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PRESENTATION
Operator
Good morning and welcome to PepsiCo's second-quarter 2015 earnings conference call. (Operator Instructions). Today's call is being recorded and will be archived at www.pepsico.com.

It is now my pleasure to introduce Mr. Jamie Caulfield, Senior Vice President of Investor Relations. Mr. Caulfield, you may begin.

Jamie Caulfield - PepsiCo, Inc. - SVP IR
Thank you and good morning. Joining me on the call today are Indra Nooyi, PepsiCo's Chairman and CEO, and Hugh Johnston, PepsiCo's CFO. We will lead off the call this morning with prepared remarks and then turn to Q&A.

As we begin the call, it is important to note the following. We will make forward-looking statements on this call. Any forward-looking statement inherently involves risks and uncertainties that could cause actual results to differ materially from current predictions and expectations. Information on such risks can be found in today's earnings release and our most recent Form 10-K and subsequent SEC filings.

In addition, we'll discuss results using non-GAAP measures and you can find the GAAP to non-GAAP reconciliations on our website under the investor section in the events and presentations tab.
Beginning with the third quarter of 2015, PepsiCo will realign some of its reportable segments as you saw in this morning’s press release. Within the next 30 days, PepsiCo expects to provide reclassified summary segment reporting for 2013 and 2014 and the first two quarters of 2015 to reflect the Company’s new structure.

And now it is my pleasure to introduce Indra Nooyi.

**Indra Nooyi - PepsiCo, Inc. - Chairman and CEO**

Thank you, Jamie, and good morning, everyone. We are very pleased with our performance in the quarter. Organic revenue grew 5.1% with global snacks up 8% and global beverages up 2%. Core gross margin improved by 115 basis points. Core constant currency operating profit grew 8% and core constant currency EPS grew 11%.

Based on the strength of the quarter, our overall first-half results, and our outlook for the remainder of the year, we are increasing our full-year core constant currency 2015 EPS growth outlook to 8%.

Our businesses are performing well both in the top line and bottom line. PepsiCo Americas beverages had an outstanding quarter. 3% organic revenue growth translated to 10% core currency operating profit growth. Frito-Lay North America delivered another quarter of very strong results with organic revenue up 3% and core constant currency operating profit up 7%.

And our developing and emerging markets delivered 11% organic growth in the quarter, revenue growth, despite the ongoing volatility in many regions of the world.

Looking across some of our key D&E markets, our businesses continue to prove resilient. Turkey and Saudi Arabia achieved double-digit organic revenue growth. China, Egypt and the Philippines achieved high single-digit organic revenue growth and Mexico achieved mid single-digit organic revenue growth.

Now I assume you’ve had a chance to read the release this morning, so rather than go through the numbers in detail by segment or country, what we will do on this call and going forward is to give you an update and provide a bit more detail on each of our big initiatives to drive performance, namely innovation supported by sensible brand management, flawless execution, sales sustaining productivity, prudent capital allocation and talent renewal and management. So today we will focus primarily on innovation and touch briefly on the others. And on future calls, we will highlight one of each of the other initiatives.

So let me begin with innovation. Our innovation success today is the result of significant investments in and changes to our innovation, research and development capabilities and processes that began about eight years ago. At that time, we were an extremely decentralized organization operating as a loose confederation of geographic business units with each largely driving its own development agenda and establishing their own processes. Development was focused largely on product line extensions and that structure, while effective in its time, led to less efficient use of resources with redundant projects often being undertaken in different parts of the world and sub-optimal resource allocation to the most promising ideas.

As a result, much of our innovation lacked staying power. In part, this had to do with the quality of our innovation but it also had to do with an inability to appropriately incubate innovation in the marketplace. And to address these opportunities, we undertook a major transformation to improve our R&D function and innovation capabilities.

Specifically, we established global category groups charged with coordinating global innovation. This resulted in a more focused innovation agenda, a greater emphasis on development platforms rather than product line extensions only and more efficient allocation of development resources as we have significantly reduced redundant efforts through better coordination.
Two, we globally adopted the proprietary demand moments framework originally developed at Frito-Lay North America. The framework focuses on the triggers of consumption by examining consumer needs based on the context of the occasion. This created much stronger linkage between consumer and shopper insights in the R&D functions and has led to our innovation being more incremental to topline growth.

Three, we implemented a common disciplined stage-gate process to gain better visibility into multi-year pipeline of R&D projects, to allocate resources to the most promising ideas and new platforms, and to ensure a better balance of refresh, reframe and breakthrough innovation.

Four, to facilitate more rapid lift and shift of our most successful innovation launches from one market to another, we provided our businesses with better visibility into new products and their performance around the globe.

Five, we increased our investment in R&D starting in 2008. In fact, in 2011 to 2014 alone, our investment in R&D has increased almost 40%.

Next, more recently we established a design capability topped with world-class design talent. Increasingly, we are involving design in the early stages of innovation taking into account the entire project to consumption cycle to create truly memorable experiences for our consumers.

And lastly we are using reverse engineering, leveraging our learnings and developing in emerging markets to yield the benefits of thinking more holistically about low-cost design of new products, packaging and equipment without sacrificing quality.

