FINAL TRANSCRIPT

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CORPORATE PARTICIPANTS

Lynn Tyson
PepsiCo - SVP - IR

Indra Nooyi
PepsiCo - Chairman, CEO

Hugh Johnston
PepsiCo - EVP, CFO

John Compton
PepsiCo - CEO - PAF

Massimo d'Amore
PepsiCo - CEO - PAB

Zein Abdalla
PepsiCo - CEO - PepsiCo Europe

Eric Foss
PepsiCo - CEO - Pepsi Beverages Company

CONFERENCE CALL PARTICIPANTS

Operator

Bill Pecoriello
Consumer Edge Research - Analyst

John Faucher
JPMorgan - Analyst

Carlos Laboy
Credit Suisse - Analyst

Christine Farkas
BofA Merrill Lynch - Analyst

Judy Hong
Goldman Sachs - Analyst

Caroline Levy
CLSA - Analyst

Lauren Torres
HSBC - Analyst

Kaumil Gajrawala
UBS - Analyst

Ann Gurkin
Davenport & Company - Analyst

PRESENTATION

Operator

Good morning and welcome to PepsiCo's second quarter 2010 earnings conference call. Your lines have been placed on listen only until the question-and-answer session. (Operator Instruction).

Today's call is being recorded and will be archived at www.PepsiCo.com. It is now my pleasure to introduce Ms. Lynn A. Tyson, Senior Vice President of Investor Relations. Ms. Tyson, you may begin.

Lynn Tyson - *PepsiCo - SVP - IR*

Thank you. With me today are Chairman and CEO, Indra Nooyi, and CFO Hugh Johnston. Indra will lead off today's call with a brief overview of our results and then Hugh will review our second quarter operating and financial results. We'll then move to Q&A, where we'll be joined by the CEOs of our operating divisions; John Compton of PepsiCo Americas Foods, Massimo d'Amore of PepsiCo Beverages Americas, Eric Foss of Pepsi Beverages Company, Zein Abdalla of PepsiCo Europe, and Saad Abdul-Latif of PepsiCo Asia, Middle East and Africa. After Q&A we'll end with some closing comments from Indra.

Along with our remarks today, I encourage you to read our newly improved earnings web deck. This document is already posted on our website at PepsiCo.com/investors. Our goal with this expanded web deck is to give additional context to our quarterly results and long-term strategic initiatives. I welcome your feedback on this document. Our activities for the second half of this year include the Barclays back-to-school conference in September, where Massimo and Eric will be talking about our Americas beverage business, and in December, Indra is scheduled to speak at the Beverage Digest Future Smart Conference in New York.

During today's call unless otherwise noted all references to EPS growth and revenue growth in division and total operating profit growth are on a core constant currency basis. Please read our Q2 earnings release for more details. Before we begin, please take note of our cautionary statement. This conference call includes forward-looking statements based on currently available information, operating plans and projections about future events and trends. Our actual results could differ materially from those predicted in such forward-looking statements, but we undertake no obligation to update any such statements whether as a result of new information, future events or otherwise. Please see our filings with the Securities and Exchange Commission, including our annual report on Form 10-K and subsequent reports on Form 10-Q and 8-K.

And finally, you should refer to the investor section of PepsiCo's website under Financial News to find disclosures and reconciliations of non-GAAP financial measures that may be used by management when discussing PepsiCo's financial results. With that, let me turn the call over to Indra.

Indra Nooyi - *PepsiCo - Chairman, CEO*

Thank you, Lynn and good morning, everyone. I'm very pleased to report that the solid performance in the quarter we more than delivered on our first half profit target with EPS growth of 7%. Net revenue for the quarter rose 37%, and core division operating profit grew 26%.

There are five key highlights in the quarter that show the success of our execution and the opportunities we have going forward. First, we drove broad-based growth across our global snacks and beverage portfolios, especially in emerging markets like India where strong market based execution and investments in infrastructure drove double-digit volume growth in both Snacks and Beverages. Second, we largely completed the integration of PBG and PAS in Mexico and Europe and we're making great progress in North America. In Russia, for example, the integration of PBG and Lebedyansky now makes us the largest multi-national food and beverage business in that country, giving us tremendous scale advantages. Globally, this bottling transaction is enabling us to fuel incremental Power of One opportunities which I will talk more about in a few minutes.

Third, we made incremental investments in strategic initiatives to enhance our competitive position in the short term, improve our of earnings profile and unlock long-term growth opportunities. As you know, we've committed to spending roughly $0.10 per share this year on these investments. Year-to-date, we have spent about $0.02 a share on projects such as expanding our beverage program in China, where we are expanding our footprint through additional routes, coolers and expanded sales capability. We've also invested in long-term research and development, and innovation to support our nutrition pro initiatives. And we've made investments in our sustainability initiatives like our partnership with Waste Management.

Fourth, we continue to drive our management operating cash flow, bringing the year-to-date increase to 26%, excluding certain items. Fifth, we continue to return value to our shareholders through share repurchases and dividends, bringing the total so far this year to nearly $5 billion. And earlier this year, we announced that we raised our annual dividend by 7%. Now, we achieved all these results with strong marketing programs, innovation, and productivity improvements. The macroeconomic environment, especially in the developed markets, eastern Europe, and some parts of Latin America, have not been particularly good. But our teams did a superb job navigating through these rough economic waters. And while global GDP growth is improving in some countries, the overall operating environment remains challenging as persistent high unemployment weighs on consumer confidence and spending.

Regardless of these dynamics, our significant and expanding product portfolio, our broad geographic footprint, and our focus on productivity positions us well to deliver on our commitments. As we move forward into the balance of the year and beyond, we are keenly focused on executing on our key strategic initiatives. First, continuing to transform our beverage portfolio in North America. The investments we made last year are starting to bear fruit such as the launch of our Gatorade G series, which is helping to drive growth and improved profitability in Gatorade. In fact, our Gatorade marketing team has been recognized by their peers for excellence in the repositioning of this great brand.

We integrated Gatorade replay campaign, which restated classic games between the nation's biggest sports rivals earned top honors at the 2010 Cannes Lions International Advertising Festival. Replay also picked up bronze and silver Lions in the category of digital and media respectively. Our highly leveraged aim and strategy with Gatorade, which utilizes all channels of communication, coupled with product innovation, is driving consistent improvements in brand scores. In fact, the perception of Gatorade improved significantly after the G series launch. Underscoring its halo effect on the rest of the Gatorade portfolio.

