

Good morning, and welcome to PepsiCo's Third Quarter 2017 Earnings Conference Call. Your lines have been placed on listen-only until the question-and-answer session. [Operator Instructions] Today's call is being recorded and will be archived at www.pepsico.com.

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

Jamie Caulfield

Thank you, operator. 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 third quarter 2017 performance and full 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 2017 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 cautionary statements and other information contained in today's earnings release and in our most recent periodic reports filed with the SEC.

Unless otherwise indicated, all references to EPS and operating profit growth are on a core constant currency basis and all references to free cash flow exclude certain items. In addition, references to organic revenue results in this call exclude the impacts 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 Investor section of PepsiCo's website under the Events and Presentations tab.

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

Indra Nooyi

Thank you, Jamie, and thank you all for joining us this morning. We will start off this morning with highlights for the third quarter and a discussion of each

of the operating sectors' performances in a little more detail; and then Hugh will cover the full year outlook.

For the quarter, we delivered revenue, operating profit, and EPS growth in what continues to be a volatile macro environment. Organic revenue was up 1.7% for the quarter and 2.3% year-to-date with solid net price realization operating margin expansion in most of the sectors.

Although we have moderated our full year organic revenue growth outlook, we now expect full year core EPS of \$5.23, which is 2 percentage points or \$0.10 higher than our previous expectation. This improvement is being driven by the strength of our year-to-date results, coupled with an improved outlook on foreign exchange impact.

Each of our operating sector's performance came in on or ahead of expectations with the numbers showing sequential topline acceleration, with the exception of our North American Beverages business, where net revenue and operating profit declined. So, let me start with that.

While North American Beverage performance was below our expectations, I will tell you upfront that the issues are temporary and we believe we have taken the necessary actions to improve the performance of this business beginning in Q4.

So, what happened? From an industry perspective, weather was comparatively negative, both temperature and precipitation, following record hot summers in 2015 and 2016, and there was a marked slowdown in the C-store channel in Q3. Now given this as a background, our performance did lag the industry, no question about it.

First, Gatorade, which accounts for approximately one-fifth of our Q3 volume declined following two sequential years of terrific Q3 growth. In fact, Q3 volumes were up a total of 18% over 2015 and 2016.

Relative to other beverage categories, this is one that is both much more sensitive to weather and more exposed to the C-store channel. So the broader weather and C-store industry themes I just mentioned had an outsized impact on Gatorade.

Second, we underperformed the industry in carbonated beverages. This summer, we directed too much of our media spending and shelf space to new low-calorie, much smaller brands at the expense of our Pepsi and Mountain Dew trademarks. While our plans for the summer were consistent with our continued and deliberate strategy to transform our beverage portfolio.

Clearly, we redirected some big brand space to these new products as opposed to focusing on new incremental space. We view both of these conditions as temporary and not structural, and we fully expect topline performance to improve in the coming quarters.

We have a good handle on what happened, and we are making immediate adjustments to get the business back to growth. We are stepping up marketing spending on Pepsi and Mountain Dew, including our zero and low calorie products under these trademarks.

We are reallocating and securing incremental shelf space in this place for our existing and new products to drive better overall velocity. We are tweaking our consumer communication with sharper brand messaging on pack, at point of sale, and through traditional social and digital media.

We have more innovation directed at our biggest trademarks, including low and no calorie products that will hit the market starting in early 2018, and we're executing our programs responsibly to ensure that we're driving profitable growth. With the expected improved topline, we also expect improved profit performance as we realize both mix and scale benefits from the improved sales trajectory.

To be clear, our beverage transformation initiatives over the longer term have been very successful in shifting our mix to faster growing subcategories and providing more low and zero sugar options.

Since 2010, we have increased our mix of non-carbonated beverages by 7 percentage points. Over the decades, we have established and maintained leadership positions in many of the most attractive noncarbonated categories, and we have successfully introduced many offerings to appeal to consumers' increasing demand for zero and low calorie offers. So, make no mistake about it, we remain squarely on strategy and having made a few course corrections, expect NAB to return to growth in the coming quarters.

Moving on to Frito-Lay North America, we had another quarter of very strong results, with a good balance of volume growth, net price realization, and operating margin expansion.

We feel very good about the business with innovation, pricing, execution, and market share performance all on target. We are particularly pleased with the continuing strength in organic sales growth, which is being fueled by effective price pack management and innovation backed by great marketing.

Take Cheetos as an example. We drove 6% net revenue growth for the trademark in Q3 with new products, such as Cheetos Paws, Jalapeño

Cheetos, and our SIMPLY line, and Mac n' Cheetos also contributing to the growth.

The innovation is well-supported by creative consumer engagement that included our award-winning Cheetos virtual museum campaign that asks, "What do you see in your Cheetos?" The program garnered 100,000 online consumer submissions and countless earned media impressions.

Ruffles, which grew net revenue 11% in the quarter benefited from innovations such as Spicy Jalapeño Ranch and Flamin' Hot that appeal to consumers' increasing desire for both flavors.

And beyond our largest trademarks, we saw impressive double-digit net revenue growth in premium and better-for-you offerings such as SunChips, Smartfood Popcorn, and Miss Vickie's and in our variety multipacks that provided great assortment of our top brands in convenient single-serve packages.

