

OUR BUSINESS

Our discussion and analysis is an integral part of understanding our financial results. Definitions of key terms can be found in the glossary on page 86. Tabular dollars are presented in millions, except per share amounts. All per share amounts reflect common per share amounts, assume dilution unless noted, and are based on unrounded amounts. Percentage changes are based on unrounded amounts.

Our Operations

We are a leading global snack and beverage company. We manufacture, market and sell a variety of salty, convenient, sweet and grain-based snacks, carbonated and non-carbonated beverages and foods.

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munities we serve. This includes meeting consumer needs for a spectrum of convenient foods and beverages, reducing our impact on the environment through water, energy and packaging initiatives, and supporting our employees through a diverse and inclusive culture that recruits and retains world-class talent. In September 2007, we were again included on the Dow Jones Sustainability North America Index and were also added to the Dow Jones Sustainability World Index. These lists are compiled annually.

We are organized into four divisions:

- Frito-Lay North America,
- PepsiCo Beverages North America,
- PepsiCo International, and
- Quaker Foods North America.

Our North American divisions operate in the U.S. and Canada. Our international

division sells products in approximately 200 countries, with our largest operations in Mexico and the United Kingdom. Additional information concerning our divisions and geographic areas is presented in Note 1.

Frito-Lay North America

Frito-Lay North America (FLNA) manufactures or uses contract manufacturers, markets, sells and distributes branded snacks. These snacks include Lay's potato chips, Doritos tortilla chips, Tostitos tortilla chips, Cheetos cheese flavored snacks, branded dips, Fritos corn chips, Ruffles potato chips, Quaker Chewy granola bars, SunChips multigrain snacks, Rold Gold pretzels, Santitas tortilla chips, Grandma's cookies, Frito-Lay nuts, Munchies snack mix, Gamesa cookies, Funyuns onion flavored rings, Quaker Quakes corn and rice snacks, Miss Vickie's potato chips, Stacy's pita chips, Smartfood popcorn, Chester's fries, branded crackers and Flat Earth crisps. FLNA branded products are sold to independent distributors and retailers.

PepsiCo Beverages North America

PepsiCo Beverages North America (PBNA) manufactures or uses contract manufacturers, markets and sells beverage concentrates, fountain syrups and finished goods, under various beverage brands including Pepsi, Mountain Dew, Gatorade, Tropicana Pure Premium, Sierra Mist, Propel, Tropicana juice drinks, Dole, SoBe Life Water, Naked juice and Izze. PBNA also manufactures or uses contract manufacturers, markets and sells ready-to-drink

tea, coffee and water products through joint ventures with Unilever (under the Lipton brand name) and Starbucks. In addition, PBNA licenses the Aquafina water brand to its bottlers and markets this brand. PBNA sells concentrate and finished goods for some of these brands to authorized bottlers, and some of these branded products are sold directly by us to independent distributors and retailers. The bottlers sell our brands as finished goods to independent distributors and retailers. PBNA's volume reflects sales to its independent distributors and retailers, as well as the sales of beverages bearing our trademarks that bottlers have reported as sold to independent distributors and retailers. Bottler case sales (BCS) and concentrate shipments and equivalents (CSE) are not necessarily equal during any given period due to seasonality, timing of product launches, product mix, bottler inventory practices and other factors. While our revenues are not based on BCS volume, we believe that BCS is a valuable measure as it measures the sell-through of our products at the consumer level.

PepsiCo International

PepsiCo International (PI) manufactures through consolidated businesses as well as through noncontrolled affiliates, a number of leading salty and sweet snack brands including Gamesa, Lay's, Doritos, Walkers, Cheetos, Ruffles and Sabritas. Further, PI manufactures or uses contract manufacturers, markets and sells many

Quaker brand cereals and snacks. PI also manufactures, markets and sells beverage concentrates, fountain syrups and finished goods under the brands Pepsi, 7UP, Mirinda, Mountain Dew, Gatorade and Tropicana. These brands are sold to authorized bottlers, independent distributors and retailers. However, in certain markets, PI operates its own bottling plants and distribution facilities. PI also manufactures or uses contract manufacturers, markets and sells ready-to-drink tea products through a joint venture with Unilever (under the Lipton brand name). In addition, PI licenses the Aquafina water brand to certain of its authorized bottlers. PI reports two measures of volume. Snack volume is reported on a system-wide basis, which includes our own sales and the sales by our noncontrolled affiliates of snacks bearing Company-owned or licensed trademarks. Beverage volume reflects Company-owned or authorized bottler sales of beverages bearing Company-owned or licensed trademarks to independent distributors and retailers. BCS and CSE are not necessarily equal during any given period due to seasonality, timing of product launches, product mix, bottler inventory practices and other factors. While

our revenues are not based on BCS volume, we believe that BCS is a valuable measure as it measures the sell-through of our products at the consumer level.

Quaker Foods North America

Quaker Foods North America (QFNA) manufactures or uses contract manufacturers, markets and sells cereals, rice, pasta and other branded products. QFNA's products include Quaker oatmeal, Aunt Jemima mixes and syrups, Life cereal, Cap'n Crunch cereal, Quaker grits, Rice-A-Roni, Pasta Roni and Near East side dishes. These branded products are sold to independent distributors and retailers.

New Organizational Structure

In the fourth quarter of 2007, we announced a strategic realignment of our organizational structure into three new business units, as follows:

- (1) PepsiCo Americas Foods (PAF), which includes FLNA, QFNA and all of our Latin American food and snack businesses (LAF), including our Sabritas and Gamesa businesses in Mexico;
- (2) PepsiCo Americas Beverages (PAB), which includes PBNA and all of our Latin American beverage businesses; and

(3) PepsiCo International (PI), which includes all PepsiCo businesses in the United Kingdom, Europe, Asia, Middle East and Africa.

In the fourth quarter of 2007, we announced a strategic realignment of our organizational structure into three new business units: PAF, PAB and PI.

In 2008, our three business units will be comprised of six reportable segments, as follows:

- FLNA,
- QFNA,
- LAF,
- PAB,
- United Kingdom & Europe, and
- Middle East, Africa & Asia.

