Trian Letter and White Paper to PepsiCo Board

February 19, 2014

THE CASE FOR
SEPARATING GLOBAL SNACKS & BEVERAGES
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February 19, 2014

Mr. Ian M. Cook, Presiding Director
PepsiCo, Inc.
700 Anderson Hill Road
Purchase, NY 10577

Dear Ian:

Investment funds managed by Trian Fund Management, L.P. (collectively “Trian”) beneficially own approximately $1.2bn of PepsiCo common stock. We appreciate your and Lloyd Trotter’s willingness to meet shortly after our first communication to PepsiCo’s Board advocating for structural change in early November 2013. We also appreciate our dialogue with CEO Indra Nooyi and members of her management team. Both management and the Board have been cordial in our dealings. However, it is clear we have vastly different views on the best path forward for PepsiCo. It appears that PepsiCo views structural change as a sign of weakness, an admission of failure and an untenable break with past traditions. Trian views structural change as the best path forward to generate sustainable increases in shareholder value.

As you know, we are extremely concerned about PepsiCo’s extended period of underperformance relative to its food and beverage peers. The deteriorating trends in North American Beverage, questionable quality of earnings in 2013 and disappointing 2014 guidance reinforce our view that now is the time for decisive action. We believe the best way to ensure improved performance at PepsiCo is to separate global snacks and beverages, putting the future of each business in the hands of empowered and focused management.

We were highly disappointed last week with the results of PepsiCo’s strategic review, especially in light of another quarter of uninspiring performance and, most disturbingly, weak 2014 guidance. Management and the Board’s conclusion that the “current structure maximizes value” is at odds with many years of subpar operating results.¹

We also find management’s rationale for maintaining the current structure highly subjective, full of platitudes and lacking strong supporting analytics, such as:²

- First, management argues that pairing beverages and snacks provides critical scale that makes PepsiCo more relevant to its customers and provides synergies in areas such as procurement, customer insights, advertising, coordinated national account activity and international expansion. We ask: what is the benefit of scale and synergies if PepsiCo loses market share in critical segments and delivers lower margins, earnings per share (EPS) growth and total shareholder returns than peers over an extended period of time?
Moreover, we believe that the $0.8-1.0bn of dis-synergies that management highlights can be more than 100% offset through the reduction of PepsiCo’s $1.1bn of unallocated corporate costs and a “blank sheet of paper” process to drive leaner cost structures at the operating divisions.iii  We also note that shareholders pay a heavy price for the integrated strategy. If you multiply the company’s $1.1bn of unallocated corporate costs (which would be eliminated if the businesses were separated) by 11x (PepsiCo’s multiple of enterprise value / 2014 earnings before interest, taxes, depreciation and amortization), it costs shareholders $12bn of value, or $8 per share, to have beverages and snacks together in a holding company structure. If you also added the portion of corporate costs actually allocated to the segments (not publicly available but we estimate at least as much as the unallocated cost), the cost per share is likely much greater than $8. We would be willing to pay that per share cost in return for PepsiCo consistently delivering better growth and margins than competitors in each of its businesses. However, given PepsiCo has delivered inferior results over many years, we believe the holding company structure should be eliminated along with the related costs. These savings can provide standalone management with funds to reinvest in the brands and drive profits, creating a multiplier effect in building long-term shareholder value.

- Second, management argues that a separation would forfeit value creation from sweetener technology and productivity savings. It is important to understand that we never advocated a sale of the business. Rather, we recommended a spin-off so that shareholders can participate in future upside. Moreover, we believe the probability of productivity hitting the bottom line and sweetener technology having a material impact increases if there is a standalone management team with “no place to hide.”

- Third, management argues that U.S. cash flow from the beverage business is necessary to provide cash returns to shareholders. We question the accuracy of this statement on several grounds. Most notably, we believe two $30bn+ standalone snacks and beverage companies anchored by large North American businesses (Frito-Lay North America and Americas Beverages) would each generate sufficient cash flow to pay dividends and invest for growth.

- Fourth, management argues a separation would “jeopardize [PepsiCo’s] ability to grow in foodservice.” As the largest shareholder of Wendy’s, we have seen first-hand how PepsiCo has been outmaneuvered by Coca-Cola in the foodservice market. The most glaring example is the Coke Freestyle machine which allows customers to customize their beverages with 100-plus flavor options. Meanwhile, Pepsi’s version of a Freestyle machine has yet to materialize, even though Nelson was told by the CEO in mid-2012 that 1,000 technologically competitive units would be in the market by the end of 2012. This is another example of PepsiCo’s “connected autonomy” slowing down innovation and negatively impacting the ability to compete.

Finally, a reason cited by some as to why snacks and beverages should not be separated is that a standalone PepsiCo beverage business cannot compete effectively against Coca-Cola. We
disagree and would note: a) PepsiCo has not competed effectively against Coca-Cola for many years, even with snacks in its arsenal; b) Dr Pepper Snapple has shined since it was spun-off from Cadbury in 2008 (in the middle of a financial crisis) and has outmaneuvered both Coke and Pepsi over the past five years. In fact, Dr Pepper Snapple grew EPS more than PepsiCo in 2013 and forecasts similar growth to PepsiCo in 2014 despite a weaker portfolio, no exposure to snacks and more exposure to N. American carbonated soft drinks; and c) PepsiCo has some of the best beverage brands in the world (e.g., Gatorade, Tropicana, Mountain Dew, Pepsi, Starbucks and Lipton, among others).

The beverage business generates strong, stable free cash flow today and we believe can generate far more cash flow under focused leadership. Freed of allocated corporate costs and bureaucracy, and able to be nimble and lean, we believe a standalone beverage business will not only compete, but thrive. Trian has so much conviction in the value of a standalone beverage business that we would buy additional shares and be willing to join the Board of the newly formed beverage company to help lead it going forward.

In the end, the wisdom or fallacy of an integrated portfolio is quantifiable. While management says “holistically, this portfolio provides a platform for balanced growth, margin and return improvement...all of which leads to top-tier total shareholder return,” it simply is not true. The results are unambiguous: during the CEO’s seven-plus year tenure, PepsiCo’s total shareholder return of 47% has grown at less than half the rate of the Consumer Staples Index (103%) and competitors like Coca-Cola (115%). PepsiCo’s EPS growth has also significantly trailed that of peers.

Management will inevitably defend performance by questioning our timeframes. They argue that if you go back further, PepsiCo’s performance looks better. However, we did not choose our timeframe arbitrarily. We did so because 2006 marks the beginning of current management’s tenure. As importantly, it also coincides with the transformation of “Power of One” from a marketing slogan with limited operational impact to a pervasive strategy that increased the influence and control of corporate. We view this strategy – now described euphemistically as “connected autonomy” – as largely responsible for a diminished PepsiCo culture and deteriorating performance. We believe that separating snacks and beverages would create a clean structural break that would eliminate corporate bureaucracy, return power and autonomy to the operating divisions, increase accountability and re-energize division management.

Last week’s earnings announcement and 2014 guidance reinforce our view. Backing out the benefits of a lower-than-expected tax rate and a one-time Vietnam refranchising gain that has no place in “core” earnings, EPS grew only 5% in 2013. That follows a major EPS re-set in 2012 that was supposed to have re-ignited growth. The Company’s share price underperformed the Consumer Staples Index by 500 basis points (bps) during the next two trading days. Meanwhile, guidance for 2014 was weak. Despite plans to buy back 4% of the shares during 2014, a lower share count to begin the year, what should be a lower initial cost base given last year’s $1bn of supposed cost savings, another $1bn of promised cost savings planned for 2014
and nearly 100 bps of tax rate favorability, management expects only 7% constant currency EPS growth in 2014 — the low-end of its long-term target and its peer group.viii

Other notable observations from last week’s announcement:

- $3bn of cost savings from 2012-2014 are not expected to hit the bottom line, suggesting the core business is declining. 2014 EPS is expected to be only $4.50, in-line with 2011 levels.ix
- PepsiCo continues to lose market share in its struggling Americas Beverage unit, as the company has been consistently out-innovated and outmaneuvered by Coca-Cola (e.g., Coke Zero, Simply Orange, Freestyle, PlantBottle, transition to more popular package sizes, Green Mountain partnership).x This has put increasing and unnecessary pressure on the company’s other divisions such as Frito-Lay, which we believe would be one of the best performing and most highly valued food companies on its own.

The market appears to agree with us. When we publicly presented our White Paper last July, which advocated a separation of beverages and snacks, the market ascribed an increased probability to such a transaction. PepsiCo stock traded up to $87 per share and may have climbed higher had there been a formal announcement of structural change. With management since talking down the likelihood of a separation, culminating with last week’s formal announcement, PepsiCo’s stock has retreated to $78 per share. Overall, PepsiCo has lost $15bn of market capitalization since July during a period when both the S&P 500 and Consumer Staples Index have appreciated.xi We believe this share price decline sends two clear messages: 1) PepsiCo is worth more and would be run better as two separate companies; and 2) the Board and management’s decision not to separate goes against shareholders’ best interests.

While the company has been willing to use its balance sheet to prop up EPS through share repurchases, we do not understand why it refuses to use its balance sheet to create stronger standalone snacks and beverage businesses. Each should be capitalized to optimize value based on different growth profiles, strategic plans and shareholder objectives. PepsiCo should eliminate its holding company structure, along with layers of value-destructive overhead and excess costs. Standalone management teams should be “unshackled” to invest as they see fit, price as they want and take risks by moving quickly to introduce new products. Granting those running the divisions authority to control their destiny may make corporate leadership in Purchase uncomfortable — but we suspect division leadership and employees within Pepsi and Frito-Lay would be reinvigorated.

Our recommendations are consistent with the successful blueprint that PepsiCo utilized for decades when the company was run entrepreneurially and was the “industry disruptor.” For many years, PepsiCo competed successfully from a #2 position by keeping Coke off-balance. Now Coke has PepsiCo on its heels and PepsiCo has too much bureaucracy to compete more effectively. That is a recipe for mediocrity, at best. Likewise, PepsiCo was once an incubator of some of the best management talent in the consumer industry. We believe PepsiCo has lost that management edge due to its holding company and centralized structure.
As support for our recommendations, we have updated our comprehensive strategic analysis (“The Case For Separating Global Snacks & Beverages”), which we previously shared with you in November. It shows:

- How PepsiCo’s corporate culture has deteriorated over time as the company lost key elements of its identity.
- A review of PepsiCo’s underperformance versus peers from 2006 through today – a time that coincides with current management’s tenure and strategic emphasis on “Power of One.” We note how declines in advertising spending and aggressive Frito-Lay price increases artificially supported profits in the years before the earnings re-set in 2012. If PepsiCo continues down this path, we foresee an ongoing cycle whereby management intermittently re-sets EPS lower, delivers several years of unsustainable growth, only to re-set EPS again when brand reinvestment is inevitably needed.
- Examples of how beverages and snacks have hurt each other under the current holding company structure and why we are troubled by trends in both businesses.
- How at a meeting in the fall of 2013, CEO Indra Nooyi told Nelson that the acquisition of the bottlers was a “mistake,” thereby conceding that $21bn ($17bn excluding the equity PepsiCo previously owned in the bottlers) was misspent.
- Why we believe the snacks and beverage businesses would be better positioned for success following a separation. Benefits include eliminating the holding company structure, removing layers of unproductive corporate overhead, creating two leaner and more entrepreneurial companies and driving cost savings to reinvest in the brands.
- Details of how efforts to mitigate dis-synergies upon separation can deliver net savings to the bottom-line and examples of spin-off successes (including two PepsiCo spin-offs).

Significant value can be unlocked when large companies separate businesses to create focus. The Bloomberg U.S. Spin-Off Index, representing companies that were recently spun-off from a parent, has generated a 286% total return versus 148% for the S&P 500 over the past five years. More importantly, both the parent and the spun-off companies tend to become stronger competitors driven by highly empowered management teams.

Two recent examples are Kraft / Mondelez and News Corp / 21st Century Fox, which have created $32bn and $31bn of market capitalization, respectively, since announcing separations. In the case of Kraft, we applaud CEO Irene Rosenfeld and the Board for separating the portfolio along its natural fault lines. The company was willing to become smaller (and drop out of the Dow 30) in order to unlock value for shareholders. In the case of News Corp, it is unlikely that an outsider could have forced a separation given Rupert Murdoch’s voting control. Moreover, we would guess Mr. Murdoch was not anxious to have twice the number of board meetings and direct management reports. Nevertheless, he made the best decision for his businesses and, in doing so, created considerable value for all News Corp shareholders.

