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PepsiCo, Inc. (PEP)

Q1 2023 Earnings Call

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OTHER PARTICIPANTS

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Andrea Teixeira
Analyst, JPMorgan Securities LLC

Kevin Grundy
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Brett Cooper
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MANAGEMENT DISCUSSION SECTION

Operator: Good morning, and welcome to PepsiCo's 2023 First Quarter Earnings Question-and-Answer Session. Your lines have been placed on listen-only until it is your turn to ask a question. Today's call is being recorded and will be archived at www.pepsico.com.

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

Ravi Pamnani

Senior Vice President, Investor Relations, PepsiCo, Inc.

Thank you, operator. I hope everyone has had a chance this morning to review our press release and prepared remarks, both of which are available on our website.

Before we begin, please take note of our cautionary statement. We may make forward-looking statements on today's call including about our business plans and updated 2023 guidance. Forward-looking statements inherently involve risks and uncertainties and only reflect our view as of today, April 25, 2023, and we are under no obligation to update.

When discussing our results, we refer to non-GAAP measures which exclude certain items from reported results. Please refer to our first quarter 2023 earnings release and Form 10-Q available on www.pepsico.com for definitions and reconciliations of non-GAAP measures and additional information regarding our results, including a discussion of factors that could cause actual results to materially differ from forward-looking statements.

Joining me today are PepsiCo's Chairman and CEO, Ramon Laguarta; and PepsiCo's Vice Chairman and CFO, Hugh Johnston. We ask that you please limit yourself to one question.

And with that, I will turn it over to the operator for the first question.

QUESTION AND ANSWER SECTION

Operator: Thank you. [Operator Instructions] Our first question comes from Dara Mohsenian with Morgan Stanley. Your line is open.

Dara Mohsenian
Analyst, Morgan Stanley & Co. LLC

Q

Hi. Good morning, guys.

Hugh F. Johnston
Vice Chairman, Chief Financial Officer, PepsiCo, Inc.

A

Good morning, Dara.

Dara Mohsenian
Analyst, Morgan Stanley & Co. LLC

Q

So very impressive price mix result in the quarter at 16%. Can you just give us an update on the competitive environment you're seeing in your key business segments and geographies, both in terms of just price increases but also promotion? And if that's picking back up to more normalized levels? And if that favorable environment is continuing?

And just as you look going forward, obviously very strong levels of pricing. How do you think about the moderation of that back to more normalized levels going forward the next few quarters and the ability of volume to recover as that pricing dissipates on a year-over-year basis? Thanks.

Ramon L. Laguarta
Chairman & Chief Executive Officer, PepsiCo, Inc.

A

Yeah. Thank you, Dara. Let me cover that, and then Hugh can add some comments. We're seeing a competitive environment. We're all trying to protect the health of the categories and then make sure that our brands are participating in those categories in a competitive way. We're investing in our innovation, investing in our brands, investing obviously in value in different ways, price and sizing mostly. So we're seeing a good positive, competitive environment in the US, in Europe and also in our developing markets, so consistently across the world.

When it comes to pricing, as we said earlier in February, we have mostly taken the pricing already this year that we needed to cover for our cost increases, and it's where we stand at this point. We're seeing a deceleration of inflation, not a reduction of cost but a deceleration of inflation, and we think that with the pricing that we've taken already, most of our business around the world that should be sufficient.

Obviously, there are some markets, highly inflationary markets around the world, where we might have to take additional pricing. If you think about Argentina, Turkey, Egypt – those kinds of markets where the currencies are suffering – but majority of our pricing is already done.

Hugh F. Johnston
Vice Chairman, Chief Financial Officer, PepsiCo, Inc.

A

The only thing I would add to that, Dara, as a reminder, you know we tend to buy commodities 9 to 12 months out. So to the degree that the rate of inflation decreases – and it will be a decrease in the rate of inflation, not deflation by any stretch of the imagination, that's going to happen very slowly over the course of 2023. I think that's more of a 2024 thing, to the degree it happens even then.

