Good morning, and welcome to PepsiCo's First Quarter 2012 Earnings Conference Call. [Operator Instructions] Today's call is being recorded and will be archived at www.pepsico.com. It is now my pleasure to introduce Mr. Jamie Caulfield, Senior Vice President of Investor Relations. Mr. Caulfield, you may begin.

Jamie Caulfield

Thanks, Jackie. With me today are Indra Nooyi, PepsiCo's Chairman and CEO; and Hugh Johnston, PepsiCo's CFO. Indra will lead off today's call with a review of our overall performance. Hugh will cover the financials and our balance of your outlook, and then we'll move on to Q&A.

Before we begin, please take note of our cautionary statement. This conference call includes forward-looking statements, including statements regarding 2012 guidance based on currently available information. Forward-looking statements inherently involve risks and uncertainties that could cause our actual results to differ materially from those predicted in such forward-looking statements. Statements made on this conference call should be considered together with 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 growth and division and total operating profit are on a core basis. To find disclosures and reconciliations of non-GAAP measures that we may use when discussing PepsiCo's financial results, please refer to the Investors section of PepsiCo's website under the Investor Presentations tab.

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

Indra K. Nooyi

Thank you, Jamie, and good morning, everyone. Our first quarter results came in right in line with our expectations. The major economies we do business in, consumer behavior, the competitive landscape and commodities were all in line with our assumptions.

Our focus this quarter was, first and foremost, to make sure we got our pricing into the market, and we are pleased with the level of pricing we achieved across each of our businesses. In addition, it was important to gain traction on the brand building, innovation, execution and productivity initiatives we communicated to you at our Investor Meeting on February 9, and we made good progress on each of these, with momentum building as we enter the second quarter.

Before I discuss our progress on these initiatives though, let me quickly review the financial highlights for Q1. Our financial results were right in line with our expectations. Core EPS was $0.69. Net revenue grew 4% and was up 5% on a constant-currency basis and reflected strong price/mix across all of our businesses. Globally, price/mix was up 5.5%, and this pricing helped to offset the impact of about $300 million in commodity cost inflation.

We had revenue gains across each of our 4 business units on an organic basis. Global snacks revenue grew. Global beverage revenue grew. And in our nutrition portfolio, which is a subset of global snacks and global beverages, we saw a 10% revenue growth.

Emerging markets revenue growth was particularly strong, up 13% on a constant-currency basis, led by strong double-digit organic revenue growth of 21% in India, 13% in Brazil, 33% in Saudi Arabia and 26% in Egypt, just to name a few. And division operating profit declined 2%, again, in line with our expectations and a solid result, given the magnitude of the commodity cost inflation we absorbed in this quarter.

Hugh will take you through the financials and outlook in a few minutes. But overall, our Q1 results are encouraging and indicated we're off to a good start and on track to deliver our full year financial targets.

So let me now turn to the progress we're making on our key initiatives for the year. We're focused on 5 big areas: brand building, innovation, execution, productivity and driving cash returns. So let me walk you through each.

On brand building, when we met with you on February 9, we said we would do 3 things. First, increase our investment in advertising and marketing from 5.2% to 5.7% of revenue this year, shift more of our spending from nonworking to working dollars and focus our A&M investments against our 12 global mega brands to drive greater scale and impact with our spending.

And I'm pleased to report that we made good progress on all of these initiatives. We significantly stepped up our media in key markets in Q1. For example, in the U.S. alone, our media spending was up 25%, and for the full year, we expect to achieve our targeted level of incremental investment. We're also being much more productive with our so-called nonworking dollars, which is an incremental source of funding for stepped-up media investment.

One of the major drivers of this productivity is the rationalization of our agency partner relationships. In North American beverages, for example, we've reduced the number of partners from roughly 150 in 2011 to about 50 today. And this rationalization is also driving better alignment in our brand messaging and marketing execution.

As we execute our brand-building initiatives, our expectation is to see our brand equity scores strengthen over the course of the year, building off of a solid base. And this should begin to translate to incremental top line benefits later this year and into 2013. We'll share with you our brand equity scorecard results during the second quarter earnings call this year.

Our second focus area is innovation, where our goal is to double the contribution of our new products to our total net revenue, and our Q1 result in this regard are encouraging. Our innovation is targeted on a specific channel, cohort and occasion opportunities with a particular focus on emphasizing our mega brands.

For example, Pepsi NEXT, which offers a great cola taste with 60% less sugar, is off to a good start, and initial feedback is that the brand is sourcing volume from other categories, consistent with our objective of bringing back lapsed cola users. And while it's very early, the results are ahead of our launch expectations, and we've already achieved nearly one value share point.

Packaging innovation plays an important role in our innovation plans as well, and we've made good progress in this area. We're encouraged about the national launch of our differentiated 24-ounce can for regular and diet Dew, and this is showing positive customer and consumer responses in tests. We believe this product plays well to young males who are loyal Dew consumers.

Building off the success of the Brisk 1-liter package, we launched the Brisk iced tea gallon jug in 4 flavors in Q1 and the launch is off to a good start. In the first 12 weeks, Brisk jug achieved almost 2.5 points of volume share of ready-to-drink tea in grocery and drove total Brisk brand volume growth of 14% across all channels in the United States.