At Quaker Foods North America, we are pleased with the sequential acceleration in organic volume, organic revenue, and core operating profit performance, and we continue to feel positive about the trends in the business.

Our activations of portable breakfast innovation, namely Breakfast Flats launched in 2016 and Breakfast Squares that were launched in the first quarter are yielding positive results.

And our second quarter launch of Overnight Oats Cups, capitalizing on the growing trend of preparing chilled oats using a variety of healthy ingredients is also gaining traction with consumers. Taken together, our innovation and other programming drove mid-single-digit volume growth in our base oatmeal portfolio.

To wrap-up North America, I'm pleased to report that year-to-date through the third quarter, we generated more retail food and beverage revenue growth in the United States measured channels than all other 5 billion plus manufacturers combined. And in the third quarter, Frito-Lay on a standalone basis was once again the number one contributor to total U.S. food and beverage retail growth among all 5 billion plus manufacturers.

Turning now to our sectors outside North America. In Latin America, we continue to see very challenging macroeconomic conditions and geopolitical instability, which dampened consumer spending.

As we enter our fourth quarter, the devastating impact of the Mexico earthquakes and hurricanes in the Caribbean and Puerto Rico are clearly

adding to these challenges. Within this context, our businesses in the region performed well in the third quarter, posting 5% organic revenue growth.

Mexico, our largest market in the region, had high single-digit organic revenue growth, while Brazil grew organic revenue mid-single-digits. Similarly, we have continued to experience macro challenges in a number of markets throughout our Asia, Middle East, and North Africa segment, including the significant currency devaluation in Egypt and the economic impacts in a number of markets across the Middle East stemming from persistently low oil prices.

However, we have been adjusting our business to address these challenges. We are pricing to cover the increased cost of doing business and we are going more aggressively after productivity to reduce our overall costs. As a result, we saw a noticeable improvement this quarter as AMENA delivered 9% organic revenue growth driven by double-digit organic revenue growth in China, Pakistan, Philippines, Egypt.

And turning to Europe and Sub-Sahara Africa, we had very good results across the region, with organic revenue growth in each of our top four markets, along with six of the next seven key markets and a sequential acceleration overall, which translates to margin expansion and 12% core constant currency operating profit growth.

Organic revenue growth was well balanced across snacks and beverages, which grew high single-digit and mid-single-digit respectively, driven by strong product innovation and in-market executions.

Russia, our largest market in the region, had mid-single-digit organic revenue growth and very strong operating margin improvement. Among our other key markets, we delivered double-digit organic revenue growth in Turkey, mid-single-digit organic revenue growth in France, Poland and Germany, and low single-digit organic revenue growth in the U.K.

Now as we mentioned last quarter, across our businesses, we're pleased with the progress we're making in the e-commerce channels, and I say channels, plural, because we're addressing growth opportunities across eGrocery, pureplay, urban grocery delivery, direct-to-business and direct-to-consumer models.

Our success is underpinned by the significant investments we've made in attracting talents to and building capabilities in our dedicated global e-commerce business unit. So today, we have a team of roughly 200 e-commerce professionals supporting our businesses to capture growth in the rapidly emerging e-commerce channels.

It's made up of seasoned e-commerce and tech professionals, combined with our best entrepreneurial talent from within PepsiCo and we're managing this unit more like a tech company than a traditional CPG from how and where they work, the risks they can take, to how they are compensated. And we continue to fortify and enhance the full suite of capabilities that we believe will enable us to win in these channels from data analytics to specialized e-commerce supply chain knowhow.

Importantly, we're increasingly collaborating with our retail customers to make our e-commerce capabilities yet another point of differentiation in our value-added relationships with them.

For example, using big data and predictive analytics to shape real-time marketing messages, dynamic merchandising, and tailored offers, our team is enabling us to drive greater purchase instrumentality and higher basket size for our customers online.

As a result of these efforts, we have a business that's approximately \$1 billion in annualized retail sales with impressive growth in key e-commerce markets. For example, this year, our e-commerce retail sales are projected to be up 80% in the United States and nearly double in China.

In many cases, our online share exceeds our offline share and we are gaining online pretty much across the Board. While overall penetration of food and beverage remains relatively low compared to most of the categories, it is growing fast and its development is sure to be highly dynamic, and we believe we are well-positioned to win in this space.

Despite the many macro challenges, we continue to feel good about the state of our business. The fundamentals we have been focusing on and discussing with you remains solidly intact. We have a leading product portfolio and deep capabilities.

We continue to drive growth, product innovation, exceptional marketing, and innovation. We continue to transform our portfolio to capitalize on evolving consumer trends and we have a robust productivity agenda that is enabling us to continue to invest in the business, while delivering attractive earnings growth.

And finally this quarter demonstrated that the PepsiCo portfolio does have the capacity to generate topline and bottom-line growth even in the occasional quarter where we see a downturn in a particular sector. And it is the resilience of the portfolio that is also enabling us to increase our earnings outlook for the year.

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

Hugh Johnston

Thank you, Indra and good morning everyone. Turning to guidance, we expect our full year organic revenue growth to approximate the 2.3% rate we have achieved through the first three quarters. We expect core constant currency EPS to grow 9%, a one percentage point increase compared to our previous guidance.