We are pleased with the progress we’ve made across all these fronts and the tangible results we are seeing. Innovation as a percentage of total revenue reached 9% in 2014, an improvement of 150 basis points compared to two years ago. Three PepsiCo products received the 2015 Nielsen Breakthrough Innovation Award. This award recognizes the most successful and enduring new CPG products launched in the US in 2013. PepsiCo was the only company to receive multiple awards this year.

And over the past three years, we’ve introduced a number of new products that have achieved, or are on pace to achieve, more than $100 million each in annual retail sales including Tostitos Cantina, Mountain Dew Kickstart, Doritos Cheetos Fun Multipack Mix, and Gatorade Fierce Blue Cherry and Frost Glacier Cherry.

More recently, we are successfully using premium innovation within key categories to capture more price realization, so we launched Caleb’s Kola and launched DEWshine, a craft premium soda inspired by Mountain Dew’s brand roots in the backwoods of Tennessee.

We are also innovating on packaging. Capitalizing on the success of our consumer engaging Lay’s Do Us A Favor Campaign, we launched Lay’s Summer Days Campaign, encouraging friends to create custom digital bags of Lay’s potato chips featuring photos of their favorite summer moments to share with friends and family on social media. Adding excitement to this experience, 10,000 lucky fans will receive a real-life customized bag of Lay’s classic potato chips featuring the photo they digitally submitted, offering consumers personalized packaging for the first time in the brand’s history.

We are also capitalizing on consumer health and wellness demand. As consumers are embracing almond milk and other plant-based proteins as an alternative to traditional dairy milk, Naked Juice has launched two new nut milks, Berry Almond Nut Milk and Peachy Almond Nut Milk. And in Quaker Foods North America, our new quick cooked steel cut innovation has propelled us to the number one market position in the on trend and growing steel cut oatmeal segment by making preparation much more convenient.

Channel focused innovation is advancing our food service business. We’re launching a new line of craft soft drinks called Stubborn Soda in fountains this summer. The Stubborn lineup includes unique and contemporary takes on traditional craft flavors. Flavors include: black cherry tarragon, lemon berry asai, agave vanilla cream and pineapple cream. They contain no high fructose corn syrup and are made with fair trade certified cane sugar and natural flavors.

And, of course, we continue to refresh and reframe our key brands to maintain a high level of consumer engagement and excitement.
Now our innovation has also contributed to good market share performance in the second quarter in the United States, and I believe our results are impressive. We held LRB value share while delivering strong net price realization. We gained value share across important subcategories including sports drinks and ready-to-drink teas.

Gatorade's share of sports drinks surpassed 80%. Mountain Dew gained 40 basis points of value share within the CSD category in Q2. In fact, if you add Kickstart, DEWshine and Baja and Sangrita Blast together, it represents more than 2 points of CSD value share in the most recent four-week period placing our recent Mountain Dew Innovation by itself as the fourth-largest flavored CSD behind base Mountain Dew, Dr Pepper and Sprite.

In Q2, we grew retail sales in measured channels in the US for regular colas and Mountain Dew within CSD, for Gatorade, Lipton Tea and Naked Juice within our non-carb portfolio. And at Frito-Lay, we held value share in savory snacks and in Quaker Foods we gained value share in key categories - hot and ready-to-eat cereals - while expanding gross margin and stepping up advertising and marketing at the same time.

And our innovation is driving growth for our retail partners as well. In the second quarter, PepsiCo was once again the largest contributor to US retail sales growth among all food and beverage manufacturers with over $400 million of retail sales growth in all major channels. This was more than two times the next largest contributor to growth and represented more growth than the next 14 largest manufacturers combined. Notably, North American beverages was the key driver of US retail sales growth within PepsiCo and the largest contributor to US retail sales growth on a standalone basis.

Our intention is to continue to invest in innovation, build upon our already strong capability base and further sharpen our holistic innovation process to drive greater growth for our customers, create compelling products for our consumers, and ultimately increase the contribution of new products to our total revenue. So that's the story on innovation.

Turning now to execution, we've ramped up our execution focus across the value chain from seed to shelf. We have established clear consistent performance metrics to track and benchmark the effectiveness and efficiency of every one of our core value driving activities from safety to manufacturing utilization to transport efficiency to promotional display execution. Execution is a never ending journey as there will always be an opportunity to raise the game of the below average performance within manufacturing lines or DSD rounds. But we are seeing solid execution and steady improvement across the enterprise and this is translating to good market based performance and financial results.

Turning now to productivity and disciplined capital allocation. As you know, we have a goal of delivering $5 billion in productivity savings over five years from 2015 to 2019, which is approximately $1 billion per year. Our current program follows a similarly aggressive three-year, $3 billion program that we successfully concluded in 2014. And, overall, our productivity initiatives are driving meaningful results.

Over the three years ending in 2014, despite adverse ForEx, we realized $1 billion of annual productivity savings, net revenue per employee is up 10% and EBIT per employee is up 9%. And since 2012, gross margins have consistently expanded. Similarly, our capital allocation discipline is yielding meaningful results. From year-end 2011 to the second quarter of 2015, net CapEx as a percentage of net revenue has improved from 4.9% to 4.1% on a rolling four-quarter basis and this 80 basis point reduction equates to approximately $500 million in incremental annual free cash flow.

