

FINAL TRANSCRIPT

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PEP - Q1 2010 PepsiCo Earnings Conference Call

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PRESENTATION

Operator



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Good morning and welcome to PepsiCo's first quarter 2010 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 Ms Lynn Tyson, Senior Vice President of Investor Relations. Ms Tyson, you may begin.

Lynn Tyson - *PepsiCo - SVP IR*

Thank you. With me today are Chairman and CEO, Indra Nooyi, and CFO, Hugh Johnston. Indra will lead off today's call with a brief overview of our results and then Hugh will review first quarter operating and financial results. We'll then move to Q&A where we will be joined by John Compton, CEO of PepsiCo America Foods, Massimo D'Amore, CEO of PepsiCo Beverages Americas, Eric Foss, CEO of Pepsi Beverages Company, Zein Abdalla, CEO of PepsiCo Europe, and Saad Abdul-Latif, CEO of PepsiCo Asia, Middle East and Africa. After Q&A we will end with some closing comments from Indra. I encourage you to very use our earnings webcast which augments our comments today and is posted on our website at www.pepsico.com/investors. Our Q2 IR activities include our annual shareholders meeting on May 5, which will also be webcast on www.pepsico.com.

During today's call, unless otherwise noted, all references to EPS growth, net revenue growth, and division and total operating profit growth are on a core constant currency basis. Please read our Q1 earnings release for more details. Before we begin please take note of our cautionary statement. This conference call includes forward-looking statements based on currently available information, operating plans and projections about future events and trends. Our actual results could differ materially from those predicted in such forward-looking statements, but we undertake no obligation to update any such statements whether as a result of new information, future events or otherwise. Please see our filings with the Securities and Exchange Commission including our annual report on Form 10-K and subsequent reports on Form 10-Q and 8-K. And finally you should refer to the investor section of PepsiCo's website under news and events to find disclosures and reconciliations of non-GAAP financial measures that may be used by management when discussing PepsiCo's financial results. With that let me turn the call over to Indra.

Indra Nooyi - *PepsiCo - Chairman, CEO*

Thanks, Lynn and good morning everyone. First of all I just want to say a big thanks to all of you for participating in our investor meeting last month in person or by website and I hope that you walked away with a better appreciation for the breadth and depth of our global portfolio, as well as increased confidence in our ability to deliver near term results while investing to drive sustained top quartile performance. Since we just spent those two days reviewing our plans in detail, this morning I'm going to keep my remarks really brief.

I have three key messages for you this morning. First, we remain confident in our ability to deliver 11% to 13% growth in EPS this year while investing behind strategic platforms for the long term. Second, we are making great progress behind each of the seven initiatives we discussed with you at our investor meeting. Third, we posted solid Q1 performance in the quarter. Net revenue grew 11%, division operating profit was up 10% driven by improved costs and continued productivity, managing operating cash flow, excluding certain items, was up 40% to \$794 million, and we continue to make incremental strategic investments in areas critical to sustained growth. More importantly, the momentum going into Q2 has picked up across-the-board.

Let me give you some operating highlights. In our \$27 billion global macro snacks business, we gained share in key markets by growing our core and our adjacencies businesses. In Q1, we continue to make progress in shifting the mix of our portfolio from fun for you to better for you with the launch of great tasting products like all natural regional flavors of Lay's potato chips and whole grain Tostitos in the United States, and we achieved all of this while investing to broaden our portfolio and expanding margins in key areas of the business. A prime example of this is that Frito Lay in North America where the team delivered great results in spite of overlapping double digit growth in net revenue and core operating profit.

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In our global beverage business, although reported volume was down half a point in the quarter, if you include March in our international numbers, volume was up in low single digits. I'd like to highlight just two markets. In North American beverages, volume trends are improving across-the-board including Gatorade. We have been very careful to pursue share judiciously and we've tended to favor value share in most cases, and we are not pursuing unbranded volume. Our core numbers reflect a healthy relationship between volume, revenue, and profits. In China beverages, we continue to step up our investments behind coolers and brand building. In the quarter, we gained share in CSD's as we lead the industry with a 14% increase in volume.

Looking forward as we look at our beverage portfolio, we are seeing improved trends around the world, and since today is Earth Day, I want to share with you that today PepsiCo is announcing a revolutionary program to accelerate recycling by launching what we call the Dream Machine. It is both a machine and a program, which in partnership with Waste Management, will allow us to expand recycling, reduce our carbon footprint, and provide us with a low cost source of PET resin. Also, the first ever 100% compostable chip bag, which was launched by Sun Chips brand earlier this month, reaches full distribution in the United States and Canada today. This bag is a terrific innovation because it will completely degrade in weeks adding nothing to landfill. We have stated that delivering on our environmental sustainability commitments is one of our top competitors and I'm pleased to report that we are taking tangible, scalable actions to deliver on those commitments. Those are just a few examples of the progress we're making against our long term competitors. I'm particularly proud that our organization has the operation agility to delivering both current results and long term competitors, especially in an environment where the macros are still challenging.

From an economic standpoint, we continue to see an environment that is similar to the one that we've described to you in the past. Solid economic growth East of the Middle East and challenging economics West of the Middle East. Regarding the West, the good news is that we are starting to see some signs of overall improvement in many of the economies. GDP declines have moderated and there is growth in a number of markets. Further, consumer sentiments are certainly on the rise in many countries. Nonetheless, the average consumer remains challenged across these economies as unemployment is still stubbornly high and consumer confidence remains at moderate to low levels. For PepsiCo this means we will need to continue to run our businesses with tight cost controls and we will need to deliver good value to encourage strapped consumers to open their pocketbooks. Now, improved GDP is a terrific signal for the future, but until we start to see unemployment numbers decrease, we will stick to our game plan of maintaining the right value equations consumers, while managing costs and driving productivity to fuel investments across our businesses.

