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PEP - Q1 2013 PepsiCo Earnings Conference Call

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OVERVIEW:

PEP reported 1Q13 reported net revenue growth of 1%. For 2013, Co. expects organic revenue growth of mid-single digits and core constant currency EPS growth of 7% off core 2012 base of \$4.10.



CORPORATE PARTICIPANTS

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PRESENTATION

Operator

Good morning and welcome to PepsiCo's first-quarter 2013 earnings conference call. Your lines have been placed on listen-only and until the question-and-answer session.

(Operator Instructions)

Today's call is being recorded and will be archived at www.PepsiCo.com. It is now my pleasure to introduce Mr. Jamie Caulfield, Senior Vice President of Investor Relations. Mr. Caulfield, you may begin.

Jamie Caulfield - PepsiCo, Inc. - SVP IR

Thank you, operator. With me today are Indra Nooyi, Pepsi's Chairman and CEO, and Hugh Johnston, Pepsi's CFO. We will lead off today's call with a review of our first-quarter performance and 2013 outlook, and then we will move on to Q&A. In an effort to get to as many analyst questions as possible within the hour, we've kept our prepared remarks relatively short this morning, and we're going to have a one question limit. So we should be able to get through the full queue of analysts when we get to Q&A.

Before we begin, please take note of our cautionary statement. This conference call includes forward-looking statements, including statements regarding 2013 guidance, based on currently available information. Forward-looking statements inherently involve risks and uncertainties that could cause our actual results to differ materially from those predicted in such forward-looking statements. Statements made on this conference call should be considered together with the cautionary statements and other information contained in today's earnings release and in our most recent periodic reports filed with the SEC.



Unless otherwise indicated, all references to EPS and total operating profit growth are on a core basis. In addition, references to organic revenue results in this call exclude the impact of acquisitions and divestitures, structural changes and foreign exchange translation. To find disclosures and reconciliations of non-GAAP measures that we may use when discussing PepsiCo's financial results, please refer to the glossary and other attachments to this morning's earnings release. And to the Investor section of PepsiCo's website under the Investor Presentations tab. As we discuss our results today, please keep in mind that our Q1 reporting period is the 12 weeks ended March 23 for our North America businesses, and is the months of January and February for the vast majority of our businesses outside North America.

Now, it is my pleasure to introduce Indra Nooyi.

Indra Nooyi - PepsiCo, Inc. - Chairman and CEO

Thanks, Jamie, and good morning, everyone. Last February, we announced and then executed a number of important actions to strengthen and ensure the long-term success of our business. Since then, we've driven greater productivity, significantly increased our advertising and marketing investments, and upped our execution in the market. Today I'm very pleased to report strong first-quarter results. We had mid-single-digit organic revenue growth, double-digit core EPS growth, and a significant improvement in cash flow. We feel good about these results and what has been and continues to be a competitive landscape in a volatile macro environment. The first quarter has us confident that we are on track to meet our 2013 financial guidance.

Our organic revenue growth was 4.4%, right in line with our mid-single-digit long-term target. With particularly strong growth at Frito-Lay North America, Latin American snacks, international beverages, and snacks and beverages throughout Asia, Middle East and Africa. Organic revenue growth reflected a good balance of volume and net pricing. Our overall servings increased 3%, with snacks volume growth of 4%, and beverage volume growth of 1% on an organic basis. But our international beverage volume growth was very strong, up 9% on a reported basis and 6% on an organic basis. More specifically, developing and emerging markets volume was particularly impressive, with snacks volume growth of 5.5% and beverage volume growth of 7% on an organic basis.

North American beverages volume was negative, driven by specific decisions we made to take pricing and sustain it during the quarter. We had good profit flow-through, with core gross margins improving almost 130 basis points in the quarter. Core constant currency operating profit up 9%. And our core operating margin up more than 80 basis points. Each of our four business units grew core gross margins, expanded or held core operating margins, and grew operating profits. And we remain focused on cash flow and cash return. Management operating cash flow, excluding certain items, was more than \$460 million, a significant increase over Q1 2012. In addition, we returned over \$1.4 billion to shareholders in the quarter in the form of dividends and share repurchases, up more than 50% year over year.

We are encouraged by the continued strength in the top line. Innovation was a strong contributor to our overall organic sales growth. And we continued to see positive signs in terms of both improving brand (inaudible) of our global brand and market share results. And our productivity program is clearly on track. We've targeted \$900 million in savings this year, which is the second year of our three-year, \$3 billion productivity program. We are leveraging best-in-class supply chain activities from around the world. We are increasing automation across the value chain, from raw materials handling through the route truck. And we are implementing new processing technologies that enable us to both increase asset utilization and reduce input costs.