Based on current market consensus rates, foreign exchange is expected to negatively impact both full year reported net revenue and EPS by approximately one percentage point, which compares to the previous market estimates of two points. So, as a result of the improved outlooks for both core constant currency EPS growth and foreign exchange, we now expect core earnings of \$5.23 per share.

In terms of other key considerations and assumptions embedded in our full year outlook, we continue to expect low single-digit raw material inflation, driven both by an increase in our basket of commodities, and some pressure from transaction ForEx.

We continue to expect core operating margin expansion fueled by our productivity programs. Our productivity programs are on track to achieve our annual \$1 billion target and we continue to expect our core effective tax rate to be approximately 24%.

Turning to cash flow, we expect to continue to generate strong cash flow and to exercise discipline over capital allocation with prudent reinvestment in the business and the majority of our free cash flow, excluding certain items, to be returned to shareholders through dividends and share repurchases.

So, for 2017, we continue to expect approximately \$10 billion in cash flow from operations, net capital spending of approximately \$3 billion, approximately \$7 billion in free cash flow, excluding certain items, cash dividends of approximately \$4.5 billion. Recall that we previously announced a 7% increase in our quarterly dividend that began with the June payment. This represents the 45th consecutive year in which we've increased our dividend and share repurchases of approximately \$2 billion.

Finally, as you update your models, I'd like to highlight the following three items as they relate to the fourth quarter. We are lapping the 53rd-week from 2016 and expect our reported revenue to be negatively impacted by three percentage points, we estimate the impact of the recent natural disasters to negatively impact EPS of by approximately three percentage points, and we expect sequential improvement at our North American Beverage business.

With that, we are ready to take the first question.

Question-and-Answer Session

Operator

Thank you. [Operator Instructions]

Our first question comes from Judy Hong with Goldman Sachs.

Judy Hong

Thank you. Good morning everyone. So, Indra I guess I just wanted to get a little bit more color just in terms of North America. Clearly, you've seen some volume pressure in the quarter, maybe a little bit more details around the brand performance in terms of how much volume was down across your brands.

And then I think you talked about some of the challenges from a weather and C-store traffic perspective, but maybe talk a little bit more about the competitive backdrop, because it does seem like there's some small brands that are gaining share, maybe there is a little bit better execution from your key competitors, so if you could just talk through those issues?

Indra Nooyi

Look, we have gone deep on the business to understand what is environmental factors that contributed to our performance and what is our own execution aspects that contributed to performance, and I'd tell you that, roughly speaking, my assessment is about 70 -30 in terms of what the weather, the precipitation, what the C-store slowdown caused to the business, and what we could have done differently.

And as I said in the script, Judy, Gatorade is a big part of our business and we were lapping 18% over 2015 and 2016, and with a slowdown of C-stores -- C-store traffic and the weather patterns in Q3, clearly Gatorade was impacted because the weather has an outsized impact on Gatorade. That was the first one.

The second is CSDs. We've been embarking on a deliberate strategy to shift the portfolio to lower calorie offerings and they tend to be more non-carbonated beverages, and that's why we shifted about seven points of the portfolio to non-carbs.

We have a lot more lower calorie and zero calorie innovation in CSDs, and we actually have it even under the big brands, the Pepsi and the Mountain Dew brands. So, what we're going to be doing going forward is taking the

big brands and doing a lot more low calorie and zero calorie offerings under that brand.

So, I tell you if I looked at this quarter, the only two that we need to focus on is getting Gatorade back to growth, which we're already beginning to see and tweaking our advertising spending against Pepsi and Dew.

The thing to be very careful about is we are focused on responsible growth. During the quarter, as we saw the trends, we could have very quickly hit a promotional lever and tried to drive growth, and we tried our best not to do that because we think that once you go down this promotional spiral, it's never-ending. So, our team is focused on profitable growth, responsible growth, and we are all focused on getting CSD trademarks and Gatorade back to growth.

Operator

Our next question comes from Laurent Grandet with from Credit Suisse.

Indra Nooyi

Good morning Laurent.

Laurent Grandet

Hey good morning Indra. Good morning Hugh. I'd like to ask you about I mean specifically -- I mean more structural issues I mean of CSD the business. I mean, it seems like Coke is getting shares clearly -- the competition would be higher next year as, I mean, your competitor would be fully refranchised.

What do you think about what's happening really in the marketplace against your key competitors? And how you think you will be able to turn this business around? I'm thinking more about the CSD business here. I know you said you will spend more in your A&M, but in terms of operating more in the business would be interesting to understand.

Indra Nooyi

Okay. Let me give my comments and then Hugh step in with yours. I actually believe ownership of the bulk of the bottling system is an advantage because you can actually do two things. One, you can flex them quickly and second is that you can extract more productivity from a bigger base. So, I actually believe it's a good thing.

During a period when a refranchising is going on, what happens is that you have funds that you can use to deploy against the market. But that is a temporary situation and that is going to get exhausted very soon.

So, we have to be careful that while the marketplace might have extra funding during a refranchising activity, we don't overreact by hitting a promotion lever to get short-term value -- volume in the business.

Having said that, what are the structural issues we see? One, we see a continued decline in full-sugar beverages. We see consumers shifting to lower calorie and zero calorie beverages. And we do see a lot of little competitors coming into the marketplace with interesting new beverage offerings, some of which stick, many of them don't stick.