A brief note in our financial performance in the quarter. I know it was challenging to correctly model the impact of the bottling acquisitions in Q1, Q2, and the balance of the year. In fact I don't think anyone got it completely right, especially on timing which drove a wide range in your revenue and division operating profit estimates as well as below the line items like net interest and equity income. I know it was also challenging to try to spin-out North America from Europe and you had acquisition accounting related adjustments to sort through. The net of all of this is that many aspects of our Q1 results did not come together the way some of you expected. Notwithstanding all of this, we did deliver a solid quarter, well in line with our own expectations and we are on a firm trajectory to hit our 11% to 13% core constant currency EPS growth target for the year.

It is still a first half-second half story though as we overlap strong performance in the first two quarters and start to realize the benefits from synergies and improved performance in the second half. So I encourage you to listen very carefully to Hugh when he takes you through the operating results and our full year outlook in more detail. We will give you enough information so that you can go back and take a harder look at how you're modeling division performance, as well as below the line items. So with that let me turn it over to Hugh Johnston, our Chief Financial Officer, who is going to review our results in greater detail. This is Hugh's debut on the earnings call as the CFO and for those of you who haven't yet had the opportunity to meet Hugh, he's just an extraordinary individual, a 23 year veteran of our business with broad experience in finance, M&A, strategy and general management. He's a fun guy and I think you'll enjoy working with him. Hugh, over to you.



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Hugh Johnston - PepsiCo - CFO

Thanks, Indra. Good morning everyone. Let me turn right to the operating performance by division, as well as some of the items that impact our year-over-year comparisons. PepsiCo Americas Foods continued to deliver solid consistent results, while lapping double digit gains last year. At Frito Lay North America, volume and net revenue were both up 1% in line with our expectations, while operating profit grew 9%. As you may know, FLNA is overlapping its strongest quarter of revenue growth in Q1 driven by pricing it took last year to offset commodity inflation. In spite of this, FLNA was able to get solid leverage in their P&L and expand operating margins through both lower commodity costs and tight cost controls. As you learned at our investor meeting, Frito has started the year with a strong innovation line up focused on expanding healthy, affordable snacking options such as our all natural and lightly salted lines. Additionally, given the economic pressures that many consumers are still feeling, FLNA continues to leverage price pack architecture to deliver value. Strong growth in Lays, variety packs, and the \$2 value line contributed to salty volume share gains for FLNA. Underscoring the power of the power of one, the joint promotion of Doritos Burn products and Pepsi Max Cease Fire drove incremental sales in the quarter and helped both companies navigate some of the softness that we are seeing in the C-store channel.

Looking at the balance of year, remember that FLNA will continue to have tough top line comps through the third quarter as they overlap pricing from last year as well as the impact of their 20% more free initiative launched in the second quarter of last year. As we move through the year, FLNA will leverage the benefit from input cost deflation to step up marketplace investments such as A&M and additional routes. But even after these volume driving investments, we expect to see robust bottom line performance through the year though as expected, volume growth will be at the low end of Frito Lay's historical range.

At Quaker Foods North America, net revenue was down 3% and operating profit was down 14%. Top line softness was driven by hot cereal where we have opportunities to improve value and innovation. The decline in profitability was driven almost entirely by the overlap of an insurance settlement last year. QFNA has stepped up innovation and value initiatives, which we believe will drive stronger performance in the second half of this year.

In Latin American Foods, volume was up 1%, net revenue was up 8%, and operating profit declined 5% as the division overlapped close to 30% growth in operating profit last year. LAF also faced the headwinds of higher input costs and challenging macros. In the second half of the year, we expect significantly improved performance in LAF as the region benefits from investments in infrastructure, selective pricing to cover inflation and local cost, and product innovation.

Now, on to PepsiCo Americas Beverages. As you would expect, our Q1 results for PAB were significantly impacted by our acquisitions at PBG and PAS. The good news is that we moved very quickly to integrate the PBG and PAS bottling operations with PepsiCo's concentrate business. Eric, Massimo and their teams are now operating these combined businesses as one system and they are fundamentally measured on one volume, one revenue, and one profit pool.

Now, for those of you who are still trying to model the businesses separately, you're likely to encounter some challenges. We aren't managing the business this way, and we won't be measuring or disclosing our performance this way either. We now have one vertically integrated value chain, just like our snacks business. That means we're now making decisions which benefit the total system without considering as to how the cost and benefits are shared between the brand and bottling operations. This was really the foundational premise for these acquisitions. Now that these decisions are made on an integrated basis, it's virtually impossible to accurately estimate what programs would or wouldn't have happened and what portion of each program would have been funded by the legacy PepsiCo business or by the bottlers, or even what the funding mechanism would have been. So there really is no clean way to do a with and without acquisition impact for revenue and operating profit.

So, with that, now let me turn to the results of PAB. Volume decreased 4% largely driven by declines in the CSD category as a whole, as well as double digit declines in Aquafina as continue to de-emphasize unprofitable case pack water. Additionally it's worth noting that we did not have the benefit of a positive Easter holiday overlap in our Q1 performance. The new distribution agreement with Dr Pepper Snapple Group positively contributed about two percentage points to the volume performance. Net revenue grew 32% and operating profit increased 28%. PAB benefited from the impact of the acquisitions, improving top

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line trends in North America, as well as solid operating performance in Latin America. The business also focused on profitable volume, balanced with selective share growth in certain categories. As Massimo discussed in detail at the investor meeting, North American Beverages is largely focused on growing value share across its portfolio by driving innovation focused on the four key LRB consumer needs phase, enjoyment, hydration, nourishment, and transformation.

I'll now share some Q1 highlights from each. In the enjoyment category which includes CSDs and ready to drink teas, the North American Beverages business maintained volume share leadership in measured channels and in a category where both volume and value share are important due to the large installed manufacturing base, we held year-over-year volume share and outperformed our largest competitor. Our overall performance was driven by the successful Pepsi refresh program, Pepsi and Mountain Dew throw back LTO's and our Super Bowl consumer value promotion.