Operator: Thank you. One moment for our next question. Our next question comes from Andrea Teixeira with JPMorgan. Your line is open.

Andrea Teixeira
Analyst, JPMorgan Securities LLC
Q

Good morning. I wanted to go back to a little bit of what you spoke in the prepared remarks that you're – and you also in an interview, Hugh, that you gave that you're not seeing – the fact inflation is still high throughout the 6 to 9 months that you're seeing here. And it doesn't look like you are seeing the need for promotional environment. But more in the context of what has happened in LatAm, I think is the only region that you haven't seen a reacceleration. In every other region you've seen an acceleration. And I'm seeing – I am talking, I'm asking this question more over the point of strength rather than a point of weakness. Of course, it's really hard not to like the numbers here. Just thinking of how to think of the volume decline you saw in snacks, and to think about how to parse it out, or it's more about the comparison getting tougher? Thank you.

Hugh F. Johnston
Vice Chairman, Chief Financial Officer, PepsiCo, Inc.
A

Yeah. Good morning, Andrea. It's Hugh. A couple things. Just for clarity, in terms of the snack food or the convenient food volume, Pioneer was a big driver of that. There are challenges with the power grid down in South Africa, and obviously, Pioneer makes a lot of heavy products. Ex-Pioneer, snacks volume was basically flat for the quarter, and beverages, obviously, was up a small amount for the quarter.

In terms more broadly of sort of the rate of growth of all of the businesses, from a revenue standpoint, I think generally speaking you see the consumer continuing to buy our products. Elasticities are still holding up quite well across most of the globe and despite the fact that we're taking pricing driven by the inflation that we're facing into. In terms of operating performance, I think what you're seeing more than anything is a reflection of the productivity initiatives that we put into place, whether they be automation in the supply chain or digitalization across the company, or leveraging global business services. So when we talk about sort of an acceleration in the operating income performance, I think it's a consumer that's responding to the brand advertising we're doing. And in addition to that, the productivity that we're driving.

Operator: Thank you. One moment for our next question. Our next question comes from Kevin Grundy with Jefferies. Your line is open.

Kevin Grundy
Analyst, Jefferies LLC
Q

Great. Thanks. Good morning, everyone. Just picking up on some of your prior commentary there, and just the decision to raise the EPS guidance at this juncture of the year, which I think is noteworthy because the company's delivery against guidance has historically been quite good, as you're well aware. But historically, the tact has been to maintain it and then as the year moves on to edge it higher. So just some context here. Was it that the first quarter was that good relative to your expectations just came in that much better? It's noteworthy within the context of all the prognostication around potential recession and market volatility for the raise at this juncture of the year. So maybe just some historical context around it and relative to first quarter results, I think, would be helpful. So, thank you.

Ramon L. Laguarta
Chairman & Chief Executive Officer, PepsiCo, Inc.
A

Yeah, Kevin. Good morning. I think you're right. Your assessment is right. We're seeing both better elasticities than some of the worst-case scenarios we were planning for. And also, we're seeing the teams delivering better productivity. So we're seeing, in general, the flow of materials, the availability of labor, transportation, all those elements that were making us a sub-optimal company, if you just to call it somehow, in terms of operating metrics. That's getting better, which is giving us the opportunity to improve some of the metrics in our operations faster than what we thought. So it's both an improvement in productivity on the cost side and better elasticity.

In the commercial programs, we're strong. You saw that we've increased A&M again in the first quarter, and I think the commercial plans, the innovation plans are very strong. So we feel comfortable that even – and we always play out a lot of scenarios before we give you guys guidance. We feel comfortable that even at this early point in the year, we can raise our top-line and bottom-line estimates.

Operator: Thank you. One moment for our next question. Our next question comes from Bonnie Herzog with Goldman Sachs. Your line is open.