While we had hoped that PepsiCo’s management and Board would make the best decision for their businesses and enhance long-term value for shareholders, this has not occurred. And
while we understand that management believes the structural review has been completed and hopes to maintain the status quo, we believe the decision is one for the owners of the company. As such, while we remain open to continued dialogue with PepsiCo’s management and Board, we have decided to broaden our communications with our fellow shareholders.

We intend to begin meeting with shareholders immediately and will consider conducting public shareholder forums. We ask that shareholders examine the company’s record for themselves and review the questions we raise in the attached analysis. We believe many shareholders already agree with us and we will look to inform those who may not have strong views that ours is the right path forward for the company. In addition, we will closely monitor PepsiCo’s performance and hold management publicly accountable for delivering top-tier shareholder returns. Our goal will be to facilitate positive change by cutting through the rhetoric with thoughtful and quantifiable analysis, thereby creating a groundswell of support such that PepsiCo’s Board concludes it must take actions that are truly in the best long-term interests of its underlying businesses and its shareholders.

Very truly yours,

Nelson Peltz  
Founding Partner &  
Chief Executive  
Officer

Peter May  
Founding Partner &  
President

Ed Garden  
Founding Partner &  
Chief Investment  
Officer

Josh Frank  
Partner and Senior  
Analyst

cc: PepsiCo Board of Directors
THE CASE FOR SEPARATING GLOBAL SNACKS & BEVERAGES

We begin with a few comments on history and culture

As a distant number two competitor in beverages, PepsiCo never had the luxury of following the same strategies as those deployed by industry leader Coke. But PepsiCo nevertheless competed extremely effectively. The company did so, from its earliest days through the 1990s, by playing the role of “industry disruptor.” While Coke often took the conservative path, Pepsi was known for being faster on its feet, quicker to introduce new products, more willing to take risks and more willing to occasionally fail by doing so. Pepsi not only survived in this role of “industry disruptor,” it thrived.

Meanwhile, Frito-Lay was known historically for having one of the best corporate cultures in America. Its culture was separate and distinct from Pepsi, which made sense given different category and competitive dynamics – snacks versus beverages, push versus pull marketing, Frito-Lay as #1 in an industry with regional competitors versus Pepsi as #2 in an industry with one large competitor. Frito-Lay’s strong culture, combined with a dominant market share in an attractive category, created a force to be reckoned with in the food industry.

On the corporate front, PepsiCo was known for running with low overheads, even after the company moved to Purchase in 1970. There were clear lines of accountability between divisions, the business leaders had autonomy over their units, there was an ownership mentality throughout the organization and there was limited interference from corporate. PepsiCo was known as one of the great training grounds for operating executives throughout the 1970s, 1980s and 1990s.

Fast forward to today and PepsiCo’s corporate culture has become homogenized in our view, with the company having lost its entrepreneurial spirit. No longer playing the role of “disruptor,” Pepsi is trying to compete with an undifferentiated strategy. It is unfortunate because the past decade has seen massive change across beverages. With the move away from carbonated soft drinks (CSDs), customers now accept and often prefer innovative new products to existing ones. This would have been an ideal environment for a fast-moving Pepsi to get in front of consumer trends and grow market share. But with Pepsi shifting to a plodding, “big company” mentality reminiscent of Coke in prior decades – and with Coke adopting elements of Pepsi’s old entrepreneurial playbook – this has not transpired and Pepsi has instead lost market share.

The size and influence of PepsiCo’s corporate has expanded over the years, to the detriment of company culture. Rather than leaving management decisions to the business units, PepsiCo has become more centralized and corporate plays a larger role. “Power of One” programs have expanded into further reaches of the organization, across categories, geographies and functions such as research and development (R&D) and supply chain. The size of corporate has swelled and, with it, decision-making has slowed and lines of accountability have faded. Frito-Lay and Pepsi’s distinct cultures have melded together, causing both businesses to lose critical parts of their heritage.
Whereas PepsiCo was once an incubator of top management talent, the company has lost numerous key personnel in recent years. We believe PepsiCo’s holding company structure, with power concentrated centrally at corporate, is an impediment to attracting, developing and retaining top management.

We hope that if the Board takes one aspect of our analysis to heart, it is that PepsiCo’s beverage and snacks businesses must recapture the key parts of their identity that allowed them to thrive for generations. The beverage business must return to its role as a fast-moving “industry disruptor,” as it will never be competitive following the same path as Coke. And Frito-Lay will lose its dominance over time if management is not given the autonomy to invest for growth without interference from corporate. Changing culture is difficult. In our experience, it is best catalyzed with a decisive corporate event – in this case, a spin-off that empowers two standalone management teams to make change happen.

**Acknowledging many years of underperformance**

Total shareholder returns (TSR) have substantially underperformed peers. Management publicly defends its performance by citing shareholder returns relative to the S&P 500 during its tenure. The problem with this comparison is virtually all consumer staples stocks significantly outperformed the S&P 500 during the economic crisis given the defensiveness of their businesses and high dividend payouts. Moreover, we would note that PepsiCo has now underperformed the S&P 500 during management’s tenure. We believe PepsiCo should be benchmarked against its competitors and consumer staples peers, where relative performance has been even worse. Since 2006 when the current leadership team took control, PepsiCo’s TSR of 47% (5% per annum) is less than half of Coca-Cola’s TSR of 115% (11% per annum) and the overall Consumer Staples Index TSR of 103% (10% per annum). See Appendix A for details. 

Significant margin gap versus peers. Despite an advantaged brand portfolio in high margin categories, PepsiCo’s consolidated operating profit margin (before advertising expense) of 19% is 679 basis points (bps) below the peer average. Likewise, we estimate that PepsiCo’s global beverage operating profit margin of 12% is 670 bps below the peer average. See Appendix B for details.

Earnings per share (EPS) growth has trailed peers. Shareholder returns generally follow earnings growth over long periods of time. Earnings growth is perhaps the most important metric to assess performance as it distills into one number the success or failure of management regarding sales, costs and capital allocation decisions. From 2006-2013, PepsiCo grew EPS at a significantly lower rate than Coca-Cola and the Consumer Staples Index (PepsiCo grew EPS 46%, Coca-Cola grew EPS 75% and the Consumer Staples Index grew EPS 81%). See Appendix C for details.

Several times last year, management appeared on television after earnings calls to celebrate 2013 performance. Trian does not see much to celebrate. The company “re-set” earnings
significantly in 2012, cutting EPS from an expected ~$5.00 to $4.10 because the brands needed reinvestment. And even with the major EPS re-set in 2012, currency-neutral EPS grew only 5% in 2013 after backing out the highly unusual inclusion of a Vietnam refranchising gain embedded in “recurring” EPS as well as tax rate favorability. This rate of growth is well below the 10% EPS growth that PepsiCo’s peers delivered this year (normalized for currency and tax) as well as the company’s target of “high single digit” EPS growth over time. See Appendix D for details.

Guidance for 2014 was weak. Despite plans to buy back 4% of the shares during 2014, a lower share count to begin the year, what should be a lower initial cost base given last year’s $1bn of supposed cost savings, another $1bn of promised cost savings planned for 2014 and nearly 100 bps of tax rate favorability, management expects only 7% constant currency EPS growth in 2014 – the low-end of its long-term target and its peer group. 2014 EPS is expected to be only $4.50, basically in-line with 2011 levels.

Advertising declines artificially propped up EPS from 2006-2011. Management has defended earnings performance during its tenure by citing the need to re-set earnings and invest back into the business. Specifically, management argues that EPS was purposefully re-set in 2012 to free up $500-600mm for additional advertising and marketing investment. Two facts negate this argument. First, according to the 2012 Annual Report on Form 10-K, advertising and marketing expense only increased $200mm in 2012, or 36% of the promised incremental spend. If the other $300-400mm was not spent, why did EPS still decline so much in 2012? Could this be why management brought the one-time Vietnam refranchising gain ($137mm) into “recurring” EPS in 2013, so that the gain would offset additional advertising expense in 2013 ($200mm) that was supposed to have occurred in 2012? Second, and most importantly, we believe the need for brand reinvestment was precipitated by years of underinvestment in advertising and marketing from 2006-2011.

Advertising and marketing expense as a percentage of sales decreased from 7.7% in 2006 (and 8.7% in 2005) to 6.5% in 2009, the year prior to the bottling acquisitions. Even factoring in the shift in sales mix after the bottlers were acquired, we estimate that advertising and marketing expense as a percentage of sales declined another 34 bps from 2009-2011. Overall, we estimate that had advertising and marketing been held constant as a percentage of sales from 2006-2013, adjusting for the bottling acquisitions, PepsiCo’s EPS would have grown only 39% over this period (~700 bps worse than reported EPS growth). See Appendix E for details.

We find it disappointing that management wants a “free” pass on the 2012 earnings re-set and does not take responsibility for the events that brought it on, specifically a reduction in advertising that spurred a need for brand reinvestment. This is the same management team that was overseeing the company when advertising was declining.

With productivity consistently failing to hit the bottom-line, we question whether associated restructuring charges should be added back to core EPS every year. PepsiCo says that it will successfully complete its three-year, $3bn productivity program this coming year. Nevertheless, management’s 2014 guidance implies operating profit will be essentially flat over
the three years of the program (2011-2014E) meaning that little or none of the cost savings have benefitted the bottom-line. This suggests that PepsiCo is either inflating its cost savings targets, execution of the productivity plan has been subpar or the company’s core business continues to atrophy. The answer may well be a combination of the above.

Last week, management announced a new five-year, $5bn productivity program through 2019. This suggests productivity is becoming a recurring fact for PepsiCo for the foreseeable future, a benefit to the extent that cost savings drive a positive return that ultimately hits the bottom-line. But if productivity programs continue to be required to drive EPS growth at the low-end of peers, we believe the company has bigger problems than it is admitting. We also question whether the associated restructuring charges should be added back to core EPS when there is seemingly no significant benefit to shareholders.

Management cites “Power of One” benefits when arguing why snacks and beverages should remain together. We believe PepsiCo’s performance disproves the “Power of One”

As PepsiCo has expanded the influence of corporate, the rhetoric around “Power of One” has intensified (see Appendix F). In the early years, “Power of One” was positioned as a way to improve sales by bundling offerings within a store. As time went on, the meaning of “Power of One” was expanded to include benefits in supply chain, purchasing, international growth, marketing and R&D. While we disagree that PepsiCo derives significant value between snacks and beverages in many of these areas (see Appendix G), the fact is that PepsiCo’s financial results, more than anything else, disprove “Power of One.” Management has had seven-plus years to prove that “Power of One” initiatives drive improvements. But despite the rhetoric around “cost savings,” “capability sharing” and “commercial benefits,” operating performance has deteriorated and PepsiCo has failed to perform in-line with peers. If “Power of One” is real, the company should obviously have performed better than peers. We believe management owes it to shareholders to quantify, once and for all, the specific benefits that accrue from “Power of One.”

Decline in Americas Beverages (32% of overall PepsiCo sales; 66% of total beverage sales)

Following the Q3 earnings release in October 2013, CFO Hugh Johnston told Bloomberg that beverages were “largely in-line” with competitors and “we think that’s enough to satisfy the broader investor base.” We could not disagree more. If PepsiCo’s management and Board are not concerned with the trajectory of beverages in their biggest and most profitable geographic market, then we would like to understand what we are missing.

In early 2012, management put N. American beverages in a category of businesses that the company would need to fix or find structural solutions for, with alternatives including a separation of part or all of the business. Yet management recently announced that not only will it retain beverages in N. America and globally but that there will effectively be no “structural” change. We struggle to reconcile this conclusion with the fact that beverage performance has materially worsened throughout 2012 and 2013, suggesting the need for change is greater...
than ever. We question whether this is responsible decision-making by management or whether pride and legacy traditions are standing in the way of shareholders’ best interests.

PepsiCo’s N. American beverage volumes are down significantly across both CSDs and non-CSDs in recent years, with the rate of decline accelerating (see Table 1). Meanwhile, PepsiCo has lost market share across most beverage categories (see Table 2). The 2012 EPS re-set and brand investment, which management explicitly promised on the Q2’12 earnings call would drive sales in N. American beverages and snacks, “the benefits from which will be increasingly seen in the second half of 2012 and into 2013,” has failed to positively impact Americas Beverages.