In hydration, where we also have share leadership excluding the unflavored water category, Gatorade sequential trends continued to improve lead by double digit growth of G2. We feel especially good about our improving performance, particularly in light of very aggressive pricing by competition. Brand health scores are also up across the Gatorade portfolio, especially among key cohort groups of teens and competitive athletes where consumption of G is up double digits. In the second quarter, Gatorade started its national launch of the G Series, which provides functional benefits to athletes before, during and after their sports activities. Further, for performance athletes, our rollout of G Series Pro across GNC and Dick's Sporting Goods is on track and expected to be highly incremental and accretive to our brand building efforts. In enhanced water, Sobe Life Water continued its strong performance and was among the top five fastest growing LRB brands in measured channels in the quarter.

Turning to nourishment which includes juice and juice drinks, our Tropicana performance trends improved aided by the launch of our national juicy rewards program and Trop 50, which launched new flavors in the first quarter. Trop 50 was also in the top 20 fastest growing LRB brands in measured channels in the quarter. The Tropicana brand continues to hold a significant lead over its key competitors on all brand health measures. And finally, in transformation, which includes ready to drink coffee and energy drinks, we launched AMP Energy Juice, a 100% juice that fills a new day part, and occasion for us, the morning wake up drink.

While we're pleased with progress that we're making in each of these need states, there is no doubt that the overall category dynamics are still very challenging. We have been able to achieve our desired pricing, but we are being very surgical about delivering value to the consumer where it is appropriate. In doing so we're working hard to find an optimal balance between volume and pricing. As Eric mentioned at the analyst meeting, we focused on balancing improved margins while delivering greater consumer value in the marketplace.

Looking forward, we have seen some strengthening in our North American Beverage business in recent weeks. In particular, trends in both the enjoyment and hydration segments have improved. Obviously, it's always difficult to forecast a sustained recovery from a trough. However, it is encouraging to see this uptick and our teams will be working hard to turn it into a new trend.

Before moving off of PAB, let me just touch on the bottler integration. We took swift actions to unlock synergies and we are on track to hit our target of \$125 million to \$150 million this year. Since we closed the transaction with only four weeks left in the quarter, our actual synergy capture was small, but we ramped up very quickly in Q2 and we are already seeing the benefits in corporate overhead, back office, operations, and supply chain. We remain confident in our ability to capture \$400 million in synergies by 2012, and we now expect one-time costs to achieve these synergies to be about \$650 million. This increase relates to our decision in the first quarter to consolidate and rationalize some manufacturing assets. Of the \$650 million, roughly \$225 million is non-cash.

Let me now turn to Europe and AMEA. Note that starting this quarter, we will no longer report combined results for PepsiCo international. This is because Europe and AMEA are under separate leadership structures. In Europe, top line performance was mixed as the macros in Eastern Europe continued to be challenging, while we are seeing some strengthening in Western Europe. In the quarter net revenue declined 3%. However, the division exercised financial discipline and strong net revenue management



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which helped to drive a 4% increase in operating profit. In Europe Snacks, the weak consumer trends in the East impacted top line resulting in a 4% decline of volume. The decline of volume also reflects the fact that we're lapping the very successful Walkers Do us a Flavor campaign. Europe is extending this promotion across key markets and also running creative consumer engagement and promotional programs linked to soccer personalities in the second quarter. A few examples include the Walker's Flavor Cup in the UK, in which 15 flavors are competing for consumer votes, and the latest football event in Spain and Portugal.

In our Europe Beverage business, volume was down 4% due to the severe weather in Western Europe and also macro softness in Eastern Europe. However we grew CSD value share in important markets such as Russia, UK, Turkey, and Germany, and we saw improved top line trends across-the-board in February. We've also gotten off to an encouraging start in the second quarter. Our Snacks and Beverage businesses saw a turnaround in March with each returning to growth in both Eastern and Western Europe. Most notably, our UK Snacks business and Beverage businesses drove significant growth and Turkey Beverages continued to grow well North of 40%.

Since our International businesses closed their first quarter at the end of February, we won't see the benefits of the bottling acquisition internationally until the second quarter. However we have already begun to see the power of the power of one as the result of our Snacks and Beverage business operating models coming closer together. For example, in the Ukraine, we transferred the management of our CSD business over to Sandora, which allows us to leverage joint go to market strategies and improve efficiencies in our supply chain, and in Russia we're doing extensive testing to determine the optimal go to market solutions.

Turning now to AMEA. Our team started the year strong across the sector. All key markets delivered strong top line growth in snacks and beverages, which helped to drive an 18% increase in net revenue and a 12% increase in operating profits. The growth in operating profit was impacted by the strategic investments we are making in our China beverage business. In the quarter, we rolled out a series of new innovative products including the regional expansion of Tropicana Pulp Sacs and Blueberry flavored [global] juice blend in China and H2O in Egypt. In snacks we launched a new flavor of you're extruded snack Kurkure in India, Dorito's Collisions in Egypt and the new deli flavors of our Red Rock deli kettle chips in Australia. In snacks volume increased 13% driven by double digit growth in China and India. China benefited from strong marketplace execution and the timing of the Chinese New Year, while India leveraged the powerful marketing calendar at the start of the year.

AMEA beverages showed strong volume momentum in the quarter across key markets such as India and China as well as in Vietnam and the Philippines. As you heard at the investor meeting, we have stepped up our investments in China as we prepare to almost double our manufacturing capacity in the country. These investments are already driving improved performance. In the quarter our volume growth in China in CSD has accelerated and we gained share.