So, what we have to do is create an entity within our company that does smaller brands, but smaller brands that stick and grow into medium size and bigger brands, we have to create that capability, which we are doing; and second is that the big lesson from Q3 is that it is an and game, not an or game.

When we launch new products, we have to go for new shelf space. The core shelf space, especially in C-stores for the big brand, we have to protect the hell out of it and that's what we're going to do. And Hugh, do you want to add anything to it?

Hugh Johnston

No, I think you've captured it well. The only thing that I would add is there clearly is going to be a competitive difference between the way our primary competitor is going to the market and the way we are. As Indra said, we think our strategy is the right one for all the reasons that are mentioned. And in addition to that, we think that that structure of the industry will lead to healthy competition, not destructive competition.

So, I think we are positioned well to see a healthy competitive environment. The consumer change is going to continue to be more towards lower calorie options and because of our investments in R&D, we think we are advantaged to capture those consumers as they move into the healthier options.

Indra Nooyi

But you know, Hugh, it's also safe to say that, as a leadership, we are focused singularly on value creation, shareholder value creation and we spot trends and if we think we have to make changes in our business, we do that. So, at this point, we think our strategy is the right strategy.

Operator

Our next question comes from Bonnie Herzog with Wells Fargo.

Bonnie Herzog

Good morning. Hi. I guess I was just hoping you could drill down a little more on your full year guidance and really what has changed now that you expect to deliver the 9% EPS growth despite your topline being slightly weaker. I know, Indra, you touched on topline for your North American Beverage business improving. So, I'm trying to think about that relative to what your expectations are for Frito revenue?

And then I still really unfair what of the levers are that you can pull to drive the faster EPS growth in light of a more difficult cost environment? And then maybe if you could just touch what drove the sharp reduction in your corporate expense line in the quarter? What that was from and then how much more of an opportunity there could be for further reduction? Thanks.

Indra Nooyi

Go ahead Hugh.

Hugh Johnston

Yes, Bonnie, happy to answer that. Two factors, all right. It's not being driven by aggregate revenue and it's not being driven by tax rate. As we noted the tax rates are same. Two primary factors. Number one is costs we're expecting now to come in a little bit better than we had previously forecast. And number two, we expect the mix of business to be a little bit more profitable, little better and those two factors gave us about an extra point of EPS growth.

Indra Nooyi

And in terms of overall cost management, we put in place a Smart Spending program about one year ago. And as the months go by, we just get better at being smarter and smarter with Smart Spending. And what you're seeing, because right here in corporate, we drive Smart Spending very, very seriously and that's where you're seeing the reduction in corporate cost.

Operator

Our next question comes from Vivien Azer with Cowen and Company.

Indra Nooyi

Good morning Vivien.

Vivien Azer

Good morning. Indra I was hoping we could touch on C-store again, please? I appreciated your comments on the channel sluggishness and the impact that's having on your Beverage business, but it does seem like there is a disconnect. And specifically, that's while beverages are under pressure, your salty snacks business actually looks to be outperforming pretty materially in that channel. So, if you could address that divergence that would be helpful? Thank you.

Hugh Johnston

Yes, I'm happy to answer that one, Vivien. A couple of things going on there. One, Frito-Lay really does have a wonderful balance of core products and great execution this year, and that's certainly helping us in the convenience store channel. And the truth is Frito-Lay is actually bucking what's a broad trend of challenges across most products in the channel.

In terms of what's driving the channel, volumes are down a little bit across the Board and C-store; pricing is up a little bit, three biggest factors in challenging the channel traffic. Number one, gas prices were up particularly in the latter half of the third quarter.

Number two, construction was down a little bit during the course of the summer and that negatively impacted traffic. And number three, we didn't get the heat burst this summer in late July and August that we had seen in the previous two summers and that negatively impacted the channel.

Operator

Our next question comes from Dara Mohsenian with Morgan Stanley.

Indra Nooyi

Dara good morning.

Dara Mohsenian

Hi, good morning. So, if we look at the year-to-date results or your full year guidance, it looks like versus years past, we're seeing low organic sales growth, weaker gross margin trends to get to that very solid 9% core EPS growth.

So clearly, you're relying more on SG&A leverage and cost cutting. So just a couple of questions off that. First, Hugh, is there something that's changed

from an SG&A or cost-control standpoint, where this improved pace of SG&A leverage see longer term? Or is it more isolated to this year and some of the Smart Spending Indra mentioned? So, just trying to understand if that changing trend is something that can get you to longer term.

And then second, Indra, you obviously made comments on the Beverage business and reinvestment in Q4 and theoretically within the next couple of quarters. Given the overall topline slowdown in the industry pressure points, is there greater reinvestment in your mind that's needed back behind the business, beyond just Q4 in light of the difficult industry environment and just that pressure of the typical earnings algorithm you've been able to deliver historically? Thanks.

Indra Nooyi

I'll answer the second answer, and then, Hugh, you should take the first one and talk about what's changed. I think that the thing to be careful about is not just the reinvestment, it's how much and in what. It's better to invest in pull activities than to hit the pedal on push activities. Because when you start getting into this competitive battle of more and more promotions, we've been there, done that, I don't think that's a way to create long-term, strong businesses. So, we've tended to focus more on innovation and pull-related spending, more A&M spending.