Bonnie Herzog
Analyst, Goldman Sachs & Co. LLC
Q

Hi. Thank you. Good morning, everyone. I had a question on organic revenue growth at PBNA. Your price mix in the quarter was incredibly impressive, but your volumes were down slightly again. So, could you touch on where you're primarily seeing the pressure and then maybe what you're seeing from the consumer? Also, it seems that incremental pricing may be a bit harder to come by, and promotion levels may need to increase in beverages this year. So could you touch on that as well as maybe your key initiatives to stabilize or turn your volume trends around at PBNA? Is your Pepsi rebranding or the new logo and visual identity for the brand one of those key initiatives, for instance? Thanks.

Ramon L. Laguarta
Chairman & Chief Executive Officer, PepsiCo, Inc.
A

Thank you, Bonnie. No, we don't see – actually, we see the momentum in the beverage category very strong in terms of demand. We're seeing away from home very strong. We're seeing the convenience channel very strong. And we're seeing most of the in-home channels also quite strong. So we don't feel that there is a competitive environment that is getting worse in beverages.

There's some one-off in the first quarter, because, as you know we're moving Gatorade from a warehouse system to a DSD system. And in that transition, there is some inventory reduction overall in the system that is impacting Q1. But we don't think that the competitive environment in beverages in the US is getting worse, and that we need to do anything special.

We have a very strong commercial program, both innovation, brands, commercial execution and customer programs, so that will be the way we're planning to continue to compete vigorously in the market.

Operator: Thank you. One moment for our next question. Our next question comes from Lauren Lieberman with Barclays. Your line is open.

Lauren R. Lieberman
Analyst, Barclays Capital, Inc.
Q

Great. Thanks. Good morning. So, you've already been asked about raising the guidance early in the year and it would sort of be mechanically hard not to given how strong the quarter was. But your prior outlook, you had baked in what we thought was one of the more conservative set of assumptions around the macro environment, at least for the second half of the year, across our coverage anyway. And so I was just curious if you're seeing anything more recently that has you more optimistic on the macro trajectory; anything in terms of that broader market outlook or consumer outlook that's informing your ability to raise the guidance? Or is it really more tied to just the momentum in your own business? Thanks.

Ramon L. Laguarta
Chairman & Chief Executive Officer, PepsiCo, Inc.
A

Yeah, Lauren, it's mostly related to the fact that we're already, one-third of the year has passed, and we have better information on our costs and everything else that complex operating [ph] model (00:13:22).

There are a few things where we're still concerned about. One is where is the consumer going to be in second half of the year. We continue to have multiple scenarios, and some of the scenarios are more optimistic, some less, and we continue to have various scenarios.

The second one, geopolitics, and that might impact the business and therefore, we want to be cautious there as well. And the third one, as I mentioned earlier, there are some currencies in some emerging and developing markets that we don't know where some of those markets will go in the second half of the year, and we also want to make sure that we have the right financial scenarios around those options.

So, those are the three variables that could define where the business goes. As I said earlier, operationally the business is better. We're seeing better labor availability, better flow of materials, suppliers are obviously getting better as well. Transportation is getting better. So, operationally the business is in a better place than it was in 2022.

Operator: Thank you. One moment for our next question. Our next question comes from Bryan Spillane with Bank of America. Your line is open.

Bryan D. Spillane
Analyst, BofA Securities, Inc.
Q

Hey. Thanks, operator. Good morning, everyone. Hugh, I wanted to ask about accounts payable. Just with a pretty meaningful shift year-over-year, I understand there is a sequential or a seasonal piece to it, but it's up more than $1 billion versus the first quarter last year. So is that tied to the Gatorade DSD distribution change? Or, I don't know. Is there something else going on with accounts payable that just is driving such a meaningful change?

Hugh F. Johnston
Vice Chairman, Chief Financial Officer, PepsiCo, Inc.
A

Yeah. Hey, Bryan. It's really two things. One is seasonal inventory build on the Gatorade thing, as you mentioned. The second is, we've got a number of significant capital projects that are in-flight right now, and the timing of the payables on the capital equipment is what drove that number. So, I would take it as a one-off, not a change in trend by any stretch of the imagination. It's just a one-off when the quarter ended.

Operator: Thank you. One moment for our next question. Our next question comes from Chris Carey with Wells Fargo. Your line is open.

