Good morning and welcome to PepsiCo's first quarter 2016 earnings conference call. Your lines have been placed on listen-only mode until the question-and-answer session. 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 - Senior Vice President Investor Relations

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 first quarter 2016 performance and full year outlook, and then we'll move on to Q&A. We've kept comments brief this morning and intend to conclude the call by 8:45.

Before we begin, please take note of our cautionary statement. This conference call includes forward-looking statements including statements regarding 2016 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. All references to free cash flow exclude certain items. In addition, references to organic revenue results in this call exclude the impact of acquisitions and divestitures, structural changes and foreign exchange translation.

To find disclosures and reconciliations of non-GAAP measures that we use when discussing PepsiCo's financial results, you should refer to the glossary and other attachments to this morning's earnings release and to the Investors section of PepsiCo's website under the Events and Presentations tab.

As we discuss today's results keep in mind that our first quarter comprises the 12 weeks ended March 19, our North American operations and it is a short quarter for international businesses, reflecting the two months of January and February for most of our operations outside of North America.

Also, please take note that we've reclassified certain functional support costs from SG&A to cost of sales, prior period amounts have also been reclassified and the details are footnoted on Pages A1 of the Q1 earnings release. These changes do not impact PepsiCo's overall revenue, operating profit, net income or earnings per share.

Now it's my pleasure to introduce Indra Nooyi.

Indra K. Nooyi - Chairman & Chief Executive Officer

Thank you, Jamie.

I'm pleased to report that 2016 is off to a good start with very strong operating results in the first quarter. Global Snacks organic volume increased by 1.5%; and Global Beverage organic volume increased 3%, the highest rate of quarterly beverage volume growth in three years.

We delivered 3.5% organic revenue growth, led by high-single digit growth in Latin America and AMENA and 4% growth at Frito-Lay North America. Our five largest segments, Frito-Lay North America, North American Beverages, Latin America, ESSA and AMENA, each had both positive organic volume growth and positive net pricing.

Core gross margins expanded by 130 basis points and core operating margins expanded by 165 basis points, driven by the positive net pricing and continued execution of our productivity agenda, including the implementation of our Smart Spending program. Core constant currency operating profit grew 12% and core constant currency EPS grew 11%.

It is noteworthy that we delivered these results in a volatile and uncertain macroeconomic environment. Most of the developed world outside the United States is grappling with slow growth. GDP growth in developing and emerging markets is also challenged with many D&E markets experiencing significant political unrest and high unemployment.

Key energy-producing countries are dealing with significant budgetary gaps; and high levels of local inflation in many of these markets are eroding disposable income and dampening consumer spending. It's a difficult environment indeed. Despite these macro challenges, we performed well. Our developing and emerging markets businesses grew organic revenue 7%, with double-digit growth in China, Saudi Arabia, Egypt and Turkey.

In the developed markets, we grew organic revenue by 2%, led by performance in the United States where we grew revenue 2.5%. In fact, in the first quarter, PepsiCo was once again the largest contributor to food and beverage retail growth in the United States, accounting for more growth than the next 17 largest manufacturers combined.

We've performed well because our approach to operating in this environment is and has been to execute well against what we can control and to retool our business models and operating system to cope with what we believe could be sustained volatility and uncertainty; and this is really what we're doing.

First, we've accelerated our innovation agenda, utilizing our proprietary Demand spaces framework. This has led to our new products being more incremental and has contributed significantly to our overall organic revenue growth. We've increased the efficiency and effectiveness of new product launches by leveraging our global scale. We're more quickly and effectively lifting and adapting successful product launches from one market to another, driving more rapid expansion of our largest brands, as well as our future billion-dollar brands.

For example, in the first quarter outside of North America, Lipton Ready to Drink tea grew 10%, Mountain Dew grew volume 9%, Gatorade grew 9%, Naked Juice grew 60%, Sunbites grew 42% and Cheetos grew 9%. We've continued to generate strong net price realization even in a sluggish consumer environment through enhanced revenue management capabilities and data analytics.

We've introduced new price pack combinations tailored to much more targeted shopper and consumer occasions. For example, in North America over the past five years, we've shifted approximately 6% of our carbonated soft drink volume mix from traditional two-liter and 12-ounce multi-pack packages to higher margin, more profitable single-serve and alternative multi-serve packages. These efforts have been driving higher net price realization for us and our retail partners.