We're also accelerating our premium innovation to drive higher net price realization, and we're increasing focus on opportunities at the value end of the spectrum to capture incremental sales and keep value-oriented consumers engaged in our categories. For example, on the premium end, Quaker Medleys, offered in a convenient single-serve bowl, allows consumers to have a premium breakfast anywhere there's hot water or a microwave. It's made from a premium blend of hearty rolled oats and whole grains with tasty chunks of real fruits and nuts. Medleys targets busy adults who are seeking healthy choices that will set them up for a successful day.

The other example is Stacy's gingerbread and Stacy's cocoa, which deliver a differentiated snacking experience by providing seasonally relevant flavors to consumers. And Stacy's pita crisps will attract new consumers to the Stacy's franchise.

In the more value-oriented offerings, Lay's Stax delivers a great tasting stacked potato chip at value price points. Stax grew net revenue 13% in the quarter and gained 2 points of value share in the stacked potato chips category, and we expect to see continued momentum as we launch new Hispanic-inspired flavors in Q3. And we're launching Taqueros in the U.S., which is a value-oriented indulgent, thick and hearty potato chip that addresses the Hispanic meal occasions.

We're also accelerating our ability to lift and shift platforms and products around the globe. For example, we continue to leverage the success of our Do Us A Flavor campaign that originated in our Walkers business in the U.K. The program promotes consumer engagement by having consumers propose new flavors that are then voted online, with the winners being launched as new products. We've successfully expanded this concept to markets as varied as Holland, Saudi Arabia and the United Arab Emirates.

And we continue to expand our Quaker business globally. For example, in Australia, we launched a range of new products including Hot Oats and healthy bars and cookies under the Quaker trademark. And in Russia, we're using our extensive oats expertise to provide healthier offerings by launching oats-based products under the locally relevant Wimm-Bill-Dann's Chudo trademark. Our Quaker efforts are delivering solid results overall with double-digit revenue growth in markets like the U.K. and China.

And finally, we're leveraging our big brands into new product platforms, giving us access to incremental cohort and channel opportunities. For instance, with Doritos, we've launched Doritos JACKED, the ultimate extreme snack that recently debuted at the South by Southwest Festival. JACKED is everything consumers love about Doritos, only jacked up for a bigger experience. It's 40% larger in size and thickness and offered in Enchilada Supreme and Smoky Chipotle Barbecue flavors, and it's supported by absolutely great advertising.

Doritos Dinamitas offers consumers everything they love about Doritos rolled in a taquito-like shape with explosive flavor. And we built upon our beverage relationship with Taco Bell to jointly launch Doritos Locos Tacos. Doritos Locos Tacos was introduced nationally on March 8 with approximately $60 million in media support from Taco Bell. Over 60 million units have been sold to date, which is over 1.5 million tacos per day. Already, new line extensions are underway to build on the success of this partnership.

So on innovation, we had a good level of new product innovation that began to launch in Q1, and you should expect to see the pace of innovation accelerate as we move through the year with great new products across the full spectrum of our portfolio in both snacks and beverages globally.

Now let me turn to execution. We're measuring and driving execution across every element of the value chain to increase efficiency, quality and service to best-in-class levels, and we're seeing good results across our functions and businesses. For example, our sales organization just gained Family Dollar as a new partner for our beverage business, opening up more than 7,000 new points of distribution for our products in North America. And the Papa John's conversion was one of our fastest ever with 3,000 outlets converted to PepsiCo products in 3 weeks. Overall, our sales organizations drove 6% growth in food service with gains of 4,500 new local food service accounts in Q1.

We're seeing strong execution in our DSD systems. For example, in our launch of Pepsi NEXT in the United States, we achieved over 90% ACV distribution in GDMx in 3 weeks, which is truly great execution. And our DSD system is driving terrific results in the C-store channel in North America. Our net revenue across snacks and beverages was up 8% in the Convenience channel in Q1, and we were the #1 contributor to the C-store channel's entire growth in the United States.

And the final example I'll point to on execution is on our integration of Wimm-Bill-Dann. We've achieved higher-than-planned synergies ahead of schedule, and virtually all Wimm-Bill-Dann functions have been fully integrated with our One Russia operating model within the first year of the acquisition. So that's on execution.

Let me turn to productivity. As we shared with you in early February, we're targeting more than $1 billion in productivity this year and $3 billion in total over the next 3 years, which includes the restructuring program we announced early this year and other productivity initiatives. Our productivity programs of 2012 are locked in, and we are very confident in delivering the targeted savings. We've made substantial progress against our productivity plans in the first quarter. Because most of the restructuring actions began in mid-Q1, the financial benefits of the restructuring will accelerate in Q2 and as we move through the year.

In addition to the restructuring program, we've also accelerated other productivity initiatives. We're driving hard against reducing the capital intensity of our business, and we are already seeing results in reduced capital spending. We're implementing programs like GES in Frito-Lay to improve the efficiency of our product distribution, and we're increasing automation in our plants to drive higher labor productivity.

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

Then we're taking steps to drive higher returns on our invested capital and cash returns to shareholders. We reduced our net capital spending in Q1 by $122 million and reduced our net CapEx as a percentage of sales over the last 4 quarters by 80 basis points. We're achieving this both by driving higher utilization of our assets and by reducing the cost of replacement in growth capacity through value engineering and through enhanced global procurement management.

And we remain committed to returning cash to our shareholders. In the first quarter, we returned almost $1 billion in cash to our shareholders through dividends and share repurchases, and we expect to return more than $6 billion for the full year, an increase of approximately 12%. Our dividend will increase again this year with the June payment, making this our 40th consecutive year of dividend per share increases.

