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PEP - Q1 2020 PepsiCo Inc Earnings Pre-recorded Management Discussion

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CORPORATE PARTICIPANTS

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Ramon Luis Laguarta *PepsiCo, Inc. - Chairman & CEO*

Ravi Pamnani *PepsiCo, Inc. - SVP of IR*

PRESENTATION

Ravi Pamnani - *PepsiCo, Inc. - SVP of IR*

Good morning, everyone, and welcome to the Pre Recorded discussion of PepsiCo's first quarter earnings results. My name is Ravi Pamnani, and I'm the Senior Vice President of Investor Relations at PepsiCo. Joining me today are PepsiCo's Chairman and CEO, Ramon Laguarta; and PepsiCo's Vice Chairman and CFO, Hugh Johnston.

Before we begin, please take note of our cautionary statement. We will make forward-looking statements on today's call, including about our business plans and 2020 guidance and the potential impact of the COVID-19 pandemic on our business. Forward-looking statements inherently involve risks and uncertainties and only reflect our view as of today, April 28, 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 read to today's earnings release and 10-Q available on 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. As a reminder, our financial results in the United States and Canada are reported on a 12-week basis, while substantially all of our international operations report on a monthly calendar basis, for which, the months of January and February are reflected in our results, with the 12 weeks ended March 21, 2020.

And now it's my pleasure to introduce our Chairman and CEO, Ramon Laguarta.

Ramon Luis Laguarta - *PepsiCo, Inc. - Chairman & CEO*

Thank you, Ravi, and good morning, everyone. I'd like to open my comments this morning with a message to our employees, customers and communities.

During this very difficult time around the globe, PepsiCo's employees quickly adapted and overcame challenges to fulfill our important role in the food supply chain of many countries. Facing very difficult conditions, we worked hard to ensure that our food and beverage products were on the shelves when shoppers needed the most. This is particularly true of our front-line employees who are the backbone of our company. We've taken steps designed to ensure they'll be protected and treated well as they do their jobs in this difficult environment. To all of our people, I say a heartfelt thank you.

To our customers, we've always sought to provide the best possible service. In the face of these many challenges, we will continue to support your business by ensuring your customers have access to a broad selection of great convenient food and beverage products. We look to earn your business every day, and we want to be your best supplier in both good times, and especially, in difficult times. And to our communities, while we work on these, we wanted to know that we recognize our role as both an employer and a neighbor. We've partnered with local officials to help keep our communities safe, and we've committed to contribute more than \$50 million to provide meals for needy families and children as well as assistance to local health care providers as they do their vital work. We're proud to be a global company with very local ties and will continue to be there for our communities.

Providing support to our employees, customers and communities, comes at a cost to the company. And I believe it's a commitment that reflects who we are, our purpose, our values, and our investment in our future together. Despite the challenges presented by COVID-19, our business delivered 7.9% organic revenue growth and 10% core constant currency earnings per share growth in the first quarter. The quarter began with a strong global macro environment backdrop in January and February, followed by the high level of uncertainty and volatility in March. As we exited the quarter, we saw a notable increase in overall customer and consumer demand, along with the shift in channel preferences due to mandated



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shelter in place and social distancing measures. The impact of these changes during the first quarter primarily occurred in the U.S. and Canada as the first quarter for most of our international businesses ended in February.

Based on our internal analysis of how organic revenue growth was faring before and after these changes, we estimate that organic revenue increased in excess of 5%, even when excluding these changes. This represents an acceleration versus the second half of 2019 and reflects the underlying strength of our categories, our focus on market share, and the investment we've made in becoming faster, stronger and better. It is also testament to having a strong portfolio of large, trusted brands in growing categories with expandable consumption trades.