Chris Carey
Analyst, Wells Fargo Securities LLC

Q

Hi. Good morning.

Ramon L. Laguarta
Chairman & Chief Executive Officer, PepsiCo, Inc.

A

Hey, Chris.

Chris Carey
Analyst, Wells Fargo Securities LLC

Q

Can you maybe just touch on how investment priorities will evolve in 2023? I think one of the key takeaways from 2022 was distribution costs between shipping, handling, and merchandising activity was a key driver of SG&A inflation. But I'm conscious of double-digit increases of that and marketing spending out of the gates into Q1. So can you maybe just frame how overall investment will be evolving over the course of this year, in the context maybe some easing on inflation and certain SG&A buckets and ability to put more spending in others? Thanks so much.

Ramon L. Laguarta
Chairman & Chief Executive Officer, PepsiCo, Inc.

A

Yeah, Chris. Listen, I think the framework of investment is similar to what we expressed in the past. The number one priority for us is to make sure that our categories remain highly visible in consumers' minds in the complex consumer choices environment, and our brands do very well in those categories. So that's priority number one, make sure that we continue to be the preferred brand with our consumers.

Second, we continue to invest in transformation of the business, digitalization and productivity at the center of the strategy. Systems, we've been investing on that for quite a while. That continues to be an enabler of all the data strategy that we have in the business. And those are the two big projects. We continue to invest in capacity. There is good volume growth across many of our markets around the world, and that continues to be a priority, enabling the brands to continue to grow. So those are the principles. I don't know, Hugh, if there's anything else?

Hugh F. Johnston
Vice Chairman, Chief Financial Officer, PepsiCo, Inc.

A

No. I think that's right. The only thing, and I think to where Chris was going with the question from his perspective as well, Chris, I think you'll see more of the financial impact of those investments in SG&A, significantly less so in cost of goods. So as you're modeling it out, SG&A is the place where you'll see all the items that Ramon referenced will be hitting.

Operator: Thank you. One moment for our next question. Our next question comes from Peter Grom with UBS. Your line is open.

Peter Grom
Analyst, UBS Securities LLC

Q

Thanks, operator. And good morning, everyone. So, I was hoping to get more color on the international performance in the quarter, but maybe specifically in China. I know it was called out in the prepared remarks as a market where you gained share. And maybe I missed this, but I don't think it was mentioned when discussing growth in the quarter. So can you maybe share a view on the current environment in China, how that evolved through the quarter, and kind of how you see that progressing from here? Thanks.

Ramon L. Laguarta
Chairman & Chief Executive Officer, PepsiCo, Inc.

A

Yeah. We're seeing obviously in China a optimism in consumers and optimism in the customers, and that's driving volume for us across both our food and our beverage business. We're getting share, especially in snacks. Snacks has been performing very well through the pandemic and continues to outgrow the category. And in beverages as well, we're seeing competing quite well in colas and in sports hydration. So, yeah. Obviously, this is going to be a tailwind for us as the year progresses, both in away-from-home and in-home consumption.

Operator: Thank you. One moment for our next question. Our next question comes from Robert Ottenstein with Evercore Group ISI. Your line is open.

Robert Ottenstein
Analyst, Evercore ISI

Q

Great. Thank you very much. Given the strong start to the year and your confidence in the year, I thought I'd ask a longer-term question. And that is, as you look at the categories that you're in, over time in the past, you've expanded in certain countries a little bit outside of beverages and snacks, either for reasons of scale or growth opportunities. Or maybe that's just what was available as part of an acquisition. Over the next – call it, next five years or so, do you believe that you're in the right categories to drive your algorithm, or do you see potentially the need or desirability to expand into some adjacent areas? And given the advances that you've made in IT and logistics, perhaps that's even a greater opportunity than in the past. Thank you.

Ramon L. Laguarta
Chairman & Chief Executive Officer, PepsiCo, Inc.