We've also been future-proofing our product portfolio, reshaping it to capitalize on consumers' increasing interest in health and wellness. Just to give you an idea, we track two sets of numbers. First, what we view as everyday nutrition, which includes products that provide positive nutrients, like grains, fruit and vegetables, and protein, plus those products that are naturally nutritious, like water and unsweetened tea. Now these products account for almost 25% of our portfolio by revenue.

Second, what we view as guilt-free products, these include the everyday nutrition products plus diet beverages and other beverages that are below 70 calories per 12 ounces, and snacks with low levels of sodium and saturated fat. Guilt-free products account for approximately 45% of our portfolio by revenue. The growth of our everyday nutrition products, which accounts for a quarter of our global net revenue, is outpacing the growth of the balance of the portfolio. And we've had a significant amount of activity underway to transform our portfolio.

Just to give you a few examples, we've broadened our beverage portfolio to lessen our reliance on colas, and today we have the leading non-carbonated beverage portfolio in the United States. In fact, globally, just 12% of our revenues come from trademark Pepsi and less than 25% comes from carbonated soft drinks on a global basis.

We've invested in R&D to create advantaged sweetener solutions and lower-calorie products, and we're aggressively moving our portfolio to package and product combinations with fewer calories. Mountain Dew Kickstart, with just 40 calories per eight ounces, is a great example of our execution in this area. Now in its third year, Kickstart generated more than $300 million in estimated retail sales in 2015 and posted 34% volume growth in the first quarter of 2016.

We've also been shifting more of our beverage A&M to lower-calorie products in order to accelerate growth in strategically advantaged subcategories. And we are increasing the nutritional profile of our snacks and foods through the introduction of products like: Smartfood Delight, which grew volume over 75% in the first quarter; reduced fat Doritos, the top-selling Frito-Lay snack brand in schools, which grew volume 30% in the first quarter; and gluten-free Quaker Oats, just to name a few. Net-net, we feel pretty good about our portfolio transformation efforts.

Next, we are building and investing in new capabilities to win in high-growth channels. To capitalize on increased out-of-home food and beverage consumption, we have consolidated our food service resources into one team, enabling us to creatively leverage the breadth of our product portfolio with our customers and consumers.

In the United States, foodservice now represents approximately 14% of our total revenue, and the first quarter outpaced the growth of the balance of other channels combined.

This year, we will be increasing the out-of-home availability of our everyday nutrition products, both snacks and beverages, through the targeted placement of approximately 20,000 Hello Goodness vending machines across North America.

Our advertising and marketing has also become more impactful. First, we have stepped up our level of investment from 5.2% of sales in 2011 to 6.3% of sales in 2015. In the first quarter of 2016, our A&M expense increased by a further 65 basis points as a percentage of sales versus the prior-year quarter. At the same time, we've increased the effectiveness of our A&M

investment by shifting more dollars into consumer-facing working A&M and by more effectively integrating social and digital media in our marketing campaigns.

We've also accelerated our productivity programs, contributing to consistent core margin expansion and providing investment funding for growth initiatives. Since 2012, we have generated $1 billion of annual productivity savings, and we are on pace to do so again this year.

In addition, we have fully implemented our zero-based Smart Spending program across the enterprise. We're already seeing significant expense reductions in the areas targeted. And our organization is fully mobilized to identify opportunities to drive even greater levels of productivity.

And then we have stepped up our market-based execution by working in creative new ways with our retail partners, like: unique joint execution of sports and entertainment properties; development of new and innovative merchandising and fountain equipment; execution of coordinated consumer promotions; and leveraging the combined power of the PepsiCo product portfolio.

For example, with 7-Eleven, Doritos and Super Bowl all turning 50 this year, in the first quarter we teamed up to offer consumers NFL experiences and prizes, including a trip to Super Bowl 50. When consumers purchase a golden combo of any size Doritos, Pepsi, Slurpee or grill item, they could scan their 7-Eleven app to receive a code to unlock prices from teamupforgold.com.

