

FINAL TRANSCRIPT

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PEP - Q2 2011 Pepsico Inc Earnings Conference Call

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PRESENTATION

Operator

Good morning and welcome to PepsiCo's second-quarter 2011 earnings conference call. Your lines have been placed on listen-only 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*

(technical difficulty)

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Operator

Ladies and gentlemen, there will be a slight delay in today's conference. We will start momentarily. Mr. Caulfield, please go ahead, sir.

Jamie Caulfield - *PepsiCo, Inc. - SVP,IR*

Thanks, operator. With me today are Indra Nooyi, PepsiCo's Chairman and CEO and Hugh Johnston, PepsiCo's CFO. Indra will lead off today's call with a review of our overall performance and outlook and then Hugh will cover the financial guidance in more detail. We will then move onto Q&A where we will be joined by John Compton, CEO of PepsiCo Americas Foods and Eric Foss, CEO of Pepsi Beverages Company who is joining us by phone this morning.

Before we begin, please take note of our cautionary statement. This conference call includes forward-looking statements, including statements regarding 2011 guidance based on currently available information and our actual results could differ materially from those predicted in such forward-looking statements.

Statements made on this conference call should be considered together with cautionary statements and other information contained in today's earnings release and in our most recent periodic reports filed with the SEC.

To find disclosures and reconciliations of non-GAAP measures that we may use when discussing PepsiCo's financial results, please refer to the Investors section of PepsiCo's website under the Investor Presentations tab. Now it is my pleasure to introduce Indra Nooyi.

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

Thanks, Jamie and good morning, everyone. I would like to give you my perspective on the quarter, share with you how we see the macro and consumer picture and then comment on our priorities and outlook for the balance of the year, including guidance.

We delivered good results in the quarter because reported EPS was up 20% and core EPS was up 10%. Our worldwide servings increased 6% with global growth across a broad range of convenience food and beverage platforms. We had solid global volume growth in both snacks and beverages. Snacks volume grew 10% and beverages grew 5%. And within that, the global nutrition portfolio grew revenues 10% on an organic basis. Net revenue was up 14% overall and 8% on an organic basis.

I am pleased that our global snacks performance was particularly strong. We had balanced top-line and bottom-line growth in our snacks business with volume growth momentum accelerating from the first quarter. Frito-Lay North America, our largest snacks business, had another very good quarter with 2% volume growth, 3% net revenue growth and 6% operating profit growth. In fact, we saw positive performance in snacks in just about every one of our most important markets around the world. We grew volume, revenue and profits in every one of our top five snacks markets. We are driving growth in developed markets by providing a wide array of innovative products backed by strong commercial programs.

And in the emerging markets, we continue to grow per capita consumption frequency with locally relevant products and by expanding our distribution reach. This is leading to double-digit volume growth across a number of markets. In the quarter, India grew 22%, China grew 25%, Turkey grew 24%, Saudi Arabia and Egypt each grew about 20%. South Africa grew in the high teens and Brazil grew in double digits.

Now to beverages. The international market performance was very good. We saw volume outside of North America grow 4.5% in the quarter and 5% in the first half on an organic basis. Again, with gains across many markets and double-digit growth in key emerging and developing markets. China beverage volume grew 13% in the quarter. India grew 17%, Turkey was up 15%,

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Saudi Arabia was up 17%, Vietnam was up 11%, France was up 12%, Germany 15% and at the same time, we are seeing carbonated soft drink volume and value share gains across a number of these important markets.

This growth is being driven by innovation and the traction we are getting from our brand-building initiatives. The growth in key emerging markets, like China and Russia, is coming directly from the actions we have taken to build out our go-to-market reach and capacity.

We are off to a good start with the Wimm-Bill-Dann acquisition in Europe. I am pleased with the progress and I am monitoring it very closely. The Wimm-Bill-Dann management team and associates who are now part of PepsiCo are top-notch. The integration is right on track and we are confident we will achieve the synergies as originally planned and the fundamental operating performance of Wimm-Bill-Dann has been rock solid. So the majority of the portfolio is performing very well.

Now let me turn to Pepsi Americas Beverages and the North American beverage category in particular. In a difficult category environment, we are encouraged by a number of positives in the business. We are maintaining our focus on Pepsi Max and Sierra Mist with good results. Both Max and Mist grew in the quarter with Max volume more than doubling compared to the prior year. And we have terrific programming against brand Pepsi for the remainder of the year, including the current Summertime is Pepsi Time campaign and later this quarter, our sponsorship of the X Factor kicks into high gear.

Gatorade had another strong quarter of strong growth and the results in the C&G channel where we are benefiting from our move to direct store delivery earlier this year were especially strong. And Trop50 continues to perform very well with volume up 40% supported by the new carafe packaging and expanding the line into new flavors.

Taken together, the positive signs we are seeing in the brands where we have innovated and executed strong marketing programs give us confidence that our brand-building initiatives are beginning to pay off. However, the operating and financial performance in North America Beverages was below our expectations for the quarter and let me take you through the drivers and address what is going on here.

As we knew we would, we had exceptionally high levels of commodity inflation. That said, it is the consumer and competitive picture that has become more difficult than we expected. Consumer category demand was lower than we anticipated because overall retail foot traffic and basket sizes have declined and the category pricing environment was tough. These factors led to lower-than-expected price realization and a delay in some of our planned pricing actions. As a consequence, our North America operating profit performance for the quarter was impacted. However, our analysis showed that our North American profit growth for the first half compares favorably with that of our primary beverage competitor on a pro forma basis.

Of the three factors impacting North America Beverages, inflation, consumer demand and pricing, the consumer demand picture is the most concerning to us at this point. In fact, the modest pickup in total consumer spending almost all US businesses saw earlier in the year has reversed in the past several months. And this general consumer weakness is driving reduced traffic in key retail channels.