**Table 1: PepsiCo N. American beverages: 2012-YTD 2013 volume trends have deteriorated, even as compared to already weak 2010-2011 trends**

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<tr>
<td>N. American Liquid Refreshment Beverages</td>
<td>(2%)</td>
<td>(8%)</td>
<td></td>
</tr>
<tr>
<td>N. American Carbonated Soft Drinks (CSD)</td>
<td>(6%)</td>
<td>(9%)</td>
<td></td>
</tr>
<tr>
<td>N. American Non-Carbonated Soft Drinks (NCSD)</td>
<td>4%</td>
<td>(5%)</td>
<td></td>
</tr>
</tbody>
</table>

Source: Company reports, Consumer Edge research (10/16/13). Q4 results for PepsiCo suggest continued market share erosion.

**Table 2: PepsiCo has lost market share to Coca-Cola in 7 of 9 major N. American categories**

<table>
<thead>
<tr>
<th>Cumulative Change in Market Share PepsiCo vs. Coca-Cola</th>
<th>2010 – YTD 2013</th>
</tr>
</thead>
<tbody>
<tr>
<td>Juice/Drinks – Refrigerated</td>
<td>(1,326) bps</td>
</tr>
<tr>
<td>Sports Drinks</td>
<td>(1,132) bps</td>
</tr>
<tr>
<td>Tea/Coffee – Refrigerated</td>
<td>(633) bps</td>
</tr>
<tr>
<td>CSD</td>
<td>(345) bps</td>
</tr>
<tr>
<td>Still Water (Convenience PET)</td>
<td>(188) bps</td>
</tr>
<tr>
<td>Sparkling / Mineral</td>
<td>(188) bps</td>
</tr>
<tr>
<td>Energy Drinks</td>
<td>(121) bps</td>
</tr>
<tr>
<td>Tea/Coffee – Ready to Drink</td>
<td>134 bps</td>
</tr>
<tr>
<td>Juice – Aisle</td>
<td>236 bps</td>
</tr>
</tbody>
</table>

Source: Consumer Edge research and IRI data. Q4 results for PepsiCo suggest continued market share erosion.

PepsiCo’s Americas business performed poorly in 2013, losing volume and value share to Coca-Cola. Specifically, PepsiCo reported Americas Beverages case volumes down 3% in 2013 compared to flat volumes at Coca-Cola, implying a 300 bps swing. Meanwhile, Coca-Cola’s Americas business grew 3% organically compared to PepsiCo’s 1% decline, implying a 400 bps swing. There is concern in the marketplace that PepsiCo’s business may not recover in 2014 and that trends are deteriorating so quickly that the company does not know how to respond. It goes without saying that this performance cannot continue or the future of PepsiCo’s beverage business will be bleak.
Claims of management price discipline ring hollow in the face of large market share declines

Management defended its loss of market share on recent earnings calls by referencing Coca-Cola’s irresponsible pricing as compared to its own rational pricing. Trian believes that losing vital concentrate sales, while convincing the public that you are not competing on price, is a “death knell” for a beverage company. Longtime industry observers have noted that the beverage industry has never been the “pillar of rational pricing”. CSDs are not a luxury item, not with 90% gross margins on marginal concentrate sales, price sensitive customers and readily available substitutes such as tap water.

PepsiCo’s decision to price higher than Coca-Cola despite share loss is likely driven by one of several factors. Management may fundamentally misunderstand the business. Management may be concerned that PepsiCo has weak brand equities and will lose volume regardless of pricing. In this case, management has decided it is better to increase price and see negative volumes than to risk lowering price and still see negative volumes. Or management may feel compelled to beat short-term EPS targets to alleviate pressure from Wall Street. If the latter, it is disappointing that weak earnings growth in recent years has compounded to the point that management is now making questionable strategic decisions in order to meet EPS targets.

We suspect management understands that they have underperformed and are now on “thin ice” with their constituents. In addition to pricing, we are concerned that management is making other decisions that are good for EPS in the short-term but not good for the business long-term, including bringing the one-time Vietnam gain into core EPS in 2013 (which management will have to lap in 2014, hopefully not by cutting advertising) and selling bottling operations in China and Mexico, which we address below in more detail. These are all examples, in our view, of structure and stubbornness endangering the long-term future of PepsiCo’s beverage business at the expense of its shareholders.

We do not believe that a standalone beverages management team would allow Coca-Cola to take such significant market share and risk impairing PepsiCo’s long-term competitive standing. First, a standalone company would have more ammunition to compete, as savings from eliminated holding company costs could be invested in the brands. Second, a standalone company with less bureaucracy could respond faster to marketplace changes (such as price changes) rather than waiting for corporate management in Purchase to opine.

Pricing dynamics for an oligopoly such as Americas Beverages often replicate a classic “prisoner’s dilemma.” All competitors benefit from rational pricing assuming stable market shares. Each competitor suffers when pricing comes down across the industry. But one company can benefit from dropping price if it takes market share from vulnerable competitors and sustains those gains long-term. Coke appears to be betting that it can take market share from a weakened PepsiCo that lacks focus and is struggling to hit EPS targets.

Lastly, management has hinted on recent earnings calls that Coca-Cola’s N. American market share gains are an example of chasing unprofitable volume. But Coca-Cola’s price/mix was +1% in 2013 in N. America. Moreover, Coca-Cola has grown faster and more profitably in the
region than PepsiCo in recent years. From 2011 through 2013 (the first year following the close of both companies’ bottling acquisitions through the latest quarter), PepsiCo’s Americas Beverage operating profit declined 14% compared to a 1% increase for Coca-Cola in the Americas. Over this same period PepsiCo’s Americas Beverage operating margin declined 129bps, worse than the 87 bps decline for Coca-Cola in the Americas. \(^{xxx}\)

**Beverage share loss and profit erosion are “symptoms;” marketing mishaps and lack of breakthrough innovation are “causes”**

We believe that Coca-Cola has outperformed PepsiCo with respect to marketing, innovation and overall beverage execution in recent years. That is what happens when a management team such as Coca-Cola is universally focused on one consumer segment and one corporate objective, not distracted balancing the interests of two businesses (snacks and beverages) with vastly different opportunity sets and challenges. Headline market share performance is a reflection of individual battles taking place at the category level and behind the scenes in R&D labs. While Coca-Cola has shined with several notable breakthrough innovations, PepsiCo has suffered numerous marketing and innovation lapses.

**Examples of Coca-Cola successes:**

- **Coke Zero:** Only CSD brand launch in recent years to build and hold sustainable market share; has allowed Coke trademark to gain share despite colas losing share as a category over the past decade; has grown fountain volume by more than 30% in each of the last three years. \(^{xxi}\)

- **Simply Orange:** Brilliantly launched by Coca-Cola in 2001 under a different brand than Minute Maid; “boxed in” Tropicana between high priced (Simply Orange) and low priced (Minute Maid) Coca-Cola products; beat Tropicana in introducing the new clear plastic carafe package; has gained roughly equal share vs. Tropicana in introducing the new clear plastic carafe package; has grown fountain volume by more than 30% in each of the last three years. \(^{xxi}\)

- **Freestyle machine:** Touchscreen soda fountain introduced by Coca-Cola in 2009 with breakthrough technology; features over 100 different Coca-Cola drink products and custom flavors; celebrated by retail and restaurant partners as an exciting new way to engage CSD consumers; machines available across the country; Trian was told by PepsiCo management in mid-2012 that PepsiCo would have a competing product and at least 1,000 units in retailers by the end of that year; we have yet to see it in the marketplace. \(^{xxiv}\)

- **PlantBottle:** First recyclable PET plastic beverage bottle made with up to 30% plant material; tangible progress towards addressing industry-wide environmental concerns. \(^{xxv}\)

- **Supply chain:** With demographics changing over time, consumers increasingly prefer non-standard package sizes (e.g., 7.5 oz, 16 oz) to traditional packages such as the 2 L bottle and 12 oz can; we believe that Coca-Cola is up to three years ahead of PepsiCo with respect to “go-to-market” expertise in these faster growing packages; allows for optimal price-pack architecture and price-mix by channel; Coca-Cola can increase its market share by aggressively discounting traditional packages in certain channels while raising prices for others; may explain why Coca-Cola has led the way in promotions in certain parts of the market, held overall pricing stable and outperformed PepsiCo on margin over time; when
we recently raised this topic with the CEO, she admitted PepsiCo was behind and said it was because the company must invest capital to catch up; with an A-rated balance sheet and having now owned its bottlers for many years, we fail to understand why that investment has not been made.

- **Keurig Cold system:** Coke partnered with Green Mountain Coffee Roasters (GMCR) in February 2014; took a 10% position in GMCR for $1.25bn at a market price; will launch the Coke brand through the Keurig Cold at-home beverage system; low-risk way to play the at-home market while gaining a first-mover advantage and having optionality on the future success of Keurig and GMCR; $700m unrealized gain (55% unrealized return) based on GMCR’s significant share price appreciation in the week since the announcement. xxxvi

**Examples of PepsiCo blunders:**

- **Pepsi:** Now the #3 CSD brand after ceding its position as #2 to Diet Coke in 2010; new logo and packaging in 2009 did not move the needle. xxxvii

- **Pepsi Max:** A great tasting product but one that has not been marketed well in our view and therefore has not matched Coke Zero’s success; confusion among consumers as to what “Max” stands for (caffeine, taste?); confusion as to how Max relates to Pepsi’s crowded stable of Diet brands (Diet Pepsi, Pepsi One, Pepsi Next, a new “Natural” Pepsi Next?).

- **Tropicana:** Ceded major market share to Simply Orange; operating challenges trace back to PepsiCo acquisition of Tropicana and relocation to Chicago; lost employees to Coca-Cola; major brand restage in 2009 failed as Tropicana embarrassingly went back to its old label; Tropicana is still using the old “milk carton” label on the new clear plastic carafe (we believe the label looks out of place); Tropicana should be fixed under focused management or sold.

- **Gatorade and SoBe:** Launched G campaign in late 2000s as sales stagnated; we believe the brand restage confused consumers and gave them a reason to experiment with other products, exacerbating sales declines; overall, PepsiCo has lost more than 1,000 bps of sports drinks market share since 2010 (based on IRI data); major market share losses at SoBe. xxxviii

- **Natural sweetener:** Management has overpromised regarding a new natural sweetener breakthrough in recent years. We find it troubling that the CEO commented on last February’s Q4’12 earnings call that “We’re just waiting for the FDA approval... that’s not in our hands, it’s in the government’s hands. Once we get the FDA approval, we’ll be launching posthaste.” Immediately, the company filed an 8-K with the SEC clarifying that the sweetener had not even been submitted to the FDA. More recently, on the Q3’13 earnings call, the CEO commented that the company is still working to ensure the natural sweetener “tastes great.” Pepsi is not a medicine; its only purpose is to satisfy consumer tastes. If the new sweetener does not yet have a good taste profile, we are concerned that the product is unlikely to be successful.

- **Private label:** Recent media reports suggest PepsiCo is considering a test of private label CSDs for Save-A-Lot; while speculation, we would view such a move as an admission that PepsiCo cannot compete and the beginning of the end for its branded products. xxxix Is this why the company purchased its bottlers for $21bn of enterprise value ($17bn excluding the equity that PepsiCo already owned)? x
**Americas Food (38% of overall PepsiCo sales; 73% of total snacks sales) has been forced to subsidize weak beverage trends**

Frito-Lay is one of the best food brands out there, with particular strength in N. America. Snacking is one of the great categories in packaged food given high growth rates, strong margins and limited private label competition. As part of a standalone snacks company, we believe Frito-Lay would be recognized for its differentiated growth potential relative to slow-growth food peers. With that said, Frito-Lay’s growth in recent years has not been as strong as it should have been. We trace the reasons back to Americas Beverages and PepsiCo’s holding company structure.

From 2002-2007, Frito-Lay was thriving. Volumes were growing at a healthy 3% annual rate, organic growth was in the mid-to-high single digits and earnings before interest and taxes (EBIT) margins were stable in the mid-20% range. But beginning in 2007, Americas Beverages volumes turned flat-to-negative, beverage margins declined and PepsiCo was in danger of missing EPS targets. Management first cut advertising in successive years, as previously mentioned. Management also began a five-year stretch, from 2008-2012, of aggressive Frito-Lay price increases (4% on average during a recession). Pricing drove Frito-Lay EBIT margins to peak levels (high 20% range) and PepsiCo hit its EPS targets from 2008-2011. Unfortunately, Frito-Lay volume growth slowed to ~1% annually during this period and the business lost market share.