The shift to digital is a question mark because I don't know what the ROI on digital is as yet. And we're relooking at all elements of our marketing spending to see exactly which method of spending gives us the best ROI by brand. So, that's a piece of work we are doing.

What we want to do over the next few quarters is look at our brand portfolio and see how best to do trademark advertising, so we can focus on the big brands and still drive lower calorie products.

The thing to be careful about is this industry should not escalate to going from push spending to pull spending and everybody throws a lot of money into this business. It's going to be a judicious management of this business, where you've got the right amount of A&M spending and judicious execution, so this business remains profitable going forward.

I think that's where ownership of the bottling business is going to make a huge difference because we can work all of these levers very carefully. So, the next few quarters, watch and see what we do to tweak our spending and what the benefits are. We feel reasonably confident.

Hugh Johnston

Yes, I'm happy to jump in on the SG&A question, Dara. You're right, we -- our gross margins were down a few basis points, operating margin was up a few basis point. The biggest change that we've seen over the last couple of years is Smart Spending. We have about 30 big categories of spend. We've really only gotten into about five or six of them at this point. The ones that we've done are the relatively simpler ones that -- the travel outside services, facilities and things like that.

The more complex areas of spend when you get into distribution, when you get into selling, when you get into certain elements of non-working A&M, those take a little bit longer. We're working on them right now. We have plans to and expect to see results from those areas of spend over the next couple of years. So, to complete the answer to your question, we do expect to be able to continue to leverage Smart Spending to deliver outsized productivity results for the coming years.

Operator

Our next question comes from Bryan Spillane with Bank of America.

Indra Nooyi

Good morning Bryan.

Bryan Spillane

Hi, good morning everyone. I guess my question is maybe a follow-up to Dara's question with regard to the algorithm. One of the questions that we fielded a lot this year is just whether or not the PepsiCo long-term algorithm is really sustainable given how -- all the dynamic changes happening at retail in the U.S., category trends in beverages.

So Indra, could you just sort of give your sort of state of the algorithm relative to all the changes that we're seeing occur in the marketplace today, and sort of how PepsiCo is just ensuring that you've still got the sort of the right resources and whether that algorithm is still right?

Indra Nooyi

So, Bryan, we're not talking about any long-term algorithm or guidance at this point. We usually do that in the February meeting. But let me tell you in broad shapes, our focus is on innovation, our focus is on portfolio expansion, our focus is on shift to Better For You, Good For You products. And our focus is on productivity and stepped up levels of productivity.

The whole goal is to marry our innovation capability with our productivity programs. And we've had remarkable success over many, many, many quarters. This one quarter was a bit of a [Indiscernible] on North American Beverages, and I call it [Indiscernible] because there were many external factors that caused this. And believe me, we are all over this business and we will be back. There is no issue.

So from a long-term algorithm, just wait until February next year when we do give you the guidance. But all I say to you, our focus is on balanced top and bottom-line growth. Invest in the topline; make sure the right productivity to deliver the bottom-line growth. Make sure that you invest in all the new capabilities needed and generate the productivity to invest in new capabilities. That is a tried and tested playbook, and we're not backing off of that.

Operator

Our next question comes from Lauren Lieberman with Barclays.

Indra Nooyi

Lauren good morning.

Lauren Lieberman

Good morning. Thank you. Two things. First was just a follow-up for Hugh on the Smart Spend conversation. You've mentioned I think 30 buckets; you're five to six in so far. I'm just curious, is it sort like a pro rata potential, where these first five to six are not just a little easier to get at, but also bigger pools than kind of what's still to be explored and understand the complexity? That was one.

Two is just going back again; I apologize, to North America Beverages, but year-to-date, at least externally the trends haven't been great or less good than they've been in the past. So, you'd also already talked about prior to today putting more money behind big franchises, you talked about behind CSDs. If I think back to the Super Bowl, it was Pepsi Zero Sugar that was supported.

So, I'm just curious kind of how some of this redirecting spending already started? It seems on TV -- I know I'm seeing a lot of the Pepsi ads, are you seeing any lift from that yet? I'm just -- I'm surprised the degree to which -- at sort of this point in time, that something went off internally that say we need to redirect and replan and it didn't happen earlier in the year. So, if you can just address kind of what flipped the switch for guys on thinking through this a bit differently?

Indra Nooyi

You want to take the first part, Hugh?

Hugh Johnston

Yes, I'm happy to handle that one. Lauren, in terms of the buckets, I would characterize our timing of them not about size, but just about complexity. Travel is obviously a relatively simple bucket to get after when you get into distribution and selling and things like, those are just more complex buckets of spend.

The size actually of the buckets that we haven't gotten to yet is substantially larger than the size of the buckets that we have already gotten to. So, I would think of it as there's lots more opportunity out there, but it just takes more time to get at them.

Travel and facilities and outside services and things like that are relatively simple and straightforward to get at, so that's why we're seeing those benefits more immediately. But it's not a question of running out of runway on the size of opportunity.

Indra Nooyi

And talking about NAB trends. When you're looking at weather and you're looking at precipitation, you don't plan for a cooler weather or higher levels of precipitation. So, we fully expected that this summer would be a normal summer, not a flaming hot summer, but we thought it'd be normal summer. And so we kept investing behind the brands like Gatorade, but then when the weather completely turned south and -- not literally, but it was cooler and a lot more precipitation, that advertising spending did not give us much lift as we would've liked the business to get.