In the first quarter of 2008, our historical segment reporting will be restated to reflect the new structure. The segment amounts and discussions reflected in this annual report reflect the management reporting that existed through fiscal year-end 2007.

Our Customers

Our customers include authorized bottlers and independent distributors, including foodservice distributors, and retailers. We normally grant our bottlers exclusive contracts to sell and manufacture certain beverage products bearing our trademarks within a specific geographic area. These arrangements provide the Company with the right to charge our bottlers for concentrate, finished goods and Aquafina royalties and specify the manufacturing process required for product quality.

Since we do not sell directly to the consumer, we rely on and provide financial incentives to our customers to assist in the distribution and promotion of our products. For our independent distributors and retailers, these incentives include

volume-based rebates, product placement fees, promotions and displays. For our bottlers, these incentives are referred to as bottler funding and are negotiated annually with each bottler to support a variety of trade and consumer programs, such as consumer incentives, advertising support, new product support, and vending and cooler equipment placement. Consumer incentives include coupons, pricing discounts and promotions, and other promotional offers. Advertising support is directed at advertising programs and supporting bottler media. New product support includes targeted consumer and retailer incentives and direct marketplace support, such as point-of-purchase materials, product placement fees, media and

advertising. Vending and cooler equipment placement programs support the acquisition and placement of vending machines and cooler equipment. The nature and type of programs vary annually.

Retail consolidation continues to increase the importance of major customers. In 2007, sales to Wal-Mart Stores, Inc. (Wal-Mart), including Sam's Club (Sam's), represented approximately 12% of our total net revenue. Our top five retail customers represented approximately 31% of our 2007 North American net revenue, with Wal-Mart (including Sam's) representing approximately 18%. These percentages include concentrate sales to our bottlers which are used in finished

goods sold by them to these retailers. In addition, sales to The Pepsi Bottling Group (PBG) represented approximately 9% of our total net revenue. See "Our Related Party Bottlers" and Note 8 for more information on our anchor bottlers.

Our Related Party Bottlers

We have ownership interests in certain of our bottlers. Our ownership is less than 50%, and since we do not control these bottlers, we do not consolidate their results. We include our share of their

net income based on our percentage of economic ownership in our income statement as bottling equity income. We have designated three related party bottlers, PBG, PepsiAmericas, Inc. (PAS)

Our anchor bottlers distribute approximately 58% of our North American beverage volume and approximately 18% of our international beverage volume.

and Pepsi Bottling Ventures LLC (PBV), as our anchor bottlers. Our anchor bottlers distribute approximately 58% of our North American beverage volume and approximately 18% of our international beverage volume. Our anchor bottlers participate in the bottler funding programs described above. Approximately 6% of our total 2007 sales incentives are related to these bottlers. See Note 8 for additional information on these related parties and related party commitments and guarantees.

Our Distribution Network

Our products are brought to market through direct-store-delivery (DSD), broker-warehouse and foodservice and vending distribution networks. The distribution system used depends on customer needs, product characteristics and local trade practices.

Direct-Store-Delivery

We, our bottlers and our distributors operate DSD systems that deliver snacks and beverages directly to retail stores where the products are merchandised by our employees or our bottlers. DSD enables us to merchandise with maximum

visibility and appeal. DSD is especially well-suited to products that are restocked often and respond to in-store promotion and merchandising.

DSD enables us to merchandise with maximum visibility and appeal.

Broker-Warehouse

Some of our products are delivered from our manufacturing plants and warehouses to customer warehouses and retail stores. These less costly systems generally work

best for products that are less fragile and perishable, have lower turnover, and are less likely to be impulse purchases.

Foodservice and Vending

Our foodservice and vending sales force distributes snacks, foods and beverages to third-party foodservice and vending distributors and operators. Our foodservice and vending sales force also distributes certain beverages through our bottlers. This distribution system supplies our products to schools, businesses, stadiums, restaurants and similar locations.

Our Competition

Our businesses operate in highly competitive markets. We compete against global, regional, local and private label manufacturers on the basis of price, quality, product variety and distribution. In U.S. measured channels, we have a similar share of CSD consumption and a larger share of liquid refreshment beverages consumption, as compared to our chief beverage competitor, The Coca-

Cola Company. However, The Coca-Cola Company has a significant CSD share advantage in many markets outside the U.S. Further, our snack brands hold significant leadership positions in the snack industry worldwide. Our snack brands face local and regional competitors, as well as national and global snack competitors, and compete on the basis of price, quality, product variety and distribution.

Success in this competitive environment is dependent on effective promotion of existing products and the introduction of new products. We believe that the strength of our brands, innovation and marketing, coupled with the quality of our products and flexibility of our distribution network, allow us to compete effectively.

Other Relationships

Certain members of our Board of Directors also serve on the boards of certain vendors and customers. Those Board members do not participate in our vendor selection and negotiations nor in

our customer negotiations. Our transactions with these vendors and customers are in the normal course of business and are consistent with terms negotiated with other vendors and customers. In addition,

certain of our employees serve on the boards of our anchor bottlers and other affiliated companies and do not receive incremental compensation for their Board services.

Our Business Risks

Demand for our products may be adversely affected by changes in consumer preferences and tastes or if we are unable to innovate or market our products effectively.

We are a consumer products company operating in highly competitive markets and rely on continued demand for our products. To generate revenues and profits, we must sell products that appeal to our customers and to consumers. Any significant changes in consumer preferences and any inability on our part to anticipate and react to such changes could result in reduced demand for our products and erosion of our competitive and financial position. Our success depends on our ability to respond to consumer trends, such as consumer health concerns about obesity, product attributes and ingredients. In addition, changes in product category consumption or consumer demographics could result in reduced demand for our products. Consumer preferences may shift due to a variety of factors, including the aging of the general population, changes in social trends, changes in travel, vacation or leisure activity patterns, weather, negative publicity resulting from regulatory action or litigation against companies in the industry, or a downturn in economic conditions. Any of these changes may reduce consumers' willingness to purchase our products. See also "Changes in the legal and regulatory environment could limit our business activities, increase our operating costs, reduce demand for our products or result in litigation" below.