In the second half of this year, we also plan to launch our first main stream all natural carbonated soft drink, Sierra Mist Naturals made with real sugar, and we just relaunched Pepsi Max as part of the effort to strengthen our position in diet colas and made progress on our global commitment to sugar reduction. I hope you saw the great commercial on television which debuted yesterday. In macro snacks we're delivering differentiated value to increasingly cost conscious consumers. Our goal, particularly in developed markets, is to grow our customer base by providing relevant innovation that they value, while carefully monitoring price points, and this strategy is paying off. In Europe, for example, we will continue to leverage strong commercial activity with promotions like Sandwich in the UK, and Do us a Favor in Turkey, which drove excellent consumer engagement and growth in the quarter. We have a lot of head room for growth in terms of portfolio and geographic expansion, and also in terms of greater efficiencies and we will continue to execute on all of this.

Third, through nutrition code we are expanding and growing our good for you products and initiatives. We've made major progress in framing our global strategy and road map to build what we believe can be a $30 billion business by 2020, while identifying growth ideas we can put into the market in 2011. You will hear more about this in the coming quarters.

Next, we are sharply focused on delivering our environmental commitment. For example, on the food side of our business, our Sabra joint venture, a market leader in refrigerated dips and spreads, opened a new plant in Virginia, which is expected to qualify as one of the only food processing factories in the US to achieve Silver Certification under the US Green Building Council's LEED certification program. And lastly, with integration of the bottlers we have reinvigorated our Power Of One efforts, and let me take a deeper dive into this for you now. In the US, one of the areas we're focused on is leveraging our portfolio to drive growth across our businesses in the food service channel. We've expanded our partnerships with distributors to deliver our beverage products to locally owned restaurants and other food service outlets in select markets where we have Company-owned bottling operations.

While DSD continues the be our primary route to market, we have a long history of working with distributors in the snack side of our portfolio and we view this as an attractive long-term growth opportunity in beverages. In fact, this added flexibility contributed to the growth of our food service business in this quarter. Another example in food service is Taco Bell's ground-breaking new $2 meal deal, featuring a choice of a Taco Bell entree, along with a bag of Doritos and a Pepsi fountain drink. This has been a great success, driving traffic and helping Taco Bell cement their value position in the quick serve restaurant marketplace.

Also in the US, we launched a number of Power of One activities across both large and small format channels. In grocery, we currently have Pepsi and Frito Power of One programs covering over 200 customers or over 70% of our volume in those channels for the 100 days of summer. In the second quarter, this initiative helped to drive strong growth and dollar sales, positive dollar share change, and increased inventory on display in accounts that executed the program. Throughout the remainder of the summer, we also have 20-ounce CSD and Fritos single serve executions in over 20,000 C&G outlets nationwide. An example of how the power of Power of One is being leveraged within beverages, is the Gatorade G2, two to $2 offer that we're running in the C&G channel.

As you know, G2 is delivered through our DSD routes while core Gatorade is in the warehouse system. In the past, we would not have been able to overcome the differing economic incentives to execute such a program. Now we can, and as a result, our 20-ounce business is up 6% in C&G year-to-date, and we've seen significant increases in G2 distribution, as a result of this joint promotion. As we move into the back half of the year, we will expand these Power of One opportunities, bringing unique ideas including targeted multi-cultural bundles which leverage our strong Mexico snack brand Sabritas with Pepsi, we'll accelerate our better-for-you portfolio combinations like Sierra Mist Naturals with Sun Chips and we'll do more like the traditional thematic promotions around football and Halloween.

The progress we are already making in Power of One initiatives is an important demonstration of the value and potential of our combined organization, largely enabled by our recent bottler transaction. This, and the progress we are making on our other strategic initiatives, gives me great confidence in our ability to deliver on our short-term goals, while making the right investment decisions to drive sustained growth in the future. With that, let me turn the call over to Hugh. Hugh?

Hugh Johnston - *PepsiCo - EVP, CFO*

Great. Thanks, Indra, and good morning everyone. I have had the opportunity to meet with many of you over the last several months, and it's been gratifying to hear that you're as confident as we are in PepsiCo's fundamental long-term strength. We're fortunate to operate in large categories with products that are enjoyed every day by consumers in both developed and emerging economies. The skill and knowledge of our local management teams allow us to thrive amid the intense competition that you can all see in these categories, capturing strong share positions through a deep understanding of our consumers. Our uniquely powerful brands, great products, and operating capability continue to drive strong growing cash flows. As CFO, I'm proud of the financial and operational processes we have in place to sensibly deploy that cash to fuel our long-term growth.

Indra already referenced the strategic investment program that we are undertaking. As we mentioned at our Investor Day, our investment approach spans across three categories. First, we're accelerating investments in emerging economies, to enable new product platforms and to strengthen our selling and distribution infrastructure. Second, we're investing behind each of our strategic initiatives, such as North American Beverage platforms, nutrition fill and sustainability.

And third, we're investing to enhance the top and bottom line productivity of our base business, through portfolio transformation, go-to-market, and the roll-out of SAP. We see lots of opportunities to accelerate top line growth and enhance margins through this investment approach, while at the same time generating a sustainable, growing cash return to our shareholders through dividends and share buybacks. As I review our results, I think you'll see that against the challenging macro backdrop, each of our businesses is fully committed to delivering solid results and enhancing its competitiveness in the near term, while investing to build an even stronger base for future growth.

So with that, let me start with PAF. FLNA posted a 3% decline in volume, a 1% increase in net revenue, and a 7% increase in operating profit. These results were well in line with our expectations, as FLNA began to overlap the 20% more free promotion from last year. We estimate that this promotion added about three points of volume growth in Q2 of last year, through the beginning of Q4. Despite the decline in volume, units were up low single digits in the quarter, and FLNA drove positive leverage to revenue, and then to operating profit. That was driven by improved cost, but also by productivity and excellent management of the middle of the P&L. And we achieved this while investing in infrastructure and innovation to grow both the core portfolio and better for you products.

