on the particular year. Drivers of that obviously are labor increases. That bucket is about half labor cost, and obviously that's naturally inflationary.

In addition to that as the business grows, it is somewhat volume variable. So you're going to get a better growth in those expenses based on volume increases as well. So that's a bit of an offset as you think about the margin flow-through.

The second margin flow-through question is around geographic mix. Obviously, we're growing more quickly in developing and emerging markets. As Dara asked about earlier, margins in those markets are lower. The natural drag out of those markets is probably about 30 basis points per year. Now that's something that, if we were to take our prices more aggressively we could chose to mitigate, but frankly for shareholder value creation over a five-year timeframe, we think that's the wrong decision. So we're willing to live with that 30 basis point margin drag.

And then the third piece is how we manage pricing in individual markets, is both an outcome of what our pricing strategy is vis-à-vis commodities, and in addition to that, what the competitive situation is in that particular market. So that tends to be a bit of a margin drag as well.

So when you put all of those pieces together, I think what you can expect from us is, is that margin improvement overall of about 30 basis points or so per year. We ought to be able to do that on a reasonably consistent basis, and combined that with the mid single-digit revenue growth and below the line leverage, I think our long-term guidance have high single-digit is what you'd be thinking about.

So hopefully that gives you some sense as to taking the productivity and mapping it all the way through to the guidance. If you'd like to spend more time on that, obviously, Jamie and the team can spend more time with you.

Indra Nooyi

And the productivity in Frito-Lay and North American beverages, it's across every part of the company. And as Hugh said, it's in G&A, it's literally corporate costs, everything. What we don't talk to is A&M and R&D. Those are the two that we've said are protected. We'll focus on ROI on those two investments, but we're not going to cut that to make the numbers.

Operator

Our next question comes from the line of Mark Swartzberg with Stifel.

Mark Swartzberg - Stifel

Two questions. I'm hoping to try to better understand from the thinking that you and your board have on TSR and CEO transition. On TSR, the 35% increase that you're announcing again, so to speak, or is a repeat of what we heard from the fourth quarter, is a very healthy, nice, good number. Can you give us some sense about the philosophy driving that?

I think one thing I'm really trying to better understand is you're putting optimal leverage target out there, do you do something to help us think beyond '14, how we should be thinking about how much cash shareholders get back from the company, again from a beyond '14 perspective? So looking for some color on TSR? And then simply any update on, Indra, how you are thinking and the larger Board is thinking on the subject of CEO transition?

Indra Nooyi

You want to take this up, and I will talk about CEO transition.

Hugh Johnston

Mark, from the perspective of TSR, I guess in terms of going beyond 2014, we haven't provided any specific guidance around share repurchase. We'll do that as we get into the next year. We've got a long history of share repurchase. We've been repurchasing our shares since 2001. So there is certainly a reasonable expectation that the share repurchase will continue to be relatively high. I don't want to get into 2015 guidance on share repo until we get closer to that timeframe.

In terms of TSR, though, perhaps from a different perspective, I would think about it from the standpoint of our long-term guidance is high single-digit EPS. So let's take the midpoint of that over time, and call it 8%. That's probably a reasonable proxy for share price increase assuming the market holds relatively stable.

Add to that, the dividend yield, right now that yield is, as I mentioned earlier, 3.1%. It's probably going to wind up hovering around the 3% range over time. So I would think of an 11 TSR is probably being a reasonable range to expect out of PepsiCo. We think with that combination of high-single digit EPS and a 3% or so yield, that's probably going to be near the top of the class in terms of TSR within the CPG space and within the F&B space. So that's the way I would think about it, more focusing on the TSR rather than the short-term cash return forecast.

Indra Nooyi

And in terms of succession, Mark, we start talking about CEO succession and all C-suite succession, the day after you appoint anybody into that job, because we have a very, very orderly succession process. The Board reviews it every other board meeting. We look at emergency succession, long-term succession. We have very deliberate talent development models within the company. And PepsiCo is known for that. We have an outstanding group of leaders within the company who can assume bigger and bigger jobs, but let me assure you at this point, I'm still on the Chair.

Operator

Our final question comes from the line of Bonnie Herzog with Wells Fargo.

Bonnie Herzog - Wells Fargo

I just have a quick question on the double-digit increase in your advertising and marketing expense for Frito-Lay and if we should expect that level of investment to continue? And then you've reported flat organic beverage volume growth in North America this quarter, which is quite positive. So could you drill down a little further and maybe give us an idea where some of this strength came from in terms of channels and brands?

Indra Nooyi

I will take the beverage question and then Hugh you can take the question on the A&M and Frito-Lay. As I mentioned on my prepared remarks, Bonnie, I tell you, we had a very, very good first quarter in North American beverages. I think we had growth across the board in all parts of the portfolio. We gained or held value share in CSDs, sports drink, ready-to-drink tea, coffee.

We grew retail sales in measured channels in the U.S. for regular cola's and Mountain Dew within CSDs. Gatorade, Lipton Tea, Starbucks Coffee, Naked Juice and non-carbs, this is one of those quarters, in spite of the fact that we had bad weather for some of the days of the first quarter, which caused some routes not to service accounts, this is the quarter where innovation stuck, our execution was terrific, and we just performed well.

But let's also make sure we recognize that now for several quarters, we have held or gained value share in U.S. LRB in measured channels. So I think all the investments, the focus on execution, brand building in North American Beverages is beginning to payoff. We're feeling good about the prospects in this business.

Hugh Johnston

And Bonnie, I will talk about the advertising and marketing spending in Frito-Lay. Obviously, when we increase A&M across the company, a couple of years ago, Frito-Lay certainly got their share of that increase. And it's worked, is the great news. We've seen the brand equity score has increased. And we've seen our ability to price successfully increase because the brands are stronger.

Regarding go-forward, what we've said is, we do not expect A&M as a percent of revenue to go down. So that will line in the centers, as Indra mentioned, regarding where we sit as a company. Beyond that, it really comes down to not a strategic move anymore. We need to increase A&M for the competitive reasons, because we think we're underspending.

But frankly, we'll base it on the opportunities that we see in the demand spaces that we're working within and within the innovation ideas that we have. So you might see a growth faster than revenue in a year or two, because we have some great products that we're putting out there.

You might see it, because we have a great combination idea of something we want to advertise between the beverage business and the snack food business, and we'll always take advantages of those opportunities when we have that kind of an insight. But there is no strategy to increase A&M faster than revenue with Frito-Lay. I would expect to see them grow basically in line. That's a big idea.

Indra Nooyi

So let me just bring this to a close. Thank you all for your questions. In closing, I think we have taken the necessary steps to position ourselves for sustainable long-term growth. We're off to a good start in 2014 and we've done a good job navigating through an uncertain and volatile environment.

And I believe the first quarter of 2014 is a good example of how well-constructive portfolio, appropriate investment and disciplined execution can drive high quality top and bottomline results. Our first quarter results give me confidence that our plans are working and that we are on track to deliver our financial goals in 2014.

So let me thank you for your time this morning and for the confidence you've placed in us with your investment. Have a great day.