And since 2012 through the second quarter of 2015, core net ROIC has improved by 310 basis points to 18.4% on a rolling four-quarter basis.

And finally, people renewal and development; this is an area that I and the Board spend a lot of time on. Our focus is twofold here, making sure we have the right leaders in place today and that we are developing the next two generations of leadership for the Company. And as all of you know, good talent management does not happen in short bursts. It requires taking a long-term view and very detailed analytical planning.

At the core of our people renewal and management plan is to focus on the 200 critical leadership roles in our Company. These are the roles that are most important to our success and that provide the greatest experiential development for our executives. For each of these roles, we have developed a pipeline that ensures that we have at least one immediate successor candidate, two people in a one- to three-year timeframe and then another three people ready four to six years out.
As a result of this process we are deliberately developing top talent by giving them multiple category, geography and job experiences and ensuring we have well-developed succession plans.

The other priority we have is ensuring that we have the right balance of homegrown talent, that we augment our talent pool from time to time with exceptional executives that we recruit from outside the Company and I believe our plans are working. When we’ve had executive transitions, both planned and unplanned, they’ve been smooth and well coordinated.

And as you look at our current leadership, you will find that executives have had very broad critical experiences within PepsiCo for many years across functions, geographies and categories. People like Tom Greco, Al Carey, Sanjeev Chadha, Ramon Laguarta and Hugh Johnston, and folks that we bought into PepsiCo later in their careers to augment our skill base and stretch our thinking, people like Mehmood Khan, Laxman Narasimhan and Tony West. And we are grooming our next generation of leadership by giving them critical experiences, people like Mike Spanos, who runs our China operation or Eugene Willemsen and Brian Newman, whose promotions we announced last night.

So to conclude, we are pleased with our financial performance in the first half of 2015 and with the progress we’ve made across our value driving initiatives. Clearly there are number of macro challenges around the world, but we believe we have the right strategies and programs in place to enable us to continue to navigate successfully through the current environment.

The construction of our product and geographic portfolios enable us to continue to deliver strong results, in part, because our balanced portfolio creates a natural hedge against the global macro and political volatility that has become the new normal, and all of this bolsters our confidence in our ability to continue to achieve our financial targets.

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

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**Hugh Johnston** - PepsiCo, Inc. - EVP and CFO

Thank you, Indra, and good morning, everyone.

Turning directly to guidance, as Indra mentioned based on the strength of our first half results and our outlook for the remainder of the year, we’ve increased our full-year core constant currency EPS growth target to 8% from 7% previously. Our other targets remain unchanged.

For the full year 2015, we continue to expect mid single-digit organic revenue growth, core operating margin expansion as organic top line growth and productivity should offset negative geographic mix and commodity inflation, which incorporates the impact of transaction related foreign-exchange headwinds and approximately $1 billion of productivity savings.

Below the division operating line, we continue to expect corporate costs to be lower, a core tax rate of approximately 25% and a reduced share count. We expect foreign exchange translation to negatively impact net revenue and core earnings per share growth by approximately 9 percentage points and 11 percentage points respectively based on current market consensus rates.

Our outlook for the year assumes translation of our Venezuela results at the CCAD rate of VEF[12].8 per US dollar. Should circumstances dictate use of a higher rate, this would also negatively impact our US dollar results.

Taking our 2014 core EPS of $4.63 and applying our guidance and current market consensus of foreign exchange impact implies 2015 core EPS of approximately $4.49.

As you model out the third quarter, I would ask you to consider the following. Foreign exchange translation should have an approximate 11 point unfavorable impact on the third quarter net revenue growth and an approximate 12 point unfavorable impact on third-quarter core EPS growth based on current market consensus rates. And we expect a profit decline in QFNA as we lap last year’s gain on the sale of the cereal business.
Below the division operating profit line, net interest expense is expected to continue to increase in the third quarter versus last year driven by higher interest rates and net debt balances and our tax rate in the third quarter is expected to be higher than the third quarter of 2014.

From a cash flow perspective, we continue to expect full-year free cash flow of more than $7 billion. We expect our capital allocation discipline to continue to drive core ROIC improvement. This is building on the steady progress we’ve made in ROIC with core net ROIC up 310 basis points from 2012 to 18.4% through the second quarter of 2015 on a rolling four-quarter basis. And, consistent with prior outlook, we expect to return between approximately $8.5 billion and $9 billion to shareholders in 2015 through both dividends and share repurchases.

As a reminder, our previously announced 7% dividend per share increase commenced with the June payment. Our annualized dividend is now $2.81, an approximate 60% payout ratio based on 2014 core EPS. This represents the 43rd consecutive year of annual dividend increases and our annualized dividends per share have grown at 10% compound annual rate over the past 10 years.

So, to summarize, our core constant currency earnings per share outlook for 2015 has improved from our last call and free cash flow, disciplined capital allocation and returning cash to our shareholders remain top priorities for the Company.

With that, operator, we will take the first question.

**QUESTIONS AND ANSWERS**

**Operator**

Thank you. (Operator Instructions). John Faucher, JPMorgan.