To recap, we're focused on brand building, innovation, execution, productivity and cash returns. We've made good progress in Q1. We expect momentum to build as the year progresses, and we are confident in achieving our 2012 goals in these areas.

Finally, let me comment on the alliance with Tingyi that we announced on March 31 after the end of our Q1. The PepsiCo-Tingyi beverage system will provide Chinese consumers with some of the country's most popular beverage products, including Pepsi, China's top-selling cola; Mirinda, China's top-selling flavored carbonated soft drink; Gatorade, one of China's top-selling sports drinks; China's top-selling tea and water brands sold under the Tingyi's Master Kong brand; and China's second-largest juice portfolio. Overall, this combination has created the #1 LRB manufacturing network in China by a wide margin and relative market volume share of 1.6x the next largest competitor's position.

In addition to creating this terrific combined brand portfolio, we also expect that this alliance will allow us to do the following: bring innovative new products to market faster; improve operating efficiency and reduce costs by combining local and global expertise in manufacturing and distribution; provide better service to PepsiCo's retail and food service customers in China through Tingyi's superior distribution expertise and network; support new opportunities to develop local economies in interior and western China; and significantly accelerate the national distribution of PepsiCo's brands in a capital-efficient way, using Tingyi's extensive manufacturing and distribution network.

We are absolutely delighted to have established this partnership with Tingyi. Both Tingyi and PepsiCo have a long history of successful partnerships with other companies, and we believe this alliance will significantly enhance our beverage business in China in the near term while maximizing our future potential in the second largest and one of the fastest-growing beverage markets in the world.

And our Q2 will be the transition quarter for our China beverage business, and we expect to see the benefits of this alliance accelerate in the second half. The integration is well underway and progressing very nicely, and we look forward to updating you in our progress with the China beverage business.

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 expected. Reported net revenue was up 4%. Constant currency net revenue increased 5%. Net revenue included a 1 point FX drag and less than a point of M&A benefit, with the net revenue contribution from Wimm-Bill-Dann largely offset by the refranchising in Mexico where we no longer consolidate bottling revenue.

We realized 5.5 percentage points of effective net pricing with increases across each of our divisions. Core gross margins were down 218 basis points, driven by higher commodity costs in the quarter, and core division operating margins were down by 91 basis points, with productivity and SG&A helping to offset a substantial portion of the commodity inflation. All-in, this resulted in a 2% decline in core division operating profit and a 1% decline, excluding a 1-point drag from currency, in line with our expectations.

Core corporate unallocated expenses increased in the quarter. There is also a $12 million change in corporate unallocated expenses related to our mark-to-market of deferred compensation balances but this is offset by a credit of roughly the same amount in net interest expense related to our hedges on the deferred compensation balances.

Net interest expense was $175 million in the quarter, an increase of $12 million over Q1 of 2011, which is a function of both higher average debt net

-- net debt balances and slightly higher rates on our borrowings, offset somewhat by the deferred comp credit that I mentioned earlier. And our core tax rate for the quarter was 26.7%, which is 70 basis points higher than the rate of Q1 2011, driven by country mix and the favorable resolution of some tax items in Q1 of last year. So in total, below-the-line items, mainly corporate expenses, interest and tax rate, drove 5 points of deleverage from our core constant-currency division operating profit decline of 1% to our core constant-currency EPS decline of 6%.

Turning to our outlook. Consistent with the outlook we shared on February 9, we expect our core constant-currency EPS to decline roughly 5% for the year. We anticipate continued strong effective net pricing, which will contribute to net revenue growth but will likely negatively impact volumes.

We expect continued commodity cost pressures. Our estimate of approximately $1.5 billion of commodity inflation for the full year which is about a 7% increase year-on-year. We expect that the rate of inflation in Q1 will be the highest of the year, with the rate of inflation abating somewhat each quarter as we work our way through the year.

We anticipate productivity of more than $1 billion this year, which represents a substantial increase versus our historical productivity target. The incremental productivity is largely driven by the restructuring program that we announced on February 9. The majority of the restructuring actions took place in the first quarter, and we expect the remainder will take place over the course of this year, so the productivity benefits will accelerate as we move through the year.

We're investing more in A&M this year to support our brands, and we're making incremental marketplace investments in routes and racks. We expect A&M as a percent of sales to increase by approximately 50 basis points on a full year basis. We began to put more media in the market in quarter 1 but the impact of the A&M expense in the P&L will be more pronounced in the back half, based on how the accounting curve of the expense works.

Below the division operating profit line, we expect an increase in corporate unallocated expenses, reflecting higher pension costs related to the change in the discount rate and investments in productivity capability. Net interest expense is expected to be higher, driven by higher net debt balances as -- and higher rates as we term out some of our debt. And we expect our core tax rate to be approximately 27% for the full year but with some variability each quarter. Based on current ForEx market consensus, currency translation would have approximately 2 points unfavorable impact on our full year core EPS.

As you model out the year, you should be mindful of 3 structural changes in particular. First, we refranchised our Mexican beverage business early in Q4 of 2011. Second, we adjusted our ownership in our joint venture with Almarai, such that we are now in the minority. And third, we entered our alliance with Tingyi, which closed on March 31.