Highlights in the quarter included value share gains in salty snacks, demonstrating the strength of our brands, driven by improved performance in the convenience and gas store and food service channels, and the success of innovations such as new Lay's Kettle Cooked Potato Chips, which use natural ingredients and great new regional flavors such as Harvest Ranch in the east and Crinkle Cut Spice Rubbed Barbecue in the west. Q2 also benefited from our Q1 launch of lightly salted Fritos and Ruffles with 50% less salt as well as high teens volume growth in variety packs, which provide both portion control and value. Investments in branding and marketing help to drive volume for our Stacy's Pita Chip brand up nearly 40% in the quarter. And as Indra mentioned, our Sabra JV recently opened a new plant in Virginia. This facility more than doubles the production capacity for Sabra and is a prime example of progress we are making to expand into adjacent categories in our macro snacks business.

Turning to Quaker. Volume was down 2%, net revenue was down 6%, and operating profit was down 14%. There's no doubt, we would have liked stronger performance from this iconic health and wellness brand. The fact is, we've underinvested in this brand and we're now moving forward with a plan to refocus, strengthen and extend the advantages of the Quaker portfolio by improving quality, aggressive investment in innovation, and delivering greater differentiation in the marketplace. Quaker's an important part of our nutrition co-initiative and we're investing to build layers of advantage in everything from consumer insights, to product innovation, to productivity, to enhancements to seed the shelf supply chain management. I should note that this will take some time.

In the interim, QFNA has stepped up near term innovation and value initiatives which we believe will drive improved performance through the back half of this year and beyond. For example, in the second half of this year, we're improving the texture of our core instant oatmeal products, and reducing salt and sugar. We're also introducing a multi-grain oatmeal for adults and a fun new product for kids called Kids Creations. So we have a clear plan for Quaker to drive improvements in the short-term, and as importantly, to strengthen our competitive position and expand our portfolio to regain long-term growth.

In Latin American Foods, volume was up 2%, net revenue was up 6%, and operating profit was down 7%. In the quarter, our teams faced challenging macros in Venezuela as well as increases in commodities such as sugar, potatoes and cocoa. In addition, the division absorbed the cost of a one time legal settlement. Despite these challenges the teams navigated extremely well by taking pricing actions and implementing excellent cost control and management of middle of the P&L. In fact, if you exclude Venezuela and the one-time legal settlement, operating profit was up 3%.

Investments we spoke about on the Q1 call in value, brands and infrastructure helped to drive growth in volume and revenue as well as improvements in share. For example, at Sabritas we added routes and racks, increasing penetration, and the frequency with which with service our customers. We're also realizing the benefits of innovation and value with brands like Paketaxo, which has reached 4% of Sabritas sales. Gamesa, which took pricing to cover higher costs, attained its highest value share ever, widening the gap with its closest competitor. Gamesa's performance also benefited from investments in new routes. In the quarter, the number of accounts serviced increased 26% year-over-year.

Now, turning to PepsiCo Americas beverages. Volume was up 13%, net revenue was up 112%, and operating profit was up 80%, as we benefited from the acquisition of our two anchor bottlers. Excluding the impact of the acquisitions, volume in North America was down 1%, a 4.5 point sequential improvement versus the first quarter. PAB is keenly focused on unlocking the strategic financial and operational benefits of the bottling acquisitions. As Indra mentioned earlier, the teams have been focused on optimizing the business by driving Power of One opportunities, identifying top line and profit growth opportunities, aligning system economics, streamlining the supply chain, and increasing the flexibility of our go-to-market system.

On the operating side, we largely completed the structure and staffing of PBC, including the elimination of several hundred positions. We've also changed the structure of our food service organization to better capture growth opportunities and introduce new PepsiCo account teams to major retailers. In terms of driving efficiency, we've improved our sourcing across the US DSD system to drive savings, including moving four million cases to lower cost production facilities. And we've reduced transportation costs by leveraging our combined scale and assets to eliminate about 500,000 transportation models. We're also making great measurable progress in marketing and innovation, evidenced by improving brand scores, third party recognition of marketing excellence, and improvement in growth trajectories across the portfolio.

Some examples include hydration, which includes sports drinks and water, we executed the successful launch of the G series in retail channels as well as G series Pro on GNC on May 1st and Dick's Sporting Goods on June 1st, driving positive volume growth in Gatorade for the first time in two years. Also in hydration, Pep gained two points of value share in enhanced water, driven by the continued strong performance of Sobe Lifewater, which is now the number two enhanced water brand in measured channels. In nourishment, which includes juice and juice drinks, we saw sequential improvement on the strength of Trop 50 and juice drinks, as well as a strong promotional calendar. And in enjoyment, which includes CSDs and ready to drink teas, the trajectory of CSDs continued to improve, benefiting from increased awareness, generated by the Pepsi Refresh project, trademark Dew and DEWmocracy, and strong promotional activity in unmeasured channels.

Teas had a strong quarter with Lipton Ready-to-Drink tea volume up mid teens in measured channels, aided by about 70% volume growth in Brisk, which was driven by the success of the one liter package. There's no doubt that category dynamics in North America are still very challenging. We're being surgical about delivering value to the consumer where it's appropriate, and we are driving the optimal balance between volume and pricing. It's clear that the steps we are taking to rebuild the beverage portfolio are working and driving positive results. We will continue to execute on these plans, while remaining committed to improved margins over time, to deliver greater consumer value in the marketplace.

In Europe, snack volume was up 2%, beverage volume up 10%, net revenue up 43%, and operating profit up 25%. This is the first quarter that our acquisitions of PBG and PAS are reflected in our international results, and the pick-up of the bottling operations largely drove these results. The acceleration we spoke about in Q1 did in fact continue in the second quarter, and the teams did an excellent job driving improved sequential performance and broad-based gains across both our snacks and beverage businesses. Despite challenging macro conditions, Europe's strong performance was driven by a consistent focus on growth, innovative consumer value initiatives, and a continued track record of driving productivity.

In snacks, we saw improved category performance across both Western and Eastern Europe, underpinned by strong commercial programs like our sandwich promotion in the UK, and Turkey's Do us a Flavor program for Doritos. Portfolio transformation continues across Europe with the Matutano Seeds launch in Iberia, and we continued to expand our local relevance in Russia with the launch of [Kerstein] Beer Sticks. Key product initiatives in the second half of this year include the kick-off of our soccer promotional activity in June across the majority of our markets and we expect our Walker's flavor cup to be bigger than the Do us a Flavor program of Q1 2009.