And at Albertsons, we executed a joint promotion across PepsiCo's entire product portfolio in the All for Super Bowl sweepstake. It was a massive blitz of in-store displays in secular advertising and online promotions. When consumers purchase two or more participating products in one transaction, they qualify to enter to win $50,000; one of 50 NFLShop.com gift cards every week during the promotion period.

These examples are by no means exception to the rule. They're just a couple of demonstrations of how we're working creatively and collaboratively to deliver value to the consumer and be an indispensable growth partner for our retailers.

The actions we've taken and the investments we've made to strengthen our capabilities, our innovation, revenue management, portfolio transformation, customer service initiatives in particular, is what helped us deliver impressive operating results in the first quarter. We continue to achieve healthy net revenue realization and new products continue to be an important contributor to our sales growth.

Next, in the context of an interesting macro backdrop, we feel good about the state of our business and we're off to a good start in 2016. We believe we have the right plans in place. We have great people. We're executing well, we're investing in capabilities that will propel our future growth. We will continue to leverage our considerable advantages, our scale, geographic presence, product portfolio and Power of One synergies to succeed in this environment. And we're well-positioned to achieve our 2016 financial targets.

Many of our investors have commented me that they value PepsiCo because of our sustained reliable performance. As the stewards of this remarkable 50 plus year-old enterprise, we're managing and investing in the business to extend the duration of performance while achieving returns above our cost of capital; and we're committed to ensuring that our best years are ahead of us.

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

Hugh F. Johnston - Vice Chairman, Chief Financial Officer & EVP

Thank you, Indra, and good morning everyone. As Indra mentioned, we're pleased with the financial results for the first quarter; and having a good start to the year with one quarter behind us gives us added confidence in achieving the financial targets we shared with you in February.

And so, as you saw in this morning's release, we reaffirm those targets. Specifically, we expect approximately 4% organic revenue growth, excluding the impact of the 53rd week. And we expect 8% core constant currency EPS growth, excluding the impact of deconsolidating our Venezuela operations; and 6% when including the Venezuela impact.

Notwithstanding our strong Q1 results, the macro outlook remains highly volatile and uncertain; and for this reason, we are maintaining a cautious stance on the external factors that influence our business. So balancing a positive view of our execution against a more negative view of the macros, we arrive at the conclusion to keep our revenue and earnings guidance unchanged.

We expect foreign exchange translation to negatively impact both revenue and EPS by approximately 4 percentage points, which is also unchanged from the full-year estimate we provided to you last quarter. As a reminder, we base our foreign exchange translation forecast on consensus rates. I know a number of you use spot rates, which currently leads you to a less significant impact. Clearly, as the year progresses, this gap will resolve itself, but we're holding to our outlook at a negative impact of 4% for the year for both revenue and EPS. As a result, we continue to expect 2016 core EPS of $4.66.

Our outlooks on the other metrics we provide remain unchanged and are set out in this morning's release. For the analysts on the call, as you update your models, I'd ask that you consider the following factors. We have a more difficult core constant currency operating profit growth comparisons in the upcoming quarters at both Frito-Lay North America and North America Beverages. We anticipate a slower rate of gross margin expansion versus Q1 as we expect raw material inflation, which includes the impact of transaction related foreign exchange for the balance of the year compared to modest deflation in Q1.

We will continue to invest in our business to drive sustainable long-term growth, including a planned increase in advertising and marketing expense as a percentage of sales for the full year. While we expect lower corporate expenses for the full year, primarily driven by lower pension cost, there will be quarterly volatility in this line item due to timing; and you should not expect to see the rate of decline that we had in Q1 for the full year.

The reinvestment of the 53rd week benefit will occur over the balance of the year. And, finally, we will be lapping Venezuela earnings of approximately $0.03 per share in Q2 and $0.06 per share in Q3. Taken together, we expect balance of year EPS growth to be disproportionately weighted toward the fourth quarter.

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

Question-and-Answer Session

Operator

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

Indra K. Nooyi - Chairman & Chief Executive Officer

Good morning, Dara.

Dara W. Mohsenian - Morgan Stanley & Co. LLC

Hi, good morning. So obviously a tough macro environment, as you mentioned, Indra, and org sales in the quarter were slightly below your full-year guidance. So I was just hoping for an update on your level of visibility you can hit 4% organic sales growth for the year, particularly as pricing moderates internationally with less FX pressure and you lap over some of the pricing changes in potato chips and A-beverages theoretically moderates a bit.