In each of these transactions, the accounting result is that we will no longer consolidate a substantial portion of the revenue. Including the impact of these transactions, we expect our core constant-currency net revenue growth to be in the low-single digits. Excluding the impact, we expect our core constant-currency net revenue growth to be mid-single digits, which is exactly what we communicated on February 9. As we report out the remaining quarters, we'll provide visibility into the impacts of these structural changes.

From a cash flow standpoint, reported cash used for operating activities was $690 million, which includes a $1 billion discretionary pension and retiree medical contribution. Net CapEx was down $122 million and down 80 basis points as a percentage of sales on a rolling 4 quarters basis. Management operating cash flow, excluding certain items, was $79 million, which is a slight increase versus Q1 of 2011.

We returned about $1 billion to shareholders in Q1 through dividends of $816 million and share repurchases of $142 million. For the full year, we expect to generate more than $6 billion in management operating cash flow, excluding certain items, and return more than $6 billion in dividends and share repurchases, including our previously announced increase in our quarterly dividend that will take effect with our June dividend payment.

Net-net, the quarter came in pretty well exactly as we expected. The pricing picture was positive, and our outlook for the year for earnings, cash flow and cash returns is completely consistent with what we shared with you on February 9.

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

Indra K. Nooyi

Thanks, Hugh.

Jamie Caulfield

Jackie, we'll take the first question.

Question-and-Answer Session

Operator

[Operator Instructions] Our first question is coming from Bill Pecoriello with Consumer Edge Research.

William Pecoriello - Consumer Edge Research, LLC

A question on Frito-Lay. One was the -- you talked a lot about the initiatives on the premium and value side. When do you expect to see that begin to impact the share trends? What do you estimate the volume and value share did in Q1? And then on the profit performance in the quarter at Frito, was that 2% profit growth also impacted by that New Year shift that you quantified on the volumes there?

Indra K. Nooyi

So, Bill, P3, P4, we're already beginning to see share start to come back. In fact, if you look at the IRI data that's coming out today, you're already beginning to see Frito share improve steadily. I think the most important thing, what we told all our businesses, focus on getting the pricing into the marketplace first, and then we can start slowly figuring out the revenue management to make sure there's a good balance. But we had to get the pricing in as early as possible, and Frito did exactly what's needed to get done to cover commodity cost inflation. And in terms of the impact on profitability, for sure, the 53rd week had an impact on volume, revenue and profitability.

Hugh F. Johnston

Yes. Bill, I think what you can extrapolate from that is we said the volume impact was about 2 points. I think you would put the profit impact in a roughly similar place. So the 2 points they did would be closer to 4. And remember, this is the heaviest of the commodity impact for Frito-Lay in Q1. So as we get through the year, the commodity impact on Frito-Lay will be less impactful. So that's kind of tying back to where you would expect Frito-Lay to be roughly normally.

William Pecoriello - Consumer Edge Research, LLC

And then the improved share performance that you're seeing now, is that coming from the initiatives on the premium and value side, or is it on all the core innovation in the mainstream segment?

Indra K. Nooyi

I think it's coming from all 3, Bill.

Hugh F. Johnston

Bill, you're going to -- as Indra said, you're going to steadily see those things impact positively during the course of the year, both core as well as the new products.

Operator

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

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

In looking at your commentary on the North American beverage industry, you talked about sort of maintaining share in LRBs, which, at least from a reported results standpoint, we're not seeing. So a couple of questions on that in terms of can you talk to us about what you're seeing that maybe not -- may not be showing up in the reported results? And then similar to what you talked about with the Frito piece, how should we judge your momentum in terms of market share as we go through the year?

Indra K. Nooyi

So, John, in Q1 x 53rd week, if you look at like-for-like Q1 in measured channels, GDMxC, which is really what we see from an IRI perspective, we gained 1/10 of value share. And we have to use measured data because that's an objective data set that we can measure ourselves by. Now when we talk about additional investment and changing the innovation model and really recommitting to this business in a different way, the results come steadily and over the year, as we talked to you early in February. What was very encouraging was in the first quarter, we began to see positive results. And if you look at the P4 IRI data, one more time in GDMxC we gained value share. So on North American beverages, we look at those numbers and we say it's making great progress. I think the other aspect of the share numbers that made us very encouraged about the progress on the business was the co-channel value share. And we've made tremendous progress in that whole co-channel business, which is really the best part of the whole beverage business, and we feel good about the progress we've made there and the successes we've had in the co-channel business. And Frito-Lay, ditto. Period 1, period 2, we put the pricing into place. Started end of last year, we put it into place. And today's IRI data, period 4 IRI data is beginning to show the positive momentum from all of our initiatives. So as Hugh mentioned in his opening comments and I did in my opening comments, as the year progresses, quarter-by-quarter, you'll start seeing the business strengthen. And we're really watching for the steady improvement in the business as the year goes on and make sure we do it the right way, not try to jerk the business around by pushing for volume in one quarter and trying to do something else in another quarter, but steadily build the brands, steadily build the business and focus on value share in the measured channels in North America because that's the only objective measure that exists.

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

If I can ask a follow-up on the cold drink stuff. So we've seen strength from other manufacturers in convenience and gas, and a lot of it's been pricing driven. I guess -- so 2 follow-ups here. The first would be, can you talk about units versus pricing in convenience and gas? And then secondly, can you sort of try and give us an idea how much weather has been a positive impact versus gas prices being a negative impact? If you have some thoughts on that.