Our organic revenue growth was broad-based with a high single-digit increase in organic revenue across developed as well as developing and emerging markets, and within both global snacks and global beverages. In our largest developed market, the U.S., all 3 of our divisions delivered very strong organic revenue growth, with a notable acceleration as the quarter progressed. Frito-Lay North America delivered strong net revenue growth across its large mainstream and premium brands. Our Quaker Food business also performed well, with net revenue growth driven by both improved category growth and market share gains across many categories. At PepsiCo Beverages North America, our carbonated soft drink business performed well, with trademark Pepsi increasing its net revenue for the 7th consecutive quarter, while trademark Mountain Dew returned to growth. And our noncarbonated portfolio delivered strong double-digit growth with broad-based strength across nearly all brands. However, our profitability of PBNA was negatively impacted by both product and channel mix shifts in the quarter and a significant reserve recorded for uncollectible receivables as a result of COVID-19. Overall, our North American businesses were performing well even before the spike in demand that occurred late in the quarter as we benefited from a very successful Super Bowl, which featured many of our big brands, combined with strong store execution of events, higher levels of advertising and marketing support. The continued success of our innovation activity, which includes Gatorade Zero, bubly, Mountain Dew Zero, Lay's Poppables, Cheetos Popcorn and many others. Increased manufacturing capacity in growth packages and selling capacity across both food and beverages, an accelerated local focus from our divisional and regional structures, and strong revenue management and productivity gains across our businesses.

Now moving to the international markets. Our businesses delivered strong organic revenue growth as developing and emerging markets led the way with a double-digit increase in organic revenue in Mexico, India, Egypt, Turkey, Pakistan, Saudi Arabia and South Africa. High single-digit growth in Colombia and mid-single-digit increase in Brazil, Russia and Poland. In most markets, the growth was broad-based across both snacks and beverages, benefiting from our investments in higher advertising and increased manufacturing and selling capacity. Our recently acquired SodaStream business also continued to deliver strong net revenue growth in excess of 20% as both penetration and frequency increased with more consumers enjoying and experimenting with these environmentally friendly at-home platform. We believe we have a long runway for growth in many international markets, and our first quarter results were a good reminder on the importance of investing in these markets for the long term.

To recap, our first quarter results show strong and accelerating momentum across our businesses, both with and (inaudible) associated to changes in consumer behavior mentioned earlier. This gives us confidence that the investment behind our faster, stronger and better framework are working as we invest in our brands, supply chain and go-to-market systems, manufacturing capacity, capabilities and culture, and our society by integrating purpose into everything we do.

As we move forward, we see many opportunities along with some risks associated with the dynamic changes in society and consumer behavior as a result of COVID-19. And we expect these changes to varying scope and timing across different markets in our retail channels throughout the world. In developed markets, we see consumers moving through several emotional and behavioral changes as they adjust their lives to the new realities they face. We believe there are 4 stages to this evolution. The first is preparation and prevention; the second is confinement and cocooning; the third is a restricted recovery; and the fourth is a new normal. These stages have important implications for our business, both from a marketing and channel perspective. Currently, in most developed markets, it's moved beyond the preparation and prevention phase, and appear to be in the later stages of confinement, in which shelter in place and social distancing have become a new way of life. Consumers have shifted their consumption habits to more at-home locations, increase their usage of traditional large-format and e-commerce channels and increased their basket size. Conversely, they've also shifted away from immediate consumption channels such as convenient and gas and foodservice, which disproportionately impact the revenue and profitability of our U.S. beverage business.



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With consumer spending more time at home, we've seen an increase in eating breakfast and a tendency to snack more during the day. The Frito and Quaker food businesses are well positioned to capitalize on these changes, and as a result, we've seen higher household penetration across a variety of our products. Given these countervailing impacts within channels and categories, our portfolio does have somewhat of a natural hedge. Although, the negative impact on beverages is more significant and the positive impact on snacks and foods. In response to these shifts, we've adjusted our advertising, revenue management and go-to-market priorities across our businesses and channels. We have privatized SKUs to maximize manufacturing capacity and supply chain efficiencies. And we're adjusting our promotions to capitalize on fewer shopping trips with larger basket size. The key uncertainty that we're facing is around timing and when consumers may shift back to restricted recovery and a new normal. With some exceptions, we largely expect consumers to eventually return to previous habits as they slowly exit confinement and cautiously settle into new normal. In the interim, we expect the continuation of increased purchasing patterns in large-format and -- e-commerce channels and softness in immediate consumption channels.