We saw very strong top and bottom line growth in AMEA in the first quarter. Over the balance of the year, we continue to expect strong top line results but there will be a slowdown in operating profit growth as we expand our strategic investment program. Taking a step back, we are feeling good about our trajectory going into the second quarter. Our businesses are focused on driving profitable growth while making investments that expand our presence in key categories and markets.

Before I turn to guidance, let me take you through some of the items that impact our year-over-year comparisons. All of these items, as well as other non-core items, are discussed in our earnings release and will be detailed in our 10-Q which we plan to file tomorrow. In the quarter our core results excluded a number of items. Let me mention five of them. First, merger and integration charges of \$321 million or \$0.16 a share, roughly \$220 million relates to cost to achieve synergies such as asset rationalization and the streamlining of supply change, and the balance, or about \$100 million, relates to deal costs such as financing costs and advisor fees. Second, there is an adjustment to the fair value of inventory of \$281 million or \$0.15 a share. This adjustment relates mostly to the impact to our cost of sales of the step up to fair value of inventory and inventory hedges acquired from the bottlers. This step up, which occurred on the acquisition date, temporarily increases our cost of sales until this inventory sell through which we expect to be largely complete in the second quarter. The third is a one-time charge of \$145 million or \$0.06 of share for SAP software. This relates to the change in scope of one release of our ongoing migration to SAP



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software. This change was driven in part by a recent review of our North American systems strategy. As Richard mentioned at the investor meeting, we are still very committed to the implementation of SAP across our global operations over the next few years. As discussed on our fourth quarter call, the fourth item is a one-time charge of \$120 million or \$0.07 a share, for the revaluation of our net monetary assets in Venezuela as a result of the devaluation that occurred in January. And lastly, we made a one-time contribution to the PepsiCo foundation of \$100 million or \$0.04 a share. This is our first contribution in a couple of years and it should cover the foundation for at least the next several years.

Turning to other items. In the quarter we repurchased \$940 million in common stock or about 14 million shares. However, it's important to note that \$205 million of that cost was actually paid in the second quarter because we executed the repurchases in the final days of the first quarter. Our reported tax rate in the quarter was a benefit of 2% mostly driven by the impact of the bottling transactions, which includes a reversal of deferred taxes attributed to previously held equity interest in the bottlers. The resolution of certain tax matters contributed about a one percentage point to the decline in the reported tax rate versus Q1 of last year. The benefit of 2% is a 27 percentage point change versus Q1 of last year. Excluding the impact of items affecting comparability, our core tax rate was 23% for the first quarter.

Now let me turn to our guidance for the full year. We are still targeting 11% to 13% core constant currency EPS growth off of our fiscal 2009 core EPS of \$3.71. We expect roughly 6% growth in core constant currency EPS in the first half of the year, which includes a charge of about \$40 million after-tax related to the healthcare legislation that was signed into law at the beginning of our second quarter. In the second half of the year, we expect our core constant currency EPS growth rate to be in the mid teens. Based on current spot rates, foreign exchange translation would be about a one point headwind for us on a full year core constant currency EPS growth. It's important for me to note that when we file our full year pro formas for 2009 on Form 8-K A later today, you will see a few pennys more of upside related to the transactions than we had last estimated translating to about \$0.17 a share or \$0.02 more of accounting and financing upsides in 2010. We plan to invest this additional \$0.02 in our business this year.

Turning to our full year reported tax rate, we expect the rate to be between 23% and 24%, which includes a benefit of about four percentage points from the items affecting comparability that I mentioned earlier. For the year, we expect management operating cash flow, excluding certain items and net of capital expenditures, to be approximately \$5.6 billion. Net CapEx should total about \$3.6 billion, which includes about \$200 million in capital investments related to the bottler integration and lastly, we anticipate that in total, we will spend roughly \$4.4 billion on share repurchases this year. With that, I'd like to turn the call over to the Operator for questions. Operator?

QUESTIONS AND ANSWERS

Operator

Thank you. (Operator Instructions) Our first question comes from John Faucher of JPMorgan.

John Faucher - JPMorgan Chase & Company - Analyst

Thanks, good morning. Hugh, wanted to just to get a clarification on the tax rate. You mentioned the reported tax rate in the comparability. I just want to make sure for the core earnings growth rate you're still using the 27% tax rate guidance, is that correct?

Hugh Johnston - PepsiCo - CFO

Yes, our core tax rate, John is 27% to 28% and that did not change.



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John Faucher - JPMorgan Chase & Company - Analyst

Okay, got it. Thanks. And then looking at Europe, which was probably one of the biggest misses relative to expectations this quarter, can you just clarify in terms of your reporting calendar, I think you are probably about what, halfway through the quarter at this point, so that obviously gives you a pretty good level of confidence. Can you talk about sort of how much you think the sequential improvement you've seen is weather and how much you think is really related to maybe some overall improving macros?

Zein Abdalla - PepsiCo - CEO of PepsiCo Europe

Yes, good morning, John. What I'd say about Q1 is we're actually on track relative to how we plan the business, it's a small quarter January, February, low seasonality. We plan for a very tough first half with momentum improving in the second half of the year and what we've actually seen is that momentum has started to improve earlier with Q2 coming through very well and very well in March, and as Hugh referenced, getting growth back in both the East and the West of Europe. We do anticipate though that the first half will remain more challenging and Q2 there will be more bumps in the road. The West Europe will recover faster than East Europe, but there have also been enough green shoots now coming through in East Europe for us to feel very strongly about the strategic value of those markets, so halfway through Q2 it's looking good.

John Faucher - JPMorgan Chase & Company - Analyst

And again, one more sort of specific question. Q2 for you ends in May or ends in June?

Zein Abdalla - PepsiCo - CEO of PepsiCo Europe

Q2 is the end of May.

Hugh Johnston - PepsiCo - CFO

For international it's end of May, John. It's really June for the North American business.

John Faucher - JPMorgan Chase & Company - Analyst

Okay, great. Thank you.