And then also, if you could, just comment specifically on the North American carbonated soft drink pricing environment, the 1% NAB result is below what we saw last year. So has anything changed from a competitive standpoint? Thanks.

Indra K. Nooyi - Chairman & Chief Executive Officer

Okay. In terms of visibility for balance of the year, again, Dara, we can talk about what we control. Our innovation pipeline is looking good. Remember, the first quarter is not really the season for international, because it's only two months; and so we're really entering the season now. And based on the innovation pipeline, based on the execution capability of our businesses, and knowing what we've sold into customers around the world both on retail and foodservice, at this point we feel optimistic about our revenue guidance for the year. Again, this is based on everything that we can control and based on our assessment of the tough macroeconomic environment as we see it today. So I'd say, as the year progresses, we'll know more, but we feel reasonably optimistic about our 4% earnings guidance for the year.

Hugh F. Johnston - Vice Chairman, Chief Financial Officer & EVP

Revenue.

Indra K. Nooyi - Chairman & Chief Executive Officer

Revenue – sorry, revenue. Pardon me. Let me now turn to North American pricing. Again, when we look at 1% pricing here, it's really rounded down. It was closer to 1.5%. And again, we're just now entering the season. So based on what we've seen in the marketplace, we actually see quite a lot of discipline in pricing. And our hope is that given the dynamics of the CSD category in particular that there will be continued discipline based mostly on revenue management and careful mix management. And that's what really what we're focused on. And our goal is to make sure that we don't do anything crazy on pricing, because pricing actions don't really drive volume growth. So we're just making sure that we focus on mix management and revenue management to keep getting the positive price utilization going through the year.

Hugh F. Johnston - Vice Chairman, Chief Financial Officer & EVP

Dara, to be also specific on CSD pricing, IRI showed 2.5% CSD pricing for the quarter. LRB was about 1.8%, which is consistent with what we've been seeing. So I think we continue to view the pricing environment as quite rational.

Operator

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

Indra K. Nooyi - Chairman & Chief Executive Officer

Good morning, John.

John A. Faucher - JPMorgan Securities LLC

Thank you. Good morning, everyone. Good morning, Indra. It was interesting. I realize that corporate expense was a little more favorable, which you mentioned in the call, but you guys – we saw a little bit less of an investment in SG&A this quarter versus what we've been seeing, let's say, over the past year and a half and really since the rebates back in 2012. So can you talk a little bit about where you think your investment levels are versus where you need to be and the balance between reinvestment and margin expansion as we look out over the next couple of years? Thanks.

Hugh F. Johnston - Vice Chairman, Chief Financial Officer & EVP

Hey, John. This is Hugh. I'm not sure exactly how you're measuring less investment in SG&A, so it's probably worth a conversation offline on that. What I can say is, number one, A&M was up 65 basis points year over year, so we continue to see a strong push into A&M. Number two, we do continue to invest in capabilities that enable globalization of best practices. And that's having a profoundly positive effect on both the innovation as well as the productivity of the company.

What I suspect you may be seeing is the impacts of Smart Spending, which is off to a very successful start as of late last year and into this year. Certain of the big buckets that we're focused on in Smart Spending, whether it be travel or facilities, are actually down by meaningful percentages. So I think what you may be seeing is the net of that reflects less margin invested in SG&A than you've perhaps seen in previous quarters. But I don't want you to think that we're not investing in the brands and we're not investing in capabilities that drive performance. We absolutely are.

Indra K. Nooyi - Chairman & Chief Executive Officer

We're committed to increasing A&M. We're investing in R&D, investing in e-commerce, the capabilities on supply chain so that we can start thinking about the future, data analytics. We've got increased investment in every bucket right now.

Operator

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

Bryan D. Spillane - Bank of America Merrill Lynch

Hey. Good morning, everyone.

Indra K. Nooyi - Chairman & Chief Executive Officer

Good morning.