Frito-Lay saw improvement in 2013 with a healthier mix of pricing (+2%) and volume (+3%). But as previously noted, Americas Beverages volume declines have materially worsened (-3%).

We suspect the pendulum has swung in the other direction and that the majority of PepsiCo’s marketing support is now going towards Frito-Lay. While we are pleased that Frito has returned to growth, PepsiCo cannot continue to oscillate investment dollars between snacks and beverages (i.e., “robbing Peter to pay Paul”) or it risks impairing its brands.

While Frito-Lay delivered terrific third and fourth quarters in 2013, we found it noteworthy that of the combined 14 questions asked during Q&A on the two earnings calls, only two questions were about Frito-Lay. We estimate that the snacks business represents two-thirds of PepsiCo’s overall value. Yet the vast majority of Q&A was spent dissecting beverages. We believe this is yet another indication that investor perception of PepsiCo is negatively colored by the fact that primarily beverage analysts cover the company. Given that beverage companies trade at a discount to snacks companies, and given that investors view Pepsi as a distant number two to Coke in beverages, we believe Frito-Lay’s value is currently obfuscated by PepsiCo’s holding company structure.

When Trian suggested that a standalone Frito-Lay could be valued at a similar multiple to Hershey (25.2x 2014 estimated earnings per share vs. 17.0x for PepsiCo), PepsiCo management argued that our multiple assumption was too high. Perhaps they are right if a standalone Frito-Lay intermittently underperforms its growth potential. But if Frito-Lay is separated, and consistently invested behind, we are convinced that it would grow and be valued in-line with premier global consumer products companies.
While Frito-Lay N. America’s performance has improved, Quaker Oats continues to struggle. Organic growth has declined 1%, on average, and margins have fallen considerably over the past five years.\textsuperscript{xlvi} We understand how Quaker’s health and wellness positioning benefits PepsiCo’s investor / public relations. But Quaker’s operating performance suggests the business is an afterthought in terms of investment priorities. As part of a smaller, focused snacks company, standalone management could choose to allocate additional resources to Quaker and the business may well thrive. Or management may decide the business fits better with a different owner; we can think of at least one obvious merger partner. Under the current structure, we believe PepsiCo management is too distracted to even consider these questions.

**Synergies in other international markets (31% of overall PepsiCo sales outside the Americas) do not justify keeping snacks / beverages together**\textsuperscript{xlvii}

Management argues that it derives significant “Power of One” synergies outside N. America, both overhead savings and increased leverage vis-à-vis retailers. Our due diligence suggests otherwise and we disagree with the notion that international synergies preclude a separation.

**Retailers impose a cost when manufacturers use a strong brand to “drag along” a weak brand.** We have found few examples where PepsiCo derives material advantage with retailers overseas by leveraging scale across beverages and snacks. When PepsiCo does leverage the strength of one brand to benefit another (for example when management uses its strength in snacks to push for beverage shelf space in a country where Pepsi is weak), we have been told that the retailer invariably imposes a cost to “drag along” the weaker brand. More often than not, we believe the cost offsets the benefit.

**PepsiCo snacks and beverages outside N. America developed independently.** Historically, there are very few examples where snacks have materially aided beverages growth internationally and vice-versa. In beverages, Pepsi is a distant #2 and is competitively disadvantaged versus Coke in almost every region of the world. Snacks generally have their strongest positions in countries where PepsiCo acquired a leading local player to gain distribution, such as Walkers and Smith’s. Importantly, in most of PepsiCo’s strongest international snacks markets (e.g., Mexico, Brazil, UK, Spain, Australia), Coke has the stronger position in beverages.\textsuperscript{xlviii}

Pockets of Pepsi beverages strength internationally are generally the result of historical events that gave Pepsi a first mover advantage (Russia and Don Kendall; Middle East and the Arab League blacklist when Coke began selling to Israel). We find it notable that, to this day, PepsiCo lists seven “key strategic markets” outside the U.S. that are its main focus.\textsuperscript{xlix} For six of these seven markets (Russia, Egypt, Saudi Arabia, UAE, UK and Mexico), PepsiCo made a large acquisition or gained a first mover advantage for political reasons.\textsuperscript{l}

**Market share analysis across PepsiCo’s top markets confirms little benefit from Power of One.** Based on a review of Euromonitor data for PepsiCo’s top 25 countries by retail sales, the company’s beverage business has lost market share in 15 countries and its snacks business has lost market share in 11 countries from 2009-2012.\textsuperscript{li} PepsiCo is even losing market share across
the majority of its snacks and beverages portfolios in its self-defined “key strategic markets.” See Appendix H for details.

There is little evidence that “Power of One” drives improved performance around the world. A recent analysis by a third-party research firm concluded that across PepsiCo’s top markets, higher market shares in one business unit (snacks or beverages) has not translated into better organic growth for the other. Said another way, there does not appear to be statistical data supporting the claim that in countries where either beverages or snacks has a market leading presence, the other category is more likely to gain market share over time. See Appendix I for details.

**China and Mexico bottling deals limit scope of “Power of One” synergies.** In 2011, PepsiCo announced agreements to contribute its Chinese and Mexican bottling operations to partners in exchange for small equity interests. These transactions had several near-term benefits, as PepsiCo was reportedly losing $180mm annually in China and the business was going to require significant plant capital expenditures.iii We suspect the company may not have hit short-term EPS targets had management retained these businesses. But Trian is on record stating PepsiCo may have mortgaged its future by relinquishing control of its brands in these two key strategic markets. Mexico is the largest beverage market in the world in terms of per capita CSD consumption.ili China is projected to become the world’s largest beverage market in total sales by 2015.iv

Regardless of whether these transactions were the right strategic moves, selling to bottlers in China and Mexico means that PepsiCo will derive minimal operating synergies between snacks and beverages in these markets going forward. If PepsiCo is so willing to give up the potential for synergies in two of the biggest and fastest growing countries in the world, we are hard pressed to believe that operating synergies elsewhere in the world are material.

**Snacks and beverages each generate strong free cash flow on their own to support emerging markets investment.** Another management argument as to why snacks and beverages cannot be separated is that the company needs the strong cash flow generated in the U.S. and other developed markets to support emerging markets growth. However, we believe it is clear that standalone snacks and beverage companies, each with $30bn+ in sales and leading brands, would generate significant free cash flow on their own to fund growth investments. Moreover, we do not believe the availability of capital is the gating item with respect to growth in many of these markets. For example, Frito-Lay has been unsuccessful in materially penetrating countries like China because consumer tastes differ. Being successful in these markets requires new approaches and ideas, not simply more dollars to invest. We believe focused management teams dedicated to growing their businesses are more likely to find breakthrough ideas.

**The “global beverage war” ended long ago.** The “global war” to win #1 share was settled long ago in almost every major beverage market. Coca-Cola has the stronger position across most of the globe while PepsiCo has areas of regional strength. lv That is not to say that Coke and Pepsi don’t fight for share on a daily basis but simply that leadership positions have generally been determined. The few areas of the world where the top market share position is still being
contested are select developing markets where companies are fighting as much to gain consumer acceptance of their products as they are to gain share from each other.

*Despite operating in more than 200 countries, PepsiCo generates the majority of its sales and profits from a handful of markets.* Within snacks, the company’s top 10 countries represent 85% of total PepsiCo snacks retail sales. Within beverages, the company’s top 10 countries represent 80% of total PepsiCo beverage retail sales.\(^{lvi}\) As for the other ~190 countries, we believe there are some markets where PepsiCo does not earn its cost of capital, there is little hope for growth, they require dedicated management oversight and the company should exit. Operations in certain of these markets date back to a time when managements simply “planted flags” around the world.

*PepsiCo’s 10.1% EBIT margin outside the Americas suggests significant opportunity.* PepsiCo’s EBIT margin outside the Americas is only 10.1% after allocation of corporate expense and backing out the one-time Vietnam refranchising gain, a level comparable to companies with commoditized product lines.\(^{lvii}\) That is an extremely low margin for a $20bn+ revenue business where a significant portion of sales comes from beverage concentrates, snacks and mature markets in Europe. Coca-Cola Enterprises has a 13% EBIT margin, operating as a European bottler.\(^{lviii}\) Coca-Cola has a 29% EBIT margin outside the Americas, with a mix of bottling and concentrate revenues.\(^{lix}\) Snacks companies tend to have mid-to-high teens EBIT margins internationally. We believe that PepsiCo’s international margins should be significantly higher than they are today.

In addition to margin, we note that the total amount of EBIT generated across half of the globe (Asia, Middle East and Africa segment) is 15% less than PepsiCo’s unallocated corporate overhead when backing out the Vietnam gain.\(^{lx}\) While PepsiCo may lose modest overhead savings between snacks and beverages should the businesses be separated, we believe these “costs” can be more than offset by running PepsiCo’s global business units more efficiently.

*Inability to build Frito-Lay into a global brand:* While Frito-Lay has a leading position in the U.S., PepsiCo has not leveraged that strength by building Frito-Lay into a truly global brand. PepsiCo still goes to market in snacks through different local brands around the world (Walkers, Sabritas, Smith’s, etc.). When we raised this with the CEO recently, she defended PepsiCo’s historical strategy by stating that packaging for snacks in many countries around the world is uniform. Our response was that best-in-class consumer products companies have been those that have built global brands – not “global bags.” A successful strategy that competitors have employed is to enter global markets by buying a local brand in the same category, shortly thereafter introduce their own brand (usually at a premium price-point) and slowly build up their own brand equity over time. We believe the inability to turn Frito-Lay into a powerful global brand has been a lost opportunity at PepsiCo.
Numerous benefits achieved from separating snacks and beverages

Elimination of an entire layer of corporate overhead. We believe PepsiCo’s holding company structure is one of the reasons why its margins are hundreds of basis points lower than peers. PepsiCo’s “core” corporate unallocated expense was $1.1bn in 2013, excluding pension expense and depreciation allocated to corporate. This is the unallocated amount of corporate only; it is our belief that allocated corporate, which is not publicly disclosed, represents a much higher number. We do not believe that holding back this information under the guise of competitive disadvantage is reasonable and we challenge PepsiCo to provide full transparency to shareholders on the total amount of corporate spending, both allocated and unallocated.

If you multiply the company’s $1.1bn of unallocated corporate costs (which would be eliminated if the businesses were separated) by 11x (PepsiCo’s multiple of enterprise value / 2014 earnings before interest, taxes, depreciation and amortization (EBITDA)), it costs shareholders $12bn of value, or $8 per share, to have beverages and snacks together in a holding company structure. If you also added the portion of corporate costs actually allocated to the segments (we estimate at least as much as the unallocated cost), the cost per share is likely much greater than $8. We would be willing to pay that per share cost in return for PepsiCo consistently delivering better growth and margins than competitors in each of its businesses. Given PepsiCo has delivered inferior results over many years, we believe the holding company structure should be eliminated along with the related costs. These savings can provide standalone management with funds to reinvest in the brands and drive profits, creating a multiplier effect in building long-term shareholder value.

“Blank sheet of paper” approach can fully offset dis-synergies. Management has claimed that potential dis-synergies from separating beverages and snacks could be as much as $0.8-1.0bn. If management is correct, this represents only 7% of PepsiCo’s consolidated EBITDA, a small price to pay if it drives improved long-term performance.

Trian believes these dis-synergies can be fully offset. First, management can take responsive action by instituting joint purchasing co-ops, cost sharing agreements and even third-party co-promotions (e.g., what Pepsi has accomplished with Budweiser or Coke has recently undertaken with Nabisco). Second, based on Trian’s experiences with corporate spin-offs, initial estimates for dis-synergies can be more than 100% offset by cost savings identified through a “blank sheet of paper” process (see: “Precedent corporate spin-offs have unlocked significant value” below). Management starts with a clean slate and designs from scratch what an ideal corporate structure would look like, what personnel would be needed, how the manufacturing base and supply chain would be designed and how the company would go to market. This approach combines a top-to-bottom strategic review with a rigorous “zero based budgeting” process. The results of this process have been powerful.

We believe management is looking at a separation the wrong way. Rather than focusing on dis-synergies, management should realize that a transformative transaction (such as a separation) provides an opportunity to make investments, and incur related one-time charges, that set up both standalone companies for long-term success. Although these investments provide
attractive paybacks, the associated restructuring charges are often difficult to incur in the ordinary course without a transaction.

