Good morning, and welcome to PepsiCo's Third Quarter 2012 Earnings Conference Call. [Operator Instructions] Today's call is being recorded and will be archived at www.pepsico.com.

It is now my pleasure to introduce Mr. Jamie Caulfield, Senior Vice President of Investor Relations. Mr. Caulfield, please go ahead.

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 performance and our balance-of-year outlook, and then we'll move on to Q&A.

In an effort to get through as many analysts' questions as possible within the hour, we're doing 2 things today: first, we've shortened the amount of time for management's prepared remarks; and second, we're going to have a one-question limit so we can hopefully get through the full queue of analysts' questions.

Before we begin, please take note of our cautionary statement. This conference call includes forward-looking statements, including statements regarding 2012 guidance based on currently available information. Forward-looking statements inherently involve risks and uncertainties that could cause our actual results to differ materially from those predicted in such forward-looking statements. Statements made on this conference call should be considered together with our cautionary statements and other information contained in today's earnings release and in our most recent periodic reports filed with the SEC.

Unless otherwise indicated, all references to revenue, EPS and division and total operating profit growth are on a core basis. In addition, references to organic results in this call exclude the impact of acquisitions and divestitures and foreign exchange translation.

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

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

Indra K. Nooyi

Thank you, Jamie, and good morning, everyone. I'm pleased to report that we continue to make progress against the plan we shared with you earlier this year.

Let me give you the headlines on our progress for the quarter. Our Asia, Middle East, Africa division had an excellent quarter across-the-board. Europe delivered solid results with very good pricing. Frito-Lay North America and Latin American Foods had good volume growth and net price utilization. And within Pepsi Americas Beverages, we gained value-sharing carbonated beverages while executing a much-needed cleanup of unprofitable segments of our noncarbonated portfolio.

And across our businesses, we continued our stepped-up brand investment programs, heightened focus on innovation, productivity and execution and cash returns to you, our shareholders.

Our financial results for the quarter were in line with our expectations. Core EPS was $1.20. Our 5% organic revenue growth reflected organic volume growth of 1% and positive price mix of 4%, which helped to offset steep commodity inflation. And our organic net revenue growth for the quarter is right in line with our year-to-date performance and they're on track to deliver the mid-single digit organic revenue growth target we shared with you at the beginning of the year.

So overall, our results for the quarter and year-to-date, as well as the outlook for the remainder of the year, are right on track.

So let me comment on each of our business units, share what's working and what we are pleased with and what aspects of the businesses we are still making progress on but remain work in process.

Frito-Lay North America delivered a strong quarter. We saw a 3% organic revenue growth in the quarter, and our brand equity scores continue to strengthen. Our premium products gained share in the quarter, and the increased advertising behind our mainstream products is strengthening our performance. Our value share trends have sequentially improved throughout the year and Q3 was no exception. And as we enter Q4, we are seeing that trend continue.

Our Quaker Foods business also had a good quarter. We are gaining share in hot cereal, driven by both increased advertising and breakthrough innovation with Quaker Medleys. The oatmeal category is very much on trend both in the United States and globally, and you can expect us to leverage our global groups to take innovation like Real Medleys around the world.

Our Latin American Foods business delivered strong volume and double-digit organic revenue growth, and we continue to invest in routes and racks to support the robust growth in these markets.

In Europe, we had strong performance with organic net revenue up 7% on 6 points of net price realization despite a challenging macroeconomic environment. Our performance is a result of both the portfolio strategies that we've executed, including our move to strengthen our presence in the faster-growing eastern European region coupled with good operating execution to capture growth opportunities.

Our AMEA performance for the quarter was outstanding with strong volume growth, double-digit organic revenue growth and 14% core constant-currency operating profit growth. The strong results were across both our snacks and beverages businesses. For example, in India, our snack volume grew 12% and our beverage volume grew 23%. In Pakistan, our snack volume grew 27% and beverage volume grew 25%. Beverage volume grew 34% in Vietnam, 10% in Saudi Arabia and 7% in the Philippines. And in China, the Tingyi integration is substantially complete, and we've seen volume growth accelerating every month since June. The fourth quarter is off to a strong start with CSD volume up 15% in the month of September.

Our North American beverage performance was mixed, some positives and a few areas that are works in progress. As we look at Q3 performance, keep in mind that we had one fewer trading day due to the timing of Labor Day, which impacted volumes by 1 percentage point. On the positive side, I am pleased with the discipline we've maintained on pricing. We achieved 3 points of positive price mix in the quarter. And we are pleased with our carbonated soft drink performance. Based on the IRI all channel data, we gained both value and volume share in the quarter. So even at higher pricing at retail, we grew our volume share. Our brand equity scores are strong, and our brand-building investments are working.