These factors are going to impact the discretionary categories like beverages where we all know consumers have non-packaged alternatives. And because beverages are also an impulse-driven category, the reduced traffic is also having an effect. Given the reduced retail traffic, the fact that Frito-Lay North America continues to perform well in this environment speaks to the relatively high resilience of salty snacks and the strength of the Frito franchise.

In developing and emerging markets, the growth picture is brighter. In most of the emerging and developing markets, we are still seeing healthy GDP growth, but global commodity inflation is pushing up food inflation in these markets and wages in the short term are not keeping pace. So disposable income and consumer discretionary spending is under some pressure.

So as we operate in this environment, we are focused on a few very important guiding principles. First, we will continue to support our brand building and other consumer facing initiatives. Given the strength that many consumers are under and the



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fact that we are putting more pricing in the market, it is more important than ever to communicate the value of our brands to our consumers to keep them engaged in our brands and our categories. So you will continue to see us on air and using digital media to stay top of mind with our consumers and keep them engaged.

Second, we are staying committed to our emerging-market initiatives to expand our go-to-market reach because emerging markets growth appears to be holding up and we want to maintain the momentum we have by strengthening our franchises in these important growth markets.

Third, in principle, we will try to cover as much of the commodity inflation as we can. As a disciplined operating company, it is critical that, over time, we price to cover our costs. This applies in both developed and emerging markets, so we are taking more pricing across all of our businesses. In the case of North American Beverages, our pricing actions have been communicated to our customers and pricing actions went into the market beginning July 11.

Fourth, as we deal with many consumer sensitivity to affordability given their limited disposable income, we are using every tool we have at our disposal, including prize pack architecture and efficient targeted promotions, to continue to provide value to the consumer. We have done a rigorous review of our portfolio to make sure we have established price points that appeal to the more value-sensitive consumer. For example, in the US, this includes the 1.5 liter take-home pack and the 16-ounce PET bottle in the cold channel in beverages.

On the snack side, we have expanded our \$2 multiserve value line with encouraging results. And we are going to continue to put the power of our portfolio to work by executing cross-brand promotions to increase value to the consumer, to motivate higher purchases in total.

Fifth, we are focusing on premium innovation to help mitigate the cost and pricing challenges. Higher-end consumers are in better shape financially and are less price-sensitive, so it is important we maintain a focus on them. We are driving growth in our premium products like our Tostitos artisanal where unique flavor, texture and taste command higher revenue per pound or products like the G Series, which captures new high revenue and margin occasions for Gatorade.

And finally, we are accelerating and intensifying all our productivity initiatives that can have a positive outcome on both this year's and upcoming years' financial performance with focus across the entire competitive cost structure.

But as you all well know, we are going to have to deal with uncertainty in the months to come and this applies to all CPG companies I believe, so we are not alone in this. Many companies have recently announced pricing actions and this will further complicate the consumer outlook and the competitive environment, understanding how all this impacts demand elasticity both within categories and across categories to require careful monitoring and adjustment.

Taking these three issues into consideration, the uncertain macro inflation, the immediate actions we are taking to mitigate them and our commitment to continue to support our strategic initiatives, we have updated our financial outlook for the year. We announced our updated outlook in this morning's release and Hugh will discuss the guidance in more detail in just a minute.

But before I hand off to Hugh, I want to be clear about my enthusiasm for the performance and potential of our portfolio. There are so many good signs that our plans are aimed correctly. I believe our global volume and revenue growth in the quarter is a good reflection of our portfolio strength. We remain absolutely committed to leading this great company on a path that effectively addresses the current uncertainty and at the same time strengthens the long-term health of our business and company. Thanks and I look forward to our discussion in the Q&A after Hugh's remarks.



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Hugh Johnston - *PepsiCo, Inc. - CFO*

Thanks, Indra. I will start with guidance. We communicated updated guidance for 2011 in our release this morning. Our updated guidance targets high single digit EPS growth on a core 52-week basis. Let me highlight the key underlying changes. First, the new guidance of high single digits is on a US dollar basis. Our previous guidance of 7% to 8% was on a constant currency basis.

Second, while the currency neutral growth under our previous guidance was 7% to 8%, our new guidance would imply 5% to 7% currency neutral growth as we expect 2 percentage points of ForEx benefit for the year.

So, let me address why we made the change. First, our primary beverage competitor is benefiting from significant ForEx tailwinds. This gives them a lot of competitive flexibility and it isn't logical for us to hold ourselves to a constant currency standard that our primary competitor isn't using.

Second, the commodities environment has been quite challenging this year and our commodities forecast is a headwind that has moved to the high end of our range. These commodities have appreciated in part due to the depreciation of the US dollar. Our international earnings on the other hand benefit from US dollar depreciation when they are converted, but we don't get that benefit when we measure our performance on a constant currency basis. The combination of these two items actually causes ForEx to be a performance drag on PepsiCo results under our old constant currency measurement.

Finally, as Indra mentioned, we, along with a number of other CPGs, have announced price increases for the back half of the year and are doing so in a relatively weak US consumer environment. While we are implementing this pricing, which we began to do on July 11, we will also need to gauge the consumer reaction in this uncertain environment and make adjustments accordingly. As such, predicting the ultimate pricing realization for the back half of 2011 is more challenging than it would be in a more stable consumer environment. I expect that we might have some questions on guidance later, but thought it would be useful to provide this context before we engaged in a discussion.