Our continued success is also dependent on our product innovation, including maintaining a robust pipeline of new products, and the effectiveness of our advertising campaigns and marketing programs. There can be no assurance as to our continued ability either to develop and launch successful new products or variants of existing products, or to effectively execute advertising campaigns and marketing programs. In addition, both the launch and ongoing success of new products and advertising campaigns are inherently uncertain, especially as to their appeal to consumers. Our failure to successfully launch new products could decrease demand for our existing products by negatively affecting consumer perception of existing brands, as well as result in inventory write-offs and other costs.

Our success depends on our ability to respond to consumer trends, such as consumer health concerns about obesity, product attributes and ingredients.

Any damage to our reputation could have an adverse effect on our business, financial condition and results of operations.

Maintaining a good reputation globally is critical to selling our branded products. If we fail to maintain high standards for product quality, safety and integrity, our reputation could be jeopardized. Adverse publicity about these types of concerns or the incidence of product contamination

or tampering, whether or not valid, may reduce demand for our products or cause production and delivery disruptions. If any of our products becomes unfit for consumption, misbranded or causes injury, we may have to engage in a product recall and/or be subject to liability. A widespread product recall or a significant product liability judgment could cause our products to be unavailable for a period of time, which could further reduce consumer demand and brand equity. Failure to maintain high ethical, social and environmental standards for all of our operations and activities or adverse publicity regarding our responses to health concerns, our environmental impacts, including agricultural materials, packaging, energy and water use and waste management, or other sustainability issues, could jeopardize our reputation. Failure to comply with local laws and regulations, to maintain an effective system of internal controls or to provide accurate and timely financial statement information could also hurt our reputation. Damage to our reputation or loss of consumer confidence in our products for any of these reasons could have a material adverse effect on our business, financial condition and results of operations, as well as require additional resources to rebuild our reputation.

If we are not able to build and sustain proper information technology infrastructure, successfully implement our ongoing business transformation initiative or outsource certain functions effectively our business could suffer.

We depend on information technology as an enabler to improve the effectiveness of our operations and to interface with our customers, as well as to maintain financial accuracy and efficiency. If we do not allocate and effectively manage the resources necessary to build and sustain the proper technology infrastructure, we could be subject to transaction errors, processing inefficiencies, the loss of customers, business disruptions, or the loss of or damage to intellectual property through security breach.

We have embarked on a multi-year business transformation initiative that includes the delivery of an SAP enterprise

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resource planning application, as well as the migration to common business processes across our operations. There can be no certainty that these programs will deliver the expected benefits. The failure to deliver our goals may impact our ability to (1) process transactions accurately and efficiently and (2) remain in step with the changing needs of the trade, which could result in the loss of customers. In addition, the failure to either deliver the application on time, or anticipate the necessary readiness and training needs, could lead to business disruption and loss of customers and revenue.

In addition, we have outsourced certain information technology support services and administrative functions, such as payroll processing and benefit plan administration, to third-party service providers and may outsource other functions

in the future to achieve cost savings and efficiencies. If the service providers that we outsource these functions to do not perform effectively, we may not be able to achieve the expected cost savings and may have to incur additional costs to correct errors made by such service providers. Depending on the function involved, such errors may also lead to business disruption, processing inefficiencies or the loss of or damage to intellectual property through security breach, or harm employee morale.

Our information systems could also be penetrated by outside parties intent on extracting information, corrupting information or disrupting business processes. Such unauthorized access could disrupt our business and could result in the loss of assets.

Our operating results may be adversely affected by increased costs, disruption of supply or shortages of raw materials and other supplies.

We and our business partners use various raw materials and other supplies in our business, including aspartame, cocoa, corn, corn sweeteners, flavorings, flour, grapefruits and other fruits, juice and juice concentrates, oats, oranges, potatoes, rice, seasonings, sucralose, sugar, vegetable and essential oils, and wheat. Our key packaging materials include PET resin used for plastic bottles, film packaging used for snack foods, aluminum used for cans, glass bottles and cardboard. Fuel and natural gas are also important commodities due to their use in our plants and in the trucks delivering our products. Some of these raw materials and supplies are available from a limited number of suppliers. We are exposed to the market risks arising from adverse changes in commodity prices, affecting the cost of our raw materials and energy. The raw materials and energy which we use for the production of our products are largely commodities that are subject to price volatility and fluctuations in availability caused by changes in global supply and demand, weather conditions, agricultural

uncertainty or governmental controls. We purchase these materials and energy mainly in the open market. If commodity price changes result in unexpected increases in raw materials and energy costs, we may not be able to increase our prices to offset these increased costs without suffering reduced volume, revenue and operating income.

Our profitability may also be adversely impacted due to water scarcity and regulation. Water is a limited resource in many parts of the world. As demand for water continues to increase, we and our business partners may face disruption of supply or increased costs to obtain the water needed to produce our products.

Our business could suffer if we are unable to compete effectively.

Our businesses operate in highly competitive markets. We compete against global, regional and private label manufacturers on the basis of price, quality, product variety and effective distribution. Increased competition and actions by our competitors could lead to downward pressure on prices and/or a decline in our market share, either of which could adversely affect our results. See "Our Competition" for more information about our competitors.

Disruption of our supply chain could have an adverse effect on our business, financial condition and results of operations.

Our ability and that of our suppliers, business partners, including bottlers, contract manufacturers, independent distributors and retailers, to make, move and sell products is critical to our success. Damage or disruption to our or their manufacturing or distribution capabilities due to weather, natural disaster, fire or explosion, terrorism, pandemics such as avian flu, strikes or other reasons, could impair our ability to manufacture or sell our products. Failure to take adequate steps to mitigate the likelihood or potential impact of such events, or to effectively manage such events if they occur, could adversely affect our business, financial condition

and results of operations, as well as require additional resources to restore our supply chain.

Trade consolidation, the loss of any key customer, or failure to maintain good relationships with our bottling partners could adversely affect our financial performance.

We must maintain mutually beneficial relationships with our key customers, including our retailers and bottling partners, to effectively compete. There is a greater concentration of our customer base around the world generally due to the continued consolidation of retail trade. As retail ownership becomes more concentrated, retailers demand lower pricing and increased promotional programs. Further, as larger retailers increase utilization of their own distribution networks and private label brands, the competitive advantages we derive from our go-to-market systems and brand equity may be eroded. Failure to appropriately respond to these trends or to offer effective sales incentives and marketing programs to our customers could reduce our ability to secure adequate shelf space at our retailers and adversely affect our financial performance.