Bryan D. Spillane - Bank of America Merrill Lynch

Hi, so just a question about I guess the mix in organic sales growth between volume and price/mix, and really just in North America and more a question going forward. Right now, we're seeing more of a contribution through revenue management I guess of price/mix, and you've supported that with product, with advertising. Just how sustainable do you think that is going forward over the next couple years? And I guess my question is just at some point will we need to begin to see maybe more volume growth in order to sustain that kind of organic sales growth, or are we comfortable that we can continue to have mix be a big component of the organic growth? Thanks.

Indra K. Nooyi - Chairman & Chief Executive Officer

Brian, I don't think there's a clear answer to that because it's like an accordion, we go back and forth. A couple of years you get volume growth and then a couple of years you get more revenue growth because you have more opportunity to do mix management. When we premiumize the portfolio, for example, we get more revenue than we do volume because you get very good price realization on premium products. And right now with the launch of lots of premium beverages and launch of premium products coming out of Frito-Lay, we're getting good price realization on that score.

And clearly when you do revenue management, even shifting to smaller packages, mini-cans, you don't get much volume lift but you get revenue lift. And I think as I look into the future, I think you're going to see some volume growth. You're going to see effective mix management, both from a revenue management perspective and the product portfolio itself, giving us robust revenue growth. A couple of years from now let's come back and revisit it, but right now that's the strategy going forward. And then we are very judicious in where we add capacity to make sure that we look at the realities of the volume growth in the marketplace.

Operator

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

William Marshall - Barclays Capital, Inc.

Good morning, thank you very much.

Indra K. Nooyi - Chairman & Chief Executive Officer

Good morning, Will.

William Marshall - Barclays Capital, Inc.

I was just curious. You alluded to the tough macro backdrop on a couple of occasions here. Two markets in particular that jump out, Brazil and Russia, and you've got fairly sizable businesses in both of those markets. I was just curious if you could give us a sense of what you're seeing on the ground, and how your business has been operating maybe compared to the broader challenges that we've seen from a macro perspective. Thank you.

Indra K. Nooyi - Chairman & Chief Executive Officer

Brazil is a tough, tough, tough market. It's fundamentally a good market. The population – the demographics are pretty good. And when the country performs well, things are good. But recently in the last I'd say 12 to 18 months, there have been a lot of self-induced problems in Brazil. And then the slowdown in China clearly has had an impact on Brazil because Brazil was the commodities supplier to the robust growth in China. And so it's going to take some time for Brazil to get through its issues, its own political problems, and then of course, the global commodity price slump right now. So we are cautious in our approach to Brazil, focused more on value products. And where we can get some premium pricing in, we try to get it in. But Brazil has been – I'd say globally, Brazil is one of the toughest economic situations today.

In the case of Russia, our core business is doing quite well because it's one of those markets where we have a spectacular portfolio, very balanced between all day parts, between good-for-you products, fun-for-you, better-for-you. It's a wonderful balance of products we have in Russia. And the Russian consumer is a good consumer, and we have a scaled business covering all of Russia.

I think two issues are impacting Russia. One is the ruble and where it stands because when you have dollar-denominated costs coming into Russia, clearly it squeezes the middle of the P&L. and you can't price enough to cover all of it because the Russian consumer, which brings me to the second point, Russian consumer wages are not going up as much as the cost of living bucket suggests it should go up. So there's a bit of a squeeze going on.

But all things considered, our team in Russia is mostly Russian, doing a very, very good job navigating through these issues in Russia. And I must say, but for these global macro conditions, especially the strength of the dollar squeezing the cost structure, we have a good business in Russia; and the team is doing a good job running it right now.

Operator

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

Indra K. Nooyi - Chairman & Chief Executive Officer

Good morning, Caroline.

Caroline S. Levy - CLSA Americas LLC

Good morning, Indra and Hugh. A question on the charge you took in China. If you could, just elaborate what's going on with Tingyi-Asahi Beverages and what you think for the outlook. So what drove the charge? What's the environment like in China, and what do you think the outlook is for your business there?

Indra K. Nooyi - Chairman & Chief Executive Officer

So let me start off by saying, Caroline, that Tingyi is still the leader in the beverage market in China; still has the most phenomenal infrastructure; widely covers China with all manufacturing technologies, cold fill, hot fill, aseptic, water lines, you name it. They are an amazing scale player and they remain a valuable partner to PepsiCo. I think Tingyi has been impacted by a couple or three issues. They're a public company. You've seen all their disclosures and announcements. I'm not going to share with you anything that you don't know.