**John Faucher - JPMorgan - Analyst**

Thanks. Good morning. Two quick questions here. One, can you just give us a little bit of the rationale in terms of the merger of the Latin American food and beverage business? Is that just sort of the regions need to manage the regions?

And then secondly, can you talk a little bit about the Frito volume, which was a little bit light relative to trends. Anything in particular going on there? Thanks.

**Indra Nooyi - PepsiCo, Inc. - Chairman and CEO**

Let me talk a bit about the Latin American merger. We are seeing success in Europe and EMEA with all of the power of one management of those regions. We are able to get more productivity, take out costs and especially with volatile economies we have to get more and more agile and more creative about how to take out costs.

And it’s not just costs within our system, John, I think even with our bottling partners there’s an opportunity to cooperate and figure out how not to duplicate efforts between the two companies and we are seeing those initiatives pay off in EMEA and Europe and we decided now is the time to do it in Latin America.

We are in the middle of a major productivity program in Latin America Foods and integrating Latin America Beverages with Foods gives us that much more of a cost base to work with.

Lastly, given the volatility of those economies there, I think it’s very important to be -- really become a lean, mean machine there in order to take the savings and reinvest it to grow the top line. So that’s Latin America.
Second is on the Frito volume. Again, we watch the Frito performance very carefully as does Tom Greco and the Frito team. In our potato chip business, we were going through a revenue management program and that revenue management program is actually yielding good revenue growth and improving topline growth and profitability for our retailers. And one of the results of the revenue management program is that it is going to impact volume because the price pack architecture shifts some of the volume to certain bag sizes which impacts volume in the short term but over the long term it’s the right thing for the business.

So I’d let it play out to the balance of the year then look at our results in 2016.

Operator

Bryan Spillane, Bank of America.

Bryan Spillane - BofA Merrill Lynch - Analyst

Just two quick ones. First, in terms of exchange rates, Hugh, you mentioned Venezuela and if you were to move to the Simadi rate, what would the impact for that be on the year and how would that affect the guidance that you’ve given for currencies?

Indra Nooyi - PepsiCo, Inc. - Chairman and CEO

Hugh, why don’t you take that here?

Hugh Johnston - PepsiCo, Inc. - EVP and CFO

Yes, happy to do that, Bryan. As you all know, we have provided pretty extensive disclosures in our 10-Qs and 10-K on the question. In the Q that we intend to file after today’s market close and consistent with past Qs, you’ll see that Venezuela represents approximately 2% of our revenue and operating profit. We also have net monetary assets of approximately $335 million and nonmonetary assets of approximately $725 million.

Now if we were to take all of that and go to Simadi, Venezuela would then represent 0% or very slightly above 0% of our revenue and operating profit. So it is roughly a 2% hit on both revenue and operating profit. We have a charge of approximately $325 million related to the net monetary assets. It would also likely lead to an impairment of our nonmonetary asset.

Now the one thing for investors to consider on this is from an economic standpoint, this really would not represent a big impact on PepsiCo given that Venezuela is largely a self-sufficient, self-funding operation. We’re not putting any capital to speak of in the country and we’ve not been able to redeploy any of our Venezuela cash outside of Venezuela. So from the perspective of cash flow and cash management, it would not have a meaningful impact on cash returns.

Bryan Spillane - BofA Merrill Lynch - Analyst

So that 2% effect on operating income though would be above and beyond the guidance that you’ve given this morning in terms of the 11% currency hit to EPS for the year. Is that right?

Hugh Johnston - PepsiCo, Inc. - EVP and CFO

That’s correct. Right now, what we are assuming for the balance of the year on Venezuela is 12.8 because that was the recent CCAD option, which was a pretty robust option. But if we did make the move to Simadi, the impact would be that much more significant.
Bryan Spillane - BofA Merrill Lynch - Analyst

Okay. And then just one other question I guess thinking about the back half of the year, it just seemed like in the first half has come in better than expected and with organic sales at mid single-digit, it seems like there’s just been a little better operating leverage; the currency neutral operating profit has been better. So, in the second half, just some higher-level thoughts in terms of why that doesn’t continue in the second half. Is there something you’re seeing on the commodity cost front? Is the flow of productivity savings? Just something that sort of raises that flag for the back half of the year that you won’t continue to kind of see the current growth? Thank you.

Hugh Johnston - PepsiCo, Inc. - EVP and CFO

Yes, I think there’s three things I would remind you of in that regard, Bryan. Number one, the back half laps particularly Q4 but both Q3 and Q4 are more challenging than the first half overlap, so we’re certainly facing more of an uphill for growth in the back half of the year.

Number two, you are correct, commodities are more of a headwind in the back half of the year than they were in the first half of the year.

Number three, again recall certainly based on what we’re seeing in the news these days, the world remains a very volatile place. We have big businesses in the Middle East. We have big businesses in Russia, and as we model things out, we obviously try to ensure that we give investors appropriate guidance, at least incorporating some of that volatility, so we’re not assuming the perfect sunny day going forward as well.

So that’s what goes into our thinking as you look at the so-called squeeze chart between the first half and the second half of the year.

Operator

Bill Schmitz, Deutsche Bank.

