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# PEP - PepsiCo at UBS - Best of Americas

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## CORPORATE PARTICIPANTS

**Dylan Haverty-Stacke**
*PepsiCo, Inc. - Director of IR*

## PRESENTATION

**Dylan Haverty-Stacke** - *PepsiCo, Inc. - Director of IR*

Thank you very much for your time -- over the last day and a half or so I've met many of you in person -- and for your time this morning. It's a real pleasure to be in London this week and people had a chance to try some of our great PepsiCo products, there's plenty more outside on your way out if you haven't had an opportunity yet.

Before we begin, if you could please just take note of our cautionary statement. Thank you very much.

Today I will focus on how PepsiCo is positioned for long-term growth and in particular how the combination of PepsiCo's uniquely powerful brands, great products and advantaged operating capabilities have allowed us to identify and unlock growth opportunities while appropriately driving productivity in what's been a difficult economic environment. And as an organization how we are focused on the right initiatives to continue driving strong growing cash flows.

So we are the second largest Food & Beverage business in the world and, across the total consumer space, PepsiCo is the third largest CPG business in the world. And we are the largest Food & Beverage business in North America and the largest CPG business overall in North America. So this is an incredible position of strength to start from, but we believe we have more than size in our favor.

PepsiCo is fortunate to operate in what are large, vibrant categories that are enjoyed every day by consumers in both developed and emerging economies. Globally Macrosnacks is about a $200 billion business. Now we play mostly in the savory piece of that which is about a $60 billion segment. Beverages are a $400 billion category and as -- retail prices around the world, which includes about $100 billion just in North America and we have products across the whole beverage spectrum.

So both snacks and beverages have a history of growing volume on a global basis and are expected to continue growing volume in the future because of population growth and the innovation that we can do and because per capita consumption for most of the world is still relatively low. So emerging markets have per capita consumption in savory snacks and beverages obviously that are much less developed -- much less than in developed markets.

There are quite a few catalysts for the per capita grow in emerging markets -- increased urbanization, a growing middle class, more women in the workforce, more disposable income -- just to name a few of the drivers. So, what does all of this mean for PepsiCo?

Well, we have about $100 in net revenues for every man, woman and child in North America, or in the United States at any rate, but only about $3.5 for every person in the rest of the world. So there are multiples of revenue that we can get. And we believe we have exactly the right global footprint to capture that opportunity. We're about equally split between beverages and snacks in terms of net revenues; this is a 2009 pro forma view. And geographically we're about 60-40 North America and international.

What these charts don't give you is a sense of the scale of our business. As I mentioned before, we are the largest CPG in North America, but we also have tremendous scale in emerging markets. They are about 31% of our snacks revenue and 24% of our beverage revenue. The combination of snacks and beverages is about $15 billion in emerging market revenues for PepsiCo.

And because the pricing that we have in emerging markets is obviously lower than pricing in the developed countries, actually from a volume standpoint it's more oriented towards the growth opportunities; almost 37% of our snack volume and 44% of our entire beverage volume is coming from emerging markets. And importantly, we are shared positioned between 30% and 80% in most of the key emerging markets and that's really built on impressive scale in most of these countries.

So, we have five emerging-market businesses, each of which has more than $1 billion in revenue, two snack businesses and three beverage businesses. And the biggest of course is in Mexico on this snack side where between Gamesa and Sabritas we are about $3 billion combined. And we also have 17 operating companies in emerging markets that have revenues north of $250 million and we probably have a couple dozen companies that are just under that size waiting to grow into this category.

So that means we have really scaled businesses in these countries. And by being part of the fabric of these countries and really connected with the local consumer we have the ability to continue to grow with them. So in both emerging markets and in the developed world PepsiCo is also a company with incredible reach.

If you look at our reach in terms of the stores that we call on, we operate over 100,000 routes directly or through our bottlers worldwide. Through those delivery routes we serve about 10 million outlets around the world. Most of them but we visit on at least a weekly basis and we generate $300 million in retail sales every day. So PepsiCo is a big company with tremendous reach, so what?

Well, interestingly is this reach and the fact that we touch so many consumers and customers around the world; it allows us to have a granular understanding of what's happening on the ground with the consumer. So whether they actually come into the stores or not, are they feeling the pinch of the economy, how are shoppers making their purchasing decisions? So our local management teams have a very good feel for their markets and that informs our execution and our strategy as a company.

