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PepsiCo, Inc. (PEP)

Q1 2022 Earnings Call

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MANAGEMENT DISCUSSION SECTION

Operator: Good morning and welcome to PepsiCo's 2022 First Quarter Earnings Question-And-Answer Session. Your lines have been placed on listen only until it is your turn to ask a question. [Operator Instructions] Today's call is being recorded and will be archived at www.PepsiCo.com.

It is now my pleasure to introduce Mr. Ravi Pamnani, Senior Vice President of Investor Relations. Mr. Pamnani, you may begin.

Ravi Pamnani

Senior Vice President, Investor Relations, Pepsico, Inc.

Thank you, operator. I hope everyone has had a chance this morning to review our press release and prepared remarks, both of which are available on our website. Before we begin, please take note of our cautionary statement. We may make forward-looking statements on today's call, including about our business plans and 2022 guidance. Forward-looking statements inherently involve risks and uncertainties and only reflect our view as of today, April 26, 2022, and we are under no obligation to update.

When discussing our results, we refer to non-GAAP measures, which exclude certain items from reported results. Please refer to our first quarter 2022 earnings release and first quarter 2022 Form 10-Q, available on PepsiCo.com, for definitions and reconciliations of non-GAAP measures and additional information regarding our results, including a discussion of factors that could cause actual results to materially differ from forward-looking statements.

Joining me today are: PepsiCo's Chairman and CEO, Ramon Laguarta; and PepsiCo's Vice Chairman and CFO, Hugh Johnston. We ask that you please limit yourself to one question.

And with that, I will turn it over to the operator for the first question.

QUESTION AND ANSWER SECTION

Operator: [Operator Instructions] Our first question comes from Bryan Spillane with Bank of America.

Bryan D. Spillane
Analyst, Bank of America Securities

Q

Thanks, operator. Good morning, everyone. I wanted to ask about margins. And I guess on the last earnings call, I think the expectation was that margins would be intact. And I guess now with today's guidance, it implies maybe a step back in margins. So maybe, Hugh, could you talk a little bit about maybe how that's changed, where we stand now in terms of like net inflation as we exit the first quarter? And then, what are some of the actions that you're taking, maybe besides pricing, to try to protect margins?

Hugh F. Johnston
Vice Chairman & Chief Financial Officer, PepsiCo, Inc.

A

Yeah. Hey, Bryan. Good morning. A couple things. One, inflation has clearly gotten a bit more challenging for the year. No question about that. We had previously indicated it was low teens. It's several points higher than that now.

Number two, and we've always talked about this in the past, when we have inflation, the first thing we do is look internally to try to find opportunities to drive productivity. And we've been pretty good at driving productivity, but we're really stepping it up even a bit further this year; whether it's identifying areas of waste, or whether it's looking to leverage digitally in a faster and more effective way, or whether it's looking to leverage shared services more. And we're obviously doing all of those things.

After that, then we obviously look for revenue management opportunities, whether it's the way that we are merchandising product in store or packaging mix or shallowing out promotions, and then obviously price ultimately becomes a factor as well. So in terms of the overall impact, I mentioned that I thought margins would be pretty level on the last call. I think, by and large, that's going to be about the same as we go forward. So clearly, we'll decide what we need to do in the balance of the year in terms of further revenue management actions. Typically, we do that in Q4. But, by and large, I think the margins will be relatively level year-over-year.

Operator: Thank you. Our next question comes from Dara Mohsenian with Morgan Stanley.

Dara Mohsenian
Analyst, Morgan Stanley & Co. LLC

Q

Hey. Good morning. So on that topic, maybe we can touch specifically a bit more on pricing. Obviously, very strong delivery in the quarter. Can you talk about consumer demand elasticity so far and what you're seeing? But more importantly, with the cost pressures we're seeing out there, can you talk about strategically how you think about pricing going forward? Is there room to take additional increases, if needed, and how you think about that in light of potential consumer sensitivity with inflation being at unprecedented type of levels? Thanks.

Ramon L. Laguarta
Chairman & Chief Executive Officer, PepsiCo, Inc.