Bill Schmitz - Deutsche Bank - Analyst

A couple of questions. The first one is, is there a price war going on in snacks, especially in the UK? Because I look at some of the market share trends and it seems like the category is under a lot of pressure and Pringles and Kellogg’s are getting pretty aggressive. And I know it’s not a huge business but I just wonder how far that travels across Europe and what the competitive response has been? And I have a follow-up.

Indra Nooyi - PepsiCo, Inc. - Chairman and CEO

I wouldn’t call it a price war. I just think that the retail environment in the UK remains interesting. The high street retailers are going through their own set of challenges. You’ve got the entry of the discounters. All of that is causing the entire competitive situation in the UK to be reset and, being one of the major food and beverage companies in the UK and the largest salty snack company in the UK, I think we have to be careful how we make our transitions with the high street retailers and the discounters.

And so in the short term, we did lose some share but we have plans in place to recover that share and somehow navigate through these retail environment changes.

Again, Bill, I tell you around the world as we see major changes in the retail environment, always in the short term there will be some dislocation because we have to make the changes to the business model very, very carefully.
Operator
Bill Marshall, Barclays.

Bill Marshall - Barclays Capital - Analyst
I was just curious, so the syndicated data in June across a lot of categories looked a little tough. I think most have come to the conclusion that maybe that was a little bit weather-related. I’m curious if you could update us on what you’re seeing in the market and then specifically if you had any comments into the July 4 holiday, how both of your beverage and snacks portfolios were doing on a volume and price perspective?

Indra Nooyi - PepsiCo, Inc. - Chairman and CEO
I think from our perspective, our numbers look fine. We got good price realization. Yes, there was some weather-related issues in some parts of the country, but I think overall we are feeling pretty good about our results.

Hugh Johnston - PepsiCo, Inc. - EVP and CFO
Yes, absolutely, Bill. To some degree I think there’s some bifurcation between what’s happening in the center of the store and what’s happening on the perimeter. But from the perspective of the categories we participate in, with the exception of center of the store where we saw Quaker slow down -- Quaker category slow down a little bit, most of our categories are robust and saw pretty good growth across the quarter.

Operator
Kevin Grundy, Jefferies.

Kevin Grundy - Jefferies LLC - Analyst
So two quick ones for you, Indra. First with respect to North American carbonated soft drinks and broadly in the industry, and given the recent pricing discipline, which has taken hold, my question is, given this dynamic, how materially does this change your view with respect to North American carbonated soft drink profit pool and do you see mid single-digit growth now as more sustainable here looking out not just this year but longer-term?

And then as sort of a follow-up sticking with North America beverages, can you give us an update, Indra, on Diet Pepsi and the change to the formulation there? Your competitors are not following, and how you’re thinking about that, how you’re defining success there with that product? Thank you.

Indra Nooyi - PepsiCo, Inc. - Chairman and CEO
In terms of the North American CSD pricing, look, we’ve been talking about disciplined pricing for a long time, I’d say a couple of years. I’m glad that there is disciplined pricing in the marketplace right now and there’s a lot more innovation in CSD in the marketplace at least from our end.

We’re going to keep playing our game. We will focus on disciplined pricing, good revenue management, good CSD innovation out into the marketplace. And ultimately it depends on the competitive situation, what the profit pool is in this whole CSD business, or the North American beverage business in totality. But we believe this is the right way to participate and play in this very, very important and large segment.
In terms of Diet Pepsi, big business. And I think for some reason, which we cannot really explain, aspartame fell out of favor with some consumers. From our perspective, we just want to make sure we have an offering for all of the consumers who want to switch out of aspartame and we have formulated a very, very good product, which is aspartame-free and will be available in the market starting in late August.

So for all of those consumers who are looking for an alternative to an aspartame sweetened diet product, we will have a product, and for those consumers who still love Diet Pepsi with aspartame, we will figure out how to make it available online. So I think this is a consumer-driven strategy to offer all of the diet lovers a diet cola that is aspartame free.

Operator
Rob Ottenstein, Evercore.

Rob Ottenstein - Evercore ISI - Analyst

Very impressive introductions on the innovation front and progress there. So wondering if you could give us a little bit more granularity on the impact to the top line both in terms of volume and price mix you are getting from innovation?

Indra Nooyi - PepsiCo, Inc. - Chairman and CEO

I would say that innovation has allowed us to get a lot more price mix. Pricing realization in particular, something that is very, very important in today's environment. And product packaging process innovation but we are also spending a lot of time on revenue management and we are really thinking through portion sizes, pack sizes and I think this combination of interesting products coming to the marketplace in interesting packages, in interesting combinations of packages, is what's resulting in incrementality on the revenue side and actually resulting in higher profit flow through.

And we're seeing it across carbonated soft drinks whether it's DEWshine or Baja Blast or any of those products, and we are seeing it even in Europe and Russia and Latin America and EMEA where I would say creative revenue management tactics coupled with innovation that cuts through the clutter is resulting in flow through to the bottom line. Again, I think in these environments the focus should be on revenue and profit, not necessarily on volume growth. We focus more on unit growth, revenue and profit in these environments because a chase for volume results in the whole business hurting.