Our noncarbonated beverage performance in North America was more challenged, driven by 3 factors: first, we cleaned up our juice portfolio by pulling out of unprofitable juice drinks; second, we made deliberate decision not to compete in case-packed water at unprofitable pricing levels; and third, Gatorade's performance was off this quarter, which was really a function of competitive pricing actions and an inventory outage at one of our major accounts. Q4 is off to a good start, and we expect the business to be positive for Q4.

So we are being deliberate about where we're choosing to compete and about maintaining disciplined pricing. Our objective is to grow beverages profitably in North America and we're making the right decisions for the long-term health of the business.

Across PepsiCo, we continue to make good progress on the brand building, innovation, execution, productivity and cash-return initiatives that are key elements of our long-term plan.

From a brand perspective, we continue to increase the level of effectiveness of our advertising through our global campaigns by directing more of our spending to consumer-facing media. We are seeing positive results already, but as we've mentioned in the past, these investments typically take a year to fully take hold. We are 6 to 8 months into the program and I'm pleased with our steady improvement in brand-building initiatives. We'll be back to you on the fourth quarter call with another update on the specific brand equity performance just as we did on the second quarter call.

Innovation has been solid across our businesses and was a key driver of our organic net revenue growth in the quarter. Our global beverage, snack and nutrition groups are having a positive impact. They are making good progress in refresh, reframe and breakthrough innovation and that's reflecting the solid top line growth we've seen over the past few quarters and the fact that our innovation, as a percentage of net revenue, is now running at approximately 8% of sales. In particular, I am pleased with breakthrough products like Quaker Real Medley, Pepsi Next and Gatorade Energy Chews, which have continued to steadily build during the quarter. We're on track to deliver in excess of $1 billion in productivity this year and to deliver our 3-year target of $3 billion. We're driving productivity across the entire value chain across all our businesses and have a robust pipeline of projects that span from best practice sharing to increased automation to new processing technology, which all give us confidence that we will achieve our 3-year target.

And we continue to execute well. A good example is our activation of our partnership with the NFL. We are building on our 28-year relationship with the NFL, one of the world's most valuable sports properties. We are integrating on execution activities from national advertising to localized packaging, in-store activities and promotions. The national ties between the NFL and PepsiCo are happening across our portfolio, from Gatorade to Pepsi and Lay's to even Quaker and we're leveraging them both using traditional and social media. And at the local level, we're bringing them to life in the marketplace with team-specific packaging and merchandising displays in 22 of 32 team markets. We also have retail store managing incentives and player appearances right through to the stadium with beverage and snack time promotions. In short, the connection between the NFL and PepsiCo is bigger and better than ever and enabling us to convert fans' passion for their teams into passion for our products.

We'll cap off the season's partnership with the NFL by having Pepsi as the official sponsor of the Super Bowl's halftime show. And just yesterday, we announced that Beyoncé will be the featured artist, so it will be a performance you just don't want to miss. This is just one of the many examples of our sharpened execution and it's one of the reasons why we are making steady progress on improving our share results.

Finally, we are making progress to drive higher returns on our invested capital and enhance shareholder return. We're delivering our earnings goals and we're converting them to stronger cash flow. We've reduced our net capital spending this year by $565 million year-to-date. We've returned $4.8 billion to shareholders through dividends and share repurchases year-to-date, a 12% increase over the comparable prior year period and remain on track to return more than $6 billion for the full year.

Overall, in a cautious consumer and retail environment in developed markets and generally strong consumer conditions in the developing and emerging markets, we continue to build our businesses in a fundamentally sound, focused, consistent manner. Our balanced portfolio of Fun-for-You, Better-for-You and Good-for-You products positions well with consumer trends. And our investments in brand building, innovation and execution are working well and enhancing both our competitiveness and capability for margin-accretive, sustainable growth in the future.

To recap. We are pleased with our year-to-date progress in this reinvestment year and are executing well against our plan. Overall, our Q3 and year-to-date results give us confidence that we're on track to deliver a full year of financial targets for 2012. Just as important, our growth is balanced and reflects the successful execution of our strategy.

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

Hugh F. Johnston

Great. Thanks, Indra, and good morning, everyone. As Indra mentioned, the quarter came in, in line with what we were expecting. Organic net revenue growth increased 5% while our reported net revenue declined, reflecting the structural changes including Mexico and China, which reduced the reported number by approximately 5 points and by negative currency translation, which was a 5-point drag on the reported net revenue. We realized 1 point of organic volume growth and 4 points of effective net pricing globally. Core gross margins rose 56 basis points, driven by our effective net pricing and productivity initiatives, offsetting commodity inflation. And core division operating margins were down by 13 basis points, reflecting a substantial increase in advertising and marketing investment to grow our brand equity.

All-in and in line with expectations, this resulted in a 3% decline in core division operating profit on a constant-currency basis and a 6% decline in core division operating profit on a U.S. dollar basis, reflecting a nearly 3-point drag from currency.