A

Yeah. Good morning. Dara. Let me take a go, and then maybe Hugh can add some comments. Clearly, obviously, if you look at Q4 and Q1, the elasticities that we're having in the business are better than historical and better than what we had planned. So that's why we're raising our guidance for the year. This is valid both for developed markets and for developing markets. We were very concerned about developing markets, but if you see the numbers in LatAm, in Africa Middle East and APAC, we're seeing good elasticities there as well, so positive.

However, we think the consumer is very early in this process of adjusting to the new inflationary environment. I think there's going to be more consumer new behaviors adapting to the new realities. There are going be channel mixes, changes. There's going to be probably packaging mixes changes and some other decisions. Consumers will stop doing certain things they were doing, going out more, maybe traveling and so on. So we think we're early in the process.

I think our categories do normally quite well in inflationary. And what makes us feel confident is that the last few years, we've invested a lot in the brands. And we've invested a lot in some new capabilities around revenue management, also understanding better opportunities for waste reduction in the company. And we've improved a lot our execution capabilities in the store, with more information and better executional tools.

So I think we feel that we're early in the process. At the same time, we feel rather confident that we can manage through this with a good balance between net revenue management, holistic cost management. And our number one objective is to keep the consumers with our brands. And obviously, if we can get new consumers to our brands, even better during this process. So that's how we're approaching this in the short-term.

And then, you were asking about long-term. These are the goals that we're setting for our teams. While we've said that, we have very experienced leaders in the market, and this is clearly a battle that you fight market-by-market. And that gives us again, I think, a better position to win versus other companies that are facing the same kind of inflation.

Hugh F. Johnston
Vice Chairman & Chief Financial Officer, PepsiCo, Inc.

A

Yeah. The only thing I'd add to that, Dara, is if you look over time, our categories have always performed pretty well during inflationary times. And as a result of that, I think, as a company, our performance has been pretty inflation-resistant as well as recession-resistant, which obviously makes us a pretty good defensive stock.

Operator: Thank you. Our next question comes from Lauren Lieberman with Barclays.

Lauren R. Lieberman
Analyst, Barclays Capital, Inc.

Q

Great. Thanks. Good morning. Was curious if you could talk a little bit about impacts from Russia-Ukraine that are embedded in the outlook. Of course, saw the impairment charges on brands that you talked about before the conflict began and then also the charges on PP&E and so on. But I was curious about how Russian-Ukraine is impacting the revenue outlook and also the EPS outlook for the year in terms of operational elements. Thanks.

Hugh F. Johnston
Vice Chairman & Chief Financial Officer, PepsiCo, Inc.

A

Yeah. Hi, Lauren. Russia, as I think we've shared in the past, is low single digits in terms of its overall size to us. Obviously, it's a bit of a drag in terms of our overall outlook, but elsewhere in the company we're doing quite well. So I think we have a pretty conservative Russia outlook embedded in our guidance, which I think will put us in good stead for most of the outcomes that could occur as we go forward.

Ramon L. Laguarta
Chairman & Chief Executive Officer, PepsiCo, Inc.

A

Yeah. And then with regards to Ukraine, obviously we had to stop all our operations there, manufacturing operations. We're still doing some sales. That's also impacting. It's also embedded in our guidance for the year. We reopened now our factory in Kyiv. Hopefully, we'll try to get back to operations in Ukraine as the safety situation allows us, but that's also embedded into our guidance.

Operator: Thank you. Our next question comes from Bonnie Herzog with Goldman Sachs.

Bonnie Herzog
Analyst, Goldman Sachs & Co. LLC

Q

Hi. Thank you. Good morning, everyone. I just wanted to get a quick clarification on your top line guide, based on your comments. So are you now expecting a greater impact from volume growth this year, as you mentioned you were maybe feeling better about elasticities going forward? And then, I'd be curious to hear specifically how your immediate consumption business is performing in key regions for both your beverage and snack business. I'm asking in light of rising fuel prices. For instance, curious to hear if you guys are seeing any signs of pressure in this channel, despite broad reopening in so many markets. And then looking forward, what strategy do you have in place to mitigate some of these pressures if they continue to intensify? Thanks.

Hugh F. Johnston
Vice Chairman & Chief Financial Officer, PepsiCo, Inc.

A

Sure. So, look, Bonnie, why I don't I start? Number one, obviously the revenue guidance is up. That's a combination of a bit more volume and a bit more price, so balanced between the two in terms of the change from prior. And previously, we'd indicated we don't expect much volume growth, so I think obviously that takes us to we expect a little bit of volume growth as the year progresses.