Because Indra has covered many of the operating trends in our business, I will comment briefly on the below-the-line items for the quarter. Our tax rate for the quarter came in better than expected driven largely by recognition of tax benefits in our international business. These were anticipated in our full-year guidance, but were realized earlier in the year than we had previously anticipated. Consequently, our Q2 tax rate was lower than we had expected, but our full-year outlook remains unchanged at approximately 27%.

On share repurchases, year-to-date, we repurchased approximately \$750 million of shares against our full-year target of \$2.5 billion. So our pace of share repurchase is expected to accelerate in the second half. The timing of share repurchases is completely consistent with what we communicated at the beginning of the year.

Now as you model out the balance of the year, I want to call your attention to a few items. First, incremental pricing actions will be realized during Q3 and into Q4, so they will have a more meaningful impact on the fourth quarter because of that timing.

Second, timing of concentrate shipments will likely be a net negative in the third quarter as we expect bottler inventories to be in that trough. Third, we intend to implement a number of accelerated productivity actions that we've planned for the balance of the year and they will also have a bigger impact on the fourth quarter than the third quarter because of the timing of execution. The net of all that is we anticipate a much stronger operating profit EPS growth rate in the fourth quarter than in the third quarter. With that, we would be happy to take your questions.



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QUESTIONS AND ANSWERS

Operator

(Operator Instructions). Christine Farkas, Bank of America.

Christine Farkas - Bank of America-Merrill Lynch - Analyst

Thank you very much. Good morning, Indra and Hugh. A couple of questions. Firstly, on C stores, I just wanted to clarify the strength in Frito-Lay because we didn't see that in the scanner data, but certainly the dollar channel seemed strong. I wonder if you could just take us through a little bit why the snacks are holding up so much better in the immediate consumption.

And then my second question was on organic growth in Russia. It wasn't listed in the countries with double-digit growth on your beverage review, but wondering if you are seeing difficult consumer trends that seems to be hitting juice for some of your competitors. Thanks.

John Compton - PepsiCo, Inc. - CEO, PepsiCo Americas Foods

Christine, this is John Compton. On the singleserve business at Frito-Lay, we are benefiting from a new line of flavors that we've launched behind Ruffles and a Hispanic line of flavors that we have launched across the entire portfolio of brands -- Doritos, Cheetos, Lays and Ruffles. And that is the type of [deal] products that we have launched in about half the country.

That combined with -- we have two different price points, as you know, that we use in the marketplace, a \$0.99 line and a \$1.29 line, and the combination of those two with the flavors helped us to offset traffic declines and our singleserve business grew mid single digit for Frito-Lay overall. So I am very pleased with the performance of the singleserve business and the up-and-down-the-street business.

Indra Nooyi - PepsiCo, Inc. - Chairman & CEO

Regarding Russia, the overall beverage category in Russia was soft in the second quarter and I think we had two kinds of behavior. One, the non-carbonated beverage business and juices in particular is a gigantic market in Russia, bigger than the carbonated soft drink business and within that, the lower-priced juices -- our juices in Russia run the whole gamut of pricing from value brands to premium brands. The value brands did better than the premium brands, although growth across the portfolio was okay. It wasn't at levels that we would like to see it, but the growth wasn't bad on an organic basis.

On the CSD side, there was some interesting behavior in the marketplace because some people decided to buy some volume in the marketplace, so you saw some very heavy price discounting in the marketplace and we chose not to play that game because we decided that we were going to focus on juices and maintain our pricing in the marketplace.

So overall, I would say our organic growth in Russia was in the very low single digits, but that is a number that we deliberately decided to focus on because we didn't want to use significant pricing drops to buy volume.

Christine Farkas - Bank of America-Merrill Lynch - Analyst

Okay, slower but positive it sounds like? And if I could just follow up with Hugh on the guidance. Correct me if I am wrong, you didn't change your outlook for the commodity hit in 2011 and just see ongoing inflation or was there an uptick in your view for that pressure this year?



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Hugh Johnston - *PepsiCo, Inc. - CFO*

No, we had previously communicated, as I am sure you remember, \$1.4 billion to \$1.6 billion and we are still in that range. Now within that range, we have moved to the higher end, but no, no change in the \$1.4 billion to \$1.6 billion range.

Christine Farkas - *Bank of America-Merrill Lynch - Analyst*

Great. Thank you very much.

Operator

John Faucher, JPMorgan.

John Faucher - *JPMorgan Chase - Analyst*

Yes, good morning. Taking a look at your decision, and I want to focus on sort of your decision in terms of the FX piece, understanding the context that it is coming through. I guess the question becomes do you believe that this is a move to dollar-based earnings guidance for the foreseeable future? Is this a move to dollar-based earnings guidance for this year? I guess the question becomes, if the dollar turns the other way, how should we look at how this plays out on the other side? So again understanding the context of what you are doing it for, but think that -- I guess I am trying to figure out how you plan to manage this going forward.

Hugh Johnston - *PepsiCo, Inc. - CFO*

So John, this is Hugh, let me talk about that in three pieces. Number one, certainly in terms of the short-term dynamic, you are aware that our primary competitor has substantial ForEx, which seems to be playing its way back into the business, particularly in North America. And we think that to not be competitive with that is not a good long-term solution for the PepsiCo shareholders.

Number two, as we think about the long-term earnings of PepsiCo, I expect that we will be looking at that on a USD basis. And then number three, for 2012, too early to talk about anything as it relates to 2012 at this point.

John Faucher - *JPMorgan Chase - Analyst*

Thanks.

Operator

Bill Pecoriello, Consumer Edge Research.

Bill Pecoriello - *Consumer Edge Research - Analyst*

Good morning, everybody. Recognize you commented that it is hard to know exactly what the price realization is going to be. Recently you had announced the 3% to 5% incremental pricing in CSDs. How much of that are you planning in the guidance to realize in the P&L given the competitive environment that you cited? And then on the snack side, what is the magnitude that you are expecting to realize? And given the weak consumer environment, how are you modeling that volume impact in the back half? Thanks.