But basically the slowdown in the Chinese market for beverages overall driven by the macros; and some of the operational issues that Tingyi has had to cope with because of the changes they were making to make their system more efficient has taken a short-term hit in performance. And I think the read-through has been that we too took a bit of a marginal hit in beverages in our performance as we've talked about openly in our earnings calls.

But having said that, within China we have a very good business in foods and nutrition and our beverage business sequentially is beginning to do better. So we remain cautiously optimistic. As far as our partnership with Tingyi is concerned, look, our ownership was based on a price that we recorded when we first did the transaction. Since that time the overall Chinese market has come down a lot.

And secondly because of Tingyi's own performance, their stock has come down quite a bit. And so we felt it was prudent to mark down the value of our investments. Having said that, we remain very committed to the Tingyi partnership. And once they get through their issues, which they have to get through, we can help them, but they're a public company, we'll be back to a partnership that continues to sing.

Operator

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

Indra K. Nooyi - Chairman & Chief Executive Officer

Good morning, Bill.

William G. Schmitz - Deutsche Bank Securities, Inc.

Good morning. Is it safe to assume that the pricing in emerging markets is going to lap in the back half of the year? And just curious for you and the industry kind of what happens when those laps take place? And then maybe if you could just sort of disaggregate the mix benefit versus the price benefit?

Hugh F. Johnston - Vice Chairman, Chief Financial Officer & EVP

Bill, this is Hugh. I think it's safe to assume that we'll continue to get good solid pricing in those markets. I understand what you're pointing out is as dollar-based commodities become less inflationary in local terms, will we continue to get the same level of commodity-driven pricing. It remains to be seen. Part of our pricing is obviously driven by commodities, part of it is driven by what else is happening in the local economy. To the degree that pricing is less, I do expect that we'll see some volume bounce back. Because in those markets when you have emerging consumers that are entering the categories, obviously as we take less price we tend to increase adoption more rapidly.

So I think we probably will see a bit more volume and a bit less price in developing and emerging markets in the back half of the year, but that remains to be seen. The outlook, as we've talked about earlier, is not just overly positive; it's also quite uncertain.

Regarding mix versus rate, I assume that's a North America beverage question because that's a tough one to answer globally. About two-thirds of the pricing benefit that we saw in the first quarter was rate, and about a third was mix. So we continue to see good balance. In fact, if anything, we've probably got a little bit more rate than we have been getting in the previous quarters.

Operator

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

Indra K. Nooyi - Chairman & Chief Executive Officer

Good morning, Judy.

Judy E. Hong - Goldman Sachs & Co.

Thank you. Good morning. So I guess on margin, if I look at the Q1 performance and then the outlook for the balance of the year, it seems like Q1 certainly benefited from very strong margin performance and then maybe the balance of the year you're really looking for very little margin expansion. So, Hugh, I know you went through some of the drivers, but if you could elaborate a little bit more just in terms of the Q1 bead. And particularly I think Frito had very strong margins and then how sort of that phasing works out for the balance of the year?

Hugh F. Johnston - Vice Chairman, Chief Financial Officer & EVP

Judy, happy to try to add a bit more on that. As I mentioned during the prepared remarks portion of the script, commodities were a little bit deflationary in Q1 because of the overlaps, particularly overlaps around the energy prices. Commodities will turn to a bit inflationary in the balance of the year. So obviously that's a drag on margins.

Number two, there were certainly some timing of expenses, particularly as it related to corporate expenses as I've mentioned. That gave us a big tailwind. Corporate expenses overall will be down in 2016, but they won't be down at the same rate that you saw in Q1. So for the balance of the year, it will spread itself out a bit more evenly. The net of all of that is I would expect less margin improvement in Q2 and Q3; and then you'll see stronger margin improvement again in Q4.

Operator

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

Indra K. Nooyi - Chairman & Chief Executive Officer

Good morning, Steve.