In terms of immediate consumption channels, relatively small impact thus far. Obviously, we'll see how it plays out. Historically, it has impacted the beverage business a bit more than it's impacted the snack food business. I think that's because beverage incidence is just higher than snack food incidence, but so far relatively muted impact on that. And the other channels are doing quite well.

Ramon L. Laguarta
Chairman & Chief Executive Officer, PepsiCo, Inc.

A

Yeah.

Hugh F. Johnston
Vice Chairman & Chief Financial Officer, PepsiCo, Inc.

A

Take home is still up big. And foodservice is growing at a nice healthy clip at this point.

Ramon L. Laguarta
Chairman & Chief Executive Officer, PepsiCo, Inc.

A

Yeah, if you think about immediate consumption, the away from home channel is growing very fast across the world and also in the US, it's recovering. So that is a positive to immediate consumption. There's a little bit of traffic decline in convenience stores, but not meaningful at this point. And obviously there, the strategy will be to gain space and gain share in that channel to compensate for whatever traffic dilution might be, also trying to be conscious of price points and entry points to the category in those channels.

Internationally, we're not seeing mobility being impacted. And we're seeing immediate consumption very strong internationally as well. As I was saying earlier, we're seeing elasticity quite positive in emerging markets. So overall, I don't think that this is going to impact us in the coming periods.

Operator: Thank you. Our next question comes from Andrea Teixeira with JPMorgan.

Andrea Teixeira
Analyst, JPMorgan Chase & Co.

Q

Good morning. I was just trying to track something in-between the lines marketing, and I know you had, SG&A was up last year, or actually you were lapping $180 million in equity investment gain from the same period last year's. But just thinking as you're mentioning elasticities coming in better, obviously that may change, but what are you embedding for the end of the year in terms of marketing from a dollar and rate perspective? And then, for the places where you count on bottlers, was there any impact of stocking this quarter or ahead of price increases? Thank you.

Hugh F. Johnston
Vice Chairman & Chief Financial Officer, PepsiCo, Inc.

A

Yeah, hey, Andrea. A&M, up roughly in line with revenue for the year. So that's where that will likely land.

Ramon L. Laguarta
Chairman & Chief Executive Officer, PepsiCo, Inc.

A

Yeah. And then your question, Andrea, on the bottlers, no, there hasn't been any loading on bottlers for price increase. We don't follow these practices, neither with our retail partners. So whatever you see as sales is basically sell-in, sell-out that we've had for the business.

Operator: Thank you. Our next question comes from Laurent Grandet with Guggenheim.

Laurent Grandet
Analyst, Guggenheim Securities LLC

Q

Hey. Good morning, Ramon and Hugh. Question on PBNA margin. You're progressing about 400 basis points in the quarter, almost back to the level of pre-COVID for the first quarter, despite, I mean, a higher inflation. Could you please share, I mean, the impact of the high cost inflation for PBNA specifically in the quarter? And also could you give us maybe more color as to where the gains are coming from, maybe dissecting between Tropicana divestiture, product mix and where do we go from here? Thanks.

Hugh F. Johnston
Vice Chairman & Chief Financial Officer, PepsiCo, Inc.

A

Yeah. Thanks, Laurent. A couple things, obviously, on that front. Number one, we continue to make progress in terms of cost management inside the business. And I've laid out for you all in the past sort of our pathway to mid-teens margins for the PBNA business. That thesis is still very much intact, and that's the plan we're executing against. Obviously, inflation has put a bit more pressure on that, but the combination of the additional cost management actions that we've taken, as well as obviously shallowing our promotions and price increases and revenue management have allowed us to continue on that journey.

We still very much expect to do exactly what we've said in the past, which is we'll progress along towards getting that business back to the margin levels that I mentioned earlier, something in the mid-teens over the course of the next several years. So I think we're making good progress, and it's going as we expected. Inflation obviously is higher than we expected, but we're taking actions to manage that.

Ramon L. Laguarta
Chairman & Chief Executive Officer, PepsiCo, Inc.

A

Yeah. I think the key levers, Laurent, of that margin improvement stay intact, right, if you think about the portfolio pivots that we're trying to do. Those are really good work in progress. If you see all the Gatorade performance, that's a high-margin business for us clearly growing again at a very fast pace. We're making good progress in energy. So that part of the transformation is good.