The other thing that's distinctive about PepsiCo is that we're a highly integrated company. We have total operating control of 85% of our system revenue, this is the after the acquisition of PBG and PepsiAmericas. We're very comfortable marrying the nuts and bolts of being an operating intensive company to managing powerful consumer brands. So our business has been built on a portfolio of $1 billion brands and that's really unparalleled, we believe, in the Food & Beverage world, the diversity and strength of these brands.

With the addition of Pepsi MAX in 2009 we reached 19 brands that each generate more than $1 billion in annual retail sales. What's really incredible about this I believe is how quickly this $1 billion club has grown. So we've gone from six $1 billion brands 20 years ago to 11 $1 billion brands 10 years ago to 19 last year. That's really a testimony to the great brand building skills of PepsiCo.

And each of these brands has great brand equity. They're trusted by consumers in their local markets, what we refer to as Lovemarks with improving brand equity scores based on the detailed scorecards that we measure. And we really feel great about this global brand portfolio. So we have a whole range of brands between $250 million and $1 billion in retail sales that are really to become the $1 billion brands, and just some examples are shown on the right side here. This is really a very strong and growing portfolio.

So together these operating capabilities that I spoke about, the great products that consumers love and the strong brands that you see here have driven stellar financial performance. Over the last 10 years we have grown revenues 7% annually, core division operating income 8% annually and core EPS 12%.

And even over the last five years in more difficult economic conditions revenue has grown 8% annually, core division operating income 7% and core EPS 10% annually. And in 2009 specifically in one of the most difficult economic environments where we were faced with very high unemployment, record inflation and deteriorating macroeconomic conditions, we still delivered on our numbers.

So, as you know a very, very challenging environment. We did a good job of keeping consumers with us, with a flat volume despite taking significant pricing to offset the commodity inflation that we experienced and we increased our margin so that we grew constant currency division operating income faster than revenue.

Because of the pending bottling transactions we weren't able to do any share buybacks and in prior years we were also selling shares of the bottlers as they did their buybacks, so we couldn't do either of those two things last year. That was worth about 2 to 3 points of growth, so even in this the most -- the worst imaginable economy, on an apples-to-apples basis we believe we would have grown EPS at 8% to 9%.

And management operating cash flow, excluding certain items, increased 16% through a renewed focus on working capital management and reduced capital spending consistent with those flat volumes that we saw last year. So we did all of that also though while continuing to invest in key areas. So we increased our spending in R&D, we continued our SAP business process transformation and we continued to invest in our North America beverage business as we continue to turn that business around.

So if we could just fast-forward to the midway point of this year as a macro economic environment, especially in the developed markets -- Eastern Europe and some parts of Latin America, have not been particularly good -- but our teams have done a superb job navigating through these rough economic waters with strong marketing programs, innovation as well as productivity improvement.

We have driven broad-based growth across our global snack and beverage portfolio, especially in emerging markets, and we've now largely completed the integration of PBG in PepsiAmericas and Mexico and Europe and we're right on track in North America. So globally the integration of the bottlers is really feeling incremental what we call Power of One opportunities.

As promised we've taken some of the P&L accretion from the bottling transaction and stepped up incremental investments in our strategic initiatives to enhance our competitive position in the short-term as well as improve our earnings profile and unlock long-term growth.

We continue to drive our management operating cash flow bringing the Q2 year-to-date increase to 26% excluding certain items. And as we continue to return value to our shareholders through share repurchases and dividends we've brought the total distributed to shareholders through the middle of the year to nearly $5 billion.

The second quarter was the first full quarter of consolidating bottlers' results with a significant increase in beverage volumes and revenue as a result. However, even on an organic basis beverage volumes were still up a healthy couple of percentage points and core constant currency EPS grew 7%.

So, great financial performance built on an advantage business model. What I'd like to do next is turn to some of the strategic imperatives that we are focused on as an organization and that will drive our performance over the next several years.

Some of you have either been at our investor meeting at Yankee Stadium in New York earlier this year or you may have looked at some of the materials online where we talked about these strategic imperatives. The first strategic imperative is to build and extend our Macrosnack portfolio. We're doing that by renovating and growing our core product portfolio while adding adjacencies in existing markets and expanding into new geographies.

Every market we go into we engineer layers of advantage into our business whether it's the agricultural programs, processing technology, product design or how we promote the brands. Our low cost, localized cost structure helps insulate us against going into a market, developing the category and then finding some local competitor competing with us on a different cost structure.

So globally we're shifting the portfolio aggressively from Fun-For-You to Better-For-You products while maintaining great taste that consumers love. And lastly, our snack businesses are focused on productivity, profitability and returns.