Operator

Your next question comes from Bill Pecoriello of Consumer Edge Research.

Bill Pecoriello - Consumer Edge Research - Analyst

Good morning, everybody.

Indra Nooyi - PepsiCo - Chairman, CEO

Good morning, Bill.

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Bill Pecoriello - *Consumer Edge Research - Analyst*

Given it's so difficult to read that North America Beverage division with the acquisition there, can you help us understand where price was coming in the quarter? And then on the underlying CSD versus non-carb, you're talking about improvement in recent weeks, so you're seeing this in immediate consumption, you said you were seeing it in both CSDs and Gatorade. So just help us understand a little bit the underlying trends given it's hard to read in the P&L. Thanks.

Indra Nooyi - *PepsiCo - Chairman, CEO*

Eric?

Eric Foss - *PepsiCo - CEO of Pepsi Beverages Company*

Good morning, Bill. It's Eric.

Bill Pecoriello - *Consumer Edge Research - Analyst*

Hi, Eric.

Eric Foss - *PepsiCo - CEO of Pepsi Beverages Company*

First of all on pricing, if you look at the quarter from a bottling standpoint, period three was the only period included and period three our net revenue per case was up about three points. So good, strong balance pricing as you come to know us for. I'd say on the broad pricing environment, we continue to view a rational pricing environment. Again, as Hugh mentioned and as I mentioned at the analyst meeting, I think given the environment we are trying to strike the right balance between volume and price and I think you can expect that to continue as we look to the remainder of the year, we're going to look to see pricing somewhere in that 2% to 3% range. In terms of the volume, more recently we've seen our cold drink and specifically the convenience channel improve sequentially. And so we're actually pretty encouraged by what we saw as the quarter unfolded and that's continued, obviously the good weather the last month or so has helped us start second quarter.

Bill Pecoriello - *Consumer Edge Research - Analyst*

Thank you.

Operator

Your next question comes from Christine Farkas with Banc of America.

Christine Farkas - *BofA Merrill Lynch - Analyst*

Thank you very much. Good morning, everyone. I wanted to look a little bit at the PAB volume number. You've indicated volumes down 4% with some benefit or two points benefit from the Dr Pepper agreement. I'm wondering if you can help us understand perhaps some performance in Mexico. Were there weather impacts there, and if your underlying beverage trends didn't improve year-over-year or sequentially with a down six and CSDs were getting slightly better, was it really water that was the offset or something else? Thank you.



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Indra Nooyi - PepsiCo - Chairman, CEO

Let me turn to Massimo to talk about Mexico, but just to give you top line, Christine, one of the things we told you at the investor meeting was that we are going to be very careful in how we pursued share, that it was not going to be a volume at all cost. We were going to not chase pricing down and as Eric just said, we are looking very carefully at this mix of volume share and value share, so we don't just compete in this business by dropping pricing, especially to push a volume number. And the second thing we've been doing is [truign] the portfolio. Where we have product lines that really don't make sense to invest in long term because the profit algorithm is not really optimal, we have been deemphasizing it and Hugh referred to the case pack water, which we de-emphasized in the quarter. In the investor meeting we talked about some juice drinks, shelf stable juice drinks which the value proposition wasn't very attractive and so over the year, we started to de emphasize that until we found a new way to compete in that business in a profitable way. So the number is well impacted by that.

The second is that remember, our quarter was different than the rest of the industry in that we didn't have the Easter benefit in our quarter. So you have to be careful to make sure that when you model that in, and last let me turn to Massimo and Eric to talk about Mexico. Eric do you want to start with Mexico and then Massimo take it from there. Go ahead.

Massimo D'Amore - PepsiCo - CEO of PepsiCo Beverages Americas

Hi, Christine. So in Mexico, as you already heard, the weather was particularly cold and contrary to Brazil, the consumer spending is still very much affected by the economic recession. So in that context, we have been really solidifying our base post-transaction with the bottling company. So for example, we have transferred the distribution of Gatorade to the bottling company in the key market of Mexico City and we have seen, in the last few weeks, a significant improvement there. Also, don't forget that for us, in Latin America, quarter one is only January and February, and in the case of Mexico, it's a low seasonality period.

Operator

Your next question comes from Carlos Laboy of Credit Suisse.

Carlos Laboy - Credit Suisse - Analyst

Yes, good morning, everyone.

Indra Nooyi - PepsiCo - Chairman, CEO

Good morning, Carlos.

Carlos Laboy - Credit Suisse - Analyst

Indra, just to stay with International and AMEA, are we to understand that the loss in operating leverage was pretty much all China investment and if that's the case, how long does China remain a drag on operating leverage in that business unit?

Indra Nooyi - PepsiCo - Chairman, CEO

It's interesting, Carlos. We don't look at it as a drag. We look at it as an exciting market with tremendous growth opportunities, and whenever we get the opportunity to step up the investment you should do it because building these big growth markets for the long term sometimes require extraordinary investments to be made at the right time. And at this point, we have the organizational bandwidth, we have the leadership in place and we have the P&L room to really step up our capability to accelerate

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our growth in China, and that's what we are doing right now, so I wouldn't use the word drag. I'd view it as China investment opportunity.

And in terms of AMEA overall, I think there were two issues that impacted the leverage. One is the China investments clearing, top line was spectacular, revenue was great. The second is also the sugar prices have been exceedingly high, and we've had to cover some of those extraordinary sugar price increases. So it's a combination of the two that created the deleverage. Did you want to add anything?

Zein Abdalla - *PepsiCo - CEO of PepsiCo Europe*

No, nothing. I just want to relate what you said about China. We're making great investments there. The investments are paying back. Our volume came in quarter one. It's growing, and we're investing in all segments. We're investing in marketplace infrastructure, we're investing in growing our trademark and we're investing in using all capacity, so we feel very good about our progress in China.