Core corporate unallocated expenses increased in the quarter, reflecting higher pension-related costs and a deferred compensation charge that was offset by a corresponding credit reflected in net interest expense.

Net interest expense was $181 million for the quarter, a decrease of approximately $28 million over Q3 of 2011. The impact of higher debt balances was more than offset by lapping a debt tender premium included in the prior year and by the deferred compensation hedge credit I just mentioned.

And our core tax rate for the quarter was 26.3%, which is 90 basis points higher than the rate in Q3 of 2011.

And finally, our fully diluted share count was down 2% in the quarter compared to the prior year period, reflecting the impact of our share repurchase program.

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

Turning to our outlook. From an earnings perspective, consistent with our previous outlook and what we've been saying since February, we expect our core constant-currency EPS to decline 5% for the year. We're on target to increase our investment in advertising and marketing to 5.7% of revenue this year, an increase of 50 basis points over our investment level last year.

Now I realize that EPS for the first 3 quarters came in a bit ahead of consensus estimate, but you should not flow that through to the bottom line as you update your full year models. Our intention is to reinvest any upside into the business to support and accelerate our brand building, innovation and productivity initiatives.

Based on current ForEx market consensus, currency translation would have approximately 3 points unfavorable impact on our full year core EPS, and we expect the core tax rate to be approximately 27% for the full year.

As you update your models for the fourth quarter, you should be mindful of a few items in particular. The impact of structural changes will have an approximate 2.5-point negative impact on revenue. ForEx is expected to have an approximate 1 point negative impact on revenue and operating profit. We anticipate both commodity inflation and price realization to moderate somewhat in the fourth quarter from the level we saw in Q3.

We're lapping several divestiture gains from Q4 of 2011, most notably the sales of several unrelated businesses within QFNA and LAF and the sale of our interest in a bottler in AMEA.

Corporate unallocated expenses in Q4 are expected to be higher than in Q3 due to the fact that Q4 is a longer reported period, so we have 4 additional weeks of costs in the fourth quarter as compared to the third quarter.

Net interest expense is expected to be higher year-on-year in Q4, given higher debt balances and higher rates.

From a cash flow standpoint, year-to-date reported cash generated by operating activities was $5.1 billion, which includes a $1 billion discretionary pension and retiree medical contribution that we made in Q1. Reflecting our capital spending productivity initiatives, net CapEx is down $565 million year-to-date and down more than 120 basis points as a percentage of revenue on a rolling 4-quarters basis.

In addition, our operating working capital also improved year-to-date with net working capital on receivables, inventory, prepaid expenses and payables improving by $685 million year-on-year.

Our management operating cash flow, excluding certain items, improved by $670 million to $4.9 billion year-to-date.

For the full year, we expect to generate more than $6 billion in management operating cash flow, excluding certain items, and return more than $6 billion in dividends and share repurchases.

Net, the quarter came in where we expected. The pricing picture and volumes overall were positive, and our outlook for the year for earnings, cash flow and cash returns is completely consistent with what we've shared previously with you.

Operator, we'll take the first question.

Question-and-Answer Session

Operator

[Operator Instructions] Our first question is coming from Bryan Spillane of Bank of America.

Bryan D. Spillane - BofA Merrill Lynch, Research Division

Just a question on Americas Beverages. Just if -- just want to understand the drag that you saw in the quarter in the noncarb portfolio relative to the inventory outage, I guess, on Gatorade and also calling some SKUs. Does that also continue into the fourth quarter and 2013, or is that just a 3Q effect?

Indra K. Nooyi

It's a 3Q effect.

Operator

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

Dara W. Mohsenian - Morgan Stanley, Research Division

I was hoping for more detail on your progress so far with the Tingyi alliance, and specifically I'm curious for how much progress you've made in terms of expanded distribution so far and how distribution expansion plays out going forward over the next few quarters.

Indra K. Nooyi

So the Tingyi deal was closed in the early part of second quarter. And through June, July and August, we went through the integration process. And starting sort of June, July, we started seeing the volumes pick up because the integration activities were completed. And in September, we actually saw the CSD volumes grow 15%. Now September is the first month in Q4, so it's not in the Q3 numbers. We haven't yet started to reap the benefits of the increased Tingyi manufacturing footprint because we haven't yet pulled the [indiscernible] lines in the new Tingyi plant. So the benefit you're seeing now is just the benefits from our own brand equity and our focus back on the business now that the integration activities are over. On the reported number, you saw volumes in AMEA up significantly, that's because some of the juice volume that we have transitioned to Tingyi and everything got rebranded as Tropicana, so you'll start seeing an acceleration of our noncarbonated beverage business starting Q4 and going into 2013. As we've mentioned before, the alliance between PepsiCo and Tingyi creates the largest beverage company in China with a 1.5 to 1.6 relative market share of -- versus the next largest competitor. Between us, we will basically cover the entire country and have over 70 plants between the 2 of us in China. So I think us going into 2013 and forward, this business is going to look very, very good.