So I think with revenue management, unit growth, value growth and profit is what we focus on and that's what our innovation efforts are yielding today, the almost 10% -- I think the high 9% is, our innovation, performance and something that is a significant step up and we keep watching that metric very, very carefully.

Operator
Caroline Levy, CLSA.

Caroline Levy - CLSA Limited - Analyst

A question on the -- there's actually talk of Russia putting an advertising ban on sugared drinks and fatty foods and things like that. And in the context of that, I am just wondering if you see increased regulatory risk to your food or beverage business around the globe and what you think the impact might be, for example, in Russia and how you would handle that?
Indra Nooyi - PepsiCo, Inc. - Chairman and CEO

Caroline, we were among the first people to recognize this risk and we have been retooling our portfolio to make sure that first of all we have a diverse portfolio that can weather any sort of action on any part of our portfolio. But we are also in constructive conversations with governments to make sure there aren’t any discriminatory taxes or just country action on any of our categories.

Having said that, on Russia in particular, it is perhaps the most diverse portfolio of any part of our Company between dairy and juices and snacks ranging from fun for you to good for you and beverages. CSDs actually are a small portion of our business in Russia and so if you want to use an example of the most diverse portfolio of doing fun for you, better for you and good for you, skewing toward good for you, I think it’s our Russia portfolio.

So we feel good about Russia so far and we all wish there weren’t any geopolitical issues to deal with from a Russian perspective, but our business is doing well and the economy has been good to us and the Russian business environment has been good for us. So we like it.

Operator

Mark Swartzberg, Stifel.

Mark Swartzberg - Stifel Nicolaus - Analyst

I was wondering if we could talk a little bit more about procurement specifically in that larger $5 billion productivity aim. Can you give us a bit of an update on to what extent that number is included in the $5 billion and how you’re leveraging your global scale and whether, if at all, these changes in the reporting structure, and particularly Latin America, have any influence on how you go after procurement savings as a global entity?

Indra Nooyi - PepsiCo, Inc. - Chairman and CEO

Hugh, go ahead.

Hugh Johnston - PepsiCo, Inc. - EVP and CFO

Yes, I am happy to take that one, Mark. The answer to your question is actually quite straightforward. We don’t include procurement savings as a part of productivity. Productivity is focused on the operating cost structure, not on the commodity and procurement cost structure. The way we report procurement savings is we share with you all a net commodity inflation number. So that includes gross commodity inflation less whatever we can do in terms of managing what we call value engineering, so managing our commodities to a lower cost through more efficient packaging, trading different types of juices and things like that. So the $5 billion number does not include any savings from procurement at all. That’s all captured in net commodity inflation.

Operator

Steve Powers, UBS.

Steve Powers - UBS - Analyst

I was actually hoping you could just talk us through the personnel and segmentation decisions that you announced alongside today’s results. Obviously congrats to you, Hugh, but could you maybe also provide a little bit more color on the other people movements that were highlighted and then also a bit broader window into your thinking on the re-segmentation? I think it makes sense to bring Latin America in line with Europe
and Asia as you mentioned and the increased visibility into North America beverages is welcome, at least from my perspective, but I would love your broader perspective on it as well. Thanks.

**Indra Nooyi** - PepsiCo, Inc. - Chairman and CEO

Steve, I will tell you one of the things we did some time ago is really sit back from the world and say how do we -- how should we think about groups of countries and clusters of operations that makes sense. And based on all the work we did, basically the world broke out into eight clusters. North America is cluster one; Western Europe as the next developed market was cluster two; three was Latin America; four was Russia and East Europe; five was Middle East and North Africa; cluster six was the Indian subcontinent; seven was China and the whole Pacific Rim; and cluster eight was sub-Saharan Africa. So those were the eight clusters.

And North America is so big that grouping it get together and not providing visibility into the pieces didn’t make sense, so we have kept North America separate in terms of North American beverages and Frito-Lay and Quaker being so different, but all of the clusters we just cleaned it up. Cluster three is Latin America, we put it together, and sub-Saharan Africa we had the snacks business of South African and Simba reporting into Europe and beverages reporting to our Asia/Middle East sector; we just cleaned it up.

So the segment changes that we reported were a cleanup of these clusters so that we can think of cluster strategies, so that’s the first one. And more and more our strategic thinking and designs for the future are based on how do we establish and grow our positions in each of these clusters? And more importantly, how do we get more productive working across our partners within each of the clusters? That’s what we’ve been focused on.

So the last group got cleaned up. In terms of personnel changes, as I talk to you earlier in my script, talent management is something that the Board and I are focused on a lot. Our Board, a phenomenal Board, spends a lot of time thinking through succession for the top couple hundred jobs and one of the things we always look at to see, where is that bright talent across the Company that should be lifted up so that they can be part of a succession process in the Company. And every time we get an opportunity, we figure out ways to lift them up in order to stretch people, in order to really build exciting talent for the future and that’s what the most recent changes enabled us to do.

And just to give you an idea, let me start with Brian Newman and I’ve worked with Brian now for 20 years off and on. Brian started in Corporate Strategy but then went to China. He went to Russia. He went to Spain, worked in European headquarters. Went to Canada. Was the Treasurer of the Pepsi Bottling Group and both Hugh and I have been mentoring him now for 20 years, Hugh?