As behaviors evolve, we expect to see a gradual improvement in the convenience and gas channels as people return to work. While restaurants and venues that involve large gatherings, such as movie theaters or sporting events take longer to adjust. One factor that we believe will help us in managing the balance of this impact is our acquisition of ROCKSTAR and our agreement to distribute Bang Energy drinks in the U.S. These strategic actions will unlock the ability to increase our participation in the higher growth and higher-margin energy drink categories, where we have not been able to capture our fair share to date. Moving forward, our energy strategy will consist of 3 elements. We would look to accelerate the performance of ROCKSTAR, which has further room for growth. We will expand the distribution of Bang and improve execution in the marketplace. And we will unlock the potential for Mountain Dew to expand in the energy category. Dew was, in many, the original energy drinks and the ROCKSTAR transaction unlocks restrictions to innovate with you in ways that were previously unavailable to us. I look forward to sharing more with you on this in the future.

Now moving to developing and emerging markets. There are different measures and restrictions in place associated with confinement and social distancing. And the timing and duration of these measures have varied by country. From a category and channel perspective, we're seeing similar trends to develop markets in which our snacks and food businesses are more resilient and less discretionary than beverages, so there's more exposure to immediate consumption channels that are being significantly impacted by the current environment. However, and like developed markets, there is a relatively lower amount of disposable income generated by most consumers. While our categories have room for development and a long runway for growth, we do expect a deceleration in organic revenue across our developing and emerging markets as macroeconomic forces strain consumer purchasing in the coming months. In addition, the strengthening U.S. dollar presents a formidable challenge in several key developing markets. Mexico and Russia are notable examples, where an economically pressured consumer will make revenue management actions difficult, while transactional foreign exchange headwinds will simultaneously create pressure on the cost structure of those businesses.

While we have expectations and strong plans, there are many unknowns and uncertainties, how people will actually behave, what will be the pace of economic and our category recoveries be. And how will COVID itself behave going forward. Therefore, we believe the company's previous financial outlook for 2020 is no longer applicable and will not be updated at this time. However, as we manage through this new environment, we are leveraging our strengths and have established a clear set of guidelines and actions for our business leaders. I'd like to highlight 3 examples.

The first is reinforcing our culture with a set of overarching principles in a manner that is consistent with the PepsiCo way, which emphasizes that associates act like owners with integrity and get things done quickly. We believe acting on these principles can enhance our standing with customers, consumers and employees. The second is about being nimble with a deep focus on accelerating revenue growth and improving value market share. In order to do so, we formed a committee to lead the recent replanning of each business, and this committee will meet biweekly for the rest of the year to monitor performance and continually make resource allocation adjustments as circumstances warrant. And the third is driving productivity to fund investments in our business. We'll continue to invest in key initiatives that will transform the operating capabilities of the company and make us stronger for the future. And made commercial investments in high-return activities that we believe will enable us to emerge from the crisis in a competitively advantaged position.

At the same time, we will aggressively challenge our cost structure holistically with a zero-based mindset and reevaluate all other investments for the year. These principles and processes are giving us the ability to quickly make decisions in a strategic manner and balances between the needs to execute now and to effectively position us to emerge from the crisis as an even stronger company that will create value for an even greater duration.



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Importantly, as the crisis evolves, there will also be opportunities to engage consumers with our brands and user breadth and depth of our go-to-market systems to improve our position in the marketplace to win with customers. We will embrace these opportunities to develop an even more agile and resilient supply chain with more accurate and rapid forecasting and response capability, support the continued growth of e-commerce, while retail sales increased approximately 45% in the first quarter. Until our plans for economically sensitive channels, such as foodservice and convenience and gas, with an objective to improve our presence and build deeper relationship with our customers. Identify and plan for lasting new habits and consumption patterns, and tailor our innovation and brand communication plans accordingly to achieve greater consumer awareness and engagement with our brands. Implement proactive long-term revenue management capabilities in developing and emerging markets to mitigate the impact of frequent foreign exchange evaluations. And finally, identify these locations for high-return-on-investment opportunities that can improve our market position or provide access to advantaged capabilities that can create value over time.