In beverages, we executed a seamless integration of the bottlers and our relative market share remains strong in all strategic markets. Volume grew 4% on an organic basis, which was nearly a nine point improvement versus the first quarter. This was driven by stronger performance across both eastern and Western markets. Consumer centric commercial programs drove especially strong beverage share performance in key markets, specifically Russia, Turkey, Spain, UK, and Germany. In Western Europe, we continue to drive growth with the new Lipton extensions in France, and in the UK, we completed the introduction of a new Tropicana flavor packed lineup. Also in the UK, we launched a new single serve package specifically for our no sugar products, driving single serve share gains.

In general, while volume momentum clearly improved in Q2, we are prudently operating under the assumption that we will continue to face a challenging environment in this market. We are staying focused on differentiated consumer value, with a strong commercial calendar including programs linked to soccer in both Snacks and Beverages. With currencies likely to continue to fluctuate, we believe that the combination of our balanced portfolio across both products and geographies, our ability to localize costs and our hedging programs position us well for the remainder of the year.

In AMEA, snack volume was up 16%, beverage volume was up 8%, net revenue grew 15%, and operating profit rose 6%. Broad based gains in the region drove top line momentum and as expected, profit growth decelerated versus the first quarter as we expanded our strategic investments program. A very strong productivity agenda, and tight cost controls helped offset the cost pressures. In snacks, volume growth was driven by double-digit growth in key emerging markets such as India, Egypt, China, and Pakistan, as the business benefited from their focus on value, innovation and an expanding footprint. AMEA snack highlights include the highest ever volume month for India in May, driven by their local digital version of the Do us a Flavor and value initiatives.

The launch of Doritos in New Zealand, Quaker Drinkable Oats in the Philippines, Quaker Congee in China and Lay's flavor extensions in Saudi, South Africa, and China all benefited our snacks business. In beverages, volume growth was driven by broad gains in India, Pakistan, Egypt, the Philippines, and Thailand. In China, volume was up 2%, as very strong growth in NCBs more than offset a sluggish CSD market. The business gained relative share in CSDs in the quarter in China, benefiting from our investments to expand market presence. Successful product launches included Mountain Dew in Malaysia, a new Lipton flavor in H2O in Saudi, a new flavor of [Globe and Fin] in China, and Pepsi cheer in Thailand.

Now let me turn to our outlook for the year. As you think about our performance for the balance of the year, there are several puts and takes that we expect and that you should take into consideration. First, FLNA will continue to experience pressure on volume growth as it overlaps the impact of the 20% more free promotion from last year. They will stop overlapping this at the beginning of the fourth quarter. During this time frame, we will be focused on driving unit growth. In addition to their other initiatives, FLNA is focused on driving growth and we are confident that the business will post strong operating profit growth for the year, as well as growth in volume and in revenue.

Second, we'll continue our stepped up levels of investment in R&D and innovation in QFNA as we reposition this brand. Third, while we see improving trends in LAF, we're mindful that several of the economies in the region are under significant pressure and we'll have to continue to balance cost pressures with providing value in the marketplace. Fourth, in the third quarter, we will overlap a one-time gain in AMEA which was in our core results, associated with the contribution of our snacks business in Japan, to form a joint venture with Calbee Foods Company, the snacks market leader in Japan. This gain was worth about 30 points of profit growth for AMEA in the third quarter last year.

In the second half of this year, we've accelerated our strategic investments across the entire portfolio and this will also have the most noticeable impact on our profit growth in AMEA. This in combination with the overlap of the Calbee gain will drive even more deleverage between top and bottom line in the third quarter versus the second quarter. Our disciplined approach ensures that we are measuring returns, and not investing ahead of people capabilities. We take a very long view of this region and believe these investments will be accretive over the long term.

Fifth, we continue to target $125 million to $150 million in annualized synergies from the bottling acquisitions this year, with $400 million in annualized savings once fully implemented by 2012. And lastly, we still expect our full year reported tax rate to be roughly 23% to 24%, which reflects a benefit of about four percentage points from non-core items. This brings me to our full year core constant currency EPS growth target of 11% to 13% which is unchanged from last quarter. Based on current spot rates, foreign exchange translation would be about a one point headwind for us on a full year core EPS growth. This translates to core EPS growth of about 10% to 12% for the year.

For the year, we expect management operating cash flow, excluding certain items and net of capital expenditures to be approximately $5.6 billion. Net CapEx should total about $3.6 billion, which includes about $200 million in capital investments relate ed to the bottler integration. We anticipate in total we will spend roughly $4.4 billion on share repurchases this year, and in the third quarter, we expect to make a second $600 million discretionary contribution to PepsiCo's pension fund, taking advantage of some very attractive financing rates.

Before we go to Q&A, let me leave you with what I think are the key take-aways from our first half performance, and a road map for PepsiCo for the balance of year. First, we delivered on our EPS commitments. Second, our teams navigated well with the proper balance of near term execution and investments, and where appropriate, for long-term growth. They achieved this by staying close to their customers and the evolving needs of consumers, despite a very diverse, and in certain areas challenging, set of macros. Third, we demonstrated excellent P&L discipline including driving productivity. Fourth, we made real progress on our strategic imperatives, and fifth, we made measurable and observable progress in NAB, consistent with the goals that we shared with you.

With that, I'd like to turn it over to the operator for questions. Operator?

QUESTIONS AND ANSWERS

Operator

Thank you. (Operator Instructions). Our first question is coming from Bill Pecoriello of Consumer Edge Research.

Bill Pecoriello - *Consumer Edge Research - Analyst*

Good morning, everybody. I had a couple of questions on Frito. One, I wanted to understand what was driving the strength in the single serve bags versus large bag. Is it a general rebound in convenience stores or more specific to actions you're taking. You had that strong 4% price mix. Will that continue?

And then just in terms of consumer purchasing behavior in snacks, we've been seeing the dropoff in week four. Also, consumer would be moving to value products. Is this still the case? Thanks.

Indra Nooyi - *PepsiCo - Chairman, CEO*

John?