We're also making good progress on efficiency and operating excellence. So the critical levers of that transformation continue intact. Clearly inflation is a factor, but, as Hugh was saying, we're doubling-down on productivity and trying to sharpen the pencil a bit more on net revenue management as well.

Operator: Thank you. Our next question comes from Vivian Azer with Cowen.

Vivien Azer
Analyst, Cowen & Co. LLC

Q

Hi. Good morning. I was hoping to dive into your European EBIT margins. While I recognize that 1Q is a seasonally low quarter, Hugh, I was wondering if you could offer any incremental color on the margin compression that you saw in that segment this quarter. Thank you.

Hugh F. Johnston
Vice Chairman & Chief Financial Officer, PepsiCo, Inc.

A

Sure. Happy to. A couple of things. Number one, and you hit on the key point, it's a very small quarter for Europe. A, it's a very short quarter, and it's seasonally low in terms of the revenue as well. In terms of some of the factors in there, obviously, Eastern Europe sort of plays something of a role in terms of that number.

Second one, we made a UK pension contribution, I think, of about $25 million. That's a relatively small number in the overall year, but in a two-month quarter, it obviously has a disproportionate impact. And then in addition to that, the SodaStream business was a little bit soft. That was a bit of a factor. And recall, we report SodaStream through Europe because that's the biggest market for the SodaStream business.

Operator: Thank you. Our next question comes from Kaumil Gajrawala with Credit Suisse.

Kaumil Gajrawala
Analyst, Credit Suisse Securities (USA) LLC

Q

Hi. If I could dig into the guidance increase a little bit, better volumes, better price this quarter, of course. Are your expectations the same volume price dynamic as we go through the rest of the year or is it [ph] you're just kind of including the volume upside (17:54) from this quarter as part of your full year? Thanks.

Ramon L. Laguarta
Chairman & Chief Executive Officer, PepsiCo, Inc.

A

Kaumil, there was a lot of echo there, but if I understand, your question was around our volume pricing guidance. We've raised the guidance on top line because we've seen better elasticities in the first part of the year. Our assumptions for the balance of the year, a bit more conservative on elasticities, because, as I said earlier, within the context for the consumer might change, might not change. We're going to obviously try to do our best with our commercial plans and our people on the ground with execution and better insights to minimize elasticities, obviously. That's our role here.

But our assumptions going forward are a little bit more conservative because we think that the consumer will be feeling the overall inflation in their disposable income and that might have an impact on the elasticities of our categories as well. Although, we think our categories normally fair quite well in inflationary and recessionary moments. And that's why we feel optimistic about raising the guidance to 8% on top of a very high fast growth, 9.5% last year. So clearly, we're growing very fast as a company.

Operator: Thank you. Our next question comes from Kevin Grundy with Jefferies.

Kevin Grundy
Analyst, Jefferies LLC

Q

Great. Thanks. Good morning, everyone. I had a question on pricing as well but from a different angle, really from a retailer's perspective. So the context, of course, your portfolio is in very large, essential and high-velocity categories that drive foot traffic for retailers. But looking at results in the syndicated data, your price mix is up anywhere from low double digits to mid-teens in your larger categories. I know that's not all front-line pricing. Some of it is mix. But nevertheless, it's certainly not inconsequential for the consumer to cope with. So my question is have the pricing discussions started to become more difficult with retailers, particularly your large customers, to the point where maybe we're closer to a tipping point where it's going to be more difficult to put the pricing through? Or is the pricing window still very much open in your view? So your thoughts there would be helpful. Thank you.

Ramon L. Laguarta
Chairman & Chief Executive Officer, PepsiCo, Inc.

A

Yeah. Listen, we always make full commercial plan discussions with our customers, and we try to create value for both. And those joint business planning are the essence of our growth strategy. So we do that in full coordination with our partners, trying to make sure that we keep the consumer with us, we keep the shopper coming to the stores and it's a win-win proposition. So we'll do it. We've been doing it the same this year, of course, even with more intensity than in the past and more insights and more value discussions. And we plan to continue to do that as we go into the second half of the year and into the coming years. Obviously, we're all concerned about elasticities and consumer reactions. So it is to our both interest to take this into consideration as we build a commercial plan.