Indra K. Nooyi

I think that weather versus gas prices have netted out, John. I mean, the convenience channel has been pretty strong in the first quarter, and we are, I'd say, cautiously optimistic on the outlook for the convenience channel. And in terms of units versus pricing, we don't have the numbers right now off the top of our head. But Jamie or somebody will make sure that we get back to all of you on this question.

Hugh F. Johnston

Yes. John, the thing I would say is that we're seeing both price and feeling good about volume as well. Obviously, in a world where everyone's trying to interpret what's going on with the economy generally, certainly, the convenience channel and the way it's held up well bodes well for both economic signals but also for our business. So we certainly feel good, both in terms of volume but we feel good competitively as well, as to what's going on in that channel.

Operator

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

Dara W. Mohsenian - Morgan Stanley, Research Division

I was hoping to get your perspective on the pricing environment in the U.S. CSD category and your confidence that price increases will hold here as we head into the summer.

Hugh F. Johnston

Yes. Dara, why don't I jump in on that one? What we've seen in the pricing environment is all of the players in the industry being very steady about pricing. Haven't seen a whole lot of discounting. Occasionally though, a skirmish will pop up in the drug channel or something like that. But the broad indications are that the pricing that we saw in Q1 continues to stick.

Operator

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

Bryan D. Spillane - BofA Merrill Lynch, Research Division

Just a question on the Europe segment. And I was surprised by how weak the margins were in the first quarter and understand, I guess, there's some -- an accrual or a reversal on the trade receivables. But is there something else that's going -- that was specific to the first quarter that drove the profitability so low and the margins so low sequentially? And if you can talk a little bit about maybe the outlook there just in terms of the profitability in Europe.

Hugh F. Johnston

Yes. So in terms of generally how Europe came in, Bryan, it was very much in line with our expectations and plans. There's a couple of factors to consider in that regard. Number one, the trade accrual fall out and fall in year-over-year. In the context of full year, it was relatively nominal. But in a 2-month quarter and in a business where the profitability is obviously quite low in the first quarter, I think it was $81 million in Europe for the quarter, it's -- it has market impacts relative to the impact on the year. Relative to margins, the other thing to consider is, in last year's numbers, we only had Wimm-Bill-Dann for 1 out of the 2 months. And we only owned 77% of the business for that one month, and Wimm-Bill-Dann, obviously, is a lower-margin business. So that certainly presented something of a drag for the quarter. But we obviously don't give guidance on a sector-level basis. But even in the environment that's as weak as it is in Europe, I think we've got to plan for it correctly, and it's certainly trending in line with our expectations.

Indra K. Nooyi

Bryan, the other thing I'd tell you is, even the team would tell you, that first quarter is a small quarter, as Hugh said, only 2 periods. But as we go into P3, P4, the business is looking good, and very much in line with what we expected. And the Russia business, in particular, looking very, very good. I mean, we did great on CSD share and the way we are re-architecting the juice business to be more disciplined about pricing, not chase volume at any cost and build the whole profitability of the business. The team is doing an absolutely superb job, and the Wimm-Bill-Dann dairy business is doing exceedingly well. So we're looking at the overall Europe business and feeling good about how our team is managing through what I would characterize as a mixed economic environment.

Bryan D. Spillane - BofA Merrill Lynch, Research Division

Indra, if I could just follow up. One of the things that we've heard through this earnings season has been -- maybe I don't know if improvement but at least at Eastern Europe and Russia especially, the consumer may be stabilizing and, in some pockets, maybe even a little bit better, just the macro environment not as depressed or at least not moving in the wrong direction. Can you comment on that at all? Is that -- have you seen any -- broadly any stabilization or any signs of improvement in that region of the world?

Indra K. Nooyi

No, I'd say that region of the world is looking good. And as we looked at upping our investment in Russia a year ago, the fundamentals of that region of the world are good because you've got huge oil reserves in Russia. You've got a well-managed economy on many economic fronts. And so we look at that part of the world and say the prospects for the whole Russia-CIS-East European cluster, if you want to think of that as one cluster, is very strong. And again, strong is a relative term but it is good. And so in this world today where you've got GDPs ranging from negative to sort of high-single digits, this Russia-East Europe cluster is looking like a solid 2% to 4% GDP growth. That's very good today, and we're feeling good.

Hugh F. Johnston

Bryan, one comment I'd add to Indra's comments as well. In Eastern Europe and Russia, we've probably got the broadest portfolio that we have anywhere in the company. And one of the benefits of that is when the economy is a little bit tougher, we have products that sell well. When the economy is going well, we have premium products that tend to sell well. So we certainly feel good about the way that we've positioned ourselves strategically in that area.

Indra K. Nooyi

And the Power of One helps us enormously there because we can flex the distribution systems. We can load up the trucks with products that cube out, weight out. I think the Russia-East Europe-CIS cluster is probably our best example of Power of One, and that's what's working so well right now.

Operator

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

Kaumil S. Gajrawala - UBS Investment Bank, Research Division

Can you speak a little more specifically on how Mountain Dew and Pepsi did in the quarter? And I believe the 24-ounce launch is in progress. If you could maybe just talk about how we should think about that.