John Compton - *PepsiCo - CEO - PAF*

Bill, hi, this is John. Yes, our single serve flex business did improve sequentially in the quarter versus Q1. I think it was driven by two factors. One is our C&G business is strengthening, and that channel grew around 3% to 4% for us. That had been flat to slightly declining in Q4 of 2009, and Q1 of this year.

The second is the food service business. And in part, that was driven by the national distribution of Doritos at Taco Bell but food service more broadly was strengthening for us, notably at Subway and some other customers. So together, single serve flex performed much better. The Power of One initiative that we just kicked off for the C&G channel this summer, I think, will only strengthen that.

The purchase dynamics question, Bill, is one where the category continues to grow in line with population growth, around 1% volume growth. And we're growing slightly faster than that, particularly in dollars. And if you look at Frito Lay year-to-date it still remains the fastest-growing consumer packaged goods company in North America, and not by a small measure but by almost 2 to 3 points relative to most other consumer packaged goods companies. The only businesses that are posting positive growth year-to-date are store brands, other than Frito Lay. So I still think that Frito Lay is growing strongly. We have great programming coming in the back half of the year. As we had in the prepared comments, we begin to lap the 20% more free bags positively in Q4 of this year. We have even greater deflation in the back half of the year, so I think Frito Lay will strengthen in the back half.

Bill Pecoriello - *Consumer Edge Research - Analyst*

Great, thank you very much.

Operator

Your next question comes from John Faucher of JPMorgan.

John Faucher - *JPMorgan - Analyst*

Yes. Thanks. Following up on Bill's question, in looking at the web deck, it looks as though you guys are expecting volume to be up for the full year, so John, can you sort of lay out how you see that playing out over the next couple of quarters? Because it would seem like that would imply a pretty big ramp-up over the back half. I'm assuming that's really the fourth quarter being up very nicely year-over-year?

John Compton - *PepsiCo - CEO - PAF*

Yes, John, remember as we said, the 20% more free lapping on Frito Lay continues through Q3, and that sort of mutes the volume impact. And in Q4 that goes away. I'm looking at the unit growth number of around 3%, and that should predict the volume growth number as we head into the fourth quarter. So when you put Q3 and Q4 together, and sort of look at half two compared to half one, yes, you will see volume growth in half two compared to half one driven by the beginning of the fourth quarter.

John Faucher - *JPMorgan - Analyst*

Okay. And continuing with the C&G impact on volumes, is that going to lessen going forward or is that going to remain about the same? Because I'm just trying to back into, for volumes to get better, what I need from a unit acceleration piece in order to get there.

John Compton - *PepsiCo - CEO - PAF*

I'm pleased with C&G. It's strengthening sequentially sort of each period for us, and this summer is the first we've seen of a national broad-based Power of One initiative between our beverage business and snack business. We're just into that as we speak. We'll see how that plays out over the summer. But we're not going to stop there. We're going to continue that in the fourth quarter as well. I think C stores progressively are going to improve.

Indra Nooyi - *PepsiCo - Chairman, CEO*

I think our Power of One initiatives are providing more value in C&G stores, and making them an attractive destination for all consumers.

John Faucher - *JPMorgan - Analyst*

Great. Thanks.

Operator

Next question comes from Carlos Laboy of Credit Suisse.

Carlos Laboy - *Credit Suisse - Analyst*

Good morning, everyone.

Indra Nooyi - *PepsiCo - Chairman, CEO*

Good morning, Carlos.

Carlos Laboy - *Credit Suisse - Analyst*

Indra, can you please maybe give us a little bit more insight on Gatorade relaunch, update on how that's coming along relative to where you thought it would be. And also if you could expand a little bit further on John's question on convenience store insights, how do you think the channel's performance holds up going forward beyond these Power of One initiatives.

Indra Nooyi - *PepsiCo - Chairman, CEO*

I'm going to have Massimo talk about the Gatorade relaunch update, and then I'll come back, Carlos, and talk about convenience stores. So Massimo, if you could talk about Gatorade.

Massimo d'Amore - *PepsiCo - CEO - PAB*

Hi, Carlos. As we planned it, we relaunched Gatorade with the G series in April, and then we followed that with the G series Pro launch at GNC and Dick's Sport on June 1st. So overall, the performance is really as expected, and within that we're very pleased with the level of repeat and trial of the two new products which are prime and recover, number one and number three. And volumes are positive, low single digit, and in addition to this we start seeing a very positive haloing effect on brand equity. Carlos, overall we are on track and we see some positive momentum, both top and bottom line.

Indra Nooyi - *PepsiCo - Chairman, CEO*

Carlos, on Gatorade, let me add my comments to what Massimo said. I think the G series launch and having a differentiated offering for GNC and Dick's Sporting Goods versus main stream channels is the first time in I think 10 years that we've had such major innovation coming from Gatorade, which is really the category. And the first time that sports enthusiasts all over the world, real participants, are having meaningful hydration innovation brought to them. So we're very optimistic about the innovation pipeline.

Remember, we're just about three or four months into the launch, and while the early indications are very positive, I think there's a lot more upside in the future because, 01 which is a prime product had to go on allocation very quickly because the demand was so high for it, we were just out of capacity. And our protein recovery product, which is 03, I think is the best protein recovery product on the marketplace, and we need to give it its own identity and pump it up.

So we are very optimistic about the future of the whole G series launch. And as we go into 2011, you'll see a lot more innovation around G series, differentiated for different groups, people who exercise versus people who are hard core athletes. You'll see a lot of interesting innovation coming out of Gatorade.

THOMSON REUTERS

So I think the core Gatorade franchise, the brand equity scores are moving up very, very nicely. The advertising is working. And we feel very good about where Gatorade is headed. So that's Gatorade.

Let's turn to convenience stores. Again, you heard what John Compton said about the C store businesses improving. Local food service is improving. All these are positive signs. But let's not forget that we are still in a difficult economic situation. Unemployment rates are still very, very high, and a lot of the C store traffic was driven by construction workers and driven by people who were willing to pay the upcharge when they go to a C store, they were willing to pay for convenience.

Now what has happened in C stores is that the value proposition in C stores has improved. C stores themselves have changed their pricing equation, and people like PepsiCo have provided very compelling Power of One programs to bring traffic back into C stores. So in a way, I think we are one of the people driving traffic into the C stores. Balance of year, you'll see a lot more Power of One initiatives that continue.