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Indra Nooyi - PepsiCo, Inc. - Chairman & CEO

You are asking for a level of detail that we are not comfortable sharing, but let me give you some broad observations based on everything we have seen in the marketplace. As it gets closer to essentials, things like what we sell in our global nutrition portfolio -- Tropicana, Quaker Foods products, even Gatorade in the scorching hot weather -- people are willing to pay out for those.

Snacks, there isn't much of an alternative to snacks. It is just a great crisp and people are willing to pay for that. In the case of beverages, we have to be a lot more careful because there are alternatives where you can start trading down pricing. You can go from packaged beverages to first of all bottled water, then to tap water. So when you look at the repertoire of beverages, when you take seven or eight packaged beverages drinking occasions, people might cut that back to four or five depending on how they want to allocate their dollars through the day.

So I would say that it is the beverage category we have to watch very carefully, along with the fact that sometimes in these environments some people might choose to buy volume and we saw that in the month of June -- or July. So I think what we have to be very, very careful about is not to give you any specific indication of exactly what price realization we are going to get by category, but all that we can tell you is generally this is what we are seeing. And we will watch this over the next few weeks and months to see what kind of price realization we get. Early indications on Frito-Lay are positive. I mean John, do you want to talk about --?

John Compton - PepsiCo, Inc. - CEO, PepsiCo Americas Foods

Yes, Bill, as you know, we have said all along that we were going to price to cover commodities and I think if you look in the second quarter, our gross margin at Frito-Lay was up 10 basis points, so we essentially did that. And going forward, that is our intent. As you know, we have multiple levers that we pull, different pack sizes, [white-out], [price up], etc., but we are not pricing to grow profits, we are pricing to cover our commodity costs. And so far, as Indra said, we put pricing into the market, incremental pricing into the market on July 10 and two weeks does not a year make, but I am encouraged by what I am seeing.

Bill Pecoriello - Consumer Edge Research - Analyst

Thank you.

Operator

Ali Dibadj, Bernstein.

Ali Dibadj - Sanford Bernstein - Analyst

Hi, guys, just a couple questions. One is -- so I think it is fair and you made the point that when you compare your results to your peers, especially in North America, it is basically in line if you try to strip things out. And of course, you are facing a lot of these externalities and you mentioned obviously macro, consumer, commodities, competition, etc., but these are externalities. I am just trying to get a better sense of do you see things specifically internally that you are not doing well, whether it be Power of One not happening enough, whether the integration -- maybe you could push that further. You mentioned some productivity improvements. Obviously there are a lot of changes in the marketing function in beverages. Are there things internally that you, all of you look at and say, gosh, we could do things better here, of course there are many, but really that have been driving or that could drive some improvement here?



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Indra Nooyi - PepsiCo, Inc. - Chairman & CEO

I think that is a great question, so let me address some of this and Hugh, if you want to chip in, go ahead. You are absolutely right in saying a lot of the externality I wish we could control, but we can't. I wish we could manage the economy, but we can't, so we have to live with them. We have to live with the uncertainty. I think what bothers us more is the uncertainty, not the economy itself, but we have to live with it.

Let's talk about the internal stuff. I would say, by and large, we are doing a very good job managing our internal P&L and our execution. Although I would say we are never happy with what we do. I mean we are one company that is constantly in a state of discontent because we think we can do better. So let me give you some areas where we are working hard.

Clearly, in our North American beverage marketing organization, there have been changes and as we have said before, we had to make those changes and the changes were made not because we had bad people or people who were not qualified, it's just that the business changed around us and we wanted to make sure we had people who were ready to sign up to the new agenda and had the skills required to perform in this new world. And I think all the people we are getting in the Company -- first of all, we have no trouble recruiting people and the people who come in are top quality. I hope you guys get a chance to meet Brad Jakeman, who is running the global CSD franchise now and Lorraine Hansen, who is running Global Hydration. I think you will be extremely impressed by the caliber of these people. So we have absolutely no issue attracting the best and the brightest.

So we had to go through those changes in the North American marketing organization and we will make them gradually to upgrade the talent and make sure we have the right people for the new environment and you'll start seeing the results of their work as we go into the balance of the year and next year.

In terms of productivity, as Hugh said, we are working hard to look at our compressible costs to see if we can get even more efficient. And this is not squeezing the cost because that is the worst thing you can do to squeeze the cost, get rid of people and make whoever is left work harder because that is a burnout strategy. We are actually looking across the Company to say can we do things differently, can we approach the market differently, can we distribute differently, can we even change the form function of our products, could we invest in productivity tools that in fact saves us a lot of money and allows us to do more with the people we have so that as we grow, we can just deploy the existing labor force to do a better job.

So I think across the Company, we have teams looking at this right now and some of the early indications are there are some additional opportunities to improve the productivity of the Company. So here is a company that is always restless, is always beating itself up rather than patting itself on the back and we are turning over every stone in the Company to see if we can be even more efficient than we are. Hugh, did you want to add anything?

Hugh Johnston - PepsiCo, Inc. - CFO

Yes, I think in many ways I would echo Indra's point that I think we have a healthy level of dissatisfaction in PepsiCo for the way we currently do things. And the good news is I think we see opportunities consistently to do them better. I will talk about the productivity side in particular. We are always looking at benchmarks in terms of how we do things across our processes, whether it be manufacturing or procurement or distribution and as we benchmark, we are always looking at the top quartile and saying why can't everything be like that. And sometimes there are structural reasons, but sometimes we just need to learn from ourselves internally and to get better at it.