Operator

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

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

Wanted -- just want to ask about Frito. So as we look at this, you're getting a little bit of volume growth, a little bit of positive price mix. From what we can tell from the scanner data, you're losing a little bit of share within the category. So can you talk about sort of what you're willing to do in terms of going after the higher end and in terms of getting the shares up? And how much do you view Frito as look, we'll take the top line and the share growth is less important, or do you feel like you need to fight back a little bit more aggressively to stem some of the share declines? And can you also comment on shares in C&G relative to shares in large format?

Indra K. Nooyi

John, I'm just going to give you some overall comments and then toss it to Brian Cornell who's here. Frito-Lay, as we mentioned in the script, we're seeing sequential improvement in shares Q2, Q3, and in Q4 we're actually in the positive territory. So we feel very, very good about it. Second, we talked about the premium business, the value business and the mainstream business. The good news is in premium, we are now gaining share; mainstream, the share is stabilized and now getting into positive territory. And we want to make sure we crack the code on the value business in a responsible way without diluting anything we're doing in the mainstream business. We are focused on share. We do not intend to lose share on a consistent basis. We are the category, so we are looking at ways that we can keep the share progression and remain in the positive territory. So let me turn it to Brian to give you a little bit more color on Frito-Lay and also talk about the convenience trend.

Brian C. Cornell

Sure. Well, John, as Indra mentioned, we really felt like Tom and the team delivered very strong results in the third quarter. That team is focused on balancing both profit volume and growing share. And I think some of the investments we've made in the first half of the year really started to pay dividends in the third quarter. Our investments in brand, in innovation, our continued focus and execution delivered 1% pound growth. We saw that translate to 3% in revenue. And despite a 41% increase in our advertising expenditures, we grow our [indiscernible] by 1%. So we're starting to see that deliver stability and share. And as I look at our share over the balance of the year, we expect to see sequential improvement continue. We were very pleased with our share performance at T10 [ph], both from a value standpoint, but importantly from a volume standpoint. And that increased pound growth is turning into an increase in our overall volume share. So we feel like we're on the right track. We've taken a very disciplined approach at Frito. We got our pricing in the first half of the year, but we're now seeing pound growth, revenues increase and stability and share improvement from a volume standpoint. So I really feel like we're on track at Frito and we expect to see sequential improvement in the fourth quarter. John, you also asked about some of the overall trends, and before I just jump into C&G, why don't I just give you a general sense for the food and beverage landscape in the third quarter. Overall, we did see food and beverage trend soften in Q3. And if you remember, the second quarter report, as we started talking about these new [indiscernible] results, the overall food and beverage growth was 3.9% in the second quarter. That softened to a growth rate of 2.4% in Q3. That was largely driven by soft trends in grocery, and we did see grocery soften to only a 50 basis point growth rate in the third quarter. That was down from growth of 1.4% in Q2. C-store continues to outperform the overall food and beverage trends. And again, in the third quarter, C&G was up 4%, so continuing to outperform the overall food and beverage trend. And as Indra mentioned, we continue to see big growth in that value segment and dollar continued to drive very strong growth. It was up 16.1% in the second quarter and actually increased its growth rate in Q3 to 18.3%. So overall at Frito, we feel like we're on the right track. We're looking to balance our focus between maintaining and growing our position in the mainstream. Indra mentioned we've been focused on accelerating our performance in premium. And in a category that grew 16%, our performance in premium was up 17%. So we're building share in those important categories and we're focused on our portfolio performance in the value segment. But overall for Frito, a very solid third quarter. We feel like we're building sequential performance as we go into Q4 and we're balancing that with the changing retail landscape.

Operator

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

Kaumil S. Gajrawala - UBS Investment Bank, Research Division

If I can ask also about China and maybe a 2-part question. The first is if you'd like to give just some context on what you're seeing from a macro perspective. And then second, your results are quite different from what we're seeing with some other companies in the region. So can you talk maybe about the sustainability of the strength you're seeing in China. And then maybe, is there -- was there anything that was, short term, maybe incremental distribution or anything in 3Q that may not continue forward in the next year or so?

