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PEP - Q3 2019 PepsiCo Inc Earnings Call

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PRESENTATION

Operator

Good morning and welcome to PepsiCo's Third Quarter 2019 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. Ravi Pamnani, Senior Vice President of Investor Relations. Mr. Pamnani, you may begin.

Ravi Pamnani

Thank you, operator, and good morning, everyone. I'm joined this morning by PepsiCo's Chairman and CEO, Ramon Laguarta; and PepsiCo's Vice Chairman and CFO, Hugh Johnston. We'll begin with some brief prepared comments from Ramon and Hugh, and then open up the call to your questions.

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 2019 guidance. Forward-looking statements inherently involve risks and uncertainties and reflect our view as of today, 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 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.



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And now it's my pleasure to introduce Ramon Laguarta.

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

Thank you, Ravi. Good morning, everyone. Before we get to our results, I would like to congratulate Ravi on his recent appointment to Senior Vice President of Investor Relations. Ravi has been with PepsiCo Investor Relations since 2012 and most of you know Ravi very well. We're very pleased to have Ravi advance to lead the IR function. Jamie Caulfield was recently appointed CFO of Frito-Lay North America, and we're glad that he'll continue to play a very important role in PepsiCo's finance organization and in the Frito-Lay business.

Now moving on to the results. We're very pleased with our results for the third quarter and year-to-date. Our top priorities entering 2019 were to accelerate our full year rate of organic revenue growth and to position the business for sustained future growth, and we have good evidence that we've made solid progress on both fronts.

In the third quarter, organic revenue increased 4.3%, lapping very strong 4.9% organic revenue growth during the third quarter of last year. And year-to-date, our organic revenue growth stands at 4.6%, an acceleration from 3.4% a year ago. So given the strength of our year-to-date performance and the solid momentum we're seeing in the business, we now expect to meet or exceed our 4% organic revenue growth target for the full year.

Our strong performance in the third quarter was broad-based with organic revenue growth generated by each one of our divisions. Frito-Lay North America grew organic revenue 5.5%, driven by volume growth and net price realization. Importantly, the business is not only growing, but winning in the marketplace versus competition. In the quarter and year-to-date, Frito-Lay is growing value share in salty, savory and macro snack categories.

Investments we've made in innovation, marketing and consumer insights and manufacturing and go-to-market capacity are providing benefits across the brand portfolio with strong net revenue growth in our large mainstream brands like Doritos, Cheetos, Ruffles and Fritos and double-digit growth in our smaller premium brands, such as Bare and Off the Eaten Path. The breadth of our growth was also evident across every key retail channel with gains in grocery, mass, club, convenience, foodservice and e-commerce.

Turning to PepsiCo Beverages North America. We're very encouraged by the 3% organic revenue growth we generated in the quarter, driven by solid net price realization, the result of effective revenue management execution. Our third quarter growth accelerated sequentially from the second quarter and was on top of 2.5% organic revenue growth achieved in the third quarter of 2018.

The business is benefiting from improved local market focus and execution driven by our streamlined field structure, increased go-to-market capacity and significant stepped up advertising support and innovation.

We're especially pleased with the performance of Gatorade, which generated mid-single-digit net revenue growth and improved sequential market share performance. Innovation has played a big role in Gatorade's performance, led by Gatorade Zero, which has surpassed \$0.5 billion in retail sales since its launch in May of last year. And we recently launched Bolt24, a new functional beverage that supports athletes around the clock by providing advanced all-day hydration.

Other key parts of the business also continued to show progress. Trademark Pepsi posted its fifth consecutive quarter of net revenue growth. And bubly has continued to post very strong growth and is gaining share in the flavored sparkling water category aided by packaging and flavor innovation.

Other notable highlights include double-digit net revenue growth for LIFEWTR and Propel and high single-digit net revenue growth for Pure Leaf Tea and Starbucks.

Rounding out our North America performance, Quaker Foods delivered net revenue growth in the quarter propelled by our light snacks, Aunt Jemima syrup and mix, (inaudible) businesses. With our advertising and marketing having increased in the quarter and year-to-date, we remain focused on accelerating growth at Quaker Foods.