**Closing of at least one major corporate headquarters.** When it comes to managing costs, we believe the tone must be set at the top. PepsiCo’s Purchase headquarters is one of the most extraordinary corporate centers in America. It sits on more than 100 acres in Westchester County. Nevertheless, management has recently committed to a $240mm renovation project. These are dollars that could have been invested in the brands. Meanwhile, PepsiCo has two other major corporate centers in the U.S.: one for beverages (Somers, NY) and one for snacks (Plano, TX), plus an additional corporate center in Chicago that houses Quaker Oats and Tropicana. Separating beverages and snacks means at least one major corporate center can be eliminated. Purchase is the logical choice given that is where the majority of corporate staff sits. New standalone management teams could further consider moving food and beverage operations in Chicago to Plano and Somers, respectively. That would leave two corporate centers in the U.S., versus four currently.

**Eliminating corporate bureaucracy empowers management and speeds decision-making.** Perhaps the most important benefit that arises when excess layers of corporate overhead are eliminated is that streamlined organizations operate more efficiently.

Trian believes that those operating the business units should make key strategic decisions. Corporate staff in Purchase should not decide how many marketing dollars are spent by snacks and beverages nor how to price. Corporate staff in Purchase should not decide where R&D dollars are spent. Are the corporate employees smarter than the senior executives tasked with running the business units? If the answer is yes, PepsiCo needs to hire smarter business leaders. If the answer is no, as we suspect, corporate staff in Purchase should get out of the way.

In a recent meeting with PepsiCo management, the CEO of Americas Foods encouraged Trian to speak with retailers and solicit opinions on the benefits of “Power of One.” We took him up on the offer and recently spoke with the most senior merchandising official at one of the largest U.S. retail chains. Here is the unfiltered commentary we received back: “Pepsi is slow to act and cannot make decisions.” One story referenced was how PepsiCo was recently given the first opportunity to sponsor a major promotion, headlined by Pepsi and Frito-Lay (a chance for “Power of One” to shine). PepsiCo did not respond quickly enough, at which point the executive said that “Coke swooped in” and seized the opportunity, co-promoting Coke’s beverage brands with Wise potato chips. Needless to say, Coca-Cola did not need to own Wise to create an effective partnership.

**Precedent corporate spin-offs have unlocked significant value**

The Bloomberg U.S. Spin-Off Index, representing companies that were recently spun-off from a parent, has generated a 286% total return versus 148% for the S&P 500 over the past five years. We believe the reasons are obvious: greater focus, reduced complexity and
Empowered management teams drive improved operating performance over time. Several recent examples of successful spin-offs highlighted below are directly applicable to PepsiCo.

**Yum! Brands.** In 1997, PepsiCo spun-off its quick service restaurant business (Tricon Global Restaurants) to focus exclusively on snacks and beverages. At the time, Tricon was viewed as competitively disadvantaged versus McDonalds in terms of global brands and financial firepower. But 15 years later, Tricon (renamed Yum! Brands) has significantly outperformed McDonalds across virtually every key metric. Since the spin-off, Yum’s market capitalization has appreciated 582% (vs. 189% for McDonalds) and its EPS has appreciated 788% (vs. 377% for McDonalds). We believe the reason is focused management and aggressive capital deployment, particularly in emerging markets. Would Yum have been as successful (and would it have built a Chinese business worth tens of billions of dollars) had it been part of PepsiCo these past 15 years? We think not. We credit the PepsiCo Board with taking bold action by separating Yum in the 1990s.

**Pepsi Bottling Group.** In 1999, PepsiCo did an initial public offering (IPO) of the Pepsi Bottling Group (PBG) citing numerous benefits, the most important of which was removing a capital intensive, low-margin bottling business while allowing for continued coordination of commercial activities. Ten years later, the beverage landscape had changed and current PepsiCo management decided to repurchase its two largest bottlers (PBG and PepsiAmericas) for a total enterprise value of $21bn. During the decade that PBG was independent, something amazing happened: PBG delivered 217% stock price appreciation (adjusted for stock-splits) from the date of the IPO through the repurchase, more than 4x the 51% increase that PepsiCo delivered to its own shareholders over the same period from 1999 through 2009. The fact that PepsiCo’s own bottler outperformed its parent despite higher capital intensity, an inferior business mix, no exposure to fast growth snacks and limited exposure to fast growth emerging markets is a resounding testament to the benefits of focus. That is why we believe so passionately in what standalone management can accomplish when they are “handed the keys” to their business.

At a fall 2013 meeting with PepsiCo’s leadership team, the CEO told Nelson that repurchasing the bottlers was a “mistake” but the bottlers were “in disarray.” First, we believe it is management’s job to ensure the bottling system is strong and the relationships between the parent and its bottlers are productive. Second, we have heard that the idea of repurchasing the bottlers first arose when PBG asked PepsiCo for permission to buy PepsiAmericas on its own. PBG management felt it could drive substantial synergies from the combination. We have been told that PepsiCo management believed that those synergies could help prop up PepsiCo’s own earnings and that is one of the significant reasons why the decision was made to buy the bottlers. Regardless of the history, a $21bn “mistake” ($17bn excluding the equity PepsiCo previously owned in the bottlers) is difficult for shareholders to accept under any circumstances.

Not only did a focused PBG management team deliver superior performance during its period of independence but, at the very end, they crystallized significant value for their shareholders through a major transaction. As for PepsiCo, at the time of the bottling acquisitions in 2009,
management promised the transactions would be accretive, provide synergies that could be reinvested back in the brands and allow PepsiCo to “take to a whole new level our ‘Power of One’ program of bundled food and beverage offerings” (PepsiCo press release, 4/20/09). Only three years later, in 2012, PepsiCo was forced to conduct a major EPS re-set as beverage performance – in particular the bottling assets acquired from PBG and PepsiAmericas – had declined precipitously and the company needed to find additional funds for reinvestment.

**Dr Pepper Snapple Group.** One of the primary reasons cited as to why snacks and beverages should not be separated is that a standalone PepsiCo beverage business cannot compete effectively against Coca-Cola. We disagree. First, we have already demonstrated that PepsiCo has not competed effectively against Coca-Cola for many years, even with snacks in its arsenal. Second, we would point to Dr Pepper Snapple as a company that has shined since it was spun-off from Cadbury in 2008 (in the middle of a financial crisis) and has outmaneuvered both Coke and Pepsi over the past five years.

Prior to 2008, critics had said that Dr Pepper Snapple would struggle to compete against larger beverage competitors with superior brands and resources. While Dr Pepper Snapple had an advantaged CSD portfolio with strength in flavors, it was viewed as overexposed to N. American CSDs and its non-CSD portfolio was considered weak. But within a short period of time, management had significantly reduced corporate expense and begun a process of reinvesting in its brands (driving advertising and marketing from 6% of sales in 2008 to 8% of sales last year). Over the ensuing five years, Dr Pepper Snapple outperformed both Coca-Cola and PepsiCo in terms of CSD share gains, operating margin improvement and total shareholder returns.

In 2013, Dr Pepper Snapple delivered 10% constant currency EPS growth. In 2014, Dr Pepper Snapple is guiding to 6-8% constant currency EPS growth. These results are projected to be slightly better than what PepsiCo will deliver, despite the fact that Dr Pepper has no exposure to the fast growth snacks business and limited exposure to faster growth international beverage markets. Said another way, Dr Pepper is delivering better performance than PepsiCo despite the fact that it is almost exclusively exposed to Americas Beverages – PepsiCo’s most challenged market. This is another stark example of the benefits of focus.

What happened to Dr Pepper Snapple’s parent company, Cadbury? Standalone Cadbury management, free to focus exclusively on optimizing its confectionary business, eliminated layers of corporate overhead, delivered 28% annual EBIT growth and improved margins by 380 bps from 2007 through 2009. Cadbury was ultimately acquired by Mondelez for a 49% premium in a cash/stock transaction and is now part of a global snacks powerhouse. 

**Separating snacks and beverages increases probability of a valuation multiple re-rating**

In addition to the operating and cultural benefits of a separation, we strongly believe standalone snacks and beverage companies, positioned correctly to the market, will trade to a higher blended valuation multiple than PepsiCo trades at today.
A standalone snacks business offers investors a compelling growth story combined with strong margins and free cash flow generation. Moreover, focused consumer staples companies, particularly snacks businesses, can trade at as much as a 40% premium to diversified peers. This is the case for focused large cap companies (Hershey, with a market cap of $23bn, trades at 25.2x PE, a premium to diversified food and beverage companies such as PepsiCo at 17.0x PE) and focused mega-cap companies (L’Oreal, with a market cap of $74bn, trades at 22.7x PE, a premium to diversified personal care companies such as P&G at 17.6x PE).

Meanwhile, a standalone beverage business offers investors lower growth but strong, stable free cash flow that can be optimized through an efficient balance sheet and capital return program. Kraft Foods Group, perceived to be a slow growth N. American grocery business recently spun-off from Mondelez, trades at a premium multiple to many large-cap food peers based on similar positioning. We believe PepsiCo’s beverage business can be stronger than Kraft Foods’ grocery business.

Summary

Recent reports and management commentary have hinted at several structural alternatives that PepsiCo could consider beyond a full separation. One notion is to further integrate beverages and snacks, potentially even combining distribution, in an attempt to create synergies. Given the deterioration in culture and poor operating performance that we believe have accompanied previous integration efforts and “Power of One” programs, we view this approach as fraught with risk. It should come as no surprise that Trian does not support any action that further entangles the businesses and blurs the lines of accountability.

We foresee a full separation driving much higher value for shareholders over time than other alternatives, even assuming management executes its plan of high single digit EPS growth in the current structure. But we are concerned that PepsiCo will not execute its plan. As we have shown, EPS growth in recent years has been well below public targets and that of peers. We question the quality of earnings in 2013 given one-time items and tax, while we view 2014 EPS guidance as weak. Results are particularly disappointing following a major EPS re-set in 2012 that was intended to re-ignite growth. The profit growth that PepsiCo has generated over the past seven-plus years has too often been driven by price increases and advertising reductions. If PepsiCo continues down this path, we foresee an ongoing cycle whereby management intermittently re-sets EPS lower, delivers several years of unsustainable growth, only to re-set EPS yet again when brand reinvestment is inevitably needed.

As PepsiCo represents one of the largest positions in our portfolio, Trian has a vested interest in the future of the company’s businesses and brands. We take pride in our standing as a long-term shareholder of companies where we seek to work constructively with the Board and management to implement strategic and operating initiatives to enhance value. We would not recommend a separation of the snacks and beverage businesses if we were not convinced that it is the best path forward for PepsiCo, its brands and shareholders for the long-term.
Appendix A: Total Shareholder Returns vs. Peers

- Total shareholder returns have significantly underperformed snacks and beverages peers over an extended period of time.

Source: Bloomberg and Capital IQ through February 14, 2014. Total returns include dividends. Consumer Staples Index represents the Consumer Staples Select Sector Index (XLP), estimated by using Consumer Staples Select Sector SPDR Fund (XLP).

Note: The estimates, projections, pro-forma information and potential impact of Trian’s ideas set forth herein are based on assumptions that Trian believes to be reasonable, but there can be no assurance or guarantee that actual results or performance of the Issuer will not differ, and such differences may be material. The above example is merely illustrative. Market conditions at the time of the events reflected above may differ materially from current and future market conditions. The performance of this example should therefore not be construed as an indication of the Issuer’s performance. This presentation does not recommend the purchase or sale of any security.

(1) As of October 2008 when PepsiCo’s current leadership team took over, Dr Pepper Snapple was not public throughout the entire timeframe.
Appendix B: Margins Relative to Peers

- PepsiCo EBIT margin before advertising expense is well below the peer group.
- Though PepsiCo does not disclose its international beverage margin (1/3 of beverage sales), we estimate its global beverage business has a 12% EBIT margin – well below beverage peers.
- Even Coca-Cola Enterprises has a higher margin despite its lack of concentrate revenue (albeit European bottling is more profitable than US bottling).