We are well on our way to achieving our current productivity goal of \$3 billion. And we have our team now focused on identifying and planning the next generation of projects that will extend our productivity savings well beyond the current program. With the productivity we are unlocking, we are able to invest in growth drivers like advertising and new product launches and to simultaneously drive margin improvement. This was evident in the first quarter where A&M expense increased by 50 basis points, while delivering an 80 basis point improvement in core operating margins.

Turning now to our businesses. Let me comment briefly on them in four buckets. Frito-Lay North America, North American beverages, all other developed markets businesses, and then developing and emerging markets. Let me begin with Frito-Lay North America. Frito had a good first quarter. We generated mid-single-digit volume and revenue growth. And going forward, we expect modest pricing to create a bit more of a spread



between volume and revenue then you saw in the first quarter. We expanded core operating margins by 40 basis points, even as we increased advertising and marketing expense.

More importantly, in Q1, Frito-Lay gained volume, unit, and value share across major channels in the United States. We feel good about Frito-Lay's growth model, because our business is largely focused on salty snacks. We are able to grow by taking occasions from other macro snacks, like cookies, crackers, nuts and seeds. For example, our Tostitos Cantina is sourcing cracker occasions. While Doritos Jacked is sourcing occasions from microwavable snacks. Additionally, with our focus on the growing premium snacking occasion, we are realizing additional growth and profitability. For example, in Q1, Sabra dips grew volume 16%. And Stacy's grew revenue 21%. And both these are premium offerings, which give us additional space in the produce and deli sections of the grocery stores. So, as we look at Frito, we believe it's in good shape.

Let me turn now to North American beverages. Our goal in North American beverages is to judiciously balance share and profitability. This is very important because we compete in every subcategory of the LRB segment. And any growth we achieve in one business comes largely at the expense of another subcategory where we also compete. So, we have to be very careful to compete in this large and profitable LRB business in a responsible way, focused more on innovation and marketing, balancing share and profit. It's our experience that short-term volume-driving activities merely rent share and is not a value-creating strategy.

Now, let me talk about the category itself and our performance in it. As you all know, about 65% of the category is non-carbonated beverages. And this segment continues to show growth potential. In the first quarter, we had good performance in teas and chilled juices, ready-to-drink coffee and in sports drinks, all supported by successful innovation. Our Pure Leaf product under the Lipton trademark, Tropicana Farmstand, Naked, our super-premium chilled juice, Starbucks Iced Coffee, Starbucks Refreshers, Gatorade SKUs and shakes, each performed well in the first quarter despite less than favorable weather in many parts of the country.

In the other 35% of the LRB category is CSDs. About 17 points are made up of colas and about 18 points are made up of flavored CSDs. Within flavor CSDs, Mountain Dew continues to perform well, significantly outperforming the overall CSD category. And gaining 0.4 of 1 share point in the quarter, bolstered by the launch of Kickstart. And the momentum of Kickstart continued into April. However, the cola category continues to be a challenge. We took pricing in this declining category and continue to invest in R&D to break some of the compromises that caused consumers to leave the cola category. While this works progresses, we are managing the business responsibly and profitably. We are supporting Pepsi with package and product innovation to drive price utilization and investing appropriately in A&M.

And this is what you see reflected in our first-quarter PAD performance. We had good disciplined net price realization. Our revenue performance was generally in line with the category. A&M expense increased by 30 basis points versus Q1 of 2012. We expanded core operating margins by 50 basis points. And we grew core constant currency operating profit 4% in the quarter. So, as we go forward, expect us to continue to play a responsible game in North American beverages, to be competitive, of course, but to also enhance our financial performance. And across the beverage business, we are taking out costs to drive margin and improve returns under our current structure. While we continue our work to explore sensible opportunities to unlock incremental value through meaningful structural alternatives. And, as we told you in the last earnings call, we do not intend to talk about this until early next year.

Let me now turn to our other developed markets outside the United States. We saw good performance in some of our larger markets. The UK had 5% organic revenue growth, Germany was up 8%, France grew 10%. But Western European macros overall continue to be challenging. And we expect that will continue to put pressure on consumer spending going forward.