To Indra's point, I do think sometimes we are very hard on ourselves and maybe at times, we talk about that a little bit too much externally when in fact I do feel like competitively we use our resources pretty efficiently compared to most companies that you would contrast us to. But I think that healthy level of dissatisfaction is also one of the things that has enabled PepsiCo to be as successful as it has been. And I would expect we will continue to have that healthy level of dissatisfaction.

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Indra Nooyi - PepsiCo, Inc. - Chairman & CEO

One other point, you talked about Power of One. We have a lot of Power of One ideas at the show, the consumer show. What we are trying to be very careful about is to execute a Power of One program, which is profit dilutive, is not a very good idea. We want to make sure it is top-line accretive and at least neutral on the profit side at a minimum. There are lots of ideas, profit dilutive ideas, so we want to make sure that we execute Power of One in the back office to the extent that it makes sense, but when it comes to consumer-facing activities, it doesn't dilute our profit margin. So that is what we are looking through very carefully.

Ali Dibadj - Sanford Bernstein - Analyst

Okay, that's helpful and then maybe to segue into perhaps an area of -- I don't know if it's discontent or expected improvement, it is great to have John and Eric both on the call and if you focus in on North America, it still remains kind of almost a tale of two cities, right, with FLNA doing a lot of the heavy lifting in North America and frankly for the whole Company, right. I think it's at least the majority of the operating profit growth for the Company and as we look at that, how do you think about the balance between those two? At what point do you think PAB starts to I guess pick up the slack so to speak? And/or should we continue to expect FLNA to really continue to deliver higher and higher margins from the places we are now? How should we think about that balance going forward in North America and of course as it relates to the whole Company? Thanks.

Indra Nooyi - PepsiCo, Inc. - Chairman & CEO

I will make some opening comments and then I am going to have Eric talk to you and then John talk about Frito-Lay. I'd say Frito-Lay is our star in the portfolio, just a fantastic business, great market position, tremendous numbers of layers of advantage and a very well-managed business. I would say if it was a standalone company, Frito-Lay North America might well be the best consumer products company. So I think FLNA is just a wonderful organization with a great franchise and great attention to detail.

I would say our North American beverage business and I would say it is not just PepsiCo, I would say the overall North American beverage environment has been an interesting one and I have made all kinds of comments on what I see as behavior in the North American beverage business, but this is not a business that, as a category, has been sensible for years. There has been trading of one-tenth of a point of share at the margin at huge cost for many, many years, and we have all been through an environment where for almost 20 years there was no commodity inflation of any significant proportion.

And in the last couple of years, we are beginning to see huge commodity inflation and a depressed economy. So the North American beverage business in total, not just PepsiCo, requires a very different mindset and approach to it, which I am not yet seeing in the industry as a whole.

Having said that, let me turn to Eric Foss to give you his comments on what we are trying to do to approach this category, and then we have to watch and see how the overall marketplace evolves. So, Eric, take it away.

Eric Foss - PepsiCo, Inc. - CEO, Pepsi Beverages Company

Ali, good morning. Just a couple of comments. First, let me just talk a little bit about our progress post the merger. If you think about our North America beverage business, really post the merger in 2010 and then through the first quarter of this year, we had really four straight quarters of volume top line and profit improvement. So if you look at second quarter, I think we were dealing with and the business was impacted by three extraordinary issues.



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One, unprecedented commodity inflation that Indra mentioned. Second, I think it is important to recognize that there was a prior-year value investment at the retail level that we were lapping that largely impacted second quarter and is now behind us. And then third, the competitive environment.

So let me tell you what we feel good about, let me tell you what kind of core issues we need to address and kind of how we are trying to play the game going forward. I think, first of all, we feel good about kind of our balanced approach to top-line growth, which on a year-to-date basis is up a couple of points, certainly in line with the category and our competitors.

We continue to improve our share position. We continue to improve the health of our brands, which we stated was a must-do coming out of the merger. We continue to feel great about the synergy capture and our cost and productivity efforts, and we continue to sell, service and execute very well at the point-of-sale.

The issues we need to address are actually isolated, pretty simple to say but tougher to do. And that is we have to price to cover COGS to make sure we have the right margin structure going forward, and we have to do that right now and balance that with a pretty difficult consumer and economic environment that you have heard Indra and Hugh refer to.

So the game we are playing is, as we go forward the second half, price to cover COGS. It is the prudent and right thing to do for the long-term health of the category in this business. Second, we are going to continue to make the incremental investments, particularly around strengthening our brand and building our core brands. And third, continue to maximize the potential of the merger and the synergy unlocks, including not just capturing cost synergies, but revenue synergies like G to DSD, Power of One, food service, etc. So that is kind of what we feel good about, what we have to address and kind of the game we are playing going forward.

John Compton - *PepsiCo, Inc. - CEO, PepsiCo Americas Foods*

On Frito-Lay, there is nothing in the first half of this year that would cause us to change our optimism about this business going forward. We continue to believe that there is volume growth in the core business. I believe the demographic changes that are taking place are actually in our favor. We have learned on how to build adjacent businesses through Stacy's and Sabra particularly and we are successful in that venture now.

Historically, we have had a terrific productivity mindset at Frito-Lay. We have ramped that up incrementally with the GES initiative that we are beginning to implement and roll now. And so no, I don't want anyone -- I appreciate your comments about Frito-Lay, but I don't want anyone to take away that we are milking that business because of a temporary softness in one business right now. That is not the case at all. It is a great business. We are running the business for the long term. We are making the necessary investment.

We took our media investment up this year because we knew that we were going to take pricing and that we thought we needed that to sort of cover any sort of consumer softness that we potentially would see. And in Latin America across the board, as you know, the snack business has performed well. We had 5% volume growth and double-digit profit growth.