Indra K. Nooyi

So Kaumil, I'm going to start with the last question you asked and then work my way backwards. First, there was nothing in Q3 that was a result of increased distribution because we haven't even begun to reap the benefits of the increased distribution that, as I said earlier, will come in the first quarter of 2013 and forward. So what you're seeing is just the strength of the brand and our innovation in China. That's the first observation. Second, both our snacks and beverage businesses are growing very nicely. The snacks business was always growing well. The beverage business, for a quarter or 2, went through its transition pains, but we're through with that and the business is back to growth. And so we feel good about China business overall. Being in partnership with Tingyi has really strengthened our franchise massively and given us instant access to the whole country. And once we've put the right manufacturing lines in Tingyi's plant, remember, we only had about 20 plants in China. Tingyi has got over 50 plants, so the combination gives us complete coverage of China. And so the combination when once we've put the [indiscernible] lines in Tingyi plants is going to give us a real boost in the coverage in China. Let's talk about the macros in China. I've been there 3 times this year, Kaumil, and I'm back in China next week. If you are on the ground in China, you don't really sense the slowdown. If GDP slows down from 9% or 10% to 7% to 8%, from a country's perspective, when you're trying to get more and more people out of unemployment into employment and then trying to address underemployment, it matters a lot. But from a consumer product perspective, especially on small ticket items, which are very basic food and beverage products, you don't really see the impact in our categories. And in every city that I've been in China, and I've crisscrossed the country, there is buoyancy, there is a certain optimism in the country. Of course, everybody would like the growth to go back to 9% or 10% in China, but at 7% -- 7.8%, I still think China is performing at the peak of its game versus all of the other countries in the region or in the world today. So macro is a bit slow but certainly not impacting our categories at this point.

Operator

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

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

I just wanted to go back to the Frito question. And I understand the volume trend has improved sequentially this year, but pricing has also moderated. So when we hear you say you're on track with Frito, I'm just wondering what kind of organic revenue and profit growth that is really realistic for this business to kind of deliver in more normalized inflationary environment. Is it sort of 3% revenue, 5% kind of profit growth or can we get back to kind of mid-single digit, 6%, 8% kind of profit growth that we saw in prior years? And what is really needed to kind of get Frito to that position?

Indra K. Nooyi

Judy, Hugh is going to take this question and then, Brian, you can chip in with any additional comments you might have.

Hugh F. Johnston

Yes. Judy, why don't I start on the questions you're asking specifically about Frito's algorithm going forward. As we've talked about in the past, we don't share division-specific algorithms. We think we wind up getting into a level of conversation that, frankly, isn't productive for everyone as we get to quarter's end. That said, in general, I think you can expect to see, as commodities normalize, you can expect to see Frito go back to a more normal type of an algorithm. Obviously, it's been more price-driven as we've seen exceptional commodity inflation. As we see commodities normalize, as the business both does well in mainstream and continues to gain share in the premium segment, you can expect to see an algorithm that's a little bit closer to what we've traditionally delivered in the past in Frito-Lay. Brian, I don't know if you want to add any color to that?

Brian C. Cornell

I think you've captured -- I think as we go forward, you're going to continue to see us take a very balanced approach. We recognize the importance of growing pounds. We want to continue to make sure we're managing pricing appropriately. And we think that'll yield through our productivity initiatives, expansion of our [indiscernible] margins. So as we go forward, you'll continue to see our strategy focused on building our mainstream portfolio. Our investments in brand and innovation are going to continue to solidify that position. We believe we can accelerate our position in premium, you're seeing that take place today. And we're very pleased with the performance of brands like Stacy's as we move into the fourth quarter. And we'll continue to make sure that we participate appropriately in the value segment. So we're going to stay very focused on executing that agenda, continue to invest in our brands, in innovation, making sure that our execution continues to improve at the point-of-purchase and as a company that's very focused on its productivity initiatives. So a very consistent strategy as we go forward.

Operator

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

William Schmitz - Deutsche Bank AG, Research Division

Can you just give us an outlook on Pepsi Americas Beverages, when you think volume growth is going to resume? I mean will it be as easy as when the pricing starts to lap, volumes should come back? Or has there been a change in some of the elasticity curves? And then if I could just sneak in one more. Can you just tell us what Gatorade grew in the quarter?

Indra K. Nooyi

Hugh?

Hugh F. Johnston

Yes. So, hey, Bill, why don't I start and then Al is here with me and he can add a bit as well. In terms of determining when volume growth is going to resume, again we're getting back to sort of decision -- division-specific guidance. It's a place that we really don't want to get into on a broad-scale basis. I do think that we look at the volumes, we look at our portfolio. As commodities normalize, we think the category is still overall LRB, probably has a little bit of growth in it. And in terms of our portfolio, there's no reason that we wouldn't be able to hold share in that environment. So a lot of the question of when is going to be driven by commodities and what happens there. But I do think that we think the category has got a little bit of volume growth in it and I think our portfolio positions us well to hold share within the category.