**Hugh Johnston** - PepsiCo, Inc. - EVP and CFO

That’s exactly right.

**Indra Nooyi** - PepsiCo, Inc. - Chairman and CEO

And now giving him this job at Operations coupled with Corporate Strategy allows him to get a whole perspective of the Company across snacks and beverages, even though he has worked in it for a while. And he is a person that speaks Mandarin Chinese, speaks multiple other languages and just a very -- a great executive to lift up. And we are looking for opportunity to do that and with the departure of Enderson, it gave us that opportunity.

And Eugene likewise. He has been running the tea partnership -- but again a Dutch national who has worked in multiple countries and a truly global executive; travels 60%, 70% of his time in every part of the world. I remember when he was running Turkey, he started to learn Turkish. Everywhere he goes he becomes a national. And again a very exciting executive.
And you will all get a chance to see these people in action as we move along. And all of the people we are elevating, whether it’s Laxman who is now going to be running Latin America, Ramon who has got additional responsibilities in Europe, Sanjeev who is running a gigantic geography -- you will see all of them over the next few quarters. And of course you all know Al Carey and Tom Greco and Hugh very, very well.

So I think that you’ll find that what PepsiCo is doing is just reinforcing the fact that we’re a talent academy and any company that’s looking for talent always raids PepsiCo, so we have to constantly make sure that our best and brightest will move up and we keep them engaged and excited about the Company. And that’s my job and the job of the Board and that’s what we’re doing.

Operator
Judy Hong, Goldman Sachs.

Judy Hong - Goldman Sachs - Analyst

So I have two questions. One, Indra, is just really more of a longer-term kind of strategy questions as you think about your global snack business. You obviously have a very good business there but in a world where scale is becoming increasingly important and you’ve got other macro snacking categories that perhaps you may not be participating as actively, how do you think about accelerating really top line as well as the profit growth as you think about the global snack platform? Is really looking at integrated beverage and snack nationally the answer, or can you really do something more with the platform?

And then second question is talking about your global e-commerce effort. It’s not an easy opportunity for CPG companies, so can you just give us some perspective on what efforts you’ve made already and what are some of the opportunities as you think about over the next few years?

Indra Nooyi - PepsiCo, Inc. - Chairman and CEO

Sure, Judy. Interesting question because I think in global snacks, we are in an interesting position because our base is savory snacks and we are a very, very strong player in savory snacks. First of all globally we still have a lot of growth within savory snacks. We came from a salty crisp snack background and we are expanding more and more into other savory snacks be it crackers, be it nuts and seeds, we are expanding into those areas. There’s a lot of opportunity there.

I see growth in global snacks along two dimensions. Dimension one is accompaniments to our snacks and that’s what made us go into dips. Because many of our snacks are consumed by themselves. Other times our snacks serve as sort of a substrate upon which you can put on products like our Sabra hummus or our Tostitos dips. So that’s one vector to grow and we still haven’t scratched the surface that we’ve got lots of growth.

The other area is taking away eating occasions from other macro snacks categories. It’s interesting, unlike beverages in the case of snacks, we can go off and take eating occasions from other macro snacks be it cookies or confectionery or chocolate. And our goal is to focus on what we are doing but looking at our science of demand spaces, which I talked about briefly, look at each eating occasion by cohort group and figure out how we can leverage our salty snack platform to go after other macro snacks be it replace it with a salty occasion or do some sort of a salty/sweet combination.

For example, Stacy’s with cinnamon sugar. It’s based on a pita chip but it certainly sweet when you taste it and has a much better mouth feel and experience than if you eat something totally sweet by itself. At least that’s my perspective.

So I think that our growth is all about growing the core and then leveraging all of the other eating occasions, taking share away from other macro snacks and other savory snacks.
In addition, I think it’s leveraging the beverage occasion to really figure out how to go into all retail outlets our beverages are in already because beverage in retail outlets, our penetration is much higher than snacks. And so if you leverage that retail base, it gives you a lot more opportunities for growth. And internationally, we are leveraging in-store promotional displays a lot more.

I was in the Middle East a few months ago and I was just amazed to see the in-store displays of Lay’s and Pepsi and again with the shares of Pepsi that we have there, it is really a powerful in-store promotion that results in tremendous lift.

So the opportunities for growth by itself and in combination with beverages are pretty significant.

So with that, let me turn to Hugh to talk about global e-commerce because he is the leader of the global e-commerce activity. Hugh.

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**Hugh Johnston - PepsiCo, Inc. - EVP and CFO**

Okay. Thank you, Indra. Global e-commerce, to talk about it in two minutes is a bit of a challenge, to say the least. I guess I’d make just a couple of quick comments to start the dialogue on that. Number one, global e-commerce can mean so many things, anywhere from just changing the way the product is ordered and picked, the so-called click-and-collect model where people order online and then go pick up products at their local retail outlet, all the way through to in China where the product is delivered significantly to door, and in more and more proportions of the overall spend.

Clearly, one of the leading areas to the UK where you see retailers also doing a lot more delivery to store, all the way through to new emerging players like the Blue Aprons of the world who are actually sort of designing meal solutions, in effect, filling demand moments for consumers by giving them an entire prepackaged meal, which you see in some urban markets in the US and starting to expand outside the US as well.