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

And we are maniacally focused on top-line growth at Frito-Lay and across the Company.

Operator

Dara Mohsenian, Morgan Stanley.

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Dara Mohsenian - Morgan Stanley - Analyst

Good morning. John, can you discuss your top-line expectations around Frito-Lay North America in the back half of the year? With the higher pricing, are you expecting to see a significant volume slowdown in the business? And also in terms of looking at your pricing, how much of it will be rate versus white-out and how that compares versus history and how that would play into your volume expectations?

John Compton - PepsiCo, Inc. - CEO, PepsiCo Americas Foods

Certainly as incremental pricing comes in, our net revenue performance should improve and most likely our volume performance might slow somewhat. Versus the pricing actions when we saw this high commodity inflation environment from 2008, less of our pricing actions are going to be white-out and more of our pricing actions this year are a combination of trade promotion practices and some visual pricing.

So back half of the year, I think the net revenue line will grow faster than it has in the first half of the year and volume will slow somewhat, but I will know more about that in the next six to eight weeks.

Dara Mohsenian - Morgan Stanley - Analyst

Okay. And can you just talk a little bit about your views around the potential demand elasticity given there is more visual pricing this time around and compare it versus demand elasticity you have seen in the past?

John Compton - PepsiCo, Inc. - CEO, PepsiCo Americas Foods

As I said, I will know more as the pricing gets fully into the marketplace, but the biggest brands, I will take Lays and Doritos as an example, are also quite frequently sold on deal. So we have a way of managing our net pricing through the marketplace. If we see the visual pricing starting to slow a little bit, we can adjust our promotion practices.

Indra Nooyi - PepsiCo, Inc. - Chairman & CEO

The other thing, Dara, the amazing thing is, around the world, pretty much every country of the world, the snacks business is very resilient and is doing well. And so we take great comfort in the fact that it is a faulty category and the strength of our franchises across the world that seem to be holding up very well in an economy where pricing is going up for all consumer products and economies have mixed performance across the world.

John Compton - PepsiCo, Inc. - CEO, PepsiCo Americas Foods

To add to Indra's point, the other thing that gives me confidence that we can get this pricing through is the innovation on the core business that we have coming and so all the flavor work that we have done on Doritos and Ruffles particularly is and will continue to work well and that flows through our big bag business, straight through our singleserve business, into our variety pack business and that gives me confidence we can get the pricing through.

Dara Mohsenian - Morgan Stanley - Analyst

Okay, thanks.

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Operator

Carlos Laboy, Credit Suisse.

Carlos Laboy - *Credit Suisse - Analyst*

Good morning. I was hoping that Hugh could give us some insight on the financial value of the PBG and Gatorade assets you sold in Mexico and the expected size of the checks that are likely to come your way as this deal closes. I think this asset sale should be worth several hundred million dollars. Are you going to deploy that money when it comes in towards funding a higher rate of investments or do the asset sales offer you unexpected money to accelerate investments even more?

Hugh Johnston - *PepsiCo, Inc. - CFO*

This is Hugh. As we mentioned in some of our earlier communication, the terms of the deal and the specifics around the financials of it are confidential and we are not going to be sharing that at this time. When the deal closes, obviously, to the degree that cash comes in, that represents a substantial change to PepsiCo's overall cash picture. Obviously, we will be talking to that piece of it at that point, but right now the terms of the deal are confidential and that is an agreement between the parties.

Carlos Laboy - *Credit Suisse - Analyst*

And maybe Eric can expand on the 1.5 liter take-home pack that Indra mentioned. It is being priced at parity it looks like with Coke's 1.25. Can you speak to the fact that you are having to give an extra quarter liter for free on a very similar package? And I guess where I am going with the question is do you worry that this opens up a slippery slope of holding price parity with your competitor on similar packs as they start plowing forward on package innovation and on new packs?

Eric Foss - *PepsiCo, Inc. - CEO, Pepsi Beverages Company*

Sure, it's Eric. Let me make a couple of points on pricing. First of all, I think you have heard us talk before that as we approach anything, certainly 1.5 liter, our pricing approach starts and ends with the consumer. And I think if you think about our success on 1.5 liter, what we are really trying to do is to make sure there is an entry point for the consumer to enter the category at a great value and we launched this 1.5 liter in June. We have had very strong execution. It is tied to meal deals and the reality is if you look at any success metric -- distribution, volume, share on 1.5 liter or share on a combined multiserve basis, 1.5 liter and 2 liter -- we are extremely happy with our success relative to the competitive entry on this package. So we feel very good about it and it is something that again as we look at taking pricing, I think you'll see the whole industry look to reconceptualize and rearchitect the whole price pack architecture. So I think you will see more to come on that front.

Carlos Laboy - *Credit Suisse - Analyst*

Thank you.

Operator

Judy Hong, Goldman Sachs.

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Judy Hong - Goldman Sachs - Analyst

Thanks, good morning. Just going back to North America beverages, if I just look at the profit decline on a year-over-year basis, can you just walk through the components of the profit decline, how much was the pricing lagging inflation, how much did spending go up, what was the cost synergy capture? And then as we think about going forward just from an inflation perspective, does it get worse and then it gets better or have we kind of hit the peak in terms of inflation just on a quarterly basis?

Indra Nooyi - PepsiCo, Inc. - Chairman & CEO

You are talking North American beverages, Judy?

Judy Hong - Goldman Sachs - Analyst

Yes.

Hugh Johnston - PepsiCo, Inc. - CFO

Let me start on it a little bit and then, Eric, to the degree that you want to add, please feel free. Judy, relative to our expectations, the costs are largely in line with what we had expected and inflation in beverages is a bit higher than what was in our plans, but not significantly so for the first half. It really is -- it is pricing and volume is really where the gap is and we have talked about some of the reasons why from a competitive perspective.