Carlos Laboy - *Credit Suisse - Analyst*

Thank you.

Operator

Your next question comes from Marc Greenberg of Deutsche Bank.

Marc Greenberg - *Deutsche Bank - Analyst*

Thanks, good morning.

Indra Nooyi - *PepsiCo - Chairman, CEO*

Good morning, Marc.

Marc Greenberg - *Deutsche Bank - Analyst*

Hugh, wanted to dig in on some of the financials around the bottler deal. You've indicated \$650 million in charges and \$400 million in synergies a few years out. How should we think about the return for PepsiCo on this deal over time and what kind of sign posts should we be looking for to give us a sense that you're getting that return?

Hugh Johnston - *PepsiCo - CFO*

Yes, I guess a couple things on that, Marc. Number one, I think you should be looking at us from a marketplace perspective and if we're driving improved marketplace performance over time, then that's a good indication that the deal is fulfilling the strategic intent and the financial intent of what we look to accomplish there. Number two is are we delivering the synergies that we've crafted out for you. Now, we've told you exactly what we intend to deliver, more cost synergies early on, more revenue synergies obviously as we get later into the deal so you should certainly be looking at that. And number three, from our standpoint, while the synergy numbers that we've put out there are the ones that we absolutely intend to deliver, we're also not going to stop there by any stretch of the imagination. Our goal will be certainly to drive for as much as we can get as we always have and that's been our history with previous acquisitions as well. So I think the combination of marketplace performance and are we

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delivering the synergy numbers should give you the best indication as to how well we're doing with the investment we've made here.

Marc Greenberg - *Deutsche Bank - Analyst*

Thanks, and just a quick follow-up on beverages. Eric, I know you talked about 2% to 3% full year pricing. Can you offer any feedback from the trade ahead of Summer as far as how promotional trends look at this point?

Eric Foss - *PepsiCo - CEO of Pepsi Beverages Company*

Well, I would say, Marc, as you look at what's happening in the marketplace, I think retailers are dealing with the same macro pressures, category pressures, consumer challenges that most packaged goods companies are. And as we look to the Summer I think you're going to continue to see retailers invest particularly on consumption elastic categories like ours to build traffic. So I would say as I mentioned earlier, we're pretty encouraged by what's happened as we've gone into second quarter, both in terms of take home and cold drink and so I think right now, we view a Summer that looks encouraging from where we sit.

Hugh Johnston - *PepsiCo - CFO*

Marc, before you sign off, I also want to congratulate you on a fabulous start to the Yankees season.

Marc Greenberg - *Deutsche Bank - Analyst*

Thank you.

Operator

Your next question comes from Kaumil Gajrawala with UBS.

Kaumil Gajrawala - *UBS - Analyst*

Hi, everybody. Good morning.

Indra Nooyi - *PepsiCo - Chairman, CEO*

Good morning.

Kaumil Gajrawala - *UBS - Analyst*

As it relates to convenience stores we talked about sequential improvements in beverages. Can you give us some insights on what you're seeing on the snack side in convenience stores? And then also as it relates to the comparison, I believe it's about around May when things started turning quite negative at convenience stores in 2009, so do the comps get easier from here based on snacks? And then also for the comps on the beverage side as well?

Indra Nooyi - *PepsiCo - Chairman, CEO*

So John, why don't you take that?



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John Compton - PepsiCo - CEO of PepsiCo America Foods

Kaamil, This is John. Listen, overall, in the C-store channel beginning in the second and third quarter of last year, it became challenged to say the least, and while it's improving, it's improving off a challenging base. So it isn't I don't think growing versus year ago yet, although we're starting to see some better trends. We did our Power of One promotion between Doritos Burn and Pepsi Cease Fire and that certainly helped both businesses, on the Pepsi Max and Doritos business in March and we're seeing that continue in April. So I would characterize it as improving, but I still think it has a ways to go as the unemployment numbers need to improve and the overall economy needs to improve.

Kaamil Gajrawala - UBS - Analyst

But the comps get easier as we move forward though correct?

John Compton - PepsiCo - CEO of PepsiCo America Foods

And the comps do get easier as we move forward though, right.

Kaamil Gajrawala - UBS - Analyst

Got it. Thank you.

Operator

The next question comes from Jonathan Feeney of Janney Montgomery Scott.

Jonathan Feeney - Janney Montgomery Scott - Analyst

Good morning, thank you. Just being a little bit more specific following up on Marc Greenberg's question on the deal, I'm surprised to see continued capital expenditure plans as high as they are considering how much beverage capacity and execution power you brought in house and when I think about how that stages in 2011 and 2012, should we expect capital expenditures to maybe slowdown a little bit given that you're getting your hands-on all of these assets right now?

Eric Foss - PepsiCo - CEO of Pepsi Beverages Company

Well, I think from a capital standpoint as we look to address the manufacturing assets, I think you'll continue to see capital expenditures on beverages be very disciplined. I think the reality is we still have opportunities on the cold drinks side, but as you look at capacity investment I think you're going to find that those investments are going to be to help improve efficiencies and aren't really on new manufacturing lines or plants. I think you'll see rationalization in the area of manufacturing capacity and capital expenditures.

Hugh Johnston - PepsiCo - CFO

Yes, in addition to that let me just remind you of two things. Number one, we have always been and will continue to be a highly disciplined company in terms of the way we review capital expenditures and any investments we'll be making there we'll be delivering good returns. The second thing is at the investor meeting, we had indicated to you that we would expect CapEx to be in the 5% to 6% range and that's what we will expect to continue to run going forward.

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Jonathan Feeney - *Janney Montgomery Scott - Analyst*

And Eric, just following up on your comment about cold drink. Are you talking about cold drink in the US internationally or both?

Eric Foss - *PepsiCo - CEO of Pepsi Beverages Company*

When I was talking about cold drink I was talking about cold drink in the US and Canada.