Emerging and developing markets. We saw very good growth in these markets in Q1, with organic revenue growth of 12%, made up of 14% in snacks and 9% in beverages, driven by executional cross-strategies to increase household penetration and frequency of consumption. We had terrific growth across each of our major developing markets, with organic revenue growth of 6% in Mexico, 8% in Turkey, and 12% in Brazil. And our emerging markets performance drove the continued great results in our AMEA sector, where organic volume grew double digits in each of snacks and beverages. And organic revenue grew 15%. Within our emerging markets, organic revenue was especially strong in Saudi Arabia, Pakistan, Vietnam and the Philippines, with each growing in excess of 20%. Organic revenue grew 19% in Jordan, and 18% in Egypt. China performed especially well, with organic volume growth of 17% in beverages, and 47% in snacks. Importantly, we also saw nice improvement in core operating margins in EMEA, with a 450 basis point increase, even as we continued to invest in brand building and capacity to drive future growth.



So, overall, we feel good about the state of the business and our first-quarter performance. Top line was strong. We continue to invest in our brands to fuel growth. Productivity is on track. And we saw solid core operating margin improvement and core operating profit growth. With the strength of the first quarter's performance, we have an even greater degree of confidence in delivering our 2013 financial guidance in a global macro economic environment that continues to be volatile.

To summarize, PepsiCo is performing well. We are growing the top and bottom line and driving margins and cash returns. We are being disciplined and responsible across the board in balancing value share and profitability. And the overall portfolio is working in terms of scale, geographic reach, and product diversity covering snacks and beverages, and different dayparts, need states and cohorts.

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

Hugh Johnston - PepsiCo, Inc. - CFO

Thanks, Indra. And good morning, everyone. I'll spend just a minute covering the financial results and guidance in a little more detail, and then we will open the lines to your questions. For Q1, organic volume grew 4% in snacks and 1% in beverages, with international organic volumes up 6% in beverages, and 5% in snacks. Organic revenue grew 4.4%. Our core gross margins improved by about 130 basis points. And we reinvested almost 50 basis points in A&M. Core operating margin improved by 80 basis points. And core constant currency operating profit grew 9%. Net interest expense increased by \$12 million, reflecting higher debt balances. Our core effective tax rate was 24.5%, approximately 220 basis points below Q1 2012. And core constant currency EPS grew 13%.

So, between core constant currency division operating profit growth of 7%, and core constant currency EPS growth of 13%, we got about 6 points of leverage. 1 point from corporate unallocated, some of which is timing related. Slight leverage from net interest expense. 3 points from tax rate, which will reverse as we are forecasting the full-year rate to come in at approximately 27%. And 1 point from weighted average share count, which was down 1% year on year. Overall, the quarter came in as expected, with pricing actions, commodity inflation, and productivity all in line with our expectations.

On a reported basis, net revenue was up 1%. And that was driven by a 0.5 point drag from ForEx, and a 3 point negative impact from structural change, reflecting the China refranchising. Reported operating profit and EPS included the \$111 million net monetary asset write-down in Venezuela that we talked about on the Q4 call. We generated over \$700 million in cash flow from operations in the quarter, a \$1.4 billion positive swing versus last year. This was driven by lower pension contributions, stronger working capital improvements, and a reduction in net capital spending. Management operating cash flow, excluding certain items, was \$464 million, an increase of \$385 million over Q1 of last year. And, we returned over \$1.4 billion to shareholders this quarter, in the form of dividends and share repurchases, a 52% increase year over year.

Now, turning to guidance. For 2013, we expect core constant currency EPS growth of 7% off a core 2012 base of \$4.10. More specifically, we expect organic revenue growth of mid single digits, core constant currency operating profit growth of approximately 6%, and approximately 1 point of leverage below the operating profit line, driven by share repurchases, offset somewhat, by higher net interest expense of approximately \$90 million from higher debt balances. We expect our core effective tax rate to be approximately 27% for the full year. Within these expectations, we assume positive price mix, low single-digit commodity inflation, productivity of \$900 million, and A&M growing at least in line with our net revenue growth. Our productivity assumption is completely in line with the three-year, \$3 billion program that we launched last year. And the savings will be used to help offset inflation, as well as to provide funding for investment back into the business.