There's some geographies in the world where these discussions a little bit more tactical. I would say some of the European markets, there is a bit more friction when it comes to pricing, and actually some of our net revenue in Q1 reflects some of these conversations and difficult realities. I would say in the majority of the markets, these are done in collaboration with our customers and in very good value-creation win-win discussions.

Operator: Thank you. Our next question comes from Bob Ottenstein with Evercore.

Robert Ottenstein
Analyst, Evercore Group LLC

Q

Great. Thank you very much. I was wondering if you could please remind us what your exposure is to China, what you're seeing there now and your long-term plans. Thank you.

Hugh F. Johnston
Vice Chairman & Chief Financial Officer, PepsiCo, Inc.

A

Sure. Hey, Robert, it's Hugh. Low single digits on revenue and very low single digits on [indiscernible] (22:19) is the number. And in terms of our plans, I think we continue to execute in the marketplace. We own the snack business. We have a bottler in China who we've had a very successful relationship with. And obviously, in what's a challenging environment, we'll continue to do what we can to continue to operate well. So but low single digits and very low singles on [ph] the number (22:46).

Ramon L. Laguarta
Chairman & Chief Executive Officer, PepsiCo, Inc.

A

Yeah. I would say, obviously, we're seeing the impact of the lockdowns in Shanghai and some other cities impacting somehow the consumer behavior. In general, I would say the in-home consumption is going up. There's been some stocking of our food business in the last few weeks. A little bit of lower mobility in the away from home channel, which is impacting mostly the beverage business. Overall, business is performing as planned. And obviously, we're doing business contingency planning to make sure that we're ready in case some of the lockdowns impact our operating plans now. But in general, I would say, yeah, the team is responding very well. And so far, we haven't seen an impact in our business, which, as Hugh said, is relatively small compared to the full size of the company.

Hugh F. Johnston
Vice Chairman & Chief Financial Officer, PepsiCo, Inc.

A

And just to build on Ramon's point, I should have mentioned as well, our guide does include a level of conservatism and an expectation that performance will be somewhat challenged based on the situation there.

Operator: Thank you. Our next question comes from Steve Powers with Deutsche Bank.

Steve Powers
Analyst, Deutsche Bank Securities, Inc.

Q

Good morning. Good morning, Ramon and Hugh. Just a quick follow up for me actually going back to Lauren's question on Russia-Ukraine. Hugh, you mentioned the contribution there at low single digits, which I think is a profit perspective. On revenue, I thought it was more like mid-single-digits, I think around 4.5% last year. So I guess in that context, just can you talk about how Russia-Ukraine factors into that 8% organic outlook, because intuition would say that the business reductions there create a drag in organic growth that you're absorbing in that 8%? But then again, there's just likely so much nominal inflation in those markets, I'm not exactly sure how or whether Russia-Ukraine net out as a positive or a negative driver of organic growth as you calculate it and to what magnitude. So just some clarity there would be helpful. Thank you.

Hugh F. Johnston
Vice Chairman & Chief Financial Officer, PepsiCo, Inc.

A

Sure. Happy to. Your thoughts are right. Last year, Russia was about 4%. Obviously with the current environment, we expect it to be less than that, hence my low-single-digit comment. And, yeah, it's incorporated into our guidance. We don't expect the business to deliver a lot of growth this year, given all of the challenges and decisions we've made. And it is, in fact, incorporated, so that we've captured that as part of the 8%. So yeah, again, without getting into a ridiculous level of detail, clearly, the business is going to be lower than it was in 2021 by a meaningful amount.

Operator: Thank you. Our next question comes from Nik Modi with RBC Capital Markets.

Filippo Falorni
Analyst, RBC Capital Markets LLC

Q

Hey. Good morning, guys. This is Filippo Falorni on for Nik. A question on your beverage alcohol strategy, maybe you can comment on how the HARD MTN DEW launch is performing in the states where you've launched the product. And then more longer term and bigger picture, like give us an update on kind of your expectations for the beverage alcohol category and any potential new launches or initiatives there.

Ramon L. Laguarta
Chairman & Chief Executive Officer, PepsiCo, Inc.