Retail consolidation continues to increase the importance of major customers. In 2007, sales to Wal-Mart (including Sam's) represented approximately 12% of our total net revenue. Our top five retail customers represented approximately 31% of our 2007 North American net revenue, with Wal-Mart (including Sam's) representing approximately 18%. These percentages include concentrate sales to our bottlers which are used in finished goods sold by them to these retailers. Loss of any of our key customers, including Wal-Mart, could have an adverse effect on our business, financial condition and results of operations.

Furthermore, if we are unable to provide an appropriate mix of incentives to our bottlers through a combination of advertising and marketing support, they may take actions that, while maximizing

their own short-term profit, may be detrimental to us or our brands. Such actions could have an adverse effect on our profitability. In addition, any deterioration of our relationships with our bottlers could adversely affect our business or financial performance. See "Our Customers," "Our Related Party Bottlers" and Note 8 for more information on our customers, including our anchor bottlers.

Changes in the legal and regulatory environment could limit our business activities, increase our operating costs, reduce demand for our products or result in litigation.

The conduct of our businesses, and the production, distribution, sale, advertising, labeling, safety, transportation and use of many of our products, are subject to various laws and regulations administered by federal, state and local governmental agencies in the United States, as well as to foreign laws and regulations administered by government entities and agencies in markets in which we operate. These laws and regulations may change, sometimes dramatically, as a result of political, economic or social events. Such regulatory environment changes include changes in food and drug laws, laws related to advertising and deceptive marketing practices, accounting standards, taxation requirements, competition laws and environmental laws, including laws relating to the regulation of water rights and treatment. Changes in laws, regulations or governmental policy and the related interpretations may alter the environment in which we do business and, therefore, may impact our results or increase our costs or liabilities.

In particular, governmental bodies in jurisdictions where we operate may impose new labeling, product or production requirements, or other restrictions. For example, we are one of several companies that have been sued by the State of California under Proposition 65 to force warnings that certain potato-based products contain acrylamide. Acrylamide is a chemical compound naturally formed

in a wide variety of foods when they are cooked (whether commercially or at home), including french fries, potato chips, cereal, bread and coffee. It is believed that acrylamide may cause cancer in laboratory animals when consumed in significant amounts. Studies are underway by various regulatory authorities and others to assess the effect on humans due to acrylamide in the diet. If we were required to label any of our products or place warnings in locations where our products are sold in California under Proposition 65, sales of those products could suffer not only in California but elsewhere. In addition, if consumer concerns about acrylamide increase as a result of these studies, other new scientific evidence, or for any other reason, whether or not valid, demand for our products could decline and we could be subject to additional lawsuits or new regulations that could affect sales of our products, any of which could have an adverse effect on our business, financial condition or results of operations.

In many jurisdictions, compliance with competition laws is of special importance to us due to our competitive position in those jurisdictions. Regulatory authorities under whose laws we operate may also have enforcement powers that can subject us to actions such as product recall, seizure of products or other sanctions, which could have an adverse effect on our sales or damage our reputation.

If we are unable to hire or retain key employees, it could have a negative impact on our business.

Our continued growth requires us to develop our leadership bench and to implement programs, such as our long-term incentive program, designed to retain talent. However, there is no assurance that we will continue to be able to hire or retain key employees. We compete to hire new employees, and then must train them and develop their skills and competencies. Our operating results could be adversely affected by increased costs due to increased competition for employees, higher employee turnover or

increased employee benefit costs. Any unplanned turnover could deplete our institutional knowledge base and erode our competitive advantage.

Our continued growth requires us to develop our leadership bench and to implement programs, such as our long-term incentive program, designed to retain talent.

Our business may be adversely impacted by unfavorable economic or environmental conditions or political or other developments and risks in the countries in which we operate.

Unfavorable global economic or environmental changes, political conditions or other developments may result in business disruption, supply constraints, foreign currency devaluation, inflation, deflation or decreased demand. Unstable economic and political conditions or civil unrest in the countries in which we operate could

have adverse impacts on our business results or financial condition. Our operations outside of the U.S. accounted for 44% and 35% of our net revenue and operating profit, respectively, for the year ended December 29, 2007. Our continued success depends on our ability to broaden and strengthen our presence in emerging markets, such as Brazil, Russia, India and China, and to create scale in key international markets.

Our continued success depends on our ability to broaden and strengthen our presence in emerging markets, such as Brazil, Russia, India and China.

Forward-Looking and Cautionary Statements

We discuss expectations regarding our future performance, such as our business outlook, in our annual and quarterly reports, press releases, and other written and oral statements. These “forward-looking statements” are based on currently available information, operating plans and projections about future events and trends. They inherently involve risks and uncertainties that could cause actual results to differ materially from those predicted in any such forward-looking statements. Investors are cautioned not to place undue reliance on any such forward-looking statements, which speak only as of the date they are made. We undertake no obligation to update any forward-looking statement, whether as a result of new information, future events or otherwise. The discussion of risks above and elsewhere in this annual report is by no means all inclusive but is designed to highlight what we believe are important factors to consider when evaluating our trends and future results.

Market Risks

We are exposed to market risks arising from adverse changes in:

- commodity prices, affecting the cost of our raw materials and energy,
- foreign exchange rates, and
- interest rates.

In the normal course of business, we manage these risks through a variety of strategies, including productivity initiatives, global purchasing programs and hedging strategies. Ongoing productivity initiatives involve the identification and effective implementation of meaningful cost saving opportunities or efficiencies. Our global purchasing programs include fixed-price purchase orders and pricing

agreements. Our hedging strategies include the use of derivatives. Certain

We manage market risks through a variety of strategies, including productivity initiatives, global purchasing programs and hedging strategies.

derivatives are designated as either cash flow or fair value hedges and qualify for hedge accounting treatment, while others do not qualify and are marked to market through earnings. We do not use derivative instruments for trading or speculative purposes, and we limit our exposure to individual counterparties to manage credit risk. The fair value of our derivatives fluctuates based on market rates and prices. The sensitivity of our derivatives to these market fluctuations is discussed below. See Note 10 for further discussion of these derivatives and our hedging policies. See “Our Critical Accounting Policies” for a discussion of the exposure of our pension plan assets and pension and retiree medical liabilities to risks related to stock prices and discount rates.