One of our key investment areas is supporting our brands with advertising and marketing, where we will grow A&M investment at least in line with net sales. Meaning you should expect A&M spending of at least 5.7% of sales, which was our 2012 baseline investment. In addition, we are also accelerating our investment in R&D and innovation. Based on current market consensus, we anticipate foreign exchange translation to have approximately a 1 point negative impact on our net revenue, operating profit, and EPS for the full year, including the impact of the Venezuela devaluation. Our ForEx outlook is marginally more negative than what we shared with you on the Q4 call, but still rounding to 1% at this point. We anticipate structural changes will have a negative impact on our full-year net revenue growth of approximately 1 point, driven by China and Vietnam.



Overall, we are pleased with how the first quarter came in, and that increases our confidence in delivering our full-year guidance. I would encourage you not to increase your estimates, however. The world remains a volatile place and we may also choose to incrementally invest in the long-term value-building initiatives such as advertising, innovation, and in emerging markets growth capacity.

As you model out the second quarter, we expect foreign exchange translation to have up to a negative 2 point impact on second-quarter revenue and EPS based on current market consensus rates. We expect revenue in the second quarter will have an estimated 1 point negative impact from structural changes due to the beverage refranchisings, both China and our recently-announced refranchising in Vietnam. We'll also have a gain on the Vietnam transaction, which we intend to reinvest in the business. So we don't expect it to have any impact on our full-year earnings guidance. Commodity inflation will ramp up sequentially from the first quarter, but our full-year outlook remains unchanged from our original guidance of low single digits.

In Europe, given the timing of expenses and continued challenges in Western Europe, Europe sectors operating profit performance may moderate from the Q1 performance. And we expect higher A&M expense will negatively impact margins across the business. From a cash flow perspective, we expect full-year core management operating cash flow, excluding certain items, of more than \$7 billion. We will continue to drive cash flow through even more efficient working capital management and continued tight controls over capital spending. For 2013, we expect to see continued improvement in our key working capital metrics, and to manage net capital spending to approximately \$3 billion, which is well within our long-term target of less than or equal to 5% of net revenue.

As a result, we will continue to return strong cash flow to our shareholders. In total, we expect to return approximately \$6.4 billion to shareholders in 2013. \$3.4 billion in dividends and \$3 billion in share repurchases. Net, our outlook for 2013 is consistent with our long-term targets for net revenue, operating profit and core constant currency EPS. We expect to drive improved margins and net ROIC. And generating and returning cash flow to our shareholders remains a top priority for the Company.

So, with that, operator, we will take the first question.

QUESTIONS AND ANSWERS

Operator

(Operator Instructions)

Bryan Spillane with Bank of America.

Bryan Spillane - BofA Merrill Lynch - Analyst

Just a question on the operating leverage in the quarter. I don't know how difficult it's going to be to try to parse this out. But just trying to get a sense for how much of it was driven just simply by commodity disinflation, how much of it is driven by the pricing actions in Latin America Foods and in America's beverages, and how much of it is you're actually beginning to see more of the productivity drop to the bottom line? So I'm just trying to get a sense for, when we look at the margin expansion in the quarter, and try to look at it going forward, just the weightings in terms of what those items contributed to the margin expansion.

Hugh Johnston - PepsiCo, Inc. - CFO

Bryan, obviously, we are getting into a fair amount of detail. And in a global P&L it's a little bit difficult to parse all of that. No doubt they were all contributing factors. We clearly did have some pricing in excess of inflation for the quarter. But we also got more than our share of the \$900 million of productivity in the quarter. And that was flowing through, as well. Instead of breaking the specific pieces down, what we really tried to do is just give you guidance on what we expect the outputs to be. And at least give you a sense for the difference between what's happening in gross margin



and what's happening and operating margin. What I would just say is, both price in excess of commodity, as well as productivity were significant contributors to the margin expansion.

Operator

John Faucher with JPMorgan Chase.

John Faucher - *JPMorgan Chase & Co. - Analyst*

I just wanted to follow up a little bit, Indra, on your comments on North America. If we look at the scanner data pricing, which is really what we have to work with, your pricing in CSDs accelerated a little bit through the quarter. And on a two-year basis you are ahead of both of your largest competitors in terms of pricing in CSDs. The big concern, given the weak volume number, is profits without a balanced algorithm really are not sustainable. And people would argue that's one of the things that got you in the hole that you were in heading into 2012. So, how do we think about that balance going forward? Because, to Bryan's point, the leverage looks good, but the viewpoint is going to be that it's not sustainable and you're going to have to drive some of that back in order to get the volume moving. So, any sort of follow-up there?