Imperative number two is to sustainably and profitably grow beverages worldwide. Within that goal one is to restore North American beverages to sustainable profitable growth starting this year. Goal number two is to invest aggressively in emerging markets with an objective of getting to leadership and parity. And third, we're stepping up our innovation and research in natural sweeteners.

Fourth, as a brand building company we do monitor our brand equity scores globally very, very carefully. We use uniform scorecards and especially focus on those brand equity scores that drive purchase behavior. We're going to be very judicious about capital spending and A&M investment, especially in North America. And six, execute, execute, execute. So this is an operationally intensive business and we have to earn our share every day on the shelf.

The third imperative is to build and expand PepsiCo's large and profitable nutrition business. Today about 18% of revenues come from our nutrition businesses. The profitability is in the midteens and over the last three years we've grown this business about 10% annually, so it's a very, very attractive part of the portfolio.

Now these brands we build really resonate with consumers and in addition to the brands you may be most familiar with -- Quaker, Tropicana, Gatorade and sports nutrition, there's also Copella Apple Juice here from here in the UK; Lebedyansky, a large juice business in Russia; Sandora in the Ukraine; Alvalle in chilled soups in Spain.

Then on the food side we have the new Sabra joint venture for hummus and chilled dips in the US, as well as a dairy joint venture we just entered into with Almarai, a large integrated dairy company in Saudi Arabia.

So the strategy to succeed in the Good-For-You space is very different from what has worked for us in the Fun-For-You and Better-For-You categories in terms of the skill set required, how you talk to consumers, how we apply our strength in research and development and agriculture as well as obviously the competitive set and the growth opportunities.

The strategy though -- sorry, our goal though is to win in these categories and to triple our revenues by 2020 and we'll have further updates on our nutrition strategy in coming quarters.

The fourth imperative is to increase the power behind Power of One. So across beverages this represents one of the biggest breakthroughs resulting from the bottler transactions. The integration allows us to build a leaner, simpler and more agile organization that's equipped to capture the synergies as well as accelerate growth and achieve sustainable long-term success.

And importantly, this strengthens our position in the world's biggest and most profitable beverage markets in North America, it increases our scale and strength and makes us more relevant to retail customers. Possibly the biggest strategic benefit is our ability over time to unlock top-line growth by innovation with these integrations.

Across PepsiCo we can do more product bundling between beverages and FritoLay and we can experiment with other innovation in areas like go-to-market systems. With customers we're sharing shopper insights and we can find ways to make the overall supply chain more efficient.

And finally, we're extending beyond our borders to partner with comparable noncompetitive companies in areas such as procurement and R&D. An example would be our recent venture with A.B. InBev where we've combined purchasing in several categories and we can use each other's purchasing scale and best practices to eliminate waste and reduce cost.

The fifth imperative is to deliver on our environmental sustainability commitments. We a recently laid out some very bold goals in the areas of water, recycling and energy usage.

That brings me to imperative six, which is to continue to refresh our capabilities. If we start with Accelerate Top-Line Growth, which is really critical to our long-term success, we're constantly refreshing our innovation capabilities and we're rethinking consumers unmet needs including innovation for specific cohort groups or demographics.

We're looking for creative ways to engage the consumer at that moment of truth when she makes her purchasing decision. So at the shelf through package design and retail theater and at home when she prepares her shopping list because in this value economy the moment of truth has shifted.

We are constantly assessing the role of brands and the preservation of their equity in this more fragmented world. We're training our lot of people to build brands in the new digital world mastering tools like social media and cell phone promotions.

The other area where we are refreshing to drive top-line growth is research and development. So with our Chief Science Officer, Mehmood Khan, who spoke at our investor meeting in March and the team that he has built, we now have an outstanding capability inside PepsiCo and are fast moving to become a science lead company.

In the human resource area there's a lot of work going on in how we hire, retain and develop our people. I'm not going to go into detail on that in this setting, so I'd like to turn to how we create an efficient middle.

PepsiCo is a highly productivity oriented company. We have an operating culture and we believe we manage to the right of the decimal place very well. We're also challenging ourselves to come up with transformational initiatives in new disruptive technologies. If you take a look at our total net revenues, about 45% of that is what we would call compressible cost. So, that's essentially everything before operating profit that's not either commodities or advertising.

So on an ongoing basis we have been getting about 3% productivity off of that base of compressible cost, that's worth $800 million a year in savings from a combination of continuous improvement plus transformational initiatives. So productivity has been and continues to be a very important source of funding for growth and a driver of PepsiCo's ability to drive operating profits ahead of revenue growth.