Indra K. Nooyi

But I should add another thing, Hugh, in that we've always said we want to grow this beverage business profitably. And this year was a big reinvestment year. We invested significantly and there was commodity inflation. But going into next year, we want to play this game in North American beverages very responsibly and make sure we're generating profit growth. So it's important we don't chase unprofitable businesses, unprofitable categories. For example, bottled water. There was hell of a price war going on in bottled water, so we chose not to play in the unprofitable segment of bottled water. We did a real portfolio scrub and we said, hey, terribly unprofitable businesses, which were chased many, many years ago for the sake of volume share, which everybody was maniacally focused on as opposed to responsible volume share, we got out of. Very painful decisions, but we got out of that. And Gatorade was down high-single digits in the quarter, but I would say a bulk of that was an inventory problem at a certain customer. As we go into Q4, we're already in the positive territory. And again, what we want to make sure in Gatorade is that we don't make the mistakes that we made in the 2004, '05, '06 time frame where we grew it as a general hydration product as opposed to a sports nutrition product. Because if we go back to that strategy of just selling it as a everyman's hydration and just another beverage, we're again renting volume. We've been there, done that. So we want to make sure we're going after the active thirst occasion, going after the athlete, sustaining our pricing and then flanking our core Gatorade product with innovation. So that's the strategy we're going to pursue in Gatorade. And we're going to focus on the overall beverage portfolio going into 2013 as opposed to looking at one category or the other. The good news is we started with carbonated soft drinks. It's going well. We are holding volume share and value share. So we're feeling good about that. And now we'll start working the other parts of the portfolio. Did you want to add anything?

Hugh F. Johnston

I'd just add this, just a quick thing. Our overall Pepsi-Cola business, our overall beverage business, and our bottling system, our company-owned as well as our franchise bottling system, was actually right in line with Q2. And our CSD trends are actually better with an improved share. Now, the Gatorade business was the big drag on our non-carb business in Q3. Some of that we knew was going to happen because we were lapping a time when we put DSD Gatorade out on our route trucks in the drug and the dollar channels, so we ended up having to lap that business and we knew that would probably happen. But we also chose to not participate in some deep discounts that we had on Gatorade from a year ago. And while it was painful, this is a year we're trying to clean up that portfolio where we're not renting share and getting into promotions that we really can't sustain the volume. So right after the summer was over with, our Gatorade business has moved back to a growth territory. And the way we think about Gatorade right now is it can grow through 3 steps: one is what I call solid, hybrid EDV [ph] pricing where we're competitive, but we're reasonable on the shelf every day. The second thing is advertising that's effective. And I think if you look at this RG3 advertising that's being played out on a lot of the NFL shows and also on the baseball playoffs, that's the kind of advertising that works for Gatorade. We're getting very good consumer response from it. And then finally, product news. And these new Chews are doing a terrific job, but they're small. We have plans next year for improved product news on the base Gatorade business that I think will add some growth. So all in all, it was a short-term blip for Gatorade and I expect that, that business will be solid for the balance of the year.

Operator

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

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

So one quick clarification on the core question, just a quick clarification in terms of the stuff you pulled out in terms of cleaning up the juice and not playing in water, why that's just a Q3 effect versus going forward. But the core question is if you take all of the explanation, that face value from a PAB volume perspective in this quarter, or even FLNA and how you're thinking about that and you translate that forward, do you think you're going to have to invest more in this category to get the results you're getting now? Or do you think you're at the right level of investment for the types of growth you're seeing in those categories, underlying, taking away all these outages on inventory and all that sort of stuff?

Indra K. Nooyi

Ali, I believe that we are investing at the right amount in this business. What we talked about is stepping up our advertising from 5.2% to 5.7% this year and then we said over the next 3 years we're going to increase that steadily, okay? And at this point, we feel good about where we are. The other thing we're doing is advertising money that sat with our bottling partners, our joint venture partners. We're making sure that's also being deployed the right way and that's not even included in the 5.7% numbers. So I think, taken together, all the marketplace investment that we have in the marketplace today, the fact that we're shifting more nonworking media to media -- working media and that we are focusing our portfolio down to 12 muscular brands, I think all of that is really driving results for the business and we feel good about the progress. Now all of this is for naught if we don't back it up with good innovation. So our global groups are focused on innovation and not just rifle-shot innovation, more platform innovation and focusing on refresh, reframe and breakthrough. And I think this sort of a deliberate focus on innovation, deliberate focus on execution and brand building is beginning to yield results. And what we have to make sure is that we don't chase or we don't try to chase volume growth at all costs. I think historically the strategy has been for many people in this industry to go after volume growth at all costs. So bottled water was fair game, going after value snacks without regard to responsible portfolio management was sort of the right thing to do for the segment -- for the category. I think going forward, especially large companies like us, branded companies like us, we have to think through carefully which parts of the portfolio we actually add value. And that's why I think we're playing a much more focused, deliberate and differential game going forward.

Operator

Your next question comes from the line of Mark Swartzberg with Stifel, Nicolaus.