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

John, I tell you, that's a great question. In the last call, I think we talked about Q1 always being a funny quarter because all the weather-related impacts hit us on Q1. So, it's very hard to read the year from Q1 alone. But, having said that, let me tell you that we look very carefully at this trade-off between volume, pricing and profit. We look at it constantly. We began the year saying we've got to take pricing and we've got to stick with it. Because this is a category where you've got to behave in a very responsible and a consistent way, so that you don't destroy value in a business that requires reinvention. That's the way we approached it.

We saw some interesting pricing activity in the first five or six weeks of the quarter. And in the second half of the quarter we started to put in the right actions on pricing; very granular, very targeted. Still with an eye towards profitability, to make sure that we balanced volume, revenue and profitability very carefully. And if you look at the last six weeks, or the last nine weeks, the performance is very different. Believe me, John, your point is exceedingly well taken. We are trading this thing very carefully. But at the end of the day, I think this industry requires responsible behavior. And we are going to try to make sure that we play this carbs, non-carbs portfolio, very carefully while getting ready for this reinvention of carbonated soft drinks. So, we will continue to play this game where we don't allow volume declines for the balance of the year to be at the magnitude of the first quarter.

Operator

Judy Hong with Goldman Sachs.

Judy Hong - *Goldman Sachs - Analyst*

On some of your emerging market or developing market performance, it's been now a few quarters where your profitability is starting to really ramp up. So, can you just give us some perspective on the sustainability of that profit improvement, your level of investment that's going into those markets, and the potential for continued profitability improvement? How much of that is going to really drive your overall profit growth performance?



Indra Nooyi - PepsiCo, Inc. - Chairman and CEO

Judy, emerging and developing markets have been growing robustly from a GDP perspective. And the differential between developed markets and emerging and developing markets tends to be about between 3 and 6 points in terms of GDP growth. So, if you look across the world, emerging, developing markets have robust growth. That's the macro economic factor. Over the past five or six years, as you well know, we've been investing to shift our portfolio to be more balanced between emerging and developing markets, and developed markets. Because prior to 2006, we tended to be more of a developed market, predominantly US-based, company. For the last six years we've been working very hard to diversify the portfolio.

So what you are beginning to see right now is the results of all those investments beginning to pay off bit by bit. When you first make the investments, it is dilutive to profitability. But you have to make those investments. Between M&A and organic investments, we had to do it. Now, bit by bit, as developed markets don't grow as robustly as they did pre-2005, and as the developing and emerging market investments start to pay off, the combination is beginning to yield results.

Now, if you're asking for a projection, it's very hard to give you a projection. All that I'd tell you is, the overall PepsiCo algorithm works because we have this nice mix of developed and developing and emerging markets. And as margin improves in those markets, and developed markets also continue to grow, the overall portfolio works. The overall financial profile works.

Operator

Ali Dibadj with Sanford Bernstein.

Ali Dibadj - Sanford C. Bernstein & Company, Inc. - Analyst

I wanted to ask a little bit about this balancing act that is certainly going on in North America, it sounds like successfully. Particularly on North American CSDs where you are seeing volume is what volume is. We're going to try to do better, but it is what it is, and we are going to try to drive profitability.

Indra Nooyi - PepsiCo, Inc. - Chairman and CEO

The question being, Ali?

Hugh Johnston - PepsiCo, Inc. - CFO

I think he's asking the balancing act between profit and market share.

Indra Nooyi - PepsiCo, Inc. - Chairman and CEO

Go ahead.

Hugh Johnston - PepsiCo, Inc. - CFO

Ali, what I would say is this. As Indra mentioned in her opening remarks, we are basically trying to do two things. Number one, we want to make sure that we ensure our competitiveness. That's something that we think is important for the long term of the business. At the same time, we do think that this is a good business. It's a business that generates a lot of cash flow. And, obviously, we are looking for it to generate profit growth as it did in Q1, with PAB delivering 4% profit growth. Which is certainly a positive, I think, in the industry.



The balancing act that we're ultimately going to manage to is, ensuring that, within the categories, we are being smart about how we manage each of the categories, where we choose to gain share, where we choose to hold share. The second thing that we are going to be doing is we will be playing a price package game to ensure that we do look across the package portfolio to get price realization where we can. In that vein, one of the things that you know we are doing this year is what we called our hybrid EDD, which is to try to balance out holiday and non-holiday pricing, to try to send the message to consumers that -- not to buy only when the product is deeply discounted. Then, obviously, the last decision that we've made is a decision to invest in research and development to address some of the core dissatisfiers with some of the products, with the belief that innovation is the way, really, to create sustainable value in the category. And I think that's what we are looking to do in the North American beverage space. And we think it's a successful strategy.