A

I think that's a great, great question. Listen, we believe our categories are large and growing at a very fast pace, around 5% globally. I think our main response is to maintain innovation and make sure that the portfolio evolves with consumers, the brands continue to be super relevant. And that is where we want to focus our efforts. We're making some small moves, as you saw, for example, we're going into low alcohol here in the US, expanding the brands.

We're making small moves like Cheetos going into Mac 'n Cheese. So we're expanding some of our brands organically into some new spaces that make sense from the consumer point of view that we believe our categories are large, global, healthy. And we, [ph] our response is to give (00:21:33) them healthy and growing very fast.

Operator: Thank you. One moment for our next question. Our next question comes from Vivien Azer with Cowen. Your line is open.

Vivien Azer
Analyst, TD Cowen

Q

Good morning. Thank you. I wanted to ask about Pepsi Zero Sugar given the reformulation and the broad-based international distribution. Can you offer some perspective on how that's performing relative to expectations? And as well, could you possibly update us on how the organization is tracking towards your 2025 ESG target to drive 67% of volumes from lower added sugar beverages? Thank you.

Ramon L. Laguarta
Chairman & Chief Executive Officer, PepsiCo, Inc.

A

Thank you. Great question. And it's essential to our strategy to continue to drive low sugar and non-sugar products as kind of the portfolio transformation. In the case of Pepsi, obviously, that is very relevant for us given the size and scale of Pepsi brand for us.

The relaunch in the US with the new formula is very – is being very well received by consumers based on our early data of repeat and preferences. The brand is growing 60%, if I remember correctly in the first quarter. And that's driven a little bit by distribution, but it's mostly velocity. So clearly the consumers are – they like the product, and they're coming back to the product.

Globally we also see big growth of the non-sugar segment in the category, 2 times, 3 times the average of the category in most of the markets. And we are driving that growth along with some of our key competitors. It's a – I think it's a strategy that is working, and it's keeping the category very relevant for consumers. We'll continue to invest in non-sugar as a driver of growth for our brands.

Operator: Thank you. One moment for our next question. Our next question comes from Gerald Pascarelli with Wedbush. Your line is open.

Gerald Pascarelli
Analyst, Wedbush Securities, Inc.

Q

Hi. Good morning. Thanks for the question. In US-measured channels for salty snacks, we've seen private label products gain share of the overall category for the past few months now. This is obviously happening in tandem with very strong performance in market share gains for Frito as well, which is great. But was just curious if you've seen many near-term changes to broad-consumer purchase patterns in this category relative to maybe a few months ago. Any thoughts there would be helpful. Thank you.

Ramon L. Laguarta
Chairman & Chief Executive Officer, PepsiCo, Inc.

A

Yeah, in general, we're seeing private label growth in some of the categories where we participate, especially waters, juices that we used to participate in some categories, in salty snacks, as well as you mentioned. As you well say, Frito-Lay is – I think it's growing share of market at the fastest pace that we've seen in the last maybe 10 years if I recall.

It's a consequence of the great work the team is doing in terms of execution, but mostly innovation and brand-building. So I think we see both private label increasing, although from a very low base in salty snacks, but most importantly, for us, we're seeing our brands continue to gain loyalty, expand the consumer base and be preferred in that segment. But yes, private label is slowly increasing, from a very, very low basis, I said, in some sub-segments of the salty snacks business.

Operator: Thank you. One moment for our next question. Our next question comes from Brett Cooper with Consumer Edge. Your line is open.

Brett Cooper
Analyst, Consumer Edge Research LLC

Q

Good morning. With about a year in of Blue Cloud and Hard Mountain Dew, I was hoping you could provide some color on your view of the performance of the brand and the operation to-date, any learnings. And then how you think about proceeding from here? Thanks.

Ramon L. Laguarta
Chairman & Chief Executive Officer, PepsiCo, Inc.

A

Yeah. Listen, we're happy with the learnings that we're taking, both in the operation of this category, which is new to us, and also in how we create consumer demand and consumer loyalty, and we continue to find partners to create new solutions for consumers with our brands.