Hugh F. Johnston

Yes. So Mountain Dew had a terrific quarter, I mean, feel great about where that brand is, and we obviously have -- had new products coming out against that. The 24-ounce can for regular and diet Dew is going along very, very well. It's -- it looks like a real premium innovation that's going to create incremental revenue and margin for us. The Pepsi business is going to steadily improve over the course of the year. A couple of things to consider in that regard: number one, the Pepsi Max business continues to chug along very well; number two, Pepsi NEXT, as Indra mentioned, has really exceeded our expectations coming out of the gate; number three, the media that we've significantly increased in the first quarter. If you watch much TV, I'm sure you've seen lots of Pepsi ads out there; and then number four, we've got lots of new marketing coming against Pepsi that we'll talk about a little bit later this year. So I think what you're going to see with Pepsi is just a steady progression and a steady improvement in that business during the course of this year. And as we exit into 2013, we expect to feel pretty good about it.

Indra K. Nooyi

Kaumil, the other thing is this is a business over the years that has been characterized by price discounting, dealing sort of back-and-forth, trading share at the margin. With all the commodity cost increases, it was critically important we put in place deliberate increases in pricing and manage this business very steadily and responsibly. And that's what we've been doing. So our goal is to look for steady share improvements through the year, so that we hold value share in LRB as the year ends, and to make sure that we don't do anything silly just to go after any sort of a value gain. So value share is really our focus.

Kaumil S. Gajrawala - UBS Investment Bank, Research Division

Got it. Maybe -- and thinking about NEXT, some innovations have a halo effect on the core, others are cannibalistic. Where would NEXT fall?

Indra K. Nooyi

Interestingly, NEXT is sourcing from outside the cola category. In fact, it's even sourcing from outside the CSD category, which means that lapsed cola users are coming back into the cola category. Now I want to make sure that you hear the appropriate caveat. It's too early to call this brand and say it's a gigantic success. But what's surprising to us is a few weeks after the launch, it's now almost one share point, which has not happened in a long time in any new product launch. So we are watching every metric very, very carefully. And every quarter, we'll update you on the progress of Pepsi NEXT. But it's really bringing back lapsed cola users, which is what's surprising.

Hugh F. Johnston

So not terribly cannibalistic.

Indra K. Nooyi

Yes.

Hugh F. Johnston

Not much at all.

Operator

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

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

First question is just in terms of bridging to the EBIT decline in the first quarter. I guess I'm just trying to better understand different components. You've got the commodity inflation. You've talked about the brand investment. But maybe if you can just give us a clarity on how much the brand investment step-up occurred in Q1, sort of the allocation by different segments as best as you can. And just give us clarity on sort of bridging to the EBIT decline and then how some of those components get phased out as we get into the back half of the year.

Hugh F. Johnston

Yes, Judy. Actually, if you go to what we shared with you on a full year basis, it was actually pretty consistent, with 2 exceptions. The curbing of the

A&M has less impact in Q1, which is what we had shared earlier, and that's purely due to the curbing. We're being very specific about saying we're going to increase by 50 basis points on A&M during the course of the full year, but we curbed that with volume and then you're dealing with the curb of the prior year. So that had a little bit less of an impact in the quarter. And then offsetting that, as we shared with you at Feb. 9, the commodities had a bigger impact in the quarter relative to the impact of the full year. Other than that, everything else was pretty consistent with what we shared with you in the -- back at the Feb. 9 meeting.

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

Okay. Hugh, the unallocated corporate expense though, just even including the pension step-up, just seems like you had a big step-up. So was there anything going on in that line item?

Hugh F. Johnston

No. I mean, nothing in particular. Corporate unallocated can be a little bit choppy, but there was nothing of note, and we indicated what we expect out of that for the year. So I wouldn't change how you're thinking about that for the year. There is no big news there.

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

Okay. And then, Indra, just going back to Frito-Lay. And you talked about improving share performance in period 3, period 4, and you've talked about some innovation around the premium and the value segments. But maybe if you just sort of take a step back and look at Frito and maybe including Quaker sort of in the context of the broader macro snacks, and you're seeing growth in some of the adjacent categories like snack bars maybe exceeding salty snacks, and how are you thinking about positioning Frito and Quaker kind of to really better address the faster-growth adjacent categories? And are you thinking about perhaps focusing on stepping up innovation and spending around that arena?

Indra K. Nooyi

Judy, I mean, you captured in your recent note what we've been telling all of you for the last couple or 3 years, that the growth in all these categories is coming from Fun-for-You, Better-for-You and Good-for-You, and it's critically important PepsiCo places its bets in all 3. And let me tell you what our strategy has been, and let me refer back to what trends you're seeing in the marketplace. In the Fun-for-You category, there's still growth, especially in salty snacks, value growth. And what we have to make sure is increase the permissibility of our Fun-for-You products by reducing the salt levels, going to heart-healthy oils. That is our "health and wellness" push in the Fun-for-You category, and we've been doing that over the last few years. The second leg of the strategy is dialing up our baked snacks, whether it's Baked! Lay's, whether it's Quaker Lite snacks, which is a baked snack, making sure we dial that up. That's what we've been doing. And the third is really investing behind the Good-for-You snacks, because the growth rate of Good-for-You snacking and Good-for-You products across the world is about 2 or 3x that of Fun-for-You and Better-for-You. And in fact, our nutrition business in Q1 grew revenue 10%. So those categories are growing exceedingly rapidly. So what we're doing with Quaker -- I mean, as the quarter progressed, period 3, period 4, the Quaker trends are looking positive. But using the Quaker trademark, we're looking to launch more healthy snacks. But what we don't want to do is to launch much lower-margin commodity healthy snacks. We have to play in the value-added healthy snacking. And what we're looking for is new innovation to play in the value-added healthy snacking, a new twist on bars, new ways to marry dips with chips so that the dips are very healthy and can provide a great source of a mini meal. So that's really what we're working on. For example, our Sabra hummus dips are just flying off the shelf. That's an example of a healthy accompaniment to any snack that you want. Our Stacy's business is doing very, very well. So I think the name of the game for Frito-Lay is slowly and deliberately building the business rather than jerking the business around to gain short-term share. And I feel good. I mean, look at the IRI data for this period 4. You see very nice steady progress across the board.