Inflationary, deflationary and recessionary conditions impacting these market risks also impact the demand for and pricing of our products.

Commodity Prices

Our open commodity derivative contracts that qualify for hedge accounting had a face value of \$5 million at December 29, 2007 and \$55 million at December 30, 2006. The open derivative contracts that qualify for hedge accounting resulted in net unrealized gains of less than \$1 million at December 29, 2007 and December 30, 2006. We estimate that a 10% decline in commodity prices would have had no impact on our net unrealized gains in 2007.

Our open commodity derivative contracts that do not qualify for hedge accounting had a face value of \$105 million at December 29, 2007 and \$196 million at December 30, 2006. The open derivative contracts that do not qualify for hedge accounting resulted in net gains of \$3 million in 2007 and net losses of \$28 million in 2006. We estimate that a 10% decline in commodity prices would have had no impact on our net gains in 2007.

We expect to be able to continue to reduce the impact of increases in our raw material and energy costs through our hedging strategies and ongoing productivity initiatives.

Foreign Exchange

Financial statements of foreign subsidiaries are translated into U.S. dollars using period-end exchange rates for assets and liabilities and weighted-average exchange rates for revenues and expenses. Adjustments resulting from translating net assets are reported as a separate component of accumulated other comprehensive loss within shareholders' equity under the caption currency translation adjustment.

Our operations outside of the U.S. generate 44% of our net revenue, with Mexico, the United Kingdom and Canada comprising 19% of our net revenue. As a result, we are exposed to foreign currency risks. During 2007, net favorable foreign currency, primarily due to appreciation in the euro, British pound, Canadian dollar and Brazilian real, contributed 2 percentage points to net revenue growth. Currency declines which are not offset could adversely impact our future results.

Exchange rate gains or losses related to foreign currency transactions are recognized as transaction gains or losses in our income statement as incurred. We may enter into derivatives to manage our exposure to foreign currency transaction risk. Our foreign currency derivatives had a total face value of \$1.6 billion at December 29, 2007 and \$1.0 billion at December 30, 2006. The contracts that qualify for hedge accounting resulted in net unrealized losses of \$44 million at December 29, 2007 and \$6 million at December 30, 2006. We estimate that an unfavorable 10% change in the exchange rates would have resulted in net unrealized losses of \$152 million in 2007. The contracts not meeting the criteria for hedge accounting resulted in a net gain of \$15 million in 2007 and a net loss of \$10 million in 2006. All losses and gains were offset by changes in the underlying hedged items, resulting in no net material impact on earnings.

Interest Rates

We centrally manage our debt and investment portfolios considering investment opportunities and risks, tax consequences and overall financing strategies. We may use interest rate and cross currency interest rate swaps to manage our overall interest expense and foreign exchange risk. These instruments effectively change the interest rate and currency of specific debt issuances. These swaps are entered into concurrently with the issuance of the debt that they are intended to modify. The notional amount, interest payment and maturity date of the swaps match the principal, interest payment and maturity date of the related debt. Our counterparty credit risk is considered low because these swaps are entered into only with strong creditworthy counterparties and are generally settled on a net basis.

Assuming year-end 2007 variable rate debt and investment levels, a 1-percentage-point increase in interest rates would have decreased net interest expense by \$1 million in 2007.

Risk Management Framework

The achievement of our strategic and operating objectives will necessarily involve taking risks. Our risk management

We leverage an integrated risk management framework to identify, assess, prioritize, manage, monitor and communicate risks across the Company.

process is intended to ensure that risks are taken knowingly and purposefully. As such, we leverage an integrated risk management framework to identify, assess, prioritize, manage, monitor and communicate risks across the Company. This framework includes:

- The PepsiCo Executive Committee (PEC), comprised of a cross-functional, geographically diverse, senior management group which identifies, assesses, prioritizes and addresses strategic and reputational risks;
- Division Risk Committees (DRCs), comprised of cross-functional senior management teams which meet regularly each year to identify, assess, prioritize and address division-specific operating risks;
- PepsiCo's Risk Management Office, which manages the overall risk management process, provides ongoing guidance, tools and analytical support to the PEC and the DRCs, identifies and assesses potential risks, and facilitates ongoing communication between the parties, as well as to PepsiCo's Audit Committee and Board of Directors;
- PepsiCo Corporate Audit, which evaluates the ongoing effectiveness of our key internal controls through periodic audit and review procedures; and
- PepsiCo's Compliance Office, which leads and coordinates our compliance policies and practices.

OUR CRITICAL ACCOUNTING POLICIES

An appreciation of our critical accounting policies is necessary to understand our financial results. These policies may require management to make difficult and subjective judgments regarding uncertainties, and as a result, such estimates may significantly impact our financial results. The precision of these estimates and the likelihood of future changes depend on a number of underlying variables and a range of possible outcomes. Other than our accounting for pension plans, our critical accounting policies do not involve the choice between alternative methods of accounting. We applied our critical accounting policies and estimation methods consistently in all material respects, and for all periods presented, and have discussed these policies with our Audit Committee.

Our critical accounting policies arise in conjunction with the following:

- revenue recognition,
- brand and goodwill valuations,
- income tax expense and accruals, and
- pension and retiree medical plans.

Revenue Recognition

Our products are sold for cash or on credit terms. Our credit terms, which are established in accordance with local and industry practices, typically require payment within 30 days of delivery in the U.S., and generally within 30 to 90 days internationally, and may allow discounts for early payment. We recognize revenue upon shipment or delivery to our customers based on written sales terms that do not allow for a right of return. However, our policy for DSD and chilled products is to remove and replace damaged and out-of-date products from store shelves to ensure that consumers receive the product quality and freshness they expect. Similarly, our policy for warehouse-distributed products is to replace damaged and out-of-date products. Based on our historical experience with this practice, we have reserved for anticipated damaged and out-of-date products. Our bottlers have a similar replacement policy and are responsible for the products they distribute.