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Before we move on to international, I want to note the terrific work our supply chain and customer teams are doing in North America with our snacks and beverages businesses, receiving the 2 top ranking in the 2019 U.S. Advantage Survey for Food Multichannel Report. This is one of the annual surveys where retailers across multiple channels provide feedback on how suppliers are performing with respect to strategy, people, category development, marketing, supply chain, customer service and e-commerce.

Moving beyond North America. Each of our international divisions delivered solid organic revenue growth in the third quarter despite ongoing macroeconomic volatility in certain markets. Notably, organic revenue in our developing and emerging markets increased 7%. This included double-digit growth in Mexico, Saudi Arabia, China, Turkey and Pakistan and high single-digit growth in India, Egypt, Poland and Colombia.

Our international results reflect the benefits of our increased investments as we continue to leverage our global capabilities to drive higher per-capita consumption and improved market share, while executing in locally relevant ways. PepsiCo's performance today gives us confidence that the strategy we laid out in February to become faster, stronger and better is working. Importantly, we're balancing our investments to both drive results in the short term and position our business for sustained long-term performance.

Becoming faster is about winning in the marketplace, being more consumer-centric and accelerated investment for top line growth. For example, we've increased our investment in advertising and marketing by 12% year-to-date. This investment spans across many of our big brands and geographies as well as support for innovation and emerging brands, which we will continue to develop over time.

We're invested to increase the capacity and reach of our go-to-market systems with substantial investments in new routes, merchandising racks and coolers, and we're investing in additional manufacturing capacity to remove bottlenecks and expand growth capacity for our brands. These includes investments in new plants, new lines and added distribution infrastructure.

Becoming stronger is about transforming our capabilities, cost and culture by operating as One PepsiCo, leveraging technology and winning globally and locally. For example, we're making significant investments in capabilities like data analytics and systems to digitalize the company to achieve precision at scale, which is to execute in every store with precisely the right products at the right price. To do so, we're capturing and analyzing more granular consumer level data to build true consumer intimacy, that is understanding the consumer in a much more personal way, to move from thinking of consumers in groups of millions, to understand in depth the household or individual level by leveraging robust data from multiple sources. Using this information, we're increasingly structuring personalized communication and satisfying demand at the store level.

We also continue to strengthen our omnichannel capabilities, particularly in e-commerce where our retail sales are expected to be nearly \$2 billion in 2019. We're building on this success by investing further in our go-to-market and supply chain systems to capitalize on more opportunities in today's dynamic retail environment. And we're elevating our talent and fostering a culture where employees act like owners with a greater sense of empowerment and accountability. To fund these investments in capability and culture, we're driving efficiency throughout the enterprise, and we remain on track to deliver our target of \$1 billion in annual productivity savings in 2019.

And finally, becoming better reflects our aspiration to integrate purpose into our business strategy and brands. With this in mind, we're embracing a set of focused initiatives to help build a more sustainable food system, and I'd like to spend a little extra time this morning to share with you what we're focusing on.

First is advancing environmental, social and economic benefits to farmers and communities by promoting more sustainable agriculture. Through our sustainable farming program in 2018, we achieved a key milestone with over half our farmer-sourced agricultural raw materials, like potatoes, whole corn or (inaudible) verified as sustainably sourced. Our aim is to reach 100% by the end of 2020.

Second is improving water stewardship across our businesses and in the regions where we operate. We're striving to improve water use efficiency and aiming to replenish 100% of the water we consume for manufacturing in high water risk areas by 2025.

Third is delivering our vision of a world where plastic packaging need never become waste. We recently unveiled a new target to reduce 35% of virgin plastic content across our beverage brands by 2025, driven by increased use of recycled content and alternative packaging materials.



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Fourth is improving choices across our portfolio by continuing to reduce added sugars, sodium and saturated fats in many of our products. We currently offer several choices that address this objective, including Pepsi Zero Sugar, Lay's Baked, whole fruit and multigrain, Tropicana Whole Fruit and Sunbites Veggie Harvest. And we will continue to expand our offerings of more nutritional options.

Our fifth focus area is mitigating the impact of climate change by curbing green house gas emissions across all our value chain with an ambitious goal to reduce absolute greenhouse gas emissions across our value chain by 20% by 2030.