On a year-over-year basis obviously commodities are up substantially and we expected to get more pricing in the marketplace, but it has proven to be a pretty competitive market. And as a result of that, that is really what is driving the year-over-year. But everything else -- the synergies are largely in line and the commodities piece, while up year-over-year are only a little bit higher than what our expectations were.

Judy Hong - Goldman Sachs - Analyst

So in Q2, what was the cost synergy capture?

Hugh Johnston - PepsiCo, Inc. - CFO

We hadn't disclosed the synergies specifically on a quarterly basis.

Indra Nooyi - PepsiCo, Inc. - Chairman & CEO

Just assume that the commodities are well above any synergies.

Hugh Johnston - PepsiCo, Inc. - CFO

Correct.

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Judy Hong - Goldman Sachs - Analyst

Okay. And then just in terms of the pricing versus the commodity delta just within Americas beverages, can you just talk about where the pressure is coming from just in terms of CSD versus non-carbs versus juice and where are you seeing sort of the most pronounced gap and where do you have the most confidence that that gap will close as the year progresses?

Hugh Johnston - PepsiCo, Inc. - CFO

Why don't I talk to that briefly and then, Eric, if you want to add in, that's fine. I think, Judy, the biggest gap is in carbonated soft drinks and primarily in the big volume packages. That is where we haven't seen pricing at the levels that we expected to.

Indra Nooyi - PepsiCo, Inc. - Chairman & CEO

Singleserve up and down the street seem to be okay.

Hugh Johnston - PepsiCo, Inc. - CFO

Seems to be fine.

Indra Nooyi - PepsiCo, Inc. - Chairman & CEO

The take-home large packs. Eric, you might want to talk to the extent you can provide some detail.

Eric Foss - PepsiCo, Inc. - CEO, Pepsi Beverages Company

Sure. Let me give you some color commentary on the pricing topic. Again, Judy, the way we think about this is there is a balance here, so we are trying to get price appreciation. If you look at it, if you really look at our business, you can look at it -- in 2010, we had 2 points of pricing; Q1, another 2 points; Q2, another 2 points; first half, two points. You have seen us really try to take a disciplined and balanced approach to the top line. You have seen our retails both on cans and 2-liter go up despite the fact that our competitors are down year-over-year. And again, right now, we feel good that we have defended and are growing our share position and we have good mix management as well. So I think the core issue is largely on CSDs, cans and multiserve pack.

Judy Hong - Goldman Sachs - Analyst

Okay. And Hugh, just a quick follow-up on your guidance. So you continue to talk about guidance on a 52-week basis. At this point, can you tell us what the 53rd week will provide you just in terms of whether you will invest that back into the marketplace or would we see higher earnings as a result of the 53rd week? And then just on the tax rate, because the Q2 tax rate actually came in a little bit lower, so for the full year, does the back half tax rate go up?

Hugh Johnston - PepsiCo, Inc. - CFO

Yes, so the tax rate, Judy, will actually be pretty well in line with what we said previously, which was 27%. This was really a timing switch, so to the degree that our first-half tax rate is under that, then obviously the back half will be a little bit higher than that.

In terms of the 53rd week, we had previously talked about that as non-core in line with past practice. So in terms of plans on that, we hadn't said anything publicly at this point.



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Judy Hong - *Goldman Sachs - Analyst*

Would you care to say anything at this point or no?

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

Not yet.

Hugh Johnston - *PepsiCo, Inc. - CFO*

No, no.

Judy Hong - *Goldman Sachs - Analyst*

Okay. All right, thank you.

Operator

Caroline Levy, CLSA.

Caroline Levy - *CLSA Limited - Analyst*

Good morning. I have just a couple. Could you talk to Wimm-Bill-Dann's performance, just the business itself versus your expectation rather than all of Russia? What is better, what is worse? If there is anything you could add? The second is on media spend. I was hoping to hear some specifics on whether that has actually been ramped up year-over-year and what the plans are for the back half, particularly on the beverage side in North America. And then just finally has Tropicana turned at all?

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

Great, three questions. So Wimm-Bill-Dann -- Caroline, first of all, hello, how are you?

Caroline Levy - *CLSA Limited - Analyst*

Hi, Indra. Well, thank you.

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

Wimm-Bill-Dann is performing exceedingly well. In fact, the more we get to know the Wimm-Bill-Dann business, the people, the strength of the franchise, the technologies they have, they are really, really impressing us. So the business is a top-notch business. I would say it is performing exceedingly well. It has its share of commodity cost inflation because grain prices go up, the cows have to eat, grain in order to produce the milk, in order for us to produce the dairy products. So there is some of that. But do you want to add something on Wimm-Bill-Dann before I --?



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Eric Foss - PepsiCo, Inc. - CEO, Pepsi Beverages Company

Yes, no, I was actually just over there with Zein a couple of weeks ago. Clearly you had things going on in terms of value versus premium products like you do with the rest of Russia, but as Indra said, the business is performing very well. We went through a full integration review and the integration and the synergies are on track, the marketplace performance is good and Zein and I actually went out to visit the cows and they seem to be doing fine as well.

Indra Nooyi - PepsiCo, Inc. - Chairman & CEO

And there's still opportunity because, in Almarai, which is our joint venture with the Saudi Dairy Company, they have the highest yield per cow and we haven't yet transferred those yield technologies from Almarai to Wimm-Bill-Dann. So we see a lot of upside going forward and the management team at Wimm-Bill-Dann is top-notch. We have retained pretty much all of them I think except one, but we have retained every one of them and they are doing a great job. They have integrated wonderfully with PepsiCo. The last time they were all here for an all-day dairy review, I must tell you, you couldn't tell the difference between who was Wimm-Bill-Dann and who was PepsiCo. Our European team has done a terrific job, Zein and Ramon, working with the Wimm-Bill-Dann people integrating them into PepsiCo. So those are all the good news.