**2013 EBIT Before Advertising: % of Net Sales**

<table>
<thead>
<tr>
<th>Company</th>
<th>EBIT Margin</th>
</tr>
</thead>
<tbody>
<tr>
<td>Coca-Cola</td>
<td>31%</td>
</tr>
<tr>
<td>Dr Pepper Snapple(1)</td>
<td>27%</td>
</tr>
<tr>
<td>Hershey</td>
<td>27%</td>
</tr>
<tr>
<td>PepsiCo</td>
<td>19%</td>
</tr>
<tr>
<td>Mondelez</td>
<td>17%</td>
</tr>
<tr>
<td><strong>Peer Average</strong></td>
<td><strong>26%</strong></td>
</tr>
</tbody>
</table>

*We look at EBIT before advertising because, with the reduction in advertising in recent years, PepsiCo now spends far less on advertising than snacks and beverage peers.

**PepsiCo Estimated 2013 Beverages Margin vs Beverages Peers**

<table>
<thead>
<tr>
<th>Company</th>
<th>EBIT Margin</th>
</tr>
</thead>
<tbody>
<tr>
<td>Coca-Cola</td>
<td>24%</td>
</tr>
<tr>
<td>Dr Pepper Snapple</td>
<td>19%</td>
</tr>
<tr>
<td>CCE</td>
<td>13%</td>
</tr>
<tr>
<td>PepsiCo Global Beverages (Trian Estimate)(2)</td>
<td>12%</td>
</tr>
<tr>
<td><strong>Peer Average</strong></td>
<td><strong>18%</strong></td>
</tr>
</tbody>
</table>

*We do not include EBIT before advertising comparisons for beverage because PepsiCo does not break down advertising between snacks and beverages. We believe PepsiCo has reduced beverage advertising more than peers in recent years.*

Source: SEC filings and Wall Street research.

Note: The estimates, projections, pro-forma information and potential impact of Trian’s ideas set forth herein are based on assumptions that Trian believes to be reasonable, but there can be no assurance or guarantee that actual results or performance of the issuer will not differ, and such differences may be material. The above example is merely illustrative. Market conditions at the time of the events reflected above may differ materially from current and future market conditions. The performance of this example should therefore not be construed as an indication of the issuer’s performance. This presentation does not recommend the purchase or sale of any security. Note: Mondelez, Dr Pepper and Coca-Cola have not filed their 10-K as of the date of this presentation and have not commented on change in advertising spend. Accordingly, Trian has assumed the companies spent the same percentage of sales on advertising as they had done in 2012.

(1) All companies add back only advertising expense except Dr Pepper Snapple. Dr Pepper Snapple only discloses "Advertising and Marketing Production Costs Related to TV, Print, Radio and Other Marketing investments" so this figure is added back to operating income.

(2) Represents 2013 Trian estimates. Beverage revenue and EBIT in EMEA, Middle East and Africa (AMEA) segments allocated per Trian estimates and Wall St. research. Corporate costs are allocated as a percentage of revenue.
Appendix C: EPS Growth Has Trailed Peers From 2006-2013

- EPS has grown at a significantly lower rate than the consumer staples index and key competitors like Coca-Cola.
- EPS has only grown 19% in total over the past five years (3% CAGR)\(^{(1)}\)

---

**PepsiCo Adjusted EPS Has Stalled...**

**...And EPS Growth\(^{(2)}\) Has Trailed Peers**

![Graph showing EPS growth of PepsiCo and peers compared to consumer staples index.](image)

### Source: Company SEC Filings and Bloomberg

Note: The estimates, projections, pro-forma information and potential impact of Trian's ideas set forth herein are based on assumptions that Trian believes to be reasonable, but there can be no assurance or guarantee that actual results or performance of the issuer will not differ, and such differences may be material. The above example is merely illustrative. Market conditions at the time of the events reflected above may differ materially from current and future market conditions. The performance of this example should therefore not be construed as an indication of the issuer's performance. This presentation does not recommend the purchase or sale of any security.

1. Compounded annual growth rate
2. Represents 2006 – 2013 total EPS growth
3. Dr Pepper Snapple EPS since first annual public data (12/31/2008). CCE 2006 EPS adjusted to reflect impact of special dividend.
Appendix D: Despite 2012 EPS Reset, 2013 EPS Growth was Below Peers

- PepsiCo reset EPS in 2012 to $4.10, well below prior consensus expectations of $5.00, partly due to $500-$600m in additional brand support
- Despite the reset and significant brand investment, 2013 EPS grew only 7%, when normalized for tax, below the peer average and at the low-end of PepsiCo’s long-term guidance (“high single digit EPS growth”)
- Excluding the gain related to refranchising the Company’s bottling operations in Vietnam, EPS increased only 5%
- As a result, 2013 EPS is 1% lower than 2011 levels (3% below excluding the Vietnam gain)

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Research Commentary on Q2 2013 Earnings Results (Including Vietnam Gain)

"Recurring" Beat Driven by ‘One-time’ Gain? Same Guidance Costs More... We found the company’s inclusion in ‘core’ of this one time item [Vietnam gain] as rather bothersome. We were particularly disappointed that we did not get the opportunity to ask about this issue – and several others – on the abridged conference call. (Bernstein, 7/25/13)

"PepsiCo is now guiding to ~5% FX neutral EPS growth (ex Vietnam benefit) lapping 5% declines a year ago... When considering that profits excluding savings programs will be down $400-$500mm in each of 2013 and 2014, it is hard to see how PEP has earned the right to trade in-line to above the global consumer staples space... PepsiCo argues that it does not need a large scale transaction and that its portfolio is well placed for growth but its financial results don’t prove that out. As presented above, while PepsiCo’s sales are growing in-line with the staples group, it’s costing more than all of its savings to deliver. In our view, this is an unsustainable long-term financial equation... Given what we see as low-quality earnings, we would prefer to put money to work elsewhere." (Consumer Edge, 7/25/13)

Source: Capital IQ and SEC Filings.

Note: The estimates, projections, pro-forma information and potential impact of Trian’s ideas set forth herein are based on assumptions that Trian believes to be reasonable, but there can be no assurance or guarantee that actual results or performance of the Issuer will not differ, and such differences may be material. The above example is merely illustrative. Market conditions at the time of the events reflected above may differ materially from current and future market conditions. The performance of this example should therefore not be construed as an indication of the Issuer’s performance. This presentation does not recommend the purchase or sale of any security.

(1) Assumes 2013 effective tax rate is equal to 2012 tax rate
(2) Peers include Coca-Cola, Dr Pepper Snapple, Mondelez, Hershey and Coca-Cola Enterprises.
Appendix E: Advertising & Marketing Decline Over Time and Impact on EPS

- Advertising fell from 7.7% of sales in 2006 (8.7% in 2005) to 6.5% in 2009. It fell by an additional 34 bps from 2009-2011, even adjusting for the acquisition of the Pepsi Bottling Group (PBG), PepsiAmericas (PAS) and Wimm-Bill-Dann (WBD).
- Had advertising as a percentage of sales been held constant at 2006 levels (adjusting for the mix impact from acquisitions), EPS would have grown only 39% from 2006-2013 – 700 bps lower than reported EPS growth.

### Actual Advertising and Other Marketing

<table>
<thead>
<tr>
<th></th>
<th>2005</th>
<th>2006</th>
<th>2007</th>
<th>2008</th>
<th>2009</th>
<th>2010</th>
<th>2011</th>
<th>2012</th>
<th>2013</th>
</tr>
</thead>
<tbody>
<tr>
<td>Revenue</td>
<td>$32,144</td>
<td>$35,137</td>
<td>$39,474</td>
<td>$43,251</td>
<td>$43,232</td>
<td>$57,839</td>
<td>$65,081</td>
<td>$66,492</td>
<td>$66,415</td>
</tr>
<tr>
<td>Advertising and Other Marketing</td>
<td>2,800</td>
<td>2,700</td>
<td>2,800</td>
<td>2,800</td>
<td>2,800</td>
<td>3,400</td>
<td>3,500</td>
<td>3,700</td>
<td>3,800</td>
</tr>
<tr>
<td>Advertising % of Sales</td>
<td>8.7%</td>
<td>7.7%</td>
<td>7.3%</td>
<td>6.7%</td>
<td>6.5%</td>
<td>5.9%</td>
<td>5.3%</td>
<td>5.6%</td>
<td>5.9%</td>
</tr>
</tbody>
</table>

### Pro Forma Advertising Spend if 2006 Levels Held Constant

<table>
<thead>
<tr>
<th></th>
<th>2006 Advertising % of Sales</th>
<th>2009 Advertising % of Sales</th>
<th>Mix Impact of Acquisitions</th>
<th>2009 Advertising % of Sales Adjusted For Acquisition x Revenue</th>
</tr>
</thead>
<tbody>
<tr>
<td>2006</td>
<td>7.7%</td>
<td>7.7%</td>
<td>0.0%</td>
<td>7.7%</td>
</tr>
<tr>
<td>2009</td>
<td>7.7%</td>
<td>7.7%</td>
<td>0.0%</td>
<td>7.7%</td>
</tr>
<tr>
<td>Mix Impact of Acquisitions</td>
<td>0.0%</td>
<td>0.0%</td>
<td>0.0%</td>
<td>-1.0%</td>
</tr>
<tr>
<td>2009 Advertising % of Sales Adjusted For Acquisition</td>
<td>7.7%</td>
<td>7.7%</td>
<td>0.0%</td>
<td>6.7%</td>
</tr>
<tr>
<td>x Revenue</td>
<td>$35,137</td>
<td>$39,474</td>
<td>$43,251</td>
<td>$43,232</td>
</tr>
<tr>
<td>Advertising and Other Marketing at 2006 Levels</td>
<td>$2,700</td>
<td>$3,033</td>
<td>$3,323</td>
<td>$4,322</td>
</tr>
<tr>
<td>2006</td>
<td>$3,033</td>
<td>$2,700</td>
<td>$3,033</td>
<td>$2,700</td>
</tr>
<tr>
<td>2009</td>
<td>$3,323</td>
<td>$3,033</td>
<td>$3,323</td>
<td>$3,033</td>
</tr>
<tr>
<td>Reduction in Advertising Spend</td>
<td>0 (133)</td>
<td>-133</td>
<td>523</td>
<td>400</td>
</tr>
<tr>
<td>Less Tax Effect</td>
<td>0</td>
<td>-133</td>
<td>144</td>
<td>132</td>
</tr>
<tr>
<td>Effective Tax Rate</td>
<td>26.0%</td>
<td>27.6%</td>
<td>26.9%</td>
<td>26.5%</td>
</tr>
<tr>
<td>Net Reduction in Advertising Spend</td>
<td>0</td>
<td>(99)</td>
<td>(310)</td>
<td>(388)</td>
</tr>
<tr>
<td>Shares</td>
<td>1,687</td>
<td>1,588</td>
<td>1,602</td>
<td>1,577</td>
</tr>
<tr>
<td>Net Reduction in Advertising Spend Per Share</td>
<td>$0.00</td>
<td>$0.06</td>
<td>$0.19</td>
<td>$0.25</td>
</tr>
</tbody>
</table>

### Core EPS Adjusted for Constant Advertising

<table>
<thead>
<tr>
<th></th>
<th>2006</th>
<th>2007</th>
<th>2008</th>
<th>2009</th>
<th>2010</th>
<th>2011</th>
<th>2012</th>
<th>2013</th>
</tr>
</thead>
<tbody>
<tr>
<td>Core EPS</td>
<td>$3.00</td>
<td>$3.38</td>
<td>$3.68</td>
<td>$3.71</td>
<td>$4.13</td>
<td>$4.40</td>
<td>$4.10</td>
<td>$4.37</td>
</tr>
<tr>
<td>Growth</td>
<td>-17.6%</td>
<td>-8.9%</td>
<td>-8.9%</td>
<td>-11.3%</td>
<td>-6.5%</td>
<td>-8.6%</td>
<td>-6.6%</td>
<td>-6.6%</td>
</tr>
<tr>
<td>Net Reduction in Advertising Spend Per Share (2006 Levels)</td>
<td>$0.00</td>
<td>$0.06</td>
<td>$0.19</td>
<td>$0.25</td>
<td>$0.22</td>
<td>$0.37</td>
<td>$0.27</td>
<td>$0.21</td>
</tr>
<tr>
<td>EPS Normalized for Advertising Spend</td>
<td>$3.00</td>
<td>$3.32</td>
<td>$3.49</td>
<td>$3.46</td>
<td>$3.91</td>
<td>$4.03</td>
<td>$3.83</td>
<td>$4.10</td>
</tr>
<tr>
<td>Growth</td>
<td>-17.6%</td>
<td>-8.9%</td>
<td>-8.9%</td>
<td>-11.3%</td>
<td>-6.5%</td>
<td>-8.6%</td>
<td>-6.6%</td>
<td>-6.6%</td>
</tr>
</tbody>
</table>