And lastly, we're working to support our associates and society by advancing respect for human rights, promoting diversity and inclusion in our workplace and increasing the earnings potential of women in our communities. This is a journey with a lot of work ahead of us, but we want all of our stakeholders to know that advancing to sustainability and being a more purposeful company will play an essential role in PepsiCo's future. For more details on how we're integrating sustainability into our business and our brands, we encourage you to read our most recent sustainability report.

And now I'll hand it off to Hugh.

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

Thank you, Ramon, and good morning, everyone. As Ramon noted earlier, we now expect organic revenue growth to meet or exceed our previous objective of 4% growth for the full year. We continue to expect our core constant currency earnings per share to decline approximately 1% as we plan to continue to invest in our business for the long term. All other guidance measures provided remain unchanged, including a core effective tax rate of approximately 21%, free cash flow of approximately \$5 billion and total cash returned to shareholders of approximately \$8 billion, comprised of dividends of approximately \$5 billion and share repurchases of approximately \$3 billion.

With respect to the fourth quarter, please keep the following in mind as you build out your models. First, our asset division will be lapping gains from a refranchising and a strategic asset sale; and second, the higher investments in the business will continue, and you will see this again reflected in both our operating margin performance and core EPS.

Now we'll open it up to questions. Operator, we'll take the first question.

QUESTIONS AND ANSWERS

Operator

(Operator Instructions) Our first question comes from the line of Dara Mohsenian of Morgan Stanley.

Dara Warren Mohsenian - Morgan Stanley, Research Division - MD

So it looks like in Frito-Lay North America, organic sales growth is probably on track for 5% or even better this full year, based on the year-to-date trends. That would be the best growth we've seen in a decade, so I was just hoping if you could give us a bit of postmortem on what's driven the acceleration year-to-date, how much is improved category growth versus building Pepsi market share momentum? And given the acceleration over the last year appears to be more driven by pricing, how sustainable is the momentum as you cycle higher pricing in Q4 and beyond? And then just last, with the capacity additions and supply chain work you're doing on the Frito-Lay side in North America this year, should that have an appreciable impact on volume or mix as we look out to 2020?

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

Thank you, Dara. This one question, good question. The performance of Frito is, I think, it's very holistic, right, what's driving the performance. And it's, I guess, a combination of increased A&M, increased capacity. We put more routes and we made some choices around what are the priority brands and nonpriority brands, and that's driving the overall business performance.

We're gaining share, but the category is also very healthy. Of course, we're a big part of the category, so we're driving the attractiveness of the category as well with our increased advertising, very good innovation across the big brands and the small brands. So I think it's a good performance both in terms of maintaining the attractiveness of the category, making sure our customers continue to see growth driven by us in this category, which is critical for our customers. And then we're gaining share because we have, I guess, a very broad portfolio that plays across all the different consumer segments, and the team is doing a fantastic job in terms of building the brand and developing the innovation. So a holistic, a holistic set of reasons why this business is continuing to perform at a very high level compared to other consumer packaged goods in the United States.

Operator

Your next question comes from the line of Bryan Spillane of Bank of America Merrill Lynch.

Bryan Douglass Spillane - *BofA Merrill Lynch, Research Division - MD of Equity Research*

I had a question, I guess, around NAB. And I think as you started this year, the investment was in a few different areas, one being marketing and product, another being in routes, and then also in packaging, like getting more mini cans into the market, I guess. And I guess, specific to CSDs, just where do you feel you are in the process of having all those investments in place and the effect of those in the marketplace, I guess, currently? And like how much more is there to go in terms of having that drive some improvement in market share as we go into next year?