In summary, we believe that PepsiCo is well positioned to adapt and succeed over the long term. We'll continue to collaborate and leverage learnings across our entire organization and build on our strengths, some of which include: well-known brands that consumers love and most importantly, that consumers trust; strong positions in growing categories with expandable consumption trades, most notably in snacks and foods; an agile supply chain with strong local sourcing networks and flexible and advantaged direct store delivery go-to-market system and a highly experienced set of global business leaders who have the empowerment, knowledge and agility to make rapid, decentralized decisions to meet the needs of their local businesses. We're focused on executing to succeed in the new environment, but also remain cognizant that we should not make short-term decisions that may impact or disrupt our business or our brands over the long term. We intend to -- to protect investments are central to our faster, stronger, better strategy, such as enhancing our systems and commercial capabilities. We believe that a focus on revenue growth and value market share will serve our company and stakeholders well over the long term.

To conclude, I want to again acknowledge the hard work of our employees during such a challenging time. They've worked tirelessly to satisfy our customers and consumers during this time of need, and I'm extremely proud of their dedication and efforts.

With that, let me now turn the call over to Hugh.

Hugh F. Johnston - PepsiCo, Inc. - Vice Chairman, Executive VP & CFO

Thank you, Ramon. Good morning, everyone. As Ramon mentioned earlier, our previous financial outlook for 2020 is no longer applicable and will not be updated at this time due to the uncertainty and volatility associated with the current environment as a result of COVID-19. While the first quarter exceeded our expectations and some of our businesses have continued to perform well to date, we have also seen significant softness in immediate consumption channels and disruptions due to retail closures and other restrictions put in place as a result of COVID-19. In addition, our businesses experienced higher labor, logistics and service costs to meet customer needs. We expect these costs to persist and remain committed to making the necessary long-term investments to support our employees and customers, while also investing in capabilities that drive competitive advantage for our business. To mitigate some of these challenges, we are controlling what we can. This includes tightly managing our discretionary expenses, reducing nonessential advertising and marketing spend to reflect the realities of the current environment and optimizing our revenue management capabilities wherever possible. We have also reduced the complexity of our product offerings by prioritizing high velocity SKUs to maximize production capacity. While we hope these challenges are temporary in nature, we cannot reasonably predict when the environment will improve or exactly how consumer habits will evolve. However, for the full year 2020, we continue to expect our annual core effective tax rate to be approximately 21%. Total cash returns to shareholders of approximately \$7.5 billion, comprised of dividends of \$5.5 billion and share repurchases of \$2 billion. And we now expect foreign exchange translation to negatively impact our reported revenue and core EPS by 3 to 4 percentage points based on current market consensus rates. The expected cash returns reflect a previously announced 7% increase in the annualized dividend per share effective with the dividend expected to be paid in June 2020. This will represent the company's 48th consecutive annual dividend per share increase.

With respect to our liquidity and balance sheet, we believe we have ample flexibility to meet the investment needs of our business and returning cash to shareholders. Our business generates a significant amount of cash flow, the long-term debt and Tier 1 commercial paper markets remain open to us at favorable rates and extended maturities, and we have not drawn on our \$7.5 billion committed bank facilities.



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Now with respect to the second quarter, I'd like to note the following. We expect our organic revenue growth to decline at a low single-digit rate and we expect our operating margin to be negatively impacted by the weakness in immediate consumption channels and retail closures and restrictions associated with COVID-19. We expect foreign exchange translation headwind to negatively impact our net revenue and core earnings per share performance by a low to mid-single-digit percentage rate. And the acquisitions of Pioneer Foods and ROCKSTAR and our distribution agreement with Bang Energy will begin to be reflected in our reported results.

Now I'll turn it back to Ramon for some closing comments.

Ramon Luis Laguarda - PepsiCo, Inc. - Chairman & CEO

Thank you, Hugh. I'll thank you, all of you, for your time this morning. I'm incredibly proud of the way our organization has responded to this crisis and executed today. We look forward to updating you on our progress throughout the year, and we thank you all for the confidence you've placed in us with your investment.

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