From the perspective of PepsiCo, we’re looking at it two ways. Number one is the existing products going through the existing channels, either current retailers or the traditional online retailers; and then second, really looking hard at demand moments and designing products that fit the e-commerce types of distribution channels and e-commerce types of consumers in a more tailored way. So that’s sort of a very brief view towards what’s happening in the e-commerce world.

The biggest opportunity, obviously, is to be able to have more of a one-on-one relationship with those consumers than we’ve ever had in the past or through traditional linear TV advertising. I expect you’ll see a lot more from us in this regard but that’s probably the best two minutes that I can give in terms of what it is that we are doing right now.

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**Operator**

Ali Dibadj, Bernstein.

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**Ali Dibadj - Bernstein - Analyst**

Wanted to follow-up on the volume versus price question that we heard about FLNA about but want to hear more about Europe and what really was driving that if we are seeing any end in sight in terms of slower volumes there is the first question and Europe specifically.

And then the second one is, if you could help us -- I guess give some quantification for the buckets where the remaining cost cutting will be coming from -- what the buckets are, how much? And if we were to talk to your employees at this point, would we hear any concerns that you’re cutting too deeply into the organization from a cost perspective?
Indra Nooyi - PepsiCo, Inc. - Chairman and CEO

Let me take the first one. The thing I will tell you is Europe is a difficult economy between East and the West. There’s some sort of volatility there all the time. I think today, year to date, we are the best performing European CPG Company based on all the numbers we’ve looked at. If you combine East and West or look at them individually, both on the topline and the profit performance, we have performed the best.

The challenge in Europe is, especially with Russia there, the high street battle in the UK going on, I think it’s very important we play a very judicious game between revenue and profit. And we’ve been playing that game very, very carefully and if you look at our year-to-date numbers -- I wouldn’t look at it on a quarterly basis, I would look at it on a year-to-date basis -- I think on a year-to-date basis, we are performing at or above our expectations in Europe. And we feel comfortable with what the team is doing and that’s what we intend to keep doing balance of the year.

And in terms of cost-cutting opportunities, Hugh, you can talk about what other opportunities exist, but in terms of employees, look nobody likes cost cutting. Everybody likes growth. I think we are one of those companies that are doing a wonderful balance of growing the topline and delivering productivity and that’s what we want to focus on. Swinging the pendulum too much to cost cutting I don’t think is a good idea at all because it just jeopardizes the future of the Company.

So we look at opportunities to shrink the cost base and get more lean and mean but without sacrificing our ability to innovate and grow. And that’s really all I have to say on this matter.

Do you want to add anything, Hugh?

Hugh Johnston - PepsiCo, Inc. - EVP and CFO

No, I think you captured it well. The areas for cost-cutting I think remain in some of the manufacturing facilities. We’re using automation where it makes more sense. Inside of the selling system, we are using technology to make our route system more productive and inside of the G&A buckets, we are doing more combinations of shared services to create more efficiency in the way we deliver shared services to the organization.

And Indra, I would reiterate what you said, which is we are finding the right balance, driving productivity, reinvesting some in growth and delivering some to the bottom line and it’s yielding results in brand building and innovation and taking some of that growth, investing it back and driving more productivity and delivering some of that to the bottom line is working well. I think we are in the sweet spot right now in terms of being able to deliver performance and it is a careful balance to manage.

Operator

Nik Modi, RBC Capital Markets.

Nik Modi - RBC Capital Markets - Analyst

Good morning, everyone, and congrats to you. I guess the question is on cost savings, so clearly you have this $1 billion per year program over the next few years but every meeting I go in with an investor or an industry conference, the word zero-based budgeting comes up or the term zero-based budgeting comes up. So I just wanted to get your perspective on that particular cost savings initiative and if you’re thinking about zero-based budgeting at all within the business in addition to the $1 billion program?

Indra Nooyi - PepsiCo, Inc. - Chairman and CEO

Look, we look at every opportunity to tighten our belts and become more efficient. As I said earlier and as Hugh reiterated, Nik, we are balancing topline and bottom-line growth very, very judiciously. When you embark on a zero-based budgeting program that [cuts] to the bone and jeopardizes your ability to grow the topline, I think that’s a formula for disaster.
We believe in smart spending initiatives where we look across all of our cost structure and see where we can selectively reduce costs intelligently, not for the short term -- but find a way to make sure it does not affect topline growth initiatives.

So rest assured that we look at every possible way to make our Company more efficient and I think we are, as Hugh said, in the sweet spot of balancing investments against topline growth and figuring out ways to, through automation, shared services, taking out work that's not needed, simplifying our processes, coordinating across the Company, reducing our costs. And that's what we're focused on.

And with that, let me reiterate that we are pleased with our results for the first half. We are confident that our plans are working and believe we are on the track to deliver our financial targets for 2015. I want to thank you all for your time and questions this morning. And more importantly for the confidence you have placed in us. Have a wonderful day.

Operator

Thank you for participating in PepsiCo's second-quarter 2015 earnings conference call. You may now disconnect.