So for the next couple of years we're targeting top-line growth in North America in the mid-single digits, and strong international revenue growth in the high single digits. With productivity and growing scale in our international businesses we're expecting our operating income to grow faster than our revenue.

And that (inaudible) into EPS this way -- from the high single digit growth in line of business we'll have 2 to 3 points of leverage from the debt that we took on in Q1 this year for the bottling transactions as was the resumption of share buybacks. And then we expect we'll get another percentage point of growth in 2011 and 2012 as we capture the remaining synergies from the bottling integration and that's what gets us to low double digit core constant currency EPS growth.

From a capital structure standpoint we need to make sure we have the financial flexibility that we need and ready access to capital and credit markets at favorable interest rates. We do generate a huge amount of cash each year and we're expecting that our operating cash flows on an ongoing basis will be in-line with our core net income growth -- at least our rate of growth.

We generally return all of our free cash flow to shareholders in the form of dividends and share buybacks. And we don't expect that the tuck-in acquisitions, the small to midsize mostly international acquisitions that we've been doing to have any impact on the share buyback.

So, before we move to Q&A, if I could wrap up. As you think about our performance going forward, there are several important advantages that PepsiCo has that we believe will allow us to achieve those objectives.

First, we have an unrivaled portfolio of powerhouse snack and beverage brands with large-scale breach into both developed and emerging markets.

Second, we have a localized [seed] to shelf supply chains, advantaged go-to-market systems and increasing scale in key markets.

Third, we have experienced management teams that really understand our local markets and are able to unlock growth opportunities while managing costs and cash flow.

Fourth, we have a disciplined and rigorous strategic investment program that will fuel future growth in 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.

And sixth and lastly, we have a portfolio that works. In any quarter there are going to be some puts and takes in individual businesses, but the overall portfolio works.

So these attributes are what give us confidence that PepsiCo has a strong base to deliver differentiated performance. So with that, let me just say thank you for your attention and I'll be glad to take any questions.

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## QUESTIONS AND ANSWERS

**Unidentified Audience Member**

(Inaudible question - microphone inaccessible).

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**Dylan Haverty-Stacke** - *PepsiCo, Inc. - Director of IR*

Please.

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**Unidentified Audience Member**

(Inaudible question - microphone inaccessible)?

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**Dylan Haverty-Stacke** - *PepsiCo, Inc. - Director of IR*

Yes.

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**Unidentified Audience Member**

(Inaudible question - microphone inaccessible)?

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**Dylan Haverty-Stacke** - *PepsiCo, Inc. - Director of IR*

Promotional activities that pays for itself can be a bad thing. We took -- PepsiCo 2010 is a deflationary year for us in terms of input costs. We took quite significant pricing in 2008 mainly, that was really the last big round of visible pricing to the consumer, certainly North America. And most of that pricing is still in the market now.

So this year, for example, in our FritoLay North America business, while you wouldn't expect to see any significant visible pricing on the top-line, we said that we will experience above the normal rate of profit growth as a result of the commodity deflation in that business. Some of that will be reinvested in growth in terms of A&M and additional go-to-market routes and some of it, though, will fall to the bottom line.

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**Unidentified Audience Member**

(Inaudible question - microphone inaccessible)?

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**Dylan Haverty-Stacke** - *PepsiCo, Inc. - Director of IR*

Like I said, that pricing that we took in that period of very high inflation in 2008 was very significant and that's still in the market.

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**Unidentified Audience Member**

Looking at the slides you show us, the price differential between emerging markets and developed market is way bigger in drinks than in snacks. Could you please explain to us why is that, the reason why? And looking forward, if you think that the gap is going to close (inaudible) prices for -- will probably go up in emerging markets.

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**Dylan Haverty-Stacke** - *PepsiCo, Inc. - Director of IR*

Yes. Part of that difference was the structural difference in the business model between developed, especially North America, and emerging markets. So those numbers were on a pro forma basis including the bottling transaction and therefore was mostly finished goods revenue in the developed markets. Whereas in emerging markets we tend to be more of a franchise business. So that explains most of that difference.

And in terms of pricing, I mean clearly pricing should be and is lower in emerging markets. You have lower costs and you have people entering our categories at a lower point in the socio economic scale. And our objective is to give consumers the value that they're looking for, keep them with us and maximize the available growth opportunities.