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

Yes. Listen, the success of our beverage business is in continuing to drive the -- the whole portfolio, the noncarbonated portfolio, so we need to continue to do a great job in our teas, our waters, our teas, our sports drinks and then obviously improve the performance in CSDs. We're seeing progress across all those multiple objectives, which is quite complex to manage, right? So we're seeing, as we continue to gain share in what are the critical strategic categories for us and doing very well with some of our critical brands, like Pepsi, as we discussed last quarter, we still have a pending matter in Mountain Dew. Mountain Dew is improving, but it's not to the levels that we would like to see. So that's the focus of the team for the next few quarters, make sure that we get Dew back to what we think is a more sustainable performance. But we're happy with the growth we're having in all the other categories. We're happy with the way Pepsi is performing. And as I said on my remarks, we're very happy with Gatorade. And the performance of Gatorade in the sports drink category this quarter, reflects both the additional investment we've made on core Gatorade, the great innovation behind Zero, which is really a very well-received incremental innovation to the category. And now we're starting to make some additional investments in that category with Bolt24. We're testing and learning, and there will be a bigger rollout of that brand next year. So overall, we feel good. Again, Mountain Dew continues to be the pending matter, but we feel good about the ideas we have, the resources we have allocated to this brand and how the teams are thinking about Mountain Dew for the future.

Operator

Your next question comes from the line of Ali Dibadj of Sanford Bernstein.

Ali Dibadj - *Sanford C. Bernstein & Co., LLC., Research Division - SVP and Senior Analyst*

So I have 2 questions. One is on CapEx, specifically. Clearly, you signaled that going up. Want to better understand please the CapEx investment. Obviously, in FLNA, you mentioned increased capacity. But in PBNA in particular and where you are in rolling that out because if it's things like your

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competitor is doing in North America, like in-store displays, like coolers like more efficient route, like more efficient vehicle, there is a lag before you get that benefit. So I want to get a sense of whether you expect that benefit on the CapEx, again particularly in PBNA, to start coming through going forward.

And then the second question is around Latin America, your Latin America Foods. I'm sure with Jamie going there as CFO, I won't have to ask about it again. But it looks like it slowed a little bit, both on the top line and the bottom line. If you can add any color there, that would be helpful.

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

Sure. Let's start with Latin America. Now Jamie is going to Frito-Lay North America, Latin America is a separate division, but regardless, the Latin America performance continues to be very strong. Mexico is growing double digits. There was a -- we have lapped in our Brazil business last year. We had the drivers' strike, remember, in Brazil, then we had a very strong June. We're lapping that June this year. The business in Brazil is back to a very good performance in the back of the quarter and into the Q4, so we don't see any deceleration. The biggest challenge, obviously, in Latin America is Argentina. You guys read the news every day. It's a very volatile environment with the currency devaluing and we're having to adjust in our affordability levels with the consumer. So that's the biggest challenge in Latin America, but it's not meaningful enough for the overall Latin America performance. That's there.

In terms of NAB, as you said, we're -- and again, it's the same answer as with Frito. We're trying to make investment in a very holistic way so that we drive performance with no bottlenecks. So we're investing in the brands both in the large brands, but also in the smaller brands in PBNA. We're investing in routes. We're investing in coolers and marketplace, cooling infrastructure, which drives our business and drives our profitability. And yes, we're seeing the performance. As you see, it's a -- 3% is a very good performance for NAB. We think that we still have opportunities to do better than that, and we'll continue to fight for that, for that performance. Again, it's holistic CapEx investments across all the levers of growth that will make us successful long term.

Operator

Your next question comes from the line of Vivien Azer of Cowen.

Vivien Nicole Azer - Cowen and Company, LLC, Research Division - MD & Senior Research Analyst

So I wanted to follow up, please, on the commentary that you just offered on NAB and continued improvement. With the CSD volumes down 3%, I mean, I think from a fundamental perspective, it is a structurally challenged category, so what do you think is reasonable from a volume perspective? What does success look like on the CSD component of the segment?

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

Yes. Great. Listen, as we discussed last quarter, I think, there is, I think, a structural change in consumer demand in this category. It's moving to a smaller format, a different format that drive a different volume net revenue construction here. So the net revenue of CSDs is up. Part of that is pricing, but a lot of that is mix. And it's mix driven by, obviously, us becoming, I would say, more insightful in what are the different occasions that consumers are buying our products and offering the best pack for those occasions. But also, I think there is a fundamental change in demand where the consumers are going for smaller packs, and that's driving a change in the price per liter of the category and price per unit. So that is the -- and relating to that, to what Ali asked before, that drives some of the CapEx as well, so we're investing capacity for those smaller formats and we're seeing the return in higher pricing.

Operator

Your next question comes from the line of Andrea Teixeira of JPMorgan.