And our goal is to make C stores a compelling destination for people who don't want to spend a lot of money in a large format store but have a small amount of money to just spend to get immediate hydration needs fulfilled or their short term snacking needs fulfilled. That's our strategy going forward.

But I tell you, given the economic environment, given where we're seeing all of the unemployment figures headed, let's take it a quarter at a time, and look and see how this whole C store business evolves. I don't want to make any prediction for how this is going to evolve balance of year.

Carlos Laboy - *Credit Suisse - Analyst*

Thank you.

Operator

Your next question comes from Christine Farkas of Bank of America.

Christine Farkas - *BofA Merrill Lynch - Analyst*

Thank you very much. Good morning. It was mentioned in your comments that the bulk of the European revenue and profit growth was driven by the pickup of the bottlers. But also based on comments about strength in western Europe and eastern Europe snack growth. I'm wondering if your underlying organic business did contribute to growth there. And if you can make similar comments about your North American Beverage business in the quarter. Thank you.

Indra Nooyi - *PepsiCo - Chairman, CEO*

I just tell you about the North American Beverage business, and I'm going to toss it to Zein. The North American beverage volume, which was only down one for the quarter on an organic basis, is a tremendous sequential improvement versus first quarter of this year. So we feel very good about the trends in the North American Beverage business, in spite of a difficult category and interesting competitive activity. So I think we feel good about the improvement. But more importantly, Christine, we've been very careful in managing our price equation and making sure we don't chase unprofitable volume. And so we've been judicious in our approach, and that's why you're seeing improved profitability across the portfolio.

Let me now turn it to Zein to talk about Europe, and then come back to Eric Foss to see, Eric, if you have anything to add on this particular issue. Go ahead, Zein.

Zein Abdalla - *PepsiCo - CEO - PepsiCo Europe*

Hi, Christine. It's Zein. You're absolutely right that the strong organic performance did contribute to that strong performance in Europe. As we outlined for you on the call in Q1, our differentiated consumer value programs were starting to get traction, and we saw positive momentum coming into Q2. That did materialize. And both in terms of the quality of the volume and its translation into revenue, the disciplined management of the cost structure, the middle of the P&L also translated into very strong organic no bid growth. Good performance in our developed markets, our powerhouse businesses in the west, but also very encouragingly, our strategic markets, Russia and Turkey coming back to very solid growth in the quarter as well.

Indra Nooyi - *PepsiCo - Chairman, CEO*

Eric?

Eric Foss - *PepsiCo - CEO - Pepsi Beverages Company*

Christine, this is Eric. I would just echo a couple of points that Indra made. I think if you think about how we approach the merger and what we said we would see out of our North America business, the first thing is we had a high degree of confidence in our ability to fully capture the synergies available. We're absolutely on track in performing as expected in that area.

I think the second thing we said is we were going to improve and sustain the profitability of the business, and as Indra mentioned we've had a good quarter in second quarter, and then see improved top line growth which we've seen as well. So I think we're three for three in terms of what we said we were going to do, and we have a very good story on synergies. Our cold drink business has improved, which you know the impact that can have on this business. So we're extremely pleased with where we are.

Christine Farkas - *BofA Merrill Lynch - Analyst*

Is it fair to say, Eric, that sequentially June looked a lot better than the earlier part of the quarter driven by perhaps weather and some retail promotions?

Eric Foss - *PepsiCo - CEO - Pepsi Beverages Company*

I think to the point that John and Indra both made, I think our Power of One promotions both in large format and small format had an impact. Those really started to kick in, in that June time frame, and will continue throughout second and third quarter, so I think the answer is yes. Obviously cold drink was helped by some of the warm weather.

Christine Farkas - *BofA Merrill Lynch - Analyst*

Thank you.

Operator

Your next question comes from Judy Hong of Goldman Sachs.

Judy Hong - *Goldman Sachs - Analyst*

Thanks. Good morning.

Indra Nooyi - *PepsiCo - Chairman, CEO*

Good morning, Judy.

Judy Hong - *Goldman Sachs - Analyst*

Couple of questions from my end. First, just in terms of obviously a lot of talk about the retailer promotions, both on the soda business and in salty snacks. Can you just talk about your perspective on how that might be impacting the broader industry. And then just in terms of how you manage balancing volume and profitability in this sort of environment from your perspective.

Indra Nooyi - *PepsiCo - Chairman, CEO*

John and Eric, do you want to take that in terms of talking about your businesses?

John Compton - *PepsiCo - CEO - PAF*

Judy, let me start with the snack business again. I mean, it remains as I said, Frito Lay remains the fastest growing CPG Company in measured channels, so we're pleased with the snack business as it is going relative to other related macro snack categories. We're growing at the rate of population, if not faster, particularly in units, where we're seeing the unit growth respond up to 3%, and it's driven by our core business. The potato chip business was very strong in the quarter. Our multi-pack business, mom for family was very strong in the quarter. So I don't see anything about the Frito Lay Company in unit growth that points to it slowing down or that other related categories are picking up volume from us. In fact, the opposite as the C store business and the food service business continues to improve.

Eric?

Eric Foss - *PepsiCo - CEO - Pepsi Beverages Company*

Judy, I think from my vantage point, I think it's very important to the point that was made earlier that we stay very sensitized to the macroeconomic conditions, the category and consumer challenges, and I think we went into this year with our eyes wide open. We were very, very sensitized to focusing on making sure we strike the right balance between price and volume, and to make sure we continue to have the right consumer value price points. Power of One gives us an opportunity to provide added value beyond purely price promotion.

And I think the reality is the environment's pretty rational, and I think at the same time we need to stay very disciplined about how we think about pricing. And so I think our track record speaks for itself, and you can continue to look for us to strike that right balance based on the conditions in the marketplace.

Judy Hong - *Goldman Sachs - Analyst*

Okay. And then Hugh, just in terms of thinking about your guidance as it relates to sort of first half, second half, obviously second quarter coming in a little bit better than expected. Can you talk about what was the delta there. And then as you think about the second half, it sounds like the operating deleveraging or the SG&A expenses sort of year-over-year could even get worse in the second half. You have the investments that you've done, $0.02 out of $0.10. You talked about the EMEA issue. Is that sort of the right way to think about the second half operating deleverage?