Now, if we have not been lapping the 18% growth, it's a whole different ballgame. The problem is the combination of lapping the 18% growth for the last two years in Gatorade, plus the fact that we had a cooler summer this year, when it's our seasonally big quarter is what caused the issue.

And one of the things we've told our businesses is that don't do anything in the short-term which will have no lasting impact for the long-term. Many years ago, we use to just hit the promotional spending lever. And I think what we're doing very carefully now is saying don't hit the promotional spending lever because that won't last for the long-term.

So, the weather was a big factor. And we hate to use weather as an excuse, Lauren, but the weather was a big factor. And we didn't make all the

changes anticipating poor weather, we just kept playing our playbook and that's what caused the issue. Again, it's temporary, we're taking the actions and we are all over it.

Operator

Our next question comes from Ali Dibadj with Bernstein.

Indra Nooyi

Good morning Ali.

Ali Dibadj

Hey how are you? So, I actually have two questions. One is I really appreciate the conversation about responsible growth and push versus pull. So, I just really want to make sure that I'm understanding correctly that the tactics going forward to improve some of the slowdown in a NAB is not going to be major increase in promotion, it's not going to be lowering price mix. So, I just want to underline that point and make sure that's not part of the plan going forward.

And then related to that, second question, I guess I'm a little confused about the margin discussion that we've been having here. Because it sounds like we're saying there are bigger pies to go after, we're going to get more savings, more spending is going to be better. But we haven't really changed the \$1 billion gross cost savings that we've been talking about for a very, very long time.

And that number hasn't changed, it's a very good number. But it feels like there's a gap between gross to net, right? So, this year, call it, 20 basis points of margin improvement, 30 basis points on the quarter, less obviously if you take away the NAB asset sale, if you take away the Britvic stake, et cetera, and you're saying you going to invest more back.

So, I guess long question as usual for the second one, but is that \$1 billion gross savings going to go up so you're going to have to spend more back, so you're getting more margin expansion? Or are you going to have to -- are you just going to spend the same amount more efficiently? Because I'm just confused, the \$1 billion number hasn't changed and I don't know if you're suggesting that's going to go up. So, thanks for the pricing question and just margin clarification for me, please.

Indra Nooyi

Well, I'm going to talk about the pricing question and then Hugh is going to give you a good answer on the rest of it. As I said, Ali, at least two or three times, and thank you for asking the question, we are focused on responsible growth. The goal is not to hit the promotional lever and try to just buy short-term volume. And that's the message that's been made very clear to our entire North American beverage Business, and Al and Kirk and the team are singularly focused on that.

So, you will see PepsiCo executing a very responsible strategy going forward, balancing push and pull spending so that it's profitable growth. In terms of productivity and the plans for cost reduction, Hugh, why don't you just provide the answer for that?

Hugh Johnston

Yes, happy to do that. I think, Ali, the confusion that you're experiencing is a result of timing. My comment earlier about we think there's a little bit more cost benefit is a way of explaining why the 9% EPS growth for this year.

Regarding the longer term, my broader points there around Smart Spending, where just that there's lots of productivity opportunity left out there. We're not making any changes to the long-term guidance, we're not making any changes to our long-term productivity targets and we're not talking about 2018 yet. I was really just offering some robustness to why we think we can continue to drive the productivity that we've already talked about. Hopefully that helps.

Operator

Our next question comes from Robert Ottenstein with Evercore ISI.

Indra Nooyi

Good morning Robert.

Robert Ottenstein

Great. Obviously, a lot of focus on the U.S. business. Could you give us a little bit more color on what's going on outside of the U.S.? And you gave us some broad-brush, but are you seeing, for instance in Brazil, some of the other markets, some underlying stabilization and improvement that would give perhaps some confidence going forward of an acceleration?

Indra Nooyi

Hugh, do you want to take that? So, let me give you some of the -- what we're seeing in some of the geographies. We're actually seeing a strong lift

in European business. All of our business -- actually West and East Europe, we're seeing tremendous strength. All our businesses are doing well. We have a wonderful portfolio in the ESSA market. And we have the right marketing programs, the right pricing programs in place and that's why you're seeing such a stepped up growth rate in the ESSA market, both East Europe and Western Europe. And our Russia business in particular is doing very well, and so we feel very, very good about that.

In the Middle East, which is another big market for us, clearly this year we saw the impact of the lower oil price, the tax on CSDs, all of that went into place. Again, we have taken all the appropriate actions to implement more productivity, start to shift the product portfolio. And while we took a short-term shock to the system, we're coming out of that. And we think that the Middle East, North Africa still represents a very, very good market with lots of consumers is still in coming into the peak consumption years. So, we feel good about that market. The prospects for recovery in those markets are good.

As I look at China and the Asia-Pacific region, our business in China is doing well, especially our Snacks business is doing very well. Our Quaker business is doing exceedingly well in China. The team is a good team. Our e-commerce business is on fire in China and doubling in size every year. And it's becoming a learning lab for us to learn how to do e-commerce for the rest of the world, so we feel good about China.