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Andrea Faria Teixeira - *JP Morgan Chase & Co, Research Division - MD*

Congrats to Jamie and Ravi on the new assignment. So very top down on international and in particular because of your experience, Ramon, I was thinking like the international growth has been accelerating and I was hoping to hear how do you feel about both beverages and snacks consumption going forward given the macro volatility?

And also, if you can, I think we haven't heard about Mountain Dew on the beverage side, so if you can kind of explain if investments might be going to that brand as well going forward.

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

Okay. Let me start with international. It is a volatile macroeconomic and political situation, more geopolitical than macroeconomic at this point. And if you go -- our larger businesses, our performance very well. I mean like Mexico is growing double digit. Russia is having a very good year. We see high growth double digit in China. Very high growth in India. Even Saudi Arabia was a challenge for us, it's going back to double digit. So we're seeing -- from the demand point of view, we're seeing a very still very strong demand to our -- for our categories. Part of that is we're gaining share in many of these markets. Part of that is still the categories are very -- not very developed and consumers continue to come to our categories as we offer more innovative products and more affordable products. So far, we're not seeing a reduction in demand for our categories on a global level. There are some markets where we've seen the consumers acting a little bit different. Like, for example, the U.K. is one where we're seeing the consumers a little bit -- a little more defensive as with all the political uncertainty there. We're seeing, obviously, Argentina, as I said. Venezuela, we've been there for many years now. But we don't see, Andrea, a fundamental change of demand, let's say, in the last few months versus the beginning of the year or last year. We're seeing the categories still growing very healthy and the demand coming to our categories in good, I would say, good positive levels, right. So that's there.

Mountain Dew, I said, the -- it is our pending subject. It is a focus of the organization, and we're -- I think the brand is well-resourced at this point and it's going to be down to having the right ideas and executing the right -- the ideas with quality. And as we're becoming a better execution company, I think that will happen. As we talked, it is a brand that is in the intersection of CSDs and energy, and it's not as easier problem to solve in terms of maintaining the relevance and the consumer high awareness for this brand compared to some of the other new trends that are happening in energy. So that's work for us to do. But I would say the brand is flat at this point, and we'll continue to invest to make it a positive brand for us in the coming quarters.

Operator

Your next question comes from the line of Caroline Levy of Macquarie.

Caroline Shan Levy - *Macquarie Research - Senior Analyst*

Congrats, Ravi, and if Jamie is in the room, too, listening. I was wondering if you could elaborate a little bit on your total stream and the opportunity there. I mean just given, I think, priority #1 for many, many companies now seems to be reducing plastic. And what is the cost of recycling investments that you see you, as a corporate, having to make alongside, perhaps, states and governments? And then what role does SodaStream play, particularly in the U.S. just because it hasn't really taken off in a way it has in parts of Europe?

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

Yes. It's a good -- great question and it's -- we made a strategic bet, right, when we decided to go and buy SodaStream. We saw this potential consumer change towards nonplastic beverages in part of the world. And also, we saw that SodaStream has the opportunity for consumers to personalize their drinks or add a personal touch to their drinks. So the good news is that SodaStream is doing very well, and it's doing better than what we had in our business case for M&A, so it continues to be very successful across multiple parts of the world. So, obviously, Western Europe,



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where it started, it's very, very strong. Germany, France, Holland, Central Northern Europe as well. It is strong in Japan. It is very strong in Canada. And there are some opportunities in the U.S., which we're making some organizational changes. We're upgrading talent. We're leveraging, obviously, the customer relationships that we have with our PepsiCo business to open some new relationships, and we are innovating a lot. You will see some, I think, some transformational programs for SodaStream next year in the U.S. that I think will -- I'm very optimistic about the step change in the household penetration that will give us.

But overall, this is a huge strategic opportunity for us as a company. We're realizing, I think, part of that opportunity. We're adding some of the knowledge from PepsiCo to SodaStream, and that will make that company better in flavor, innovation, in design of the machines, in some technologies, direct-to-consumer. So I think SodaStream will be a better company as part of PepsiCo, and PepsiCo will be a better company by having SodaStream and being able to address that potential consumer opportunity. So good news on the financial short term delivery and I think very good news coming for us in the future with this new business.

Operator

Your next question comes from the line of Bonnie Herzog of Wells Fargo.