Our policy is to provide customers with product when needed. In fact, our

commitment to freshness and product dating serves to regulate the quantity of product shipped or delivered. In addition, DSD products are placed on the shelf by our employees with customer shelf space limiting the quantity of product. For product delivered through our other distribution networks, customer inventory levels are monitored.

Our policy for DSD and chilled products is to remove and replace damaged and out-of-date products from store shelves to ensure that consumers receive the product quality and freshness they expect.

As discussed in "Our Customers," we offer sales incentives and discounts through various programs to customers and consumers. Sales incentives and discounts are accounted for as a reduction of revenue and totaled \$11.3 billion in 2007,

\$10.1 billion in 2006 and \$8.9 billion in 2005. Sales incentives include payments to customers for performing merchandising activities on our behalf, such as payments for in-store displays, payments to gain distribution of new products, payments for shelf space and discounts to promote lower retail prices. A number of our sales incentives, such as bottler funding and customer volume rebates, are based on annual targets, and accruals are established during the year for the expected payout. These accruals are based on contract terms and our historical experience with similar programs and require management judgment with respect to estimating customer participation and performance levels. Differences between estimated expense and actual incentive costs are normally insignificant and are recognized in earnings in the period such differences are determined. The terms of most of our incentive arrangements do not exceed a year, and therefore do not require highly uncertain long-term estimates. For interim reporting, we estimate

total annual sales incentives for most of our programs and record a pro rata share in proportion to revenue. Certain arrangements, such as fountain pouring rights, may extend beyond one year. The costs incurred to obtain incentive arrangements are recognized over the shorter

of the economic or contractual life, as a reduction of revenue, and the remaining balances of \$287 million at year-end 2007 and \$297 million at year-end 2006 are included in current assets and other assets on our balance sheet.

We estimate and reserve for our bad debt exposure based on our experience with past due accounts. Bad debt expense is classified within selling, general and administrative expenses in our income statement.

Brand and Goodwill Valuations

We sell products under a number of brand names, many of which were developed by us. The brand development costs are expensed as incurred. We also purchase brands in acquisitions. Upon acquisition, the purchase price is first allocated to identifiable assets and liabilities, including brands, based on estimated fair value, with any remaining purchase price recorded as goodwill. Determining fair value requires significant estimates and assumptions based on an evaluation of a number of factors, such as marketplace participants, product life cycles, market share, consumer awareness, brand history and future expansion expectations, amount and timing of future cash flows and the discount rate applied to the cash flows.

We believe that a brand has an indefinite life if it has a history of strong revenue and cash flow performance, and we have the intent and ability to support the brand with marketplace spending for the foreseeable future. If these perpetual brand criteria are not met, brands are

amortized over their expected useful lives, which generally range from five to 40 years. Determining the expected life of a brand requires management judgment and is based on an evaluation of a number of factors, including market share, consumer awareness, brand history and future expansion expectations, as well as the macroeconomic environment of the countries in which the brand is sold.

We did not recognize any impairment charges for perpetual brands or goodwill in the years presented.

Perpetual brands and goodwill, including the goodwill that is part of our non-controlled bottling investment balances, are not amortized. Perpetual brands and goodwill are assessed for impairment at least annually. If the carrying amount of a perpetual brand exceeds its fair value, as determined by its discounted cash flows, an impairment loss is recognized in an amount equal to that excess. Goodwill is evaluated using a two-step impairment test at the reporting unit level. A reporting unit can be a division or business within a division. The first step compares the book value of a reporting unit, including goodwill, with its fair value, as determined by its discounted cash flows. If the book value of a reporting unit exceeds its fair value, we complete the second step to determine the amount of goodwill

impairment loss that we should record. In the second step, we determine an implied fair value of the reporting unit's goodwill by allocating the fair value of the reporting unit to all of the assets and liabilities other than goodwill (including any unrecognized intangible assets). The amount of impairment loss is equal to the excess of the book value of the goodwill over the implied fair value of that goodwill.

Amortizable brands are only evaluated for impairment upon a significant change in the operating or macroeconomic environment. If an evaluation of the undiscounted future cash flows indicates impairment, the asset is written down to its estimated fair value, which is based on its discounted future cash flows.

Management judgment is necessary to evaluate the impact of operating and macroeconomic changes and to estimate future cash flows. Assumptions used in our impairment evaluations, such as forecasted growth rates and our cost of capital, are based on the best available market information and are consistent with our internal forecasts and operating plans. These assumptions could be adversely impacted by certain of the risks discussed in "Our Business Risks."

We did not recognize any impairment charges for perpetual brands or goodwill in the years presented. As of December 29, 2007, we had \$6.4 billion of perpetual brands and goodwill, of which approximately 60% related to Tropicana and Walkers.

Determining the expected life of a brand requires management judgment and is based on an evaluation of a number of factors, including market share, consumer awareness, brand history and future expansion expectations, as well as the macroeconomic environment of the countries in which the brand is sold.

Income Tax Expense and Accruals

Our annual tax rate is based on our income, statutory tax rates and tax planning opportunities available to us in the various jurisdictions in which we operate. Significant judgment is required in determining our annual tax rate and in evaluating our tax positions. We establish reserves when, despite our belief that our tax return positions are fully supportable, we believe that certain positions are subject to challenge and that we may not succeed. We adjust these reserves, as well as the related interest, in light of changing facts and circumstances, such as the progress of a tax audit.

An estimated effective tax rate for a year is applied to our quarterly operating results. In the event there is a significant or unusual item recognized in our quarterly operating results, the tax attributable to that item is separately calculated and recorded at the same time as that item. We consider the tax adjustments from the resolution of prior year tax matters to be such items.

Tax law requires items to be included in our tax returns at different times than the items are reflected in our financial statements. As a result, our annual tax rate reflected in our financial statements is different than that reported in our

tax returns (our cash tax rate). Some of these differences are permanent, such as expenses that are not deductible in our tax return, and some differences reverse over time, such as depreciation expense. These temporary differences create deferred tax assets and liabilities. Deferred tax assets generally represent items that can be used as a tax deduction or credit in our tax returns in future years for which we have already recorded the tax benefit

We adopted the provisions of FIN 48 as of the beginning of our 2007 fiscal year.

in our income statement. We establish valuation allowances for our deferred tax assets if, based on the available evidence, it is more likely than not that some portion or all of the deferred tax assets will not be realized. Deferred tax liabilities generally represent tax expense recognized in our financial statements for which payment has been deferred, or expense for which we have already taken a deduction in our tax return but have not yet recognized as expense in our financial statements.