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

Ali, the other thing, as we talked in our earnings call, it's interesting because the North American beverages, we participate in every subsegment of the North American beverage business. So, we have to be careful that we don't take pricing down too much in one category and source from a more profitable part of the other subcategory. So, we have to make sure we play this overall category game very carefully. And because we've owned operating businesses around the world in snacks, we are very cognizant of how you play the game in a big operating business. It's very different from playing the game in a franchise business. We have volumes of learnings from around the world from our various operating businesses. I think we are borrowing a page from that play book to participate in this NAB, the North American beverage business.

Operator

Dara Mohsenian with Morgan Stanley.

Dara Mohsenian - *Morgan Stanley - Analyst*

Hugh, given the 9% core profit growth in Q1 despite the 11% ad increase, your full-year guidance implies a few 100 basis point slowdown, at least, in the balance of the year on core profit growth. I know you mentioned commodities get worse. But I was hoping for a bit more detail on why you'd expect that level of deceleration. And, also, can you quantify what you are expecting on commodities in the balance of the year relative to Q1?

Hugh Johnston - *PepsiCo, Inc. - CFO*

Yes. I think a couple of things to keep in mind on that, Dara. The first and probably the biggest factor is, the world is certainly a volatile place. As we look forward into the balance of the year, we are certainly thinking about our guidance in the context of the world being a volatile place. And at the same time ensuring that we deliver our guidance through thick and thin, in terms of the challenges that we might face.

The second piece to consider, is given that we have seen some success in terms of moving the top line with investments that we've made in the business, we're only going to do things that we view as creating sustainable shareholder value. But to the degree that there are opportunities to invest in the business to create sustainable shareholder value, we are obviously going to be looking towards doing that, as well. And then the last piece, I talked about core division operating profit growth of 7% for the quarter, and core division operating profit growth of 6% for the year. So, that's about a 1 point gap. Frankly, with the timing of A&M expenses, with the timing of commodities, that gap isn't so large that just the general quarterly movements in those expenses would move the number from a 7% to a 6% in a relatively undistruptive way. So, that's basically how we get there. And hopefully that gives you a little bit of a sense of the context as to how we are thinking about it, as well.

Operator

Bill Schmitz with Deutsche Bank.



Bill Schmitz - *Deutsche Bank - Analyst*

Can you just give us some color on the organic growth rates in some of the bigger countries -- Russia, China, ex the Tingyi partnership, Brazil and Mexico? And then maybe Gatorade on the organic side, too? And then, the second part of the question is maybe how March is looking in some of the international markets, because I know the books close in February. Maybe some update on what happened in March and what your view is going forward?

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

Organic growth pretty much in every one of those markets was strong. We talked about it in our earnings script. China, volume grew, organic revenue grew. If you look at the UK, you look at Russia, you look at every country, pretty much across the board we had organic revenue growth. Whether it was developed or developing. I don't think there was any country around the world, Bill, where we did not have some organic growth. So, we feel good about the growth rates, even though many of those international markets were just two months. India grew 9%, Egypt grew 20%, Saudi grew 21%, Pakistan grew 37%. I could go on and on. But every one of these countries grew mid single digits or even in the 20% or 30%. So, good revenue performance across the board.

The first quarter is a two-month quarter. It's the smallest quarter in the year. So, the costs and the profits are not fully balanced. What I would say to you is that we had very good gross margins. In EMEA, for example, we had a 438 basis point improvement in gross margins. But it's a small quarter. So let's wait and see how that evolves through the year. But all that I'd tell you is Latin America, EMEA, doing well. Margins expanding, profits going well. Russia doing well. Western Europe, we're going to watch and wait and see what happens with the macro economic environment. And North America we've talked enough about it. So, overall, I'd say it's a good outlook for our developing and emerging markets.

Operator

Caroline Levy with CLSA.

Caroline Levy - *CLSA Limited - Analyst*

I wonder if you could actually just -- the last part of the last question was around Gatorade and Trop. Talk about the strategy for this year and longer term, the repositioning that happened at Gatorade, and what the volume was like this quarter.