Stephen R. Powers - UBS Securities LLC

Good morning, thanks. I guess two, if I could. Hugh, you mentioned the worsening macro assumptions in your outlook versus a few months ago. Could you just talk maybe about where those incremental concerns are most focused? And then, Indra, picking up on your comments on new product innovations, could you update us on how much of your revenue is driven by new product innovation and whether that differs materially across divisions? And I guess also if there's a measure you look at to assess the longevity of new product contributions; in other words, differentiating between sort of short-term flavor extensions and more lasting successes like Kickstart has come to represent. Thanks.

Indra K. Nooyi - Chairman & Chief Executive Officer

Go ahead, Hugh.

Hugh F. Johnston - Vice Chairman, Chief Financial Officer & EVP

So I think the two places where we're probably incrementally less optimistic, number one is South America, not Mexico. Mexico, I think, we're quite positive on, but the balance of South America obviously is a challenge. And then number two is Eastern Europe. Eastern Europe is obviously continuing to be challenged from a GDP perspective and that flows through to disposable income and therefore to consumer spending on our products. The balance I think were probably roughly in line with where we've been.

Indra K. Nooyi - Chairman & Chief Executive Officer

And in terms of new products, Steve, typically what we look for is 9% of our revenue growth to come from new products and innovation. That's really what we targeted for ourselves this year, and we're running close to that number. Again, one quarter in innovation for the year does not make. So what I'm going to give you is what we expect the year to come in at. And last year, we came very close to that 9% number. And typically, what we look for within that is a 75% line extensions, what we call, refresh innovation, because news drives growth in this category. And then 25% we'd like it to be reframe and breakthrough, which is new platforms or substantially new packaging that can take the business to a whole new level. And again, across the world this number varies, but roughly speaking that's what we shoot for.

And the thing to be careful was about Kickstart was a new platform, but after a couple of years it becomes part of the base of the company, and then we have to rely on flavor extensions to continue to drive it. And so something that's reframe or breakthrough the first year after a couple or three years starts to go back into the base and starts getting counted in refresh. So really how we count innovation is really stuff that's been launched and is in the market for at least two years. And we look at the performance of that business on a rolling basis. So right now we're running at about 9%; and it's 75:25 refresh versus reframe and breakthrough.

Operator

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

Indra K. Nooyi - Chairman & Chief Executive Officer

Good morning, Ali.

Ali Dibadj - Sanford C. Bernstein & Co. LLC

Hey, guys, so three quick things, if I may. One is, if you could, just tell us about the impact of the deconsolidation of Venezuela on your organic top line growth and maybe even on your margins, if any. So as you're pulling it out, what was the impact on the organics?

Two is, if you could, give us some more – particularly for investors who remain concerned about price irrationality coming back in the U.S. Clearly it's just a little bit of Nielsen data, one quarter of what you said rounded down. But can you give us more to those investors about why you think you need to continue being price rational in the North American market? I field those questions all day, so I'd love to hear from you.

And then third is just Tingyi as a jumping off point. If you can, characterize the problems there that you described earlier. How much of it was macro stock market broad issues versus the PepsiCo-Tingyi partnership, that 3P, third-party type partnership, and if that means anything differently in the way you guys view the way you want to distribute on a global basis with third parties. And I think specifically, for example, about Brazil beverages woes historically and ABI-SAB obviously coming together, but just broadly as well. Thank you for those.

Indra K. Nooyi - Chairman & Chief Executive Officer

Hugh, do you want to talk about the impact on Venezuela or Venezuela?

Hugh F. Johnston - Vice Chairman, Chief Financial Officer & EVP

I'm happy to. Ali, revenue on Venezuela was a point, not meaningful on margins.

Indra K. Nooyi - Chairman & Chief Executive Officer

Let me talk about pricing. Ali, I can only talk about what we're going to do. Our belief is that it's very important that you really execute price rationally in the market because when you drop the price too much, it doesn't drive that much consumption growth, volume growth. I think we're at a point in the market in many of our categories where you can grow the business through premiumization, real innovation. But just playing a price game does not drive volume growth and it actually destroys value. So that's our strategy and that's the playbook that we're going to execute.