Mark Swartzberg - Stifel, Nicolaus & Co., Inc., Research Division

To continue the conversation on Americas Beverage, could you give us the actual numbers for carb and noncarb in North America? And then more qualitative, perhaps for you, Al, still on track for your plans to decrease promotions around key holidays and using the fourth quarter to kind of lay the structural foundation for that for next year?

Hugh F. Johnston

Yes, Mark, this is Hugh. The numbers on sparkling and on noncarbs, sparkling was down 2, but as we talked about, we do have a timing difference in terms of the quarter. And in terms of the impact on that, when you work your way through that timing difference, the down 2 is closer to flat once you sort of take out that trading day piece. So we think on carbonated, we were basically in line with primary competition. Noncarbonated was down 7, which was obviously much -- a much deeper number. And the reasons were exactly the ones that Indra shared earlier: number one, we made some changes in terms of some unprofitable juice drink businesses that we had; number two was there were some pretty aggressive case-packed water deals out there that we chose not to participate in; and then number three was the Gatorade issue that we've been talking about. Going forward, the Gatorade issue is behind us. As Al has referenced, we're back to growth in the fourth quarter. In terms of the unprofitable juice, I think we're largely past that now at this point. That overlap is also largely behind us. Case-packed water, as Indra mentioned, our stance is going to be consistent on that. We're not interested in chasing unprofitable case-packed water deals. So given all of that, we'd certainly expect to see the noncarb numbers pick up on a go-forward basis and that's how we're thinking about it.

Albert P. Carey

Mark, the other part of your question was about the tremendous amount of volume done on promotion in the category. It's not just us, I think it's the overall category. And the answer is, we're moving to what I call a hybrid

EDV [ph] pricing strategy. It's a tricky thing to implement, so you can't do it overnight. But I think towards the end of the fourth quarter, you'll see more of that and certainly in 2013.

Hugh F. Johnston

And that'll benefit, we believe, pricing flow-through within the PepsiCo P&L. We think it's the right strategy.

Operator

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

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

Couple of questions. But I'm actually going to ask about your thinking in North America Beverages. First, I think you said that you'll examine all underperforming assets and you've done that with Mexico, done it with China very successfully. Can you update us, Indra, on your thinking on North American bottling ROIC, et cetera? And separately, energy drinks are taking market share in CSDs and they seem to be, to some degree, the drink of the youth today. What's your position on energy drinks?

Indra K. Nooyi

On energy drinks, I think the way we'd like to play the energy drinks is in a more responsible way, maybe I should use that word. We have some interesting launches that we have next year on the cards, which plays it in a way that is consistent with our product portfolio and consistent with where we think consumers want to go with energy. So I think that's the right strategy for energy and you'll see some of those launches coming to the marketplace next year. There's no question energy drinks took share from mainstream players. But I think that's not a strategy that any of the big companies could have deployed and been successful at. So we're going to take a more responsible and a disciplined approach in energy drinks going into next year. Let's talk about our thinking in North American beverages. What we told you earlier this year was that in North American beverages, we were going to execute -- improve our execution significantly. We would invest behind brand building. It was going to take a year or 18 months to start to see the results. And we are very steadily executing on the game plan that we outlined for you in the early part of February. Meanwhile, we also have seen some interesting results come out from our technology investments. And our hope is that by this time next year, we should start seeing the benefit of a lot of the technology bets we placed, whether it's natural sweeteners, enhancers, whatever that will allow us to go in and create real differentiation in our product portfolio, especially in carbonated soft drinks so that we can actually offer to the consumers in the 2014 and beyond a product portfolio that consumers love. They love bubbles, they love the caffeine, they love cola taste, but addresses any value that might exist in the areas of sugar in the portfolio or artificial sweeteners. So we are optimistic about the results of R&D investment and we are hopeful that towards the end of 2013, early 2014 and beyond, we can actually launch differentiated innovation in some of our core categories. So our North American beverage business, our reinvestment activities, our turnaround activities are all on track and we'll keep giving you updates every quarter. But believe me, we look at everything about this business and we look at improving the returns of the company on an ongoing basis.

Hugh F. Johnston

And Indra, if I can add one more comment to that. Just going back to the energy drink question, I want to take one thing off the table very explicitly. We do not have the strategy or an intention to deploy significant M&A capital into the energy drink category. So I want to make sure we're crystal clear on that so that it's well understood by all.

Operator

Your next question comes from the line of Jonathan Feeney with Janney Capital.

Jonathan P. Feeney - Janney Montgomery Scott LLC, Research Division

Indra, I thought it was interesting on the Asia, Middle East and Africa business not only the great volume performance, but really the margin performance. And I wonder if you take a step back and you talked about China, do you -- is there an opportunity over time to raise the margin of that business over -- through positive price mix over time? I think we're trained to thinking about emerging markets businesses as lower gross margin. I think that's true in most cases. But have we hit inflection point at China or other major emerging markets where either volumes are good enough, the consumer healthy enough that you can really start to up margin those markets over the next couple of years?