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

I'm sorry, Bill, that I didn't answer that Gatorade and Tropicana part. And, Caroline, thank you very much for asking that question again. Actually, Gatorade and Tropicana had very good quarters. Sequentially the performance is sustaining itself. Again, as you well know, in Gatorade, we are playing a sports nutrition game between Gatorade juice, Gatorade hydration, and Gatorade Recover. As a system, that business is doing well. We are staying very true to our premium sports nutrition positioning. We continue to play the game that way. We are beginning to gain share in sports nutrition, even though we had low-price competition come in with really aggressive pricing. We held our ground and we are beginning to gain share. So, we feel very good about our sports nutrition strategy.

In the case of Tropicana, between Tropicana Trop50, the Tropicana franchise also includes Naked. But let me just speak to Tropicana. Again, coming out of the first part of Q1, going to the second part, and now going into Q2, we are beginning to gain share in the chilled juice category. Just a lot of great advertising, incredible execution focus in all of our traditional strongholds. And we are seeing impressive performance gains in Tropicana. And just look for us to grow the Naked franchise, continue to bring innovation into the Tropicana franchise. And the launch of Tropicana Farmstand, which is our fruit and vegetable product, is also doing very well. So continue to look for innovation from Tropicana. We feel good about the tail winds those categories have, because they are more in the nutrition space, coupled with the fact that our brands are very strong.



Operator

Mark Swartzberg with Stifel Nicolaus.

Mark Swartzberg - *Stifel Nicolaus - Analyst*

A two-part question. It looks like, in c-stores, there's an increasing divergence between what you're seeing on the snack side of your business and the beverage component of your business. And, as you say, we've only got two months here. So, perhaps on the beverage side we should not make too much of that. Can you speak to how accurate that assessment is? And what kind of promise these tie-ins with AB and the promotions you have incrementally from a Power of One perspective, how you feel they might address that issue? And then related to that, but could we speak a little bit more about how this large-format effort on the promotional side, changing the promotional calendars, is actually going? It sounds like the aim is good and you've had some success to an extent. But perhaps the pace of success, in terms of getting that better promotional environment, is a little slower than you would have thought about a year ago.

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

Convenience stores in the first quarter, especially the first part of the first quarter, perhaps not a very good-performing channel. We are talking about our business. As a channel, convenience stores did not perform very well because weather impacted convenience stores significantly. You can't do anything about mother nature. So convenience stores didn't perform well. But now, as the weather is improving across this country, a little bit slower than we'd like, because snow in the West in April doesn't feel that good. But we are seeing trends improve in convenience store. And we are very strong in convenience stores, both in beverages and snacks. We are beginning to see sequential improvement. Because of the underperformance in the first part of Q1 of the channel itself, and now that we are seeing sequential improvement, we think the year for c-stores will still end up with 3.5%, 4% growth in the channel. And if the channel grows at that rate, you should expect to see good performance from PepsiCo in that channel. I'll be honest with you. The divergence between snacks and beverages is not that much. Both our businesses are doing fairly well in the convenience stores. And I think that as the year goes on, you'll start to see better performance in the convenience store channel. And in terms of -- did you want to add something?

Hugh Johnston - *PepsiCo, Inc. - CFO*

Yes, if can add just particularly to the convenience store piece, as well. As Indra mentioned, the weather lap in convenience is particularly challenging for beverages. We had a particularly warm winter last year, lapping that now with a really long extended winter. That's just going to have a more natural effect on beverages than it will on the snacks business. I think the divergence that you are referring to can be more attributed to that than it can be to anything else. It's also indicated in the overall performance in the convenience channel, which was down obviously in the first quarter. And, as Indra mentioned, we expect for the full year that channel to be up 3.5%, 4%. We don't normally like to use weather as much of a conversation piece. But I think in this case, because it's just so stark, and it does have such a significant impact on that channel in that particular set of businesses, it is a relevant factor.

Operator

Bonnie Herzog with Wells Fargo.

Bonnie Herzog - *Wells Fargo Securities, LLC - Analyst*

I just had a follow-up on the c-store channel and then Frito-Lay. I was actually hoping you could give us a little more color on some of the new initiatives in this channel, such as your individual store planograms that you started to implement. I'm curious to hear how broad-based this initiative will be. And then maybe could you talk about any other changes you've been making in the important channel?



Indra Nooyi - PepsiCo, Inc. - Chairman and CEO

Frito-Lay has always had the convenience store as a very strong go-to-market outlet, and it continues to be that way. Frito had terrific performance in Q1. And to get to that level of detail on how individual store planograms are working, Bonnie, my suggestion is, at some point, if you want to visit Frito-Lay and get a better sense for what they are doing in c-stores, we invite you to do that.