Kaumil Gajrawala - *UBS - Analyst*

Okay. I guess I'm just trying to understand how that squares with the reality that convenience stores aren't really growing right now.

Eric Foss - *PepsiCo - CEO of Pepsi Beverages Company*

Well, again, I think to John's point, what I mentioned is we're starting to see an improvement in the trends and so if you look at I think actually first quarter you actually started to see even some traffic in trip increase sequentially, not versus year ago but sequentially. And so again, we were looking for early encouraging signs in the cold drink and convenience channel and my point is in Q1, we started to see a slight improvement.

Indra Nooyi - *PepsiCo - Chairman, CEO*

But given all of that let me just say that it's just been about four weeks since we closed the transaction and across the Company, we are taking a hard look at every dollar of capital we're spending in markets where the top line, especially volume growth, is not there. So trust me, as the year progresses we'll be back to you in terms of exactly what capital levels need to be deployed against these businesses.

Jonathan Feeney - *Janney Montgomery Scott - Analyst*

Great. Thank you very much.

Operator

Your next question comes from Lauren Torres of HSBC.

Lauren Torres - *HSBC - Analyst*

Good morning.

Indra Nooyi - *PepsiCo - Chairman, CEO*

Good morning, Lauren.

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Lauren Torres - HSBC - Analyst

A question on the step up in investment spend in the second quarter. Hoping you could be just a bit more specific about where that spend is directed and also what gives you the confidence that the spend will materialize to better second half results, particularly talking about the softness in the environment that we expect to persist over the course of the year?

Hugh Johnston - PepsiCo - CFO

Yes, Lauren. Why don't I take that one. I think you have to think about it in two pieces. As we talked about back at the investor meeting, we talked about base investment spend in each of the businesses, and that's going to go into areas like rot ads and A&M and those types of things, and we will be adding that type of investment into our businesses in order to drive growth going into the future. In addition to that, we're certainly going to continue to invest in things over the top like China, like nutrition, like sustainability and those types of investments will take a little bit longer to pay back but they're basically about building where we're trying to strategically take the Company as we spent a couple of days going through. So in terms of getting into specific markets and specific areas where we're going to be investing, it would probably be competitively inappropriate for me to get into that level of detail so I'd rather not do that.

Indra Nooyi - PepsiCo - Chairman, CEO

Lauren, just be assured that we have a very rigorous process to first allocate the strategic investment, track, monitor it, we have metrics against each, and if we think something is not yielding the kind of results we need, we will pull it and if that happens we will pull that through to the bottom line. That's what we promised you at the investor meeting. And at the right time, we will come back and talk to you about it. Remember, with these strategic investments, we are making some breakthrough platforms. Some of these platforms may breakthrough, some may not. There is a hit rate associated with it, but we think the time is right to reinvent some of these businesses we have and that's what we're doing.

Lauren Torres - HSBC - Analyst

Great, thank you.

Operator

Your next question comes from Caroline Levy of CLSA.

Caroline Levy - CLSA - Analyst

Good morning. A couple of questions. One is Eric, thank you for the net revenue per case discussion on March, but I'm just wondering what it looked like in January and February?

Eric Foss - PepsiCo - CEO of Pepsi Beverages Company

Well let me tell you, in the early part of the quarter I think we were up a little over a point and then again, it improved sequentially in period three, we're up three points, which is the number that's reported, but I would tell you if any of your question Caroline is around Super Bowl let me just go into that. The reality is we had very strong performance in Super Bowl. We had great activity. We grew our share, had positive share swing and our pricing at retail was actually pretty disciplined. We were flat year-over-year on our two liter retails and we actually saw an increase in our canned retails versus a competitive environment that saw decreases on both year-over-year. So I think we were very disciplined as we went through and actually the Super Bowl activity was largely driven by improvement in feature activity and just good execution.

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Caroline Levy - CLSA - Analyst

Thank you, that's great and then what were the volume trends on Trop and Gatorade in the quarter?

Indra Nooyi - PepsiCo - Chairman, CEO

Remember, these are low quarters for Gatorade. We don't provide details by business, but these are low quarters because Gatorade was just selling in the new innovation. And as we mentioned on the call, Caroline, we are seeing tremendous volume improvements in Gatorade and again, it's very hard to predict off of one or two periods what the long term trend is going to be, but right now, we're seeing wonderfully improving trends in Gatorade.

Caroline Levy - CLSA - Analyst

Thank you, so much. Last question, can I just understand, how does Venezuela devaluation affect operating income for the balance of the year? In Pepsi Americas Beverages I'm assuming is a big part of it.

Hugh Johnston - PepsiCo - CFO

Yes, it will come through in transaction FX and we've talked about that in total as a one point headwind. That's the biggest factor in that.

Caroline Levy - CLSA - Analyst

As a one percentage point headwind to growth?

Hugh Johnston - PepsiCo - CFO

As a one percentage point headwind to growth. I discussed that in the up front script, yes. Total FX. It's in that.

Caroline Levy - CLSA - Analyst

It's total, yes, I just didn't know if in that division there's that -- you've got a 50% devaluation. Is that flowing through that operating income line?

Hugh Johnston - PepsiCo - CFO

Well no, remember the monetary devaluation we took it down at the corporate level so that occurred up front.

Caroline Levy - CLSA - Analyst

Okay.

Hugh Johnston - PepsiCo - CFO

Okay?

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Caroline Levy - CLSA - Analyst

Thank you.

Operator

Your next question comes from Judy Hong of Goldman Sachs.

Judy Hong - Goldman Sachs - Analyst

Thanks, good morning.

Indra Nooyi - PepsiCo - Chairman, CEO

Good morning, Judy, how are you?