A

Yeah. This is Ramon. Listen, I think we're testing and learning at a fast speed, right, both. Boston Beer Company is learning how to market and improve the products in their responsibility in the partnership. We're also learning about how to distribute and sell low-alcohol beverages, which obviously have a lot of restrictions in each state and even municipality level. We're having to train our people the right way and so on. So there's a lot of just the learning, very encouraging learnings actually as we're seeing the consumers. Obviously, MTN DEW is a big brand, and it's generating a lot of excitement. There's a lot of initial trial. As always in these circumstances, we have to wait and see repeats and see really where the business stabilizes, right.

I would say good learnings for the organization. It's still very early in the process of building the infrastructure and the talent base and pretty good response from the consumer. Yes, we're going to continue to try to create new exciting products that would go through this platform in the future. And as we learn more about the consumer together with our partners, we'll be able to, I think, innovate meaningfully in this category. But as I said, too early. Too early yet to call it a huge success.

Operator: Thank you. Our next question comes from Brett Cooper with Consumer Edge Research.

Brett Cooper
Analyst, Consumer Edge Research LLC

Q

Morning. I was just hoping you could update us on where you are on digitizing your relationship with customers and consumers, aspirations on both levels. And then I guess if I can nest underneath the consumer, if there's any challenges you guys have in going direct, given independent bottling contracts. Thanks.

Ramon L. Laguarta
Chairman & Chief Executive Officer, PepsiCo, Inc.

A

Yeah, Brett. It's a journey that we started quite some years ago, both on the consumer and the customer. I would say different levels of progress in different parts of the world. Probably US and Western Europe, more advanced when it comes to consumer interaction, the way we can kind of target our messaging in a much more granular way. And we've made good progress how we're doing that, how we're making our media much more efficient by targeting better, so that's an important progress. The same with retailers. Obviously, we have platforms that are fully digitalized and allow our retailers to buy from us directly, and especially smaller customers, fragmented trade around the world. That's a platform that we're benefiting both for better service and also some productivity, being able to target the retailer better.

So good progress across each, strategically a very important part of our journey, trying to both generate additional growth through personalization through targeting the consumer. And that's a journey through innovation, through new digital tools, through better learning and training of our people, our marketeers, our leaders in the marketplace. So it's a journey.

I would say in emerging markets, we're a bit behind. But it's an investment that we're putting in place, part of our large investment in the utilization that we've been talking about for already a few years.

Operator: Thank you. Our last question comes from Chris Carey with Wells Fargo Securities.

Chris Carey
Analyst, Wells Fargo Securities LLC

Q

Hi. Good morning. Thank you. So just two connected questions on cost and productivity, if I could. So, Hugh, you noted the prior outlook was for commodities to be low teens. I believe that's impacted COGS and the company's now tracking higher by a couple points. I guess that would imply things get worse from here. Can you just maybe help us with perspective on the visibility you have and some commodity expectations? I understand you're locked specifically for the next few quarters, but as [ph] spot exposure (30:36) increases in Q4 and how you're thinking about incremental pricing in Q4. And then just connected, Ramon, I think you noted a couple times on the call that you're doubling-down on productivity. Would you expect to be in a position to exceed the $1 billion in productivity savings target for the year or is this just more conceptual? Thanks so much.

Hugh F. Johnston
Vice Chairman & Chief Financial Officer, PepsiCo, Inc.

A

Yeah. Hi, Chris. Yeah, your math is right. We said low teens before, and it'll be several points higher than that. In terms of what that means for Q4, when we typically see pricing in the business, we're still in the process of figuring out how much that will be. That's sort of our normal pricing window in the US, in particular. Obviously, other markets have different windows. So we'll see what that looks like when we get a little bit closer to the time.

In terms of your second question around productivity, yeah, we've historically said $1 billion. And yeah, we'll be several hundred million dollars higher than that this year, based on the actions that we've needed to take to try to help manage a challenging inflationary environment, but one that we have pretty well under control.

Ramon L. Laguarta
Chairman & Chief Executive Officer, PepsiCo, Inc.

A

Ravi?

Ravi Pamnani
Senior Vice President, Investor Relations, Pepsico, Inc.

Okay. So thanks, everybody, for joining us today and for the confidence you've placed in us with your investments. And we hope that you'll stay safe and healthy. Thank you very much for your time. Thanks.

Operator: Well, ladies and gentlemen, this does conclude today's presentation. You may now disconnect. And have a wonderful day.