In 2006, the Financial Accounting Standards Board (FASB) issued FASB Interpretation No. 48, *Accounting for Uncertainty in Income Taxes — an interpretation of FASB Statement No. 109* (FIN 48), which clarifies the accounting for uncertainty in tax positions. FIN 48 requires that we recognize in our financial statements the impact of a tax position, if that position is more likely than not of being sustained on audit, based on the technical merits of the position. We adopted the provisions of FIN 48 as of the beginning of our 2007 fiscal year. As a result of our adoption of FIN 48, we recognized a \$7 million decrease to reserves for income taxes, with a corresponding increase to opening retained earnings. See Note 5 for additional information regarding our tax reserves and our adoption of FIN 48.

In 2007, our annual tax rate was 25.9% compared to 19.3% in 2006 as discussed in "Other Consolidated Results." The tax rate in 2007 increased 6.6 percentage points primarily reflecting an unfavorable comparison to the prior year's non-cash tax benefits. In 2008, our annual tax rate is expected to be 27.5%, primarily reflecting the absence of the non-cash tax benefits recorded in 2007.

Pension and Retiree Medical Plans

Our pension plans cover full-time employees in the U.S. and certain international employees. Benefits are determined based on either years of service or a combination of years of service and earnings. U.S. and Canada retirees are also eligible for medical and life insurance benefits (retiree medical) if they meet age and service requirements. Generally, our share of retiree medical costs is capped at specified dollar amounts that vary based upon years of service, with retirees contributing the remainder of the cost.

On December 30, 2006, we adopted SFAS 158, *Employers' Accounting for Defined Benefit Pension and Other Postretirement Plans — an amendment of FASB Statements No. 87, 88, 106, and 132(R)* (SFAS 158). In connection with our adoption, we recognized the funded status of our pension and retiree medical plans (our Plans) on our balance sheet as of December 30, 2006 with subsequent changes in the funded status recognized in comprehensive income in the years in which they occur. In accordance with SFAS 158, amounts prior to the year of adoption have not been adjusted. SFAS 158 also requires that, no later than 2008, our assumptions used to measure our annual pension and retiree medical expense be determined as of the balance sheet date, and all plan assets and liabilities be reported as of that date. Accordingly, as

As of the beginning of our 2008 fiscal year, in accordance with SFAS 158, we will change the measurement date for our annual pension and retiree medical expense and all plan assets and liabilities from September 30 to our year-end balance sheet date.

of the beginning of our 2008 fiscal year, we will change the measurement date for our annual pension and retiree medical expense and all plan assets and liabilities from September 30 to our year-end

balance sheet date. As a result of this change in measurement date, we will record an after-tax \$7 million reduction to 2008 opening shareholders' equity which will be reflected in our 2008 first quarter Form 10-Q. For further information regarding the impact of our adoption of SFAS 158, see Note 7.

Our Assumptions

The determination of pension and retiree medical plan obligations and related expenses requires the use of assumptions to estimate the amount of the benefits that employees earn while working, as well as the present value of those benefits. Annual pension and retiree medical expense amounts are principally based on four components: (1) the value of benefits earned by employees for working during the year (service cost), (2) increase in the liability due to the passage of time (interest cost), and (3) other gains and losses as discussed below, reduced by (4) expected return on plan assets for our funded plans.

Significant assumptions used to measure our annual pension and retiree medical expense include:

- the interest rate used to determine the present value of liabilities (discount rate);
- certain employee-related factors, such as turnover, retirement age and mortality;
- for pension expense, the expected return on assets in our funded plans and the rate of salary increases for plans where benefits are based on earnings; and
- for retiree medical expense, health care cost trend rates.

Our assumptions reflect our historical experience and management's best judgment regarding future expectations. Due to the significant management judgment involved, our assumptions could have a material impact on the measurement of our pension and retiree medical benefit expenses and obligations.

At each measurement date, the discount rate is based on interest rates for high-quality, long-term corporate debt securities with maturities comparable to those of our liabilities. In the U.S., we use the Moody's Aa Corporate Bond Index yield (Moody's Aa Index) and adjust for differences between the average duration of the bonds in this Index and the average duration of our benefit liabilities, based upon a published index. As of the beginning of our 2008 fiscal year, our discount rate will be determined using the Mercer Pension Discount Yield Curve (Mercer Yield Curve). The Mercer Yield Curve uses a portfolio of high-quality bonds rated Aa or higher by Moody's. We believe the Mercer Yield Curve includes bonds that provide a better match to the timing and amount of expected benefit payments than the Moody's Aa Index.

The expected return on pension plan assets is based on our historical experience, our pension plan investment strategy and our expectations for long-term rates of return. Our pension plan investment strategy is reviewed annually and is established based upon plan liabilities, an evaluation of market conditions, tolerance for risk, and cash requirements for benefit payments. As part of our investment strategy, we employ certain equity strategies which, in addition to investing in U.S. and international common and preferred stock, include investing in certain equity- and debt-based securities used collectively to generate returns in excess of certain equity-based indices. Our investment policy also permits the use of derivative instruments to enhance the overall return of the portfolio. Our expected long-term rate of return on U.S. plan assets is 7.8%, reflecting estimated long-term rates of return of 9.3% from our equity strategies, and 5.8% from our fixed income strategies. Our target investment allocation is 60% for equity strategies and 40% for fixed income strategies. We use a market-related valuation method for recognizing investment gains or losses. For this purpose, investment gains or losses are

the difference between the expected and actual return based on the market-related value of assets. This market-related valuation method recognizes investment gains or losses over a five-year period from the year in which they occur, which has the effect of reducing year-to-year volatility. Expense in future periods will be impacted as gains or losses are recognized in the market-related value of assets over the five-year period.