Judy Hong - Goldman Sachs - Analyst

I'm good. I guess my first question is really on Frito Lay. On the positive side, the margin improvement was very impressive in the first quarter. I'm wondering if some of that was timing related and that as you increased spending in the back half, whether margins behavior would be a little bit softer. And then on the volume side, some of the [scanner] data has shown continued sluggishness in the volume side even with pricing moderating and obviously you're investing more behind the brands and innovation. So maybe just talk about the volume performance there just on Frito.

John Compton - PepsiCo - CEO of PepsiCo America Foods

Judy this is John. On the margin side, we've said all along that we expect 2010 to be a year where the profit growth in the business is going to be higher than we've done historically and that our volume would be sort of the low single digit range and this is not a year where we're going to get a lot of price mix. So yes there will be margin expansion at Frito Lay during the course of the year. That's going to come through two areas. One is there is deflation in the business and two the practices on productivity there continue to step up. We are making investments back into the business so that we can keep the volume growing and while we grew volume 1% in the quarter, it's sort of I'd look at it in two different ways. One is sort of the core salty business is growing at its historical rate in large format stores and where our volume has been impacted has been in the small format stores, C-stores and food service. So once that starts to turn, I think you'll see Frito Lay back to its 2% to 3% growth rate we've historically achieved.

In our adjacency side of the business that I talked about at the investor conference, the Stacy's business, the Sabre business, the Quaker Snacks business that we execute through Frito Lay continue to grow double digit in some cases and high single digits in others. So I think we've got a nice mix between the core and adjacencies, the large format business remains strong and once the small format business turns then the total volume growth in the Company will be back to where it is, and we will expand margins at Frito Lay this year while investing back in the business. So a good start to Frito Lay in the first quarter.

Judy Hong - Goldman Sachs - Analyst

But there wasn't anything in terms of timing of spending that's helped the first quarter versus maybe some of that gets taken out in the second quarter as you talk about spending going up?

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John Compton - PepsiCo - CEO of PepsiCo America Foods

No, Judy. We don't give quarterly guidance but I think the first quarter is consistent with where we expect the business to perform during the course of the year.

Judy Hong - Goldman Sachs - Analyst

And then just a quick follow-up, Hugh. On the synergy numbers, you've raised the cost to achieve the synergies but you haven't raised the synergy target. Obviously you've talked about going after other opportunity in terms of cost savings, but the fact that you're raising the cost to achieve these synergies, how should we think about that as it relates to the fact that you're still looking for the \$400 million in terms of cost savings?

Hugh Johnston - PepsiCo - CFO

Yes, I guess the best way to think about that is as you go through this process, you certainly learn both in terms of the benefits you're going to get as well as the costs you're going to take on. The increase in cost was largely non-cash and it very much relates to the rationalization of some manufacturing assets, both in the Gatorade as well as in the bottling business. The net of it is the savings on that is still captured within the range of \$125 million to \$150 million, so as we refine the estimates that's where we are right now and we wanted to provide you with that update and also give you an update on cash versus non-cash. So that's really where we stand.

Judy Hong - Goldman Sachs - Analyst

Okay, thank you.

Operator

Our final question is from Damian Witkowski of Gabelli & Company.

Damian Witkowski - Gabelli & Company - Analyst

Hi, good morning. Just anything in particular that's behind the strength in beverages in Turkey this quarter? And then you talk about a very rational pricing environment in the US. Are there any big regions, countries, important countries around the globe where you're seeing opposite of what you're seeing sort of irrational pricing and behavior?

Indra Nooyi - PepsiCo - Chairman, CEO

Zein, do you want to take Turkey?

Zein Abdalla - PepsiCo - CEO of PepsiCo Europe

Yes, good morning Damian. In Turkey it's a great execution of our differentiated value program in these tough economic times, we've saw ways to give value back to the consumer in this highly differentiated way. So in Turkey we're running promotional programs like free mobile airtime for our target group, that's resonated very well, and then also, as we were pulling the integration of the bottling system together, starting to get traction on leverage around Power of One. So just a tremendous quarter in Turkey.

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Damian Witkowski - *Gabelli & Company - Analyst*

Okay.

Indra Nooyi - *PepsiCo - Chairman, CEO*

And in terms of irrational pricing, it's difficult to point out countries, but I will tell you even the United States, it was interesting that the first eight weeks or so of the year started off well and we were gaining share doing great and all of a sudden we see a competitor dropping their pants in the last couple weeks when the volume is missing. So we see this behavior on and off, end of the quarter behavior, but we live with it and beyond that, I think by country, by period, behavior varies all over the place, so there isn't any systematic behavior that I can point to.

Damian Witkowski - *Gabelli & Company - Analyst*

And Indra, just one more thing, in the beginning in your prepared remarks you said you're making progress on the better for you and then you listed Lays and Sun Chips I believe, and whole grains, and that would not be counted as part of the better for you would it?

Indra Nooyi - *PepsiCo - Chairman, CEO*

Adding the whole grains, going to local flavor Lays, reducing the sodium content, all of that is better for you. The good for you is the real Tropicana, the Quaker. The moving from fun for you to better for you is reducing salt, reducing sugar, adding more whole grains, all of that is the transition to better for you.

Damian Witkowski - *Gabelli & Company - Analyst*

Okay, thank you.

Indra Nooyi - *PepsiCo - Chairman, CEO*

Thank you, Damian, and thank you, Operator. Let me close with this. We are off to a solid start this year and we're all very pleased with the progress we're all making this quarter. Our rigorous financial discipline has enabled us to grow even while we've made critical investments in our business and as a result we're optimal it poised to capture our fair share of growth as the worldwide economy improves. I'm confident we've positioned the business to achieve our commitment for the year, while also driving sustained top quartile performance well into the future. Thank you all for joining us this morning.

Operator

And ladies and gentlemen, that concludes PepsiCo's first quarter 2010 earnings conference call. We appreciate your time. You may now disconnect.

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