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**Unidentified Audience Member**

You talked about share buybacks and you suggested that be an ongoing feature of the Company in the future. Can you -- presumably that means you think the PepsiCo share is somewhat undervalued. Can you tell us the nature of the analysis that is being performed that led you to come to that conclusion?

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**Dylan Haverty-Stacke** - *PepsiCo, Inc. - Director of IR*

After we've invested in growth internally what's left is management operating cash flow, what you might think of as free cash flow. And our past practice has been to return essentially all of that to shareholders. We do want to maintain the financial flexibility that I talked about, but essentially our past practice has been to return all of that free cash flow to shareholders and we've done that in a balanced way between dividends and share buybacks.

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**Unidentified Audience Member**

(Inaudible question - microphone inaccessible)?

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**Dylan Haverty-Stacke** - *PepsiCo, Inc. - Director of IR*

We don't go into detail in exactly how the mechanics work of the share buyback program. But -- we don't go into detail on that.

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**Unidentified Audience Member**

With the integration of the bottlers will it (inaudible)?

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**Dylan Haverty-Stacke** - *PepsiCo, Inc. - Director of IR*

Not essentially, our strategy remains the same which is to provide sufficient visibility into future cost for those people who are managing the pricing and promotion decisions and making promotional calendar plans with the retailers and they have sufficient visibility into the input cost to make reasonable plans. We always had a joint procurement function combined with the bottlers, so there really is no significant change with the integration.

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**Unidentified Audience Member**

Why didn't you take any pricing in the carbonated soft drink market in developed economies given that the affordability of your products on inflation on an adjusted basis probably at an all-time high and you're operating a duopoly?

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**Dylan Haverty-Stacke** - *PepsiCo, Inc. - Director of IR*

Why do we?

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**Unidentified Audience Member**

Why don't you?

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**Dylan Haverty-Stacke** - *PepsiCo, Inc. - Director of IR*

Why don't we? I mean, I think we've been as a PepsiCo system and I'm thinking especially North America here, the PepsiCo bottlers in North America have been pretty disciplined about taking pricing. Most years they do it after Labor Day each year and that's been a pretty consistent pattern.

And I would say that the pricing environment is pretty rational. It's clearly a competitive market and you make your decisions within that context. But I think we've been -- the PepsiCo bottlers have a good history of being disciplined, rational prices and essentially it's the same management team running the bottling business today. There's a question here.

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**Unidentified Audience Member**

Can you comment on volume trends yet, especially on the back of Wal-Mart's promotional activity?

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**Dylan Haverty-Stacke** - *PepsiCo, Inc. - Director of IR*

I mean, there was a lot of promotional activity around cans in North America around Labor Day. But our feeling is mostly what that did was cause some channel shift and mix shift within the category rather than really having a big impact on the category overall.





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On the food side, FritoLay is overlapping pound growth in the prior year that was driven by a special promotion we ran during Q2 and Q3 finishing in the first week of Q4 last year. But actually unit growth in FritoLay grew low single digits in Q2.

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**Unidentified Audience Member**

(Inaudible question - microphone inaccessible)?

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**Dylan Haverty-Stacke** - *PepsiCo, Inc. - Director of IR*

Sure. So the question was, of the 19 $1 billion brands how many of those did we develop internally? I'm looking at the list here, maybe -- can we put that slide back up? It was slide 12. But I think just about all of these actually. Some of them were more historical acquisitions like Walkers for example in the UK. But I think it's grown for a very long period of time under PepsiCo.

I'm just looking at these here. I think Lipton is a joint venture with Unilever, but again, we developed that together. Slide 12, if you could. 7-Up we acquired the international license for that, but Gatorade we -- and Tropicana we acquired 10, 12 years ago. So, I think we feel pretty proud that most if not all of that brand development has been with PepsiCo.

In terms of R&D, we've -- as you look at the increased segmentation in especially the beverage category but also in foods, the more differentiated and focused functional benefits you can bring to consumers I think the more advantaged you'll be.

And we saw an opportunity with Dr. Mehmood Khan who came on board with real expertise in the area of developing an R&D function that's science-based that can effectively partner with other organizations to really capture some of those opportunities, can be a meaningful driver of growth for us.

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**Unidentified Participant**

(Inaudible - microphone inaccessible).

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**Dylan Haverty-Stacke** - *PepsiCo, Inc. - Director of IR*

Okay.

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**Unidentified Participant**

(Inaudible - microphone inaccessible).

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**Dylan Haverty-Stacke** - *PepsiCo, Inc. - Director of IR*

Absolutely. Thank you. Thanks very much for your time.

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