Bonnie Lee Herzog - *Wells Fargo Securities, LLC, Research Division - MD and Senior Beverage & Tobacco Analyst*

I did want to ask on gross margin, which has really been quite impressive this year. So kind of wondering how we should think about the margins through the end of the year, especially given the tough comp you're lapping in Q4? And then could you highlight some of the key puts and takes for margins? Especially as we look into next year, you're definitely going to be facing some tough gross margin compares in 2020, so any color on how you're looking to lap those, particularly in FX headwind amounts, that would be helpful.

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

Bonnie, it's Hugh. Yes, couple of comments on gross margin. Number one, obviously, we've gotten very good price realization across the company this year. As we get into Q4, we will start to lap some of the pricing that we took in Q4 of last year, so we'll get less of a pricing benefit to gross margins.

Regarding commodities, nothing notable there. As you know, we have our forward-buying program on commodities, so we have good line of sight into what we will see there, and no notable change versus year-to-date.

And then last, obviously, our productivity has been quite strong this year. We'll continue to see that in Q4. So gross margins will certainly continue to be positive as we move forward. But do note that the pricing benefit to our gross margins will be less as we enter the quarter.

Regarding 2020 and forward, I think it's best if we talk about that holistically as a part of our 2020 guidance, which we'll get to in February.

Operator

Your next question comes from the line of Rob Ottenstein of Evercore.

Robert Edward Ottenstein - *Evercore ISI Institutional Equities, Research Division - Senior MD, Head of Global Beverages Research & Fundamental Research Analyst*

Ramon, you touched on a little bit in terms of consumers moving to smaller packs for CSDs, but I was wondering if you could kind of step back and give us your assessment of where the U.S. consumer is on health and wellness-related issues, sugar, artificial sweeteners and what your company strategy is on that. And one of the reasons why I'm asking it is Gatorade Zero doing really well, great product and then -- but then you come out



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with the Bolt24, and if I recollect, quite a lot of sugar in that, which was a little bit surprising to me. So I'm just trying to understand where you see the consumer and how you're responding to it.

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

Right. Good question. Great question, and it's critical to our strategy, right? So when we talked about our strategy in February, we said we're going to play against each one of the vectors of demand in our categories and not only health and wellness, but every vector of demand. So what we're seeing the consumer, and it's not only snacks, but beverages, the 2 categories, we're seeing the consumer going after functionality, going after health and wellness, but also going after indulgence and going to many spaces in the convenience, association, so a lot of different vectors that drive consumer preference and choices. And then, obviously, a very important vector which is price, right? So premium value, I mentioned, being a very important segmentation as consumers make choices. So the decision we made is that we're going to give the consumer maximum choice, again, to each one of the vectors and we're trying to capture demand from all of the different occasions throughout the day. That's the only way we're going to keep our share continue to grow and we're going to be successful in our category. So that's what we're seeing.

The trend towards small packs is not only in beverages, it is also in snacks. And actually, it is been going on in snacks for several years as well where our variety packs in Frito-Lay are growing very fast. And then internationally, by far, our smaller packs are the #1 packaging of choice for consumers.

And to the point on Gatorade, yes, Zero is great. Zero has been a great addition to the category, to the brand. It is capturing consumers that I think were very heavy users of Gatorade and have abandoned the brand because of the calories. So it's been a great addition. It's putting the brand back as a relevant brand to many more consumers as they exercise or do other activities. And it's expanding the brand, I think, structurally. And it will give us, I think, a lot of great moments going forward.

Bolt24 is a very low-calorie product and is not -- no added sugars and it's all the sugar that is in the -- basically the watermelon water that is kind of the base of the product. Obviously, we reserve the right to have a Zero Bolt24 going forward. I think, at this point, the brand is positioned for athletes of the field, and you will see innovation around functionality, functionality more than sugar, no sugar. But very, very low sugar levels, actually much lower than competitors in that space for sure. And I think it's the right way to launch the brand. It is below 100 calories per bottle, so it's 80 calories. So it's very, very -- a very healthy balance between taste, functionality and sugar levels.

Operator

Your next question comes from the line of Laurent Grandet of Guggenheim.