Operator

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

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

So a few things. One is, we asked you this back on February 9 at the strategy reset and again at CAGNY about Frito-Lay North America and the growth in margins and the growth in top line. And I just want to make sure we're -- you're still on the same page in terms of for this year -- despite what we've seen this quarter from margin and from a volume perspective, but for this year, you're going to be able to price away commodities. You're going to be able to hold or grow volumes and hold or grow margins. Is that still the expectation?

Hugh F. Johnston

Yes. I mean -- yes. So, Ali, what we're really focused on is ensuring that we are both getting the pricing through, and we will and certainly expect to hold or grow margins. The volume, obviously, in Q1 was down 2, but we also said that we saw a negative 2 impact from the 53rd week. As the innovation gets out the door, we certainly expect to see all of the metrics from Q1 improve.

Indra K. Nooyi

And to focus on value share.

Hugh F. Johnston

Yes.

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

Okay, okay. So I think that's helpful because I think that's a yes. That's good that that's still consistent. Shifting gears a little bit, and this is more of a kind of philosophical question and maybe it's just me being confused again, but whenever we talk about shares on the beverage business, we're always refocused on LRBs versus just CSDs. You guys consistently talk about LRB shares. But doesn't that muddy the waters a little bit, and isn't that manifested in what we saw this quarter? I mean, you had pretty good non-carbs of plus 1, CSD is down 2, and in the end, you had a negative 1 in PAB. So how do you think about that balance internally? I know you're communicating it as an LRB and I understand why, but how do you think about that balance internally in funding the non-carbs piece versus the CSD piece? Because you have to be successful in CSDs, obviously.

Hugh F. Johnston

Yes. So Ali, I guess a couple of things. One, we think about the LRB category because we know consumer behavior at the end of the day is such that people cut across LRBs. It's a repertoire category, and it's certainly been that way for a while. The one thing that we point to as something of an exception in that regard is energy, because it's such a unique category from so many dimensions. In terms of how we manage, do we have expectations for CSDs, as well as for individual non-carbs and Gatorade and Tropicana and SoBe Life Water and all those things? Yes, absolutely we do. Do we see ourselves in a position where we want to lose large amounts of value share in any of those categories? Certainly not. We would not want to see that. But we do have to also recognize and acknowledge the fact that it is a repertoire category. Certain of the subcategories have more tailwinds than others, and certain of them we have better brand positions, primarily in non-carbs. So we're going to look at our funding opportunities based on where we think the best value creation comes from, and that value creation includes a recognition of we need to manage value share effectively. But LRB, we do think is the right way to think about it because of the repertoire nature of consumer behavior.

Indra K. Nooyi

And, Ali, if I look at overall North American beverage volume, if you look at about the 20 billion 8-ounce cases that are sold, I've been tracking this industry for a long time, it used to be sort of 60-40 carbs, non-carbs, shifted to 50-50. It's now shifting the other way. And so consumer behavior is shifting, that's one. And second, the way we look at this business, we look at profit per case across each of our categories, and we make sure the combination of businesses drives the best profit per case result for us. And that's what we do in each region of the country by brand, and we do that over the year.

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

That's helpful. But your portfolio is still very much skewed, certainly in North America, to carbonated. So you have to win. You have to be successful in CSDs to win in LRBs. And it's tough for me, I guess, to differentiate those 2 somewhat.

Hugh F. Johnston

Well, but I -- I think actually you just made your point and our point, which is, given CSDs are such a substantial portion of our portfolio, we've set out as an objective hold or grow value share. And we can't allow CSDs to do poorly if we intend to do that. So I agree with your point. It's an and game, not an or game. We have to be able to do both.

Indra K. Nooyi

And, Ali, key thing is look at CSDs as a whole. I mean, look at LRBs as a whole, look at CSDs as a whole, because what happens is we start with LRB then we quickly come down to CSD. Then we quickly come down to colas, then we come down to regular colas, then we start defining the market too narrowly. So clearly, we look at overall LRB. And you're right. To gain -- I mean, to hold value share in overall LRB, you've got to do well in CSD, but CSDs as a whole. We've got Mountain Dew, which is doing very, very well. Parts of the CSD portfolio doing well. The challenge is to play a deliberate profitable game in the whole CSD category, which is really what we're focused on.

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

Okay. That helps a lot. And just one last one, to shift gears. If you can remind us a little bit more about where the productivity is coming from specifically. So how much is in North America DSD? How much is just broadly GES or overhead? Just – for you to help us bucket that overall productivity, that'd be helpful.

Hugh F. Johnston

Yes. So in terms of -- we haven't really broken out the specifics of exactly where the $1 billion-plus money is going to come from. But certainly, you can expect more of it to come from the North American businesses and both the Frito business and the -- or the PAF North American businesses, as well as the PAB business in North America. And then probably the next biggest area where you'll see it come from is Europe. AMEA will probably be the smallest of the 4 for all of the reasons you might expect.