And again, Power of One-wise, exploiting the coolers, exploiting our existing infrastructure in snacks and beverages along with Wimm-Bill-Dann, that work is just beginning. And at this point, we are only seeing upside on the Wimm-Bill-Dann transaction.

Let me get to the media question. Across PepsiCo, in 2011, in spite of the economic issues, we are increasing our overall A&M spend and we are increasing our media spend. In fact, our second half is a pretty significant step-up even in North America and we have decided not to back off that increase because, as I said in my opening comments, it is even more important that when you take up pricing, you keep getting the message out on your brands so people stay engaged with the brand. So in North America beverages for example, the Summertime advertising will continue. The X Factor advertising is a pretty big step-up and in Frito-Lay North America, second half of the year, we will continue to invest. Europe is still continue to invest, EMEA is investing, Quaker Foods is investing. So across the board, we are going to continue to keep investing in A&M and media.

And on Tropicana two things. Let me separate out Trop50 and cold Tropicana carafe. Tropicana 50, as I said, is growing 40%, doing very well across the country. So we feel very, very excited about the prospects for Trop50 as the product is today and all of the spinoffs of Trop50 that could come in as innovation next year.

On core Tropicana itself, we resisted going to the plastic carafes because we thought environmentally staying with gable top was a better idea, but the consumer wants the plastic carafe, so we launched a beautiful plastic carafe in the West, and where we have launched the plastic carafe, we are gaining share handsomely. So we feel very, very good and this is now beginning to roll through the whole country. And in some parts of the country, I suspect we will leave the gable top also for those consumers who are very environmentally conscious, as they should be. But I think that early time, two or three months of the Tropicana carafe on the West Coast, we feel very good.

And overall because of the G&G and all the innovation platforms they've come up with on fruit and vegetables, the pipeline for Tropicana going to next year and beyond is looking very good. So this is a great franchise, very strong, still has great resonance with the consumer. So we feel good about the prospects.

Hugh Johnston - PepsiCo, Inc. - CFO

If I can add one comment around the media question as well. I would not assume that the level of A&M increase is the same as the media percentage spending increase. In fact, media spending increase has been much higher. One of the things that we have done I think very effectively inside the Company is had a significant productivity program to shift dollars from what we

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refer to as nonworking to working. And as a result of that, as we found that productivity, we have put it right back into media. So while you will see A&M up, the media spending levels will be up meaningfully more than the A&M spending level overall.

Caroline Levy - CLSA Limited - Analyst

Very helpful. Thank you so much.

Jamie Caulfield - PepsiCo, Inc. - SVP,IR

Operator, we will take one more question.

Operator

Kaumil Gajrawala, UBS.

Kaumil Gajrawala - UBS - Analyst

Good morning, everybody. First question on -- Hugh, are there forecasts in your commodity cost outlook such that if there is -- if commodity costs were to come down, there could be some benefit or based on the hedges that you have or the numbers that you provide of essentially how the year will play out?

Hugh Johnston - PepsiCo, Inc. - CFO

Very little at this point. We are largely hedged at this point through the end of the year.

Kaumil Gajrawala - UBS - Analyst

Okay, got it. And then, John, I think you mentioned singleserve was up low single digits. Could you talk a little bit about what is driving that given the current environment? And then, Eric, if you wouldn't mind commenting on the singleserve business in beverages.

John Compton - PepsiCo, Inc. - CEO, PepsiCo Americas Foods

The singleserve business for us is being driven by the fact of the new flavors that we have put into the marketplace largely behind Ruffles. As I said also, the Tapatio line of products that we launched behind Doritos, Lays, Cheetos and Ruffles in about half the country. So just core flavors are driving our singleserve business. We haven't taken pricing yet on that business, so it is really unit growth that is driving the growth.

Kaumil Gajrawala - UBS - Analyst

Okay, got it.



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Eric Foss - PepsiCo, Inc. - CEO, Pepsi Beverages Company

On beverages, our cold drink business was really driven and was slightly positive in the quarter really driven by 16-ounce CSDs, as well as Gatorade. So I think we have had five straight quarters of growth. We grew our cold drink share and although we did see and are starting to see fuel prices impact the consumer from a traffic standpoint and occasions in C&G.

Kaumil Gajrawala - UBS - Analyst

Okay, got it. And then just final question, as it relates to the incremental productivity, is any of it structural, meaning joint ventures, changes in distribution structure, or is it simply more G&A types of things?

Indra Nooyi - PepsiCo, Inc. - Chairman & CEO

Right now, we are working on compressible costs within the Company beyond G&A. It is all of the compressible costs in the Company and [despite not seeing] the structural changes, if they happen, we will be out there talking to you guys. At this point, we are not looking at that.

Kaumil Gajrawala - UBS - Analyst

Got it, thank you, everybody.

Indra Nooyi - PepsiCo, Inc. - Chairman & CEO

Let me just close by saying that, as a company, we are all operating in a highly uncertain environment, especially in the developed markets. In this difficult macro and consumer environment, I believe our portfolio is being managed sensibly to deliver good short-term results while continuing to invest in our future. And all 300,000 associates at PepsiCo remain extremely committed to the Company and are excited about the prospects of the Company in the short term and the long term. Thank you.

Operator

Ladies and gentlemen, that concludes PepsiCo's second-quarter 2011 earnings conference call. We appreciate your time. You may now disconnect.

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