Hugh Johnston - *PepsiCo - EVP, CFO*

Yes, Judy, a couple things on that. One, what we had previously told you is 6% roughly in the first half and mid-teens in the second half. Obviously, we've overdelivered and hit 7% in the first half, rather than the 6%. But we haven't changed the full year. So the balance of year change is down a bit.

In terms of operating deleverage, really the investments are going to hit across the P&L, so it's not one particular line item. I wouldn't necessarily focus on SG&A versus other areas. It's going to hit in different areas of the P&L. Certainly we can help you a little bit with modeling that. But the net of it is, we said we were going to invest about a dime. We've invested $0.02, which means we'll be investing about $0.08 in the balance of year, and that will hit across the P&L.

Judy Hong - *Goldman Sachs - Analyst*

Okay, but in terms of second quarter coming in a little bit better, was that more timing or was the beverage volume stronger than expected? What was the key driver there?

Hugh Johnston - *PepsiCo - EVP, CFO*

We did clearly see a little bit more strength in the beverage business relative to what we had expected. And for the full year, I think we're basically calling it exactly as we've seen it to date.

Judy Hong - *Goldman Sachs - Analyst*

Okay. Got it. Thank you.

Operator

Your next question comes from Caroline Levy of CLSA.

Caroline Levy - *CLSA - Analyst*

Good morning. Thank you for all the detail in the press release. It's really helpful. If you could just comment, perhaps this is for Eric, if we could dive a little deeper into the carbonated soft drink market. And also just to talk in North American or Pepsi Americas Beverages, what happened to price mix in the quarter?

Indra Nooyi - *PepsiCo - Chairman, CEO*

Eric?

Eric Foss - *PepsiCo - CEO - Pepsi Beverages Company*

Sure. I think if you think about volume, I think as Hugh mentioned, we saw our CSD business perform a little better, down low single digit. Non-carb business was very strong, and actually our water business was strong, led by the enhanced water performance in life water. I think all three subsegments performed better. But as I go back to the point I made earlier about striking the right balance between volume and price, given the environment, if you think about what happened on price year-to-date, the reality is that the rate increases that we had planned to take and we did take, you're really seeing that, a fairly significant mix shift. And the mix shift in the quarter took place with our mix shift moving into cans. We actually saw some shift within cans, particularly to cube in the quarter, as well as mix into unflavored water.

I think the important thing to note is, again, we're going to strike the right balance as we look forward, as I mentioned earlier. We plan to be very disciplined and look at that Labor Day time frame to put some pricing into the marketplace.

Operator

Your next question comes from Lauren Torres of HSBC.

Lauren Torres - *HSBC - Analyst*

Good morning. I was curious to hear a bit more about the progress you're making with the bottler integration in the US. At this point, you're confirming your synergy target. Just curious if you think there's potential upside there. Or just more generally speaking, now that you're further along in the process, any additional benefits maybe now that you're further along through this integration that you may not initially or that you didn't initially anticipate?

Indra Nooyi - *PepsiCo - Chairman, CEO*

Hugh?

Hugh Johnston - *PepsiCo - EVP, CFO*

Yes, so as I said in the opening, we've said 125 to 150 for this year, and 400 over three years. Now, as you get further into it, obviously you learn, your plans evolve and develop. We see different ups and downs in that. But in terms of where we are right now in communicating to all of you, we're reaffirming that those are the numbers that we feel comfortable sharing with you, are going to be the synergies we would deliver.

I don't want to leave you the impression that we're not shooting for more, but these are the numbers that we feel comfortable sharing with all of you. And obviously as we get further into it, our degree of certainty in delivering those numbers goes up as we build more specific plans around executing against them.

One of the things that's been terrific both with Eric's team and with Zein's team is they are now building and have built in most cases very, very detailed execution plans on exactly how we intend to realize those synergies, where they're going to come from, what actions need to happen, by what date, and who needs to take them. So we are -- we have an increasingly higher and higher level of confidence that we'll be able to hit the numbers that we shared with you.

Lauren Torres - *HSBC - Analyst*

And just curious, generally speaking, now that you're further along, are there any surprises with respect to more benefits or something that's a little bit more tangible that you're further in this process that you could realize.

Indra Nooyi - *PepsiCo - Chairman, CEO*

No surprises. I tell you, the teams are working exceedingly well together, and I think it's hard to separate out now the bottling Company from the original PepsiCo. Everybody's blended in so well. And as Hugh said, if there are upsides to our synergy targets, because we constantly look for them, we'll come back and give you an update. So as we do in every quarterly call, we'll give you an update on the synergy estimates, and if we exceed it we'll talk about it.

Hugh Johnston - *PepsiCo - EVP, CFO*

If I could even add just one comment to that, Indra, if anything's been a surprise and it's not a surprise in the way that you would think about it, it's how quickly the organization has come together. This really feels like it's always been this way, and it's just been a few short months still the deal was closed. But it's just working so smoothly and so easily across the teams, you really don't know who used to be a part of which prior organization. That's a positive.

Indra Nooyi - *PepsiCo - Chairman, CEO*

Eric, do you want to add something to that?

Eric Foss - *PepsiCo - CEO - Pepsi Beverages Company*

No, I think the reality is the integration is on track. The synergies are as expected. I think the benefits of one voice, one face to customers, some of the benefits we're starting to see in service, the benefits of Power of One. In addition to the benefits of the synergy unlocks to me are quite pleasing at this point in time. So we're very, very happy.

Lauren Torres - *HSBC - Analyst*

Very good. Thank you.

Operator

Next question comes from Kaumil Gajrawala of UBS.

Kaumil Gajrawala - *UBS - Analyst*

Two questions. First thing, there's been quite a bit of step-up in spending since really November of 2008. Is this the appropriate level of spending we should think about long-term, or do you feel that there's a period of time where you could pull back the throttle a little bit as top line steps up.

And then second question, any update on the distribution overhauls at Frito? Thanks.

Hugh Johnston - *PepsiCo - EVP, CFO*

Hi, Kaumil, this is Hugh. You said a stepup in spending. What are you referring to?

Kaumil Gajrawala - *UBS - Analyst*

November 2008 was the beginning of the refresh campaign, and then we've had obviously some of the step ups that we've talked about over the course of last year. So there's been a variety of different programs over, now about 20 months.