Indra K. Nooyi

Ali, you know what I feel good about? We've put in place a restructuring program. We put in place $1 billion productivity program. We announced it right after the February 9 meeting. Our teams did a terrific job making sure they delivered on the restructuring program. And they did it flawlessly, and they did it with great sensitivity. So I'm actually feeling good about how well this was done without disrupting the business.

Operator

For our final question comes from the line of Mark Swartzberg with Stifel, Nicolaus.

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

I was hoping we could spend a minute or 2 -- a few minutes here talking about AMEA a little bit more. Because as you point out in the press release, and it's been evident for a while now, it's really been a standout region for you even in the more difficult recent years. Can you speak a little bit -- and markets are a factor here, right, just the dynamics there. But when you think about the strategy you've deployed in that market, can you speak a little bit to how relevant it is to your efforts to sharing best practices and other aspects of PepsiCo, and maybe use that as a platform for talking to this larger subject of learning from each other, so to speak, within the larger PepsiCo company?

Indra K. Nooyi

Yes, Mark, great question. AMEA clearly is riding the wave of GDP growth, all of these economies east of the Middle East. I think what we shouldn't forget is our AMEA business has performed well in spite of all of the geopolitical issues they've had to handle, the natural disasters that happened in AMEA.

So we have a resilient AMEA team and a good business in all of AMEA. So that's the good thing that I'll tell you about AMEA. Now let me talk about the business model in AMEA. I think you've got a mix of developed, developing and emerging markets in AMEA. It's a unique region, besides the regional and cultural diversity. You can argue that Japan, Australia fall in the developed market, Korea, all of those countries. Then you've got parts of the Middle East that are more developing markets. Then you've got China and India, which fall more in the emerging markets category. So for each of these clusters, what we have to do is sit down and think about what model can we take from the proven PepsiCo models adapted for the local countries, but then more importantly, how can we evolve local models, which play to the local cost structure, and then bring it back to the developed market. I'll give you an example. We opened a value innovation center in India a year ago, and what we told them was rather than take our western equipment and our western approaches and cost reduce them, start clean sheet of paper in India. Whether it's a cooler, a food service equipment, whatever it is, start clean sheet of paper and tailor that piece of equipment for the economics of the business in India, and then let's see how we can ruggedize it to bring it back to the west. It reduces the cost base significantly. The initial results from the value innovation center are very encouraging. And so I think piece by piece, we're looking at AMEA not just as a growth engine for the company for many years because the population of -- the percentage of young people in that part of the world is very, very high. So we have years of growth there. But we're now looking at it as an innovation source so that we can do reverse innovation, bring products and ideas from there at a very different set of economics back to the developed world for the value consumer or for whoever else. So it's a great learning lab and a growth source.

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

And that's helpful. And in terms of -- so there's an opportunity there, and then of course, unlocking is another exercise. In terms of your ability to unlock that in whatever market might be appropriate or whatever sector might be appropriate, whether it's in North America beverage or Latin America snack, in terms of unlocking, having that organizational capabilities, where are you, in your opinion, in that exercise?

Indra K. Nooyi

We're making progress. It's a big market. It's growing, changing. So the journey is never going to end there. I think the strength of PepsiCo is the Power of One. Because with snacks and beverages and the fact that we have a diversified portfolio, we're able to attract very good talent to our businesses in AMEA, and then we're able to give them extremely wide range of experiences, move them from beverages to snacks and back and forth. And people love coming to work for PepsiCo. I'll be honest with you. Even people who get recruited out of PepsiCo, within 60 days or 6 months are always calling saying, "Can I come back?" That's the strength of the company. So I think our teams there are all local, Mark. I'd say almost no expats. Everybody there is local. And so we have the benefit of local knowledge, and we have the benefit of getting those people to come to the developed market and transfer some of the knowledge back to us. So I think AMEA is going to be a growth engine for many, many, many years. And our models are going to evolve. Our partnerships are going to evolve in AMEA. But we're going to have to play the game for each of those local markets, not export our model there.

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

Great. And finally on -- that's helpful. And finally, on China. You just called out the 500 ml and also, of course, the Tingyi transaction closed, so -- or I guess at the -- shortly after the end of the quarter. But what -- to what extent was Tingyi a factor? And what did the -- what was the beverage performance there in the quarter, and what's going on in that market?

Indra K. Nooyi

The first quarter in AMEA, the China volume was impacted because of the 600 ml to 500 ml trade down. So unit growth was robust, but volume growth was impacted. x China, volumes in AMEA grew spectacularly in double digit. So we had a very good quarter in AMEA. I think the real benefits of Tingyi you'll start seeing in Q3 because Q2's a transition year -- transition quarter, and we want to make sure the business transitions the right way. We build all the disciplines and really work with our partners in Tingyi to make sure this is a excellent transition to them. They're a great company incidentally. But starting Q3, I think you'll start seeing tremendous ramp-up in performance. So we look at the prospects of this business. We look at the relative market share that the system is going to have in China, which is going to be the second-largest LRB market in the world, and we're feeling good at this point.

So in closing, Q1 marked good progress against a clear focused game plan that allowed us to compete effectively today, and it also positions well for sustainable long-term growth and value creation. You have my and our entire leadership's commitment that we'll continue to act with great urgency to deliver against our 2012 targets and our strategic objectives.

So let me close by saying thank you to all for joining us and for the confidence you've placed in us with your investment. Have a great rest of the day.