Laurent Daniel Grandet - *Guggenheim Securities, LLC, Research Division - Senior Analyst and MD of the Consumer & Retail Team*

A question on Quaker. Quaker's trend seems to be getting better, second quarter in a row that -- of organic growth at Quaker, something not seen since 2015, if I'm correct. So could you please give us more granularity in those results, especially, and it's not necessarily what we are seeing in Nielsen data? And how sustainable this trend is in your view? And also, I mean, this growth seems to be coming at the expense of operating income, which seems to be a change of strategy this year versus the last few years. Should we think about operating margins to continue to compress to sustain the growth here?

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

Good question, Laurent. Of course, we want each one of our businesses to be a positive growth business, so Quaker, no different. We will continue to invest to make sure that business continues to grow, maybe not at the levels that we have Frito-Lay, but just good levels.

We've done several things with that business. One is we invested a bit more, both in CapEx and on cost of goods. Cost of goods, specifically in the area of improving the formulation of our Quaker products. So we've eliminated all the artificials, now it's only natural and I think that will do well



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for the brand going forward. Although it's quite an important investment in terms of cost of goods. So that's why you're seeing the operating -- the gross margin reducing a little bit in Quaker.

In terms of the breadth of growth, it is across all the different brands that make up that business. So it is our oats, but it's also on light snacks, which actually have a tremendous, tremendous potential. It's part of Aunt Jemima. It's part of the convenient foods in -- with (inaudible). So it's a broad, broad growth, and I think it's sustainable as we put a bit more focus on the brands, the innovation and the execution of those particular brands.

The fact that we've put this business under the Frito-Lay organization so they report to Williams now, it will bring more operational excellence to that organization in terms of both supply chain and sales. And I think that, per se, will drive growth as we execute better. So I would say, again, a holistic look at the business starting from innovation, brands. And in this case, execution as well, being a big lever I think of potential future performance.

Operator

Your next question comes from the line of Kevin Grundy of Jefferies.

Kevin Michael Grundy - Jefferies LLC, Research Division - Senior VP & Equity Analyst

Question on the Pioneer Foods deal and in M&A more broadly. So the Pioneer deal announced back in mid-July, I understand it hasn't closed yet. But perhaps a little background how the deal came together and why Pioneer is the right asset to accelerate growth in the Sub-Saharan Africa region?

And then more broadly, Ramon, on M&A, is it fair to say that international and food snacks is where investors should expect to see capital deployed going forward from an M&A perspective?

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

Yes. Listen, Pioneer is -- Africa is a continent of the next 30 years, right? So we're putting a capital against a market opportunity that will deliver itself in the next 20 years. What Pioneer gives us is more scale in a continent where you're successful not only because of you have good products, but you need to have very good infrastructure, very good go-to-market, very good manufacturing, clearly closer to the consumer and very good talent. I think from Pioneer, we get a very good set of brands across multiple categories, starting with basic food, but going all the way to more sophisticated breakfast solutions and juice solutions. It gives us great talent, great local talent that understands how to operate in Africa. It gives us scale for our go-to-market, and this will help our beverages and our snack businesses. And it gives us a good operating efficiency as we integrate all these businesses. So it is a good investment for us.

Why Pioneers? We've been looking at different options, obviously, over time. And Pioneer, we've been -- we're good friends for many years with the Pioneer team, and the opportunity came as of recently. So it is a strategic geography for us from, I would say, horizon 3, not horizon 1 or 2, but horizon 3. And we think it's going to be a very, very strategic investment for us going forward.

Operator

Your next question comes from the line of Amit Sharma of BMO Capital Markets.

Amit Sharma - BMO Capital Markets Equity Research - Analyst

I want a follow up, too. I think there was a question earlier about pricing in FLNA, like clearly pricing-driven, but just about how sustainable that is going forward.



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And then broadly, for Hugh, we clearly hear you on small packages and innovation in beverages. But as you look at your overall portfolio, do you feel like you have the brand to meet evolving consumer demand or do you need to look at M&A for your beverage portfolio as well?