### Analysis of Acquisitions Impact on Advertising

<table>
<thead>
<tr>
<th></th>
<th>PepsiCo</th>
<th>PBG</th>
<th>PAS</th>
<th>WBD</th>
<th>Pep Adj</th>
<th>PepsiCo (Loss)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Revenue</td>
<td>43,232</td>
<td>13,219</td>
<td>4,421</td>
<td>2,181</td>
<td>63,063</td>
<td>65,881</td>
</tr>
<tr>
<td>Adjustment as a Result of Being Acquired</td>
<td>0 (2,406)</td>
<td>(395)</td>
<td>0</td>
<td>(3,401)</td>
<td>0</td>
<td></td>
</tr>
<tr>
<td>PF Revenue</td>
<td>43,222</td>
<td>13,183</td>
<td>4,226</td>
<td>2,181</td>
<td>60,062</td>
<td>65,881</td>
</tr>
<tr>
<td>2009 Advertising &amp; Marketing</td>
<td>2,800</td>
<td>315</td>
<td>120</td>
<td>140</td>
<td>3,373</td>
<td>3,900</td>
</tr>
<tr>
<td>% of Sales</td>
<td>6.5%</td>
<td>2.6%</td>
<td>3.5%</td>
<td>6.4%</td>
<td>6.7%</td>
<td>6.3%</td>
</tr>
<tr>
<td>Change</td>
<td>-34 bps</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
</tbody>
</table>
Appendix F: PepsiCo Has Increasingly Touted Power of One Initiatives (Quotes from Management)

"Power of One is emerging as a significant competitive advantage for PepsiCo in North America. PepsiCo offers multiple go-to-market systems and flexibility to our customers. This enables us to match the right products to the right system, while our scale reduces costs. Our ability to integrate everything we know about our customer, the consumer of our brand, and who is shopping in each of our customer's stores gives us a decided insight advantage." (10/23/2006)

"We think we have...distinct capabilities at PepsiCo that give us a competitive advantage in the marketplace...We have Power of One sales organizations that bring the scale of this entire portfolio together, so that we can have collaborative summits with our retailers in terms of how to bring this pipeline of innovation together through our retailers, together in a powerful way...Power of One is more than a catchy phrase. It's a way in which we do business every day at PepsiCo, all around the world." (02/20/2008)

"In terms of Power of One. In the past we talked about Power of One strictly in terms of bundled offering in the store but I think there's so much more we can do to align merchandising efforts across beverages and snacks, think about how to improve the service to customers by aligning our supply chains even more closely. We could improve the speed, flexibility with which we respond to consumer...So we have a whole team that's working on this. We're not just calling it Power of One. We're talking about the power of Power of One." (2/11/2010)

"With the acquisition of the bottling company, we can take Power of One into areas we've never done before...Across beverages, we can now become more agile, flexible, nimble. We can do things much faster, we can cut out redundant costs. We can just become a lean machine there...Across PepsiCo, we can do a lot more product-sized bundles, a lot more bundling with Frito-Lay. But more importantly, we can also do things like putting a merchandiser in-store to merchandise all PepsiCo categories in prime time when out-of-stocks are high...So the power of Power of One, I think, is going to result in increased growth in the top line, improved service levels to the customer, and reducing costs." (3/22/2010)

"PepsiCo's value is maximized as one Company. ...First, it provides compelling cost leverage across the value chain from R&D, procurement, consumer insight, sales, merchandising, back-office functions...Second, it enables us to accelerate in-market growth. Because in-market we benefit from the coincidence of snack and beverage consumption locations...The third reason is that our operation as one Company enables us to share capabilities across geographies and sectors and allows us to attract better talent." (2/9/2012)

"We think the benefit of having the global snack and beverage business together is north of $900 million, so $800 million to $1 billion of synergies created by virtue of having those two together, and that's purely based on the cost side of it. It doesn't account for any -- at the revenue and the longer-term strategic benefits as well. So as we think about these things, same consumers, same customers, shared R&D, oftentimes shared elements of the supply chain, we think there's real tangible advantage in the short term, and we think there are significant strategic advantage to the complementarity of the portfolio over the longer term." (2/21/2013)

Source: PepsiCo management speaking on 2006-2013 conference calls.
Appendix G: Cost Savings: A Power of One Myth?

<table>
<thead>
<tr>
<th>Claimed Synergies:</th>
<th>Trian Response:</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Procurement</strong></td>
<td>- Limited ingredient overlap between snacks and beverages</td>
</tr>
<tr>
<td></td>
<td>- Limited benefits to scale in packaging between buying aluminum cans, plastic and glass bottles vs. flexible plastic</td>
</tr>
<tr>
<td></td>
<td>- Standalone snacks and beverages companies would have purchasing clout (each has $30bn+ in global sales)</td>
</tr>
<tr>
<td></td>
<td>- Can still joint-purchase; PepsiCo/AB In Bev precedent for indirect goods/services</td>
</tr>
<tr>
<td><strong>Shared Corporate Functions, Back Office and Infrastructure</strong></td>
<td><strong>- As evidenced by PepsiCo’s low margins, shareholders lose any benefit of shared infrastructure and functions as a result of excess holding company bureaucracy and costs. In Trian’s experience, dis-synergies are often more than offset from savings following a break-up as standalone management has “no place to hide”</strong></td>
</tr>
<tr>
<td></td>
<td><strong>- Large conglomerates often duplicate people and functions – e.g., segments replicate and customize “cookie-cutter” corporate functions</strong></td>
</tr>
<tr>
<td></td>
<td><strong>- Several regional corporate centers can be eliminated</strong></td>
</tr>
<tr>
<td></td>
<td><strong>- Negligible manufacturing and distribution savings</strong></td>
</tr>
<tr>
<td></td>
<td><strong>- Some cost savings initiatives have arguably destroyed value (e.g., relocating Tropicana from Bradenton to Chicago)</strong></td>
</tr>
<tr>
<td><strong>Consolidated Margins</strong></td>
<td><strong>- Consolidated EBIT margin (pre-advertising) of 19% is 679 bps below the peer average^{1}</strong></td>
</tr>
<tr>
<td></td>
<td><strong>- Beverage EBIT margin of 12% is 670 bps below the peer average^{1}</strong></td>
</tr>
<tr>
<td></td>
<td><strong>- Reduction of corporate overhead can increase profitability and create funds for investment</strong></td>
</tr>
</tbody>
</table>

---

Note: The estimates, projections, pro-forma information and potential impact of Trian’s ideas set forth herein are based on assumptions that Trian believes to be reasonable, but there can be no assurance or guarantee that actual results or performance of the issuer will not differ, and such differences may be material. This presentation does not recommend the purchase or sale of any security.

^{1} Source: SEC Filings. EBIT defined as earnings before interest and taxes. Peer group includes KO, DPS and CCE for beverages. Peer group also adds HSY and MDLZ for the consolidated company, but excludes CCE from EBIT margin (pre-advertising) as CCE does not disclose advertising figures.
### Appendix G: Capability Sharing: A Power of One Myth?

<table>
<thead>
<tr>
<th>Claimed Synergies:</th>
<th>Trian Response:</th>
</tr>
</thead>
<tbody>
<tr>
<td>R&amp;D</td>
<td>• Still waiting for breakthrough natural sweetener / low sodium salt</td>
</tr>
<tr>
<td></td>
<td>• Yet to match Coke Freestyle (Pepsi discussed 1,000 units in mid-2012)</td>
</tr>
<tr>
<td></td>
<td>• Lost out to Coke on “PlantBottle” (addresses environmental concerns)</td>
</tr>
<tr>
<td></td>
<td>• R&amp;D driven productivity (processes, packaging and ingredients) is not dropping to the bottom line → EBIT margin has declined since 2006 (excl. M&amp;A) (^1)</td>
</tr>
<tr>
<td></td>
<td>• $30bn+ standalone snacks and beverages companies can support strong R&amp;D programs and drive better results through focus</td>
</tr>
<tr>
<td>Marketing</td>
<td>• Cut advertising to hit EPS targets prior to 2012; cut EPS targets in 2012 to fund marketing</td>
</tr>
<tr>
<td></td>
<td>• Less than half of the claimed $500-600mm of incremental ad spend in 2012 is reported in the 10-K (where is the balance of the investment?)</td>
</tr>
<tr>
<td></td>
<td>• Meanwhile, discounts &amp; allowances as a % of sales have increased almost every year since PG and PAS were acquired</td>
</tr>
<tr>
<td></td>
<td>• Long-term market share loss across portfolio (Pepsi, Gatorade, Tropicana, Lipton, Aquafina). Pepsi now #3 CSD behind Coke and Diet Coke</td>
</tr>
<tr>
<td></td>
<td>• Cola suite remains confusing (Pepsi, Diet Pepsi, Pepsi Max, Pepsi One, Pepsi Next)</td>
</tr>
<tr>
<td></td>
<td>• Copied Coke’s Simply Orange carafe despite #1 OJ position</td>
</tr>
<tr>
<td></td>
<td>• A focused beverage company would not risk re-branding failures across three core products at the same time (Pepsi, Gatorade, Tropicana)</td>
</tr>
<tr>
<td>Best Practices</td>
<td>• Productivity initiatives / LEAN / “best practices” have not delivered bottom-line savings (operating profit essentially flat from 2011-2014E despite $3bn of claimed savings)</td>
</tr>
<tr>
<td>Across Efficiency &amp; IT Programs</td>
<td>• Billions spent on adoption of SAP</td>
</tr>
</tbody>
</table>

Note: The estimates, projections, pro-forma information and potential impact of Trian’s ideas set forth herein are based on assumptions that Trian believes to be reasonable, but there can be no assurance or guarantee that actual results or performance of the Issuer will not differ, and such differences may be material. This presentation does not recommend the purchase or sale of any security.

\(^1\) SEC filings and Trian estimate for PepsiCo pro forma results excluding Wimm-Bill-Dann, Pepsi Bottling Group and Pepsi Americas.
### Appendix G: International Expansion: A Power of One Myth?

#### Claimed Synergies:

<table>
<thead>
<tr>
<th>Development of Brands Globally (Leveraging Scale Abroad)</th>
</tr>
</thead>
</table>

#### Trian Response:

- Historically, we do not believe snacks has helped beverages grow internationally nor has beverages helped snacks. Market share analysis across 25 countries confirms little benefit from Power of One.<sup>(1)</sup>

- Snacks has the strongest positions in countries where PepsiCo acquired a leading local player for distribution.<sup>(2)</sup>

- Beverages is a distant #2 and is competitively disadvantaged vs. Coke in almost every region. Pockets of relative strength, such as the Middle-East, are the result of independent historical events.<sup>(3)</sup>

- Much of the revenue in Russia, management’s favorite Power of One example, was bought for 17.5x EBITDA and is in different categories (e.g., dairy).<sup>(4)</sup>

---

#### Cash Flow From Developed Markets Funds International Expansion

- $30bn+ standalone snacks and beverages companies would each generate significant free cash flow to fund growth investments

- Beverages has struggled to grow market share and remains a distant #2 to Coke in most countries despite powerful snacks brands.<sup>(2)</sup>

- Frito-Lay has been unable to materially penetrate markets like China because consumer tastes differ. Being successful in these markets will require a new approach and new ideas, not simply access to capital for investment.

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<sup>(1)</sup> Refer to Appendix H.

<sup>(2)</sup> Euromonitor data.

<sup>(3)</sup> Coca-Cola was blacklisted by the Arab League for more than 20 years, ending in 1991. Source: Euromonitor data. “Arab Blacklist Drops Coca-Cola”, Los Angeles Times, 5 & 6 1991.

<sup>(4)</sup> PepsiCo SEC filings.
### Appendix G: Commercial Benefits / Talent: A Power of One Myth?