Let me turn to Tingyi. I think I gave you a pretty complete answer when Caroline asked the question, but let me just add to it. You've seen the Tingyi results, you've heard their call, you've heard all of the news that comes out of Tingyi, so I'm not going to talk about a public company that announces its results on its own. I'll just tell you that from my perspective or our perspective, clearly macroeconomics has played a role. I think Tingyi itself is trying to retool itself to become more efficient. And whenever you're going to do a transformation or retooling, there is going to be disruption in the business.

And finally, the PepsiCo-Tingyi partnership started off very well and I think it will come right back to where it was intended to be. The transition where we consolidate distribution systems, where we sort our products between PepsiCo-oriented distribution system or premium products oriented distribution system versus a value-oriented product distribution system, that transition is taking a little bit longer and it's a little bit more painful. I wish it could happen faster, but that's the reality of what we're living with because the slowdown in the macros has not helped either. So from a Tingyi perspective, as I said, we remain optimistic, and we just need to power through this and provide the help in terms of capabilities and knowledge transfer to them so they can get through the difficult period.

And I don't think Tingyi is indicative of any problems on a global basis. I'll tell you something. We have hundreds of partners globally in the beverage business. At any point, some percentage of those bottlers go through issues. That's the same for any company in this beverage business. And the strength of the franchise company is how do you help that bottling entity recover from its issues given that we operate COBOs [Company Operated

Beverage Operations] and we have a reservoir of capabilities. That's really what we're doing it, taking people from our established COBOs, sending them into these bottler businesses to help them improve their performance. So I don't see any major red flags here, Ali.

Operator

Your next question comes from the line of Robert Ottenstein of Evercore ISI.

Indra K. Nooyi - Chairman & Chief Executive Officer

Good morning, Robert.

Robert E. Ottenstein - Evercore ISI

Hey, thank you. Thank you very much. Good morning. A couple of questions. You noted in most of the segments that you're starting to face now some operating cost inflation. Is that primarily wage inflation? Can you give us any more details on that please?

Hugh F. Johnston - Vice Chairman, Chief Financial Officer & EVP

The biggest factor in that is wage inflation. Recall, when we've talked about in the past, we have about $28 billion in operating expense. Roughly half of that is labor; and outside the U.S. labor is obviously inflationary, it's just based on local inflation rates.

Operator

Your next question comes from the line of Kevin Grundy of Jefferies.

Kevin Grundy - Jefferies LLC

Good morning.

Indra K. Nooyi - Chairman & Chief Executive Officer

Good morning.

Kevin Grundy - Jefferies LLC

A question for Hugh on North American profitability and margins there in your line of sight for improvement. So this is kind of a broader question for you, but I was hoping you could kind of briefly touch on what's the margin ambition in Frito? Can that be a 35% operating margin business over time? Quaker would seem like there's a significant opportunity there now without the Muller JV weighing on it. Can that return to a 30% operating margin business? And that would seem like that could happen over a much quicker period of time without that weighing it down. And then if you could briefly touch on NAB as well, which is a bit more difficult given the vertical integration there with bottler ownership. So any commentary there? I'm sorry that's a bit broad-based, but would be helpful. Thank you.

Hugh F. Johnston - Vice Chairman, Chief Financial Officer & EVP

I'm happy to do that. As you all know, we don't give division-specific margin guidance. It just gets into a level of granularity and detail that's probably more confusing than helpful. That said, I would broadly say all of our North American businesses have the potential to continue to see improved margins. How are they going to do that? Number one, it will be through our broad-based supply chain productivity programs. We continue to take cost out. Particularly moving from the plant to the store, we're getting more and more efficient at operating that distribution network.

Number two, Smart Spending continues to present an opportunity to enhance margins; and again that occurs across all of our businesses. And number three, as Indra pointed out earlier, we continue to see a lot of opportunities to premiumize our products. With those premium products come good price points. And once the products are in the marketplace and the A&M has normalized on those new products, you can expect to see those earn premium margins over time.

So, again, I don't want to get into specific division level margin guidance, but I do believe that all of our North American businesses will continue to see margin improvement over time.

Indra K. Nooyi - Chairman & Chief Executive Officer

So with that, thank you all for your questions. And in closing, let me just say we're off to a good start. We're confident that we have the right plans in place and we will continue to execute to the best of our abilities. We look forward to updating you on our progress as the year advances. Have a great day. Thank you.