The wonderful thing about the rest of Pacific Rim is that you've got many markets; all these little tigers are recording pretty good GDP growth. The markets may not be big as a China or India, but each of these markets contributes positively to our performance, and we've been doing well on those markets and gaining share in all of those markets. We have good bottling partners. Our own operating businesses are very good. Good leadership teams. Those businesses are doing well. We don't see much of a concern in those markets, even though they've gone through some political ups and downs.

In the South Asian subcontinent -- India, Pakistan, Nepal, Sri Lanka, we face the normal upheavals from GST, the demonetization -- or remonetization, I should say. We are through all that now. And hopefully the business will start to steadily recover in India. But Pakistan has been a big success story for us. We have a good business there and it's growing very nicely and profitably.

Latin America is a big question. We have strong businesses in Mexico and Brazil in Central America. Clearly, Latin America has gone through its share of geopolitical issues, and recently, the earthquakes have really had a

devastating impact in Mexico; and the hurricanes that swept through the Caribbean and Puerto Rico have a really decimated those islands.

In spite of that, the teams have performed well. And our Brazil business is doing very well and our Mexico business is doing well across both Snacks and Beverages. So, in those markets, I would say we're holding in Latin America, doing exceedingly well in the ESSA region.

Our AMENA sector is, in spite of all the issues, coming back very nicely. North America is our core, and we remain positive about the North American business. Now and then, there will be a quarter where some business has a hiccup or a toast up. The resilience of our overall portfolio is what allows us to deliver the numbers we're delivering.

So, overall, we still feel quite confident about our prospects and we are buckling our seatbelts and saying, "There will be geopolitical instability, there will be weather-related issues, we just have to build a portfolio that can weather that and somehow profit through and deliver the performance."

Operator

Our next question comes from Pablo Zuanic with SIG.

Indra Nooyi

Good morning Pablo.

Pablo Zuanic

Thanks for taking -- thanks Indra for taking the last question. Look, just two quick ones. One, I understand the idea with retailers who will try to get space back for CSDs, that it's a case of and, and not or. But when I see LaCroix in some targets having 30 feet of space and Coke and Pepsi each maybe five or six, I wonder how much is it about what you can do and about what the retailers and the consumer wants. So, if you can comment on this strategy, on the retailers, on the retail space, I find that it would face a lot of pushback from the retailers? And number two -- which maybe means you just have to double-down on non-CSDs, but that's the question.

And the second one, I know this is going back in time, but when you bought Wimm-Bill-Dann back then, you were talking about dealing a third leg with this big nutrition arm. And since then it's been -- it's become more about transforming the potato chips, to better nutrition and drinks and so on. Maybe you got -- things got changed because of [Indiscernible] back then, but is there -- is this a moment to maybe think about that third leg again? Thanks.

Indra Nooyi

Pablo, great question. First of all, we always get pushback from retailers and everything. I think the real thing is that from PepsiCo's perspective and DSD company, we have big brands and our brands have high velocity. So the combination of those three yields tremendous profitability for retailers. And clearly, some upside brands have come in and taken a lot of shelf space.

Our challenge is not to just say, "Hey, give us more space for core CSDs," it's how do we provide the right innovation to go after those upstarts who are taking a lot of space. I tell you one of the issues I would say, and I take full responsibility for this, maybe in a couple of cases we were slow to respond to some of these newcomers who have taken a lot of space.

And believe me, we will fix that. And going forward, the agility and speed of response from our company will go up significantly. Sometimes when you have too many big brands and too much success under your belt, you lose a little bit on speed, and we are working to fix that.

So, I think you'll find that the retailers actually welcome the DSD suppliers to keep their shelves looking good going forward and that's what we provide with our beverage portfolio.

In terms of the third leg, we've tried to build it organically with success, Wimm-Bill-Dann was the last big acquisition we made, and except for the Russian ruble that went through its own share of challenges after we bought Wimm-Bill-Dann, coming out of that, the business has performed exceedingly well. It's an ideal portfolio.

I think what we have to be very, very careful about -- if we went off and built that third leg through acquisitions, we have to think hard whether they're shareholder value creating, what kind of a premium do you pay for any acquisition and how do we realize the benefits of that deal enough to offset the acquisition premium.

And believe me, the stuff we've looked at so far, we don't see a clear path to that. And so as we've said many, many times to all of you, we want to make sure that any major acquisition we may -- minor or major, I'm sorry; any acquisition we make has a clear path to value creation. And if we don't see that, we typically do not make the acquisition. We try to do things organically. It may take longer, but they create much more value over the long-term. Hugh, did you want to add anything on that?

Hugh Johnston

No, I think that was perfect.

Operator

Our next question comes from Mark Swartzberg with Stifel Financial.

Indra Nooyi

Mark good morning.

Mark Swartzberg

Hi Indra, good morning. Hi Hugh. Thanks for taking the question. Continuing this line of questioning on the algorithm, of course you're not going to give us an update. But I do wonder if we're seeing a bit of a prequel to how you'll keep delivering the algorithm, meaning it seems that productivity and cost savings are gaining importance. And while I think we all agree that 1.7% is not the right run rate, you're going to be do better than that. You did take your revenue growth for the year down to at least 3% before we had the third quarter. So, -- and you were doing 4s and 5s. So, is it right to think that you need to lean harder into productivity to get to the same outcome over a series of years to come?