<table>
<thead>
<tr>
<th>Claimed Synergies:</th>
<th><strong>Trian Response:</strong></th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Go-to-Market / Leverage Coincidence of Purchase</strong></td>
<td>• Franchise bottling partners impair coordinated go-to-market activities</td>
</tr>
<tr>
<td></td>
<td>• Management concedes there is mainly commercial benefit where there is “modern trade”(^{(1)}); but even then there is a “cost” to co-promotions</td>
</tr>
<tr>
<td></td>
<td>• Countries with “modern trade” tend to be mature / slow growth with established market shares</td>
</tr>
<tr>
<td></td>
<td>• In W. Europe, Pepsi is almost a “private-label” brand and all of Europe represents only 12% of total PepsiCo segment EBIT – roughly equivalent to PepsiCo’s unallocated corporate expense(^{(2)})</td>
</tr>
<tr>
<td></td>
<td>• In fast-growth / emerging countries, there is limited modern trade and therefore limited commercial benefit between snacks and beverages</td>
</tr>
<tr>
<td></td>
<td>• AMEA represents only 10% of total segment EBIT ex gain – less than PepsiCo’s unallocated corporate expense(^{(2)})</td>
</tr>
<tr>
<td></td>
<td>• We believe it is safe to say that most consumers who buy Frito-Lay and other PepsiCo snacks globally buy them with a Coke, not a Pepsi</td>
</tr>
</tbody>
</table>

| **Talent / Personnel** | • Management bench historically among the best in corporate America |
| | • But recent years have seen many talented executives depart PepsiCo; a period of time – again – that coincides with focus on Power of One |
| | • $30bn+ standalone snacks and beverages companies should be able to attract great talent on their own |
| | • We believe two independent public companies would be more exciting to prospective employees, with fewer levels of bureaucracy and where operating divisions are empowered to make decisions and where equity awards are granted at the business unit level |

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\(^{(1)}\) Refers to organized retail such as hypermarkets and supermarkets.

\(^{(2)}\) PepsiCo SEC filings. Segment EBIT is pre-corporate expense and excludes the Vietnam gain. AMEA EBIT also excludes the gain.
Appendix H: PepsiCo Has Lost Market Share Across the Majority of Its “Key Strategic Markets”

- Seven of PepsiCo’s eight “key strategic markets,” as laid out by management on recent conference calls, are also top 25 countries where access to retail sales market share data is readily available\(^1\)
- Within these seven countries, PepsiCo is losing market share across the majority of its snacks and beverages portfolios\(^2\)

### Table: PepsiCo Value Share 2012 v 2009

<table>
<thead>
<tr>
<th>Rank</th>
<th>Country</th>
<th>Retail Sales ($m)</th>
<th>Beverages</th>
<th>CSDs</th>
<th>Snacks</th>
</tr>
</thead>
<tbody>
<tr>
<td>1</td>
<td>USA*</td>
<td>$38,495</td>
<td>(2.1)%</td>
<td>(0.3)%</td>
<td>(0.7)%</td>
</tr>
<tr>
<td>2</td>
<td>Russia**</td>
<td>$8,135</td>
<td>(0.6)%</td>
<td>6.3%</td>
<td>0.7%</td>
</tr>
<tr>
<td>3</td>
<td>Mexico*</td>
<td>$6,117</td>
<td>0.2%</td>
<td>(0.4)%</td>
<td>(1.4)%</td>
</tr>
<tr>
<td>4</td>
<td>Brazil</td>
<td>$3,996</td>
<td>(0.2)%</td>
<td>(0.9)%</td>
<td>(1.2)%</td>
</tr>
<tr>
<td>5</td>
<td>United Kingdom*</td>
<td>$3,721</td>
<td>0.8%</td>
<td>2.3%</td>
<td>(1.8)%</td>
</tr>
<tr>
<td>6</td>
<td>Canada</td>
<td>$3,431</td>
<td>(1.4)%</td>
<td>(2.0)%</td>
<td>1.7%</td>
</tr>
<tr>
<td>7</td>
<td>China</td>
<td>$3,369</td>
<td>(0.7)%</td>
<td>(1.0)%</td>
<td>0.6%</td>
</tr>
<tr>
<td>8</td>
<td>Venezuela</td>
<td>$2,474</td>
<td>2.3%</td>
<td>2.4%</td>
<td>3.0%</td>
</tr>
<tr>
<td>9</td>
<td>Japan</td>
<td>$2,133</td>
<td>(0.3)%</td>
<td>(0.6)%</td>
<td>0.0%</td>
</tr>
<tr>
<td>10</td>
<td>Saudi Arabia**</td>
<td>$1,953</td>
<td>1.2%</td>
<td>2.2%</td>
<td>(1.2)%</td>
</tr>
<tr>
<td>11</td>
<td>India*</td>
<td>$1,611</td>
<td>(1.5)%</td>
<td>(1.3)%</td>
<td>(2.8)%</td>
</tr>
<tr>
<td>12</td>
<td>Argentina</td>
<td>$1,456</td>
<td>0.4%</td>
<td>0.9%</td>
<td>0.1%</td>
</tr>
<tr>
<td>13</td>
<td>Colombia</td>
<td>$1,363</td>
<td>0.1%</td>
<td>0.2%</td>
<td>7.1%</td>
</tr>
<tr>
<td>14</td>
<td>Australia</td>
<td>$1,286</td>
<td>(2.9)%</td>
<td>(6.2)%</td>
<td>(1.2)%</td>
</tr>
<tr>
<td>15</td>
<td>Spain</td>
<td>$1,208</td>
<td>(0.3)%</td>
<td>0.0%</td>
<td>0.2%</td>
</tr>
<tr>
<td>16</td>
<td>France</td>
<td>$1,076</td>
<td>0.7%</td>
<td>0.1%</td>
<td>1.3%</td>
</tr>
<tr>
<td>17</td>
<td>Turkey</td>
<td>$1,062</td>
<td>1.5%</td>
<td>(0.2)%</td>
<td>3.6%</td>
</tr>
<tr>
<td>18</td>
<td>Thailand</td>
<td>$968</td>
<td>(4.8)%</td>
<td>(8.0)%</td>
<td>(0.4)%</td>
</tr>
<tr>
<td>19</td>
<td>Germany</td>
<td>$813</td>
<td>(0.3)%</td>
<td>(0.5)%</td>
<td>(0.0)%</td>
</tr>
<tr>
<td>20</td>
<td>South Africa</td>
<td>$658</td>
<td>(0.2)%</td>
<td>(0.0)%</td>
<td>2.0%</td>
</tr>
<tr>
<td>21</td>
<td>Ukraine</td>
<td>$596</td>
<td>(0.6)%</td>
<td>1.1%</td>
<td>4.5%</td>
</tr>
<tr>
<td>22</td>
<td>Poland</td>
<td>$587</td>
<td>0.4%</td>
<td>0.8%</td>
<td>(0.6)%</td>
</tr>
<tr>
<td>23</td>
<td>Netherlands</td>
<td>$549</td>
<td>(0.1)%</td>
<td>0.1%</td>
<td>(1.3)%</td>
</tr>
<tr>
<td>24</td>
<td>Egypt**</td>
<td>$516</td>
<td>(1.9)%</td>
<td>(0.9)%</td>
<td>1.9%</td>
</tr>
<tr>
<td>25</td>
<td>Philippines</td>
<td>$485</td>
<td>0.4%</td>
<td>(1.5)%</td>
<td>0.1%</td>
</tr>
</tbody>
</table>

\(^1\) And \(^2\) denote the seven countries within the top 25 markets that PepsiCo has highlighted as a key strategic market.

** Strategic markets where PepsiCo had historical advantage and later fell back to periods when they had virtually a 100% share vs. Coke.

(1) PepsiCo presentation at Barclays conference on 9/4/13 highlighted eight key strategic markets, including the seven countries listed above plus the UAE (market share data not available given it falls outside the company’s top 25 markets by retail sales).

(2) Source: Consumer Edge research and Euromonitor market share data from 2009 through 2012.
Appendix I: Country-by-Country, PepsiCo’s Stronger Business Unit Has Generally Not Driven Faster Growth for the Weaker Business Unit

- There is no statistical significance to the claim that in countries where either beverages or snacks has a dominant market share, the other category is likely to receive a market share boost.

![Graph showing market share comparison](image)

**Across the vast majority of countries, higher market share in one business unit has not translated into better organic growth for the other.**

**Australia:** An example of high market share in snacks having no benefit when it comes to driving market share of beverages.

Source: Euromonitor data and Consumer Edge research.

Note: Cut-off is for a business unit (beverages or snacks) to have a 30%+ market share in 2009 and then that level of market share is regressed vs. the market share change for the other business unit (snacks or beverages) to create this analysis.
End Notes

i Source: Q4 2013 press release.

ii Source: Q4 2013 transcript and slide presentation.


iv Source: PepsiCo Q4 2013 transcript.


vi Source: PepsiCo Q2 2013 and Q4 2013 press releases and Trian estimates.

vii Source: Bloomberg.

viii Source: PepsiCo Q4 2013 press release and Trian estimates.

ix Source: PepsiCo Q4 2013 press release and slide presentation and Trian estimates. PepsiCo’s 2014 EBIT is projected to essentially be in-line with its 2011 EBIT.

x See pages 13 and 14 for further detail.

xi Source: Bloomberg and SEC filings. Date as of July is July 18, 2013 (the day after Trian’s presentation calling for a separation was made public). “Today” is as of February 14, 2014.


xv Source: SEC filings of respective companies and Trian estimates. Peers for consolidated PepsiCo include Coca-Cola, Dr Pepper Snapple, Hershey and Mondelez, but excludes Coca-Cola Enterprises as it does not disclose advertising. Peers for PepsiCo’s global beverage business include Coca-Cola Enterprises, Dr Pepper Snapple and Coca-Cola. Note: 2013 advertising figures for Mondelez, Dr Pepper and Coca-Cola are not yet available, so Trian has assumed the companies spent the same percentage of sales on advertising as in 2012. Trian’s estimates for AMEA and Europe beverages are based on Morgan Stanley research as of 5.9.2013, Bernstein research as of 8.4.2011, and PepsiCo’s 2013 10-K.

xvi Source: SEC filings and Bloomberg.

xvii Source: SEC filings of respective companies and Trian estimates. Peers for PepsiCo include Coca-Cola, Dr Pepper Snapple, Hershey, Coca-Cola Enterprises and Mondelez.

xviii Source: PepsiCo Q4 2013 press release and Trian estimates.


xx Source: PepsiCo Q4 2013 press release and 2013 10-K.

xxi Source: PepsiCo SEC filings (10-Ks, earnings press releases, and 8-K filed April 22, 2010) and Wimm-Bill-Dann, Pepsi Bottling Group and PepsiAmericas 2009 Annual Reports.


xxiii Source: Q4 2013 press release.

xxiv Source: Various PepsiCo conference call and management presentation transcripts.

xxv Source: SEC filings and Trian estimates based on Morgan Stanley research as of 5.9.2013, Bernstein research as of 8.4.2011, and Q4 2013 earnings presentation.

xxvi Source: Q4 2013 press release.

xxvii Source: PepsiCo and Coca-Cola Q4 2013 press release. Coca-Cola Americas figures are North America and Latin America figures weighted by the prior year’s sales from the two segments.

xxviii Source: Beverage industry participants.


xxx Source: Coca-Cola Q4 2013 press release.

xxxi Source: PepsiCo and Coca-Cola Q4 2011 and Q4 2013 press release.


xxxvi Source: Bloomberg and Coca-Cola press release as of 2.15.2014.

In Russia, PepsiCo had an advantage selling beverages beginning in the early 1970s when PepsiCo’s CEO (Don Kendall) negotiated a barter agreement that gave PepsiCo the exclusive right to sell cola in the Soviet Union, which lasted until the mid-1980s. Egypt, Saudi Arabia, and UAE, among other countries, abided by the Arab League’s ban of Coca-Cola for more than 20 years before the ban was lifted in 1991, allowing PepsiCo beverages to gain share. In the UK, PepsiCo acquired Walkers Crisps and Smith’s Crisps, two of the United Kingdom’s leading snack food companies, in 1989. In Mexico, PepsiCo acquired Sabritas and Gamesa, their leading snack brands, in 1966 and 1990, respectively.

Sources:
- Source: Consumer Edge research and Euromonitor.
- Source: Consumer Edge research and Euromonitor.
- Source: Trian calculations and Coca-Cola Q4 2013 press release. “Coca-Cola outside of the Americas” comprises Eurasia & Africa, Europe, Pacific, and Bottling Investments segments and allocates corporate as a percentage of total segment revenue (revenue before corporate and eliminations).
- Source: Trian calculations and PepsiCo 2013 10-K. Excludes Vietnam gain from AMEA EBIT.
- Source: Trian calculations and Capital IQ.
- Source: Trian calculations and Capital IQ.
- Source: Q4 2013 slide presentation.
- Source: Respective companies’ SEC filings, Nielsen Data and Bloomberg.