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

I'll talk about the brands and maybe Hugh can talk about the other part of the question. I think we have a very good portfolio, actually, in North America to cover both existing demands and future demands, right? So if you think about our CSD brands, when you think about our water brands with LIFEWTR, bubly, Aquafina, if you think about our coffee, Starbucks, if you think about our teas, Pure Leaf, it's -- I mean we have a newly-acquired value-added dairy business, SodaStream going forward, so we have I think a very broad portfolio to cover both existing demands, future demands. And as I said, indulgent functional hydration, I mean multiple, multiple occasions around the day and today's demand and future demand.

Whether we'll need some smaller brands to add to the portfolio, like we have KeVita or some other smaller brands, we'll see as we go forward. They will not be meaningful to the overall breakdown of the portfolio that I think we have. The big brands that we need to take the business forward and those brands can innovate into multiple spaces, right? So I mean, that's the beauty.

So Gatorade, you can see it's a beautiful brand that has been playing on part of the market. Now we take it to another part of the market, and we generate \$500 million of additional revenue in 1 year. So I think we have the brands. Now we need to keep those brands very relevant, keep them modern, keep them attractive to the consumer as the new generations come into the marketplace. And then we need to keep innovating into new spaces under the umbrella of those brands. And they're broad enough brands that can cover multiple spaces. So I would not -- I think we're very well positioned better than our competition, I think, in that space. And then we'll have to, as I said, keep innovating and keep building the brand into more modern ways of communicating. But it's -- I think we're very well positioned to capture today's demand and future demand. And, Hugh, if you want to talk about the other part.

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

Yes. Yes. Regarding Frito-Lay. Amit, a couple things to keep in mind. Number one, the Sabra business, we include Sabra in our volume, but not in our revenue. It's not a consolidated venture, so we do capture volume but not revenue. Sabra is growing below the Frito-Lay average and the product is quite heavy. If you back out Sabra, that's worth 0.5 point. So the 1.5 volume is actually 2 points of volume if you back out Sabra. That relates more directly to the 5.5 Frito-Lay revenue, so that leaves you with about 3.5 points of price/mix. Obviously, pricing was a bit higher this year than what we've seen on average over the last couple of years, but not dramatically so. And mix is clearly a tailwind as well as we move more the portfolio into premium products. So I think you'll see numbers that are pretty consistent with that relationship. Once you back out Sabra, it may be a little bit less, but not dramatically so in the Frito-Lay business.

Operator

Your final question comes from the line of Bill Chappell of SunTrust.

William Bates Chappell - *SunTrust Robinson Humphrey, Inc., Research Division - MD*

Just looking at Gatorade in particular, I mean, great that it's turned around. And is it as simple as saying just long overdue in putting a zero-cal version out there and if that's the right way to look at it? I mean is that resident in the whole business? And maybe you were a little too conservative, a little too slow to some of the changes and some things can be done to kind of accelerate the beverage business going forward?



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

No, it's not. We didn't say it was the only lever, right? It's multiple levers that we're playing to make Gatorade successful. And we're changing packaging, we improved our communication, we improved our execution on kind of the broad Gatorade brand. And then we added innovation, which normally it is a big lever of acceleration, right? If you hit the right innovation in these big brands, that gives you a big, big lever.

We're looking at hydration as a holistic opportunity. And we have Gatorade, we have propel, we have Bolt24, so we're looking at different solutions for different type of consumers there. We're looking at direct-to-consumer solution for Gatorade. We're looking at other ways of personalizing consumption for Gatorade to make sure our kind of value added to the consumer is higher, more personalized. So I didn't mean to say that it was only launching Zero and that was it, right? It's a much broader set of efforts across the organization to make sure that we continue to be the preferred house of solutions for sports drinks, Gatorade being one part, again Propel is growing fast, and it's a great solution for low-calorie hydration. The same now with Bolt24, where we expect to innovate going forward. So that we're looking at this opportunity. And physical performance is a big going forward consumer need, that I think we want to participate, not only with hydration, but maybe other solutions as well.

So thank you all for your time and participation in this morning's call. To conclude, summarizing, we're pleased with our results in the third quarter and we now expect to meet or exceed our original target for our full year organic net revenue growth. We're executing well against our key priorities, and especially, we thank you all for your confidence you've placed in us with your investment. Thank you.

Operator

Thank you for participating in PepsiCo's Third Quarter 2019 Earnings Conference Call. You may now disconnect.

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