We just launched a tea version, a hard tea version, with Lipton and FIFCO Company. They develop a great product, which we're going to start distributing through our system in the next few weeks. So we're going to go into the summer with two main products, Mountain Dew – Hard Mountain Dew and Hard Lipton.

As I said, our intention is not to build a large portfolio of products and complex portfolio, but it's to focus on a few good brands developed with strategic partners and then leverage our distribution capabilities to give it to consumers all across the country. That's our journey.

We're not rushing. We're going at a speed that we learn and we make this business solid, and with the right margins and the right consumer propositions.

Operator: Thank you. One moment for our next question. Our next question comes from Filippo Falorni with Citi. Your line is open.

Filippo Falorni
Analyst, Citigroup Global Markets, Inc.

Q

Hey, good morning, everyone. Question on the Pepsi Beverage North America business. It seems clearly this year you're making a lot of investments: the Pepsi logo change; the Starry launch; a lot of other launches; expansion of Pepsi Zero Sugar; and Hard Mountain Dew. Just bigger picture, what are your expectations from kind of a market share standpoint in the business? What would you consider a success for this year?

And then secondly, how do you balance these investments that you're making with your target of getting back to a mid-teens margin for the business? Thank you.

Ramon L. Laguarta
Chairman & Chief Executive Officer, PepsiCo, Inc.

A

Yeah, I mean, we expressed this in the past. We want to have a business that grows at the category pace or above and expands its margins to the mid-teens levels that we have mentioned as well in the next two to three years. That is the strategic intent for this business. I think the team is executing very well.

The way we measure our share is full LRB, so it's the full set of brands that we have in our portfolio, not just small segments within the category. And obviously, I think we're progressing well against that growth target for the year, whilst also expanding the margins for the business. We feel good about the margin expansion this year.

Operator: Thank you. One moment for our next question. Our last question comes from Charlie Higgs with Redburn. Your line is open.

Charlie Higgs
Analyst, Redburn (Europe) Ltd.

Q

Thanks for the question. Good morning, everyone. I was just wondering if you could talk a little bit more about the Frito-Lay North America division and the volume growth there. How did Lay's, Doritos, Cheetos perform? Is there any color you can give on the single-serve packs versus multipacks? And then just how you see the very strong margin growth in Q1 progressing throughout the year would be useful. Thank you.

Ramon L. Laguarta
Chairman & Chief Executive Officer, PepsiCo, Inc.

A

Yeah, great. Listen, as I said earlier, Frito-Lay I think is in the US but also the whole snack business globally is doing extremely well. But if we focus on the US, I think the team is doing a fantastic job growing the large brands, as you mentioned, Lay's, Doritos, Ruffles, Tostitos, Cheetos, and at the same time building peripheral brands that cover some spaces that we're not covering with the big brands. Let's call it PopCorners or SunChips, Smartfood [indiscernible] (00:29:56) we're really building a portfolio of brands that covers different cohorts and different need states in a unique way.

We're also innovating in new formats. You mentioned multi-packs, which has been a great hit for us in terms of variety and empowering consumers for personalization. But this year, a few months ago, we launched Minis, which is also an incredible innovation if you think about the convenience – the additional convenience it gives consumers. And putting our best brands in that format, opens a whole set of new occasions for the business.

So we feel very good about the innovation strategy and how we keep capturing new occasions into our brands. As I said earlier, I think the business is becoming better operationally as the supply of materials is getting better, labor availability is getting better. So we should see operational metrics improving, and that's what you're seeing in the margins, although the Q1 margin was a little bit elevated. The strategic intent with Frito-Lay is growing it very, very fast, and keeping the margins at those high levels because that's super accretive for the PepsiCo overall business.

Ramon L. Laguarta
Chairman & Chief Executive Officer, PepsiCo, Inc.

Okay. I think this is the last question. So I really appreciate the conversation this morning and thank you, everyone, for joining today, and especially for the confidence that you're all placing in our company and the investments you're making in our company. Thank you very much and have a great day.

Operator: Ladies and gentlemen, this does conclude today's presentation. You may now disconnect and have a wonderful day.