Indra Nooyi

Don't know. Don't know, Mark. You know what I think with our revenue growth rate, they're still up there in the top performance in the Whole Food and Beverage space. And so it's an environment that requires us to modify our model, our innovation model, our retail, our outreach model. And you know what, when you go through these sorts of transformations and you're tweaking part of the business model, there will be issues along the way.

If we focus on the year and looked at our performance versus other people in the space, I think we stack up pretty well, both on the top and the bottom-line. And so will we lean harder on productivity, we will always lean harder on productivity, because we believe that we ought to take out any cost that is not value creating and put it back into investments in the business or flow it through to the bottom-line. And that has been our modus operandi.

So, productivity will always be paramount in PepsiCo. As we get better at it, we will keep doing more of it. But we're not taking our focus off of growing the topline. To us, growing the topline is really the right way to grow the company in a very, very balanced way.

So, we are redoubling our efforts to grow the topline. We're looking to see how to spend the A&M that we put out in a much more efficient way. To me,

that's the Holy Grail. We all spend a lot of money on A&M, how do you spend it in an efficient way so we get the appropriate lift from the A&M?

But you know it's interesting times in the entire CPG world globally. And we have the size, scale, capabilities, the brands to be a very, very important player in this business and a top performer and that's what we're focused on maniacally.

And Mark let me just close by saying; personally, I'm completely committed to this company because 50 times my salary is in PepsiCo stock. And with that level of ownership, believe me, this is something Hugh and I focus on 24 hours a day.

Operator

Our next question comes from Caroline Levy with Macquarie.

Indra Nooyi

Good morning Caroline. Caroline, good morning.

Operator

Caroline your line is open.

Caroline Levy

Good morning. Can you hear me now?

Indra Nooyi

Yes, good morning Caroline.

Caroline Levy

Sorry. Thank you very much. I would really appreciate your take on the changing climate of retail, because that is on everybody's mind so much with Amazon buying Whole Foods. I know that you touched upon what's going on in your e-commerce business. But the other conversation that's raised its head is private label. And over many decades we've had this conversation about will it suddenly take off and become like Europe and the U.S. So, I'd really love your opinion as to what e-commerce and Amazon probably change that dynamic, because private labels really never succeeded in your categories.

Indra Nooyi

Yes, look even in Europe, our categories have had private label penetration, but not to the extent that many other HPC or other categories have had. Having said that, we are not complacent about any of this. Basically, I think, as we look forward, we're still looking at retailers, if they want to deliver margin growth in a period in which they're seeing price compression, they have a couple choices. They can do private label or they can get more efficient or they can get innovation to the stores from the big manufacturers that drive more traffic and velocity.

So, I think what could happen -- Caroline, this is just my perspective, is that you could see a bifurcation. You could see big brands, big companies taking the burden off of retailers through DSD and by bringing our own label into the store and driving more velocity and traffic through the big brands and innovation. And then you could see on the other end, a combination of small brands and private label that flanks it on the other side. What could be squeezed in the middle is sort of the mid-size brands.

Now, this is just my perspective, and we've been looking at all of this really hard. We think that could be a possible scenario going forward. So, from our perspective, doubling down on big brands, making sure innovation is -- making sure execution is perfect; our whole system is aligned, so when we have to make changes, we can do it fast.

And then within our company, making sure we have enough levers on productivity so we can get more and more efficient deploying automation and other tools to be able to put it back on innovation, driving the topline growth, whatever we have to do. I think that's going to be the game going forward.

As we said in the last call, this is going to be a period of brilliant disruption over the next three to five years and we're going to approach it with pessimism or optimism. We actually think this could be a time when a lot of competitor balances could be reset. And as perhaps the largest U.S. company in food and beverages and the second largest food and beverage company in the world, believe me, we will play an outsized role in this resetting of the competitive balance.

Operator

Our next question comes from Andrea Teixeira with J.P. Morgan.

Indra Nooyi

Good morning.

Andrea Teixeira

Good morning everyone. Thank you. Thank you for taking the questions. So, first on Frito, I think going back to Caroline's question and I think also boding into what your comments, but just curious how you're seeing your competitor -- any competitor reaction, because clearly you have been gaining share consistently there. And if you're seeing anything in terms of your DSD against one of your competitors kind of getting out of DSD, if you're seeing any potential reaction to that? Or are you sort of seeing that market share gains as secular and more resilient than before?

Indra Nooyi

Go ahead Hugh.

Hugh Johnston

Yes. I'm happy to answer that Andrea. I think what you see is more resilient rather than temporary. A lot what's happening right now with Frito-Lay is less driven by what competition is doing and just more driven by the fact that Frito-Lay is both running the core portfolio very well and innovating well around that portfolio with products like Stacy's and Smartfood and many of the premium products.

So, if you look at what's going to drive Frito-Lay's growth for the future, it's going to be continuing to execute that core portfolio and continuing to innovate premium and that will likely result in continued share gains over time, not anything that's happening competitively.

Indra Nooyi

So, thank you all for your questions. And let me just summarize by saying we are pleased with our year-to-date results for the third quarter with strong results across most of our sectors and we expect our topline performance to accelerate in Q4 as performance at NAB recovers.

And we're on track to deliver our fifth consecutive year of at least 9% core constant currency EPS growth. And we believe we are well positioned to continue to perform well over the long run.

As always, thank you for joining us this morning and for the confidence you have placed in us with your investment. Thank you.