Indra K. Nooyi

I think, overall, AMEA, our Middle East business is very strong. Great volume growth, revenue growth, margin growth, margin expansion, profit growth, no issues. I think markets like South Asia, you get tremendous volume growth, you get revenue growth, but we're also investing heavily because the market is growing 15%, 20%, so we have to put in tremendous investment to keep the growth going. And the good news is once the growth starts moderating and I hope it takes many years before it moderates, the business starts to yield very, very attractive return. But on the short term, we have to keep growing the business through investments, both P&L and on the balance sheet. And in China, absolutely once the Tingyi deal is up and running, which we hope will be going into 2014 and beyond, you should start seeing margins in the beverage business improve. But again, we want to reinvest that back in the snacks business and keep growing the overall portfolio. So basically, what we are focused on is PepsiCo as an overall portfolio. AMEA will always be a big growth engine. We will always keep investing in AMEA, and then the slower growth markets will be the source of investment for areas like AMEA. And so taken together, this portfolio should be able to deliver for PepsiCo along the lines that we talked about.

Operator

Your next question comes from the line of Lauren Torres with HSBC.

Lauren Torres - HSBC, Research Division

It's been great to hear that you've been able to confirm, and I guess, reaffirm guidance for this year throughout the year. But as most of us are thinking about next year, Indra, I was curious to get your confidence level if you think we could return to your long-term growth goals in 2013?

Indra K. Nooyi

I'm going to have Hugh talk to that. Hugh?

Hugh F. Johnston

We'll talk about 2013 specifically in February. We've given long-term guidance to give you an indication as to how you should model out multiple years. But with the world as volatile as it is, we think just as a practice the right answer is to give guidance in February as we do our Q4 call. So no indications, positive, negative or otherwise, in terms of 2013. We'll get to that in the course of a couple of months.

Operator

Your final question comes from the line of Damian Witkowski with Gabelli & Company.

Damian Witkowski - Gabelli & Company, Inc.

As we're 6, I think, 8 months into the incremental advertising spend here in the U.S., just curious how do you measure its effectiveness and how -- is there a way of measuring shorter-term versus just looking at it from a long-term perspective? And then any media that's performing better than other, whether it's for beverages or snacks, that's sort of standing out?

Indra K. Nooyi

We did talk about the fact that we are going to be measuring brand equity, especially of the 12 big brands that we outlined in our February meeting. And we're doing 2 things: We're looking at what we're doing in process and then we're looking at sort of tailpipe metrics. In process, we're looking to make sure that we are shifting more nonworking media to media -- to working media. And then we're also making sure we're investing more in the 12 brands and slowly start to cull the tail. So we are making progress on that and we track it almost on a monthly basis. From a tailpipe metric, it's brand equity. Now typically, brand equity scores take 12, 18 months to really show improvement, sustained improvement. Interestingly, as we shared with you in our Q2 scorecard, and we're going to show you again the next scorecard in Q4 as part of our Q4 call, we are beginning to see improvement across most of the brand portfolio. So the programs we have in place, the additional investment and the fact that we're doing a 360-degree activation, not just spending money on television advertising, but in the digital world, executing better, doing the right promotion. All of that, we're seeing as beginning to drive the brand equity scores into positive territory. Now let me make sure we all understand. Our brand equity scores for these 12 brands is already pretty high. And we wanted to make sure that we continue to hold it or increase it in an advertising environment that was extremely cluttered. And I think the efforts that we're undertaking we're already beginning to see some results, which is very, very comforting to see. And I think as the quarters go on, you'll see even more benefit and that will then translate to higher value share. And so we're watching this virtuous circle very, very carefully and making adjustments as we go along and it's happening both in beverages and snacks and our nutrition products and it's across all 12 brands.

So with that, let me just say, in closing, Q3 marked good progress against a clear, focused plan. As we said earlier, our AMEA region had an excellent quarter across-the-board. Europe delivered solid results behind good pricing and marketplace execution. Americas Foods had good volume growth and net price realization. Share trends in Frito-Lay North America are encouraging. And North American beverages, we gained value share in carbonated beverages while executing a cleanup of unprofitable segments of our noncarbonated beverage portfolio. Our stepped up brand-building investments are beginning to pay off. Innovation performance is improving.

We are executing in a disciplined way in the marketplace. We're on track to deliver our productivity commitment and on our cash returns to you, our shareholders. In short, we are executing with great focus to drive results and do what's right for the short-term, medium-term and long-term health of the business.

So with that, let me just say thank you to all of you for joining us and for the confidence you've placed in us with your investment. Have a good day.