Hugh Johnston - PepsiCo, Inc. - CFO

In addition to that, Bonnie, I don't know that what's going on is as much planogram oriented. Frankly, it's out of the blocks really well and we feel very good about it.

Operator

Damian Witkowski with Gabelli & Co.

Damian Witkowski - Gabelli & Co. - Analyst

Indra, in the past you have called the US pricing environment probably one of the most irrational you've seen in any industry. I'm wondering if you've changed your mind about that with what happened over the last couple of years, and pricing seeming to be a little bit more rational. And then the second part is, are we seeing any of that in the international markets, especially ones that are growing and getting bigger?

Indra Nooyi - PepsiCo, Inc. - Chairman and CEO

I think, Damian, I made that comment a couple of years ago when pricing was crazy. But I would say that -- I wouldn't say that it's become rational. I would say in bursts it becomes irrational. I think if we continue to focus just on volume, and maniacally on volume -- I'm talking mostly about beverages -- if we only focus on volume growth, it does lead to some irrational pricing. Especially when quarters have to end, or when people are trying to make some volume numbers just to report something good. I think in this LRB category in particular, it's very important we thread volume and value very carefully. It's a big, profitable category. And we run the risk of sucking the profits out if we don't play this game responsibly. So, that's the tack we've chosen to take and I hope that's how the industry gets played out. We see bursts of responsible behavior, then at times we see action that we can't even explain. But I guess this is part of free markets and competition, so we just keep playing this.

Operator

Ali Dibadj with Sanford Bernstein.

Ali Dibadj - Sanford C. Bernstein & Company, Inc. - Analyst

Thanks very much for coming back to me. Sorry about the technical issues.

Indra Nooyi - PepsiCo, Inc. - Chairman and CEO

Sorry that you got cut off, Ali.



Ali Dibadj - *Sanford C. Bernstein & Company, Inc. - Analyst*

No, it's okay. I did hear the answer on North America CSD balancing act. So I appreciate that. But my question is a little bit broader. Which is really around whether we should philosophically think of the global portfolio being one of part generating cash and profit in North America, beverages, in particular, particularly North American CSDs. To then take that and invest in parts of the global business that are actually growing more robustly. So, emerging markets, snacks in the emerging markets, in particular. Is that the model you guys explicitly think about and talk about internally like some other CPG companies and retail companies do? Or is that just more organic in the way it's been happening?

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

Ali, actually that's a very insightful observation. Because I think every company -- if you go back to the old growth share matrix that Boston Consulting came up with, I think in the '60s or '70s, you are really talking about how you have some cash cows to go off and invest in big growth stars. And that's how we all have to pay the portfolio, because a portfolio is completely comprised of growth vehicles. You can't sustain the investment. You do need some cash cows to be able to invest in growth engines. Having said that, I think that mature, low-growth businesses, especially if they're big and have consumer appeal, are also ripe for reinvention. I think it's very important that established players reinvent their categories, as opposed to allowing others to reinvent it and push them out. There are examples, many examples, of big companies, especially companies based here in the US, that did not reinvent their categories.

So, I think we adopted a -- behave responsibly, generate the cash in the North American business, grow responsibly, invest for international growth. But reinvent North America simultaneously. Which is why we stepped up all our R&D investments in sweeteners, flavoring agents, new processing technologies. Unfortunately, the timing is a bit off, because R&D projects don't result in major breakthroughs in the same time frame with which you can manage responsibly. So you've got to give a little bit more time to yield results.

So, you're absolutely right, and thank you. You've got to play the overall portfolio carefully. And what I feel good about, the PepsiCo portfolio, we have a very good mix of growth businesses, businesses that generate cash and good returns to keep funding this growth. I think our portfolio is so well-balanced in terms of snacks, beverages, geographic mix, different growth rates, that we are able to manage it sensibly, and deliver the kind of profit that I think this portfolio is capable of generating well into the future.

Operator

That was our final question. I would now like to turn the floor back over to Indra for any closing comments.

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

Thank you all. In closing, I'd just like to say that we are pleased with the way we are navigating through an uncertain and volatile environment. We've taken all the steps necessary to strengthen and position ourselves for sustainable, long-term growth. I think the first quarter of 2013 is an excellent example of how a well constructed and developed portfolio, coupled with disciplined execution and re-investment, can drive high-quality, top- and bottom-line results. So, I thank you for your time and for the confidence you have placed in us with your investment. Have a great day.

Operator

Thank you. This concludes today's conference call. You may now disconnect.

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