Hugh Johnston - *PepsiCo - EVP, CFO*

Your reference is to marketing spending or -- I'm trying to understand where it is that you're -- .

Kaumil Gajrawala - *UBS - Analyst*

Some of it's been marketing. Some of it is obviously is the build-out in China. There's been a variety of things.

Hugh Johnston - *PepsiCo - EVP, CFO*

What we've told you on that is, through the integration and through the algorithm that we put together for this year, we've got about $0.10 which we committed to investing in 2010. We've told you that of the $0.10, we've spent $0.02 year-to-date, and that we intend to spend $0.08 in the balance of the year, and our plans are very, very much on track to spend that full $0.10. That's the spending that I'm telling you is going to be happening, and we feel very comfortable that that's the right spending.

You should also feel comfortable that we have built very disciplined processes around looking at these investments, to ensuring that we're taking the right actions, and to ensuring over time that we get the right types of paybacks and the right types of returns on the investments that we're making. So from that standpoint, no real change relative to what we've been communicating for a while.

Kaumil Gajrawala - *UBS - Analyst*

Okay--.

Indra Nooyi - *PepsiCo - Chairman, CEO*

We feel good about the fact that we have these opportunities. We have opportunities in China because our spending is giving us volume growth and improved profitability. The investments we made behind our brands in North America are resulting in tremendous improvements in brand equity scores. The investments we're making in NutritionCo are strategic investments, we are confident will start paying dividends starting 2011 and beyond.

As Hugh said, we're looking at the fact that we have so many investments in front of us, and each of these investments have a pretty good return in front of it, some in the short term, some in the medium and long term. So we're looking at this as a portfolio of investments, and we'll keep investing until we get the growth. As long as we get the growth and as long as there's a return on those investments.

Kaumil Gajrawala - *UBS - Analyst*

Okay. So the $0.10 is more of a run rate, though, it's not a one year $0.10 step up.

Indra Nooyi - *PepsiCo - Chairman, CEO*

$0.10 this year. And then as we said, we'll come back next year and talk about what's the return on the first $0.10, and what comfort level do we have with keeping this going or increasing it or decreasing it. We'll come back and talk to you I guess when we talk about the Q4 earnings in early 2011.

Hugh Johnston - *PepsiCo - EVP, CFO*

But to indra's point, that does not imply any change relative to what we had shared with you in previous investor meetings regarding our outlook for 2011 and 2012. That remains unchanged.

Kaumil Gajrawala - *UBS - Analyst*

Got it, thank you. And then on Frito?

John Compton - *PepsiCo - CEO - PAF*

No change from the investors conference in March. We're very optimistic on GES, the transformation of the go-to-market system. We continue to build out Perry, Georgia. We began the construction in Topeka, Kansas. We laid out the calendar for 2011. We committed at the conference that this is a multi-year journey as we go forward, in part enabled by SAP that we have to plug into Frito Lay. So it's a five-year-plus journey that we're undertaking. But every day that goes by we become more pleased and more confident that we've chosen the right strategy in how to extend the DSD advantage that we have today.

Kaumil Gajrawala - *UBS - Analyst*

Got it. Thank you.

Operator

Your next question comes from Ann Gurkin of Davenport.

Ann Gurkin - *Davenport & Company - Analyst*

Good morning.

Indra Nooyi - *PepsiCo - Chairman, CEO*

Good morning.

Ann Gurkin - *Davenport & Company - Analyst*

Just curious, as you review your operations globally, given the continued challenged economic environment and high unemployment rates, are there any areas, either consumer behavior or markets where you feel you need to change your viewpoint as you look over the next six to 12 months?

Indra Nooyi - *PepsiCo - Chairman, CEO*

Change our viewpoint in terms of what, Ann?

Ann Gurkin - *Davenport & Company - Analyst*

Either more optimistic or more conservative, given the world remains very challenging, just wondering are there any changes in your outlook.

Indra Nooyi - *PepsiCo - Chairman, CEO*

East or the Middle East remains pretty robust, and you see the numbers, both top line and bottom line, and tremendous investment opportunities, so we feel good. I tell you, the European economy's coming back, at least for our categories, gives us some room for optimism there. But again, let's watch and see how it evolves over the next couple of quarters, but the second quarter, how the European business performed was pretty good. Latin America, I think parts of Latin America have deteriorated since the last quarter, but Brazil is still very, very strong. And so since we have a big business in Brazil, especially our snack business, we're doing quite well. But again, I'd say it's a mixed picture in Latin America.

And North America, the rays of hope are convenience store coming back and food service actually trending positive, so those are positive signs for PepsiCo. But again, Ann, I'd say to you that this is one situation where we've got to look at it every quarter because the economic environment is not showing consistent improvement across all measures. And so let's watch and see what happens as the year progresses, and every quarter we'll talk to you and as we make our visits with all of you we'll give you more color. But I'd say that east of the Middle East, positive. Europe getting more positive. Latin America, mixed, and North America is wait and see.

Ann Gurkin - *Davenport & Company - Analyst*

That's great. Thank you very much.

Indra Nooyi - *PepsiCo - Chairman, CEO*

So let me just close then, and say that as you think about our performance for the balance of this year and beyond, I want you to keep in mind several important advantages that PepsiCo has that we believe will allow us to achieve our objectives in this environment. First, we have an unrivaled portfolio of powerhouse snack and beverage brands with large scale reach into both developed and emerging markets. Second, we have localized seed to shelf supply chain. We are advantaged go-to-market system and increasing scale in key markets.

Third, we have experienced management teams that understand their local markets, they're able to unlock growth opportunities while managing cost and cash flow. Fourth, we have a disciplined and rigorous strategic investment program that will fuel future growth and productivity, particularly in emerging markets and adjacent categories. Fifth, we have an aligned organization focused on clear initiatives that drive near term performance, while at the same time enhancing opportunities for long-term growth. Sixth and lastly, we have a portfolio that works. In any quarter, there will likely be some puts and takes in individual businesses, but the overall portfolio works.

These attributes are what gives us confidence that PepsiCo can deliver differentiated performance in the second half of this year, providing a strong base for 2011 and beyond. So with that, let me just say thank you for joining us today.

Operator

And ladies and gentlemen, that concludes PepsiCo's second quarter 2010 earnings conference call. We appreciate your time. You may now disconnect.