Other gains and losses resulting from actual experience differing from our assumptions and from changes in our assumptions are also determined at each measurement date. If this net accumulated gain or loss exceeds 10% of the greater of plan assets or liabilities, a

portion of the net gain or loss is included in expense for the following year. The cost or benefit of plan changes that increase or decrease benefits for prior employee service (prior service cost/(credit)) is included in earnings on a straight-line basis over the average remaining service period of active plan participants, which is approximately 11 years for pension expense and approximately 13 years for retiree medical expense.

Effective as of the beginning of our 2008 fiscal year, we amended our U.S. hourly pension plan to increase the amount of participant earnings recognized in determining pension benefits. Additional pension plan amendments were also made as of the beginning of

our 2008 fiscal year to comply with legislative and regulatory changes.

The health care trend rate used to determine our retiree medical plan's liability and expense is reviewed annually. Our review is based on our claim experience, information provided by our health plans and actuaries, and our knowledge of the health care industry. Our review of the trend rate considers factors such as demographics, plan design, new medical technologies and changes in medical carriers.

Weighted-average assumptions for pension and retiree medical expense are as follows:

| | 2008 | 2007 | 2006 |
|--|------|------|-------|
| Pension | | | |
| Expense discount rate | 6.3% | 5.7% | 5.6% |
| Expected rate of return on plan assets | 7.6% | 7.7% | 7.7% |
| Expected rate of salary increases | 4.4% | 4.5% | 4.4% |
| Retiree medical | | | |
| Expense discount rate | 6.4% | 5.8% | 5.7% |
| Current health care cost trend rate | 8.5% | 9.0% | 10.0% |

Sensitivity of Assumptions

A decrease in the discount rate or in the expected rate of return assumptions would increase pension expense. The estimated impact of a 25-basis-point decrease in the discount rate on 2008 pension expense is an increase of approximately \$36 million. The estimated impact on 2008 pension expense of a 25-basis-point decrease in the expected rate of return is an increase of approximately \$17 million.

See Note 7 regarding the sensitivity of our retiree medical cost assumptions.

Future Funding

We make contributions to pension trusts maintained to provide plan benefits for certain pension plans. These contributions

are made in accordance with applicable tax regulations that provide for current tax deductions for our contributions, and taxation to the employee only upon receipt of plan benefits. Generally, we do not fund our pension plans when our contributions would not be currently deductible.

Our pension contributions for 2007 were \$230 million, of which \$92 million was discretionary. In 2008, we expect to make contributions of up to \$150 million with up to \$75 million expected to be discretionary. Our cash payments for retiree medical are estimated to be approximately \$85 million in 2008. As our retiree medical plans are not subject to regulatory funding requirements, we fund these plans on

a pay-as-you-go basis. Our pension and retiree medical contributions are subject to change as a result of many factors, such as changes in interest rates, deviations between actual and expected asset returns, and changes in tax or other benefit laws. For estimated future benefit payments, including our pay-as-you-go payments as well as those from trusts, see Note 7.

Recent Accounting Pronouncements

In September 2006, the SEC issued Staff Accounting Bulletin No. 108, *Considering the Effects of Prior Year Misstatements when Quantifying Misstatements in Current Year Financial Statements* (SAB 108), to address diversity in practice in quantifying financial statement misstatements. SAB 108 requires that we quantify misstatements based on their impact on each of our financial statements and related disclosures. On December 30, 2006, we adopted SAB 108. Our adoption of SAB 108 did not impact our financial statements.

In September 2006, the FASB issued SFAS 157, *Fair Value Measurements* (SFAS 157), which defines fair value, establishes a framework for measuring fair value, and expands disclosures about fair value

measurements. The provisions of SFAS 157 are effective as of the beginning of our 2008 fiscal year. However, the FASB deferred the effective date of SFAS 157, until the beginning of our 2009 fiscal year, as it relates to fair value measurement requirements for nonfinancial assets and liabilities that are not remeasured at fair value on a recurring basis. We are currently evaluating the impact of adopting SFAS 157 on our financial statements. We do not expect our adoption to have a material impact on our financial statements.

In February 2007, the FASB issued SFAS 159, *The Fair Value Option for Financial Assets and Financial Liabilities Including an amendment of FASB Statement No. 115* (SFAS 159), which permits entities to choose to measure many financial

instruments and certain other items at fair value. The provisions of SFAS 159 are effective as of the beginning of our 2008 fiscal year. Our adoption of SFAS 159 will not impact our financial statements.

In December 2007, the FASB issued SFAS 141 (revised 2007), *Business Combinations* (SFAS 141R), and SFAS 160, *Noncontrolling Interests in Consolidated Financial Statements* (SFAS 160), to improve, simplify, and converge internationally the accounting for business combinations and the reporting of noncontrolling interests in consolidated financial statements. The provisions of SFAS 141R and SFAS 160 are effective as of the beginning of our 2009 fiscal year. We are currently evaluating the impact of adopting SFAS 141R and SFAS 160 on our financial statements.

OUR FINANCIAL RESULTS

Items Affecting Comparability

The year-over-year comparisons of our financial results are affected by the following items:

| | 2007 | 2006 |
|--|----------|----------|
| Operating profit | | |
| Restructuring and impairment charges | \$(102) | \$(67) |
| Net income | | |
| Restructuring and impairment charges | \$(70) | \$(43) |
| Tax benefits | \$129 | \$602 |
| PepsiCo share of PBG tax settlement | — | \$18 |
| Net income per common share — diluted | | |
| Restructuring and impairment charges | \$(0.04) | \$(0.03) |
| Tax benefits | \$0.08 | \$0.36 |
| PepsiCo share of PBG tax settlement | — | \$0.01 |

For the items affecting our 2005 results, see Notes 3 and 5, as well as our 2006 Annual Report.

Restructuring and Impairment Charges

In 2007, we incurred a charge of \$102 million in conjunction with restructuring actions primarily to close certain plants and rationalize other production lines across FLNA, PBNA and PI.

In 2006, we incurred a charge of \$67 million in conjunction with consolidating the manufacturing network at FLNA by closing two plants in the U.S., and rationalizing other assets, to increase manufacturing productivity and supply chain efficiencies.

Tax Benefits

In 2007, we recognized \$129 million of non-cash tax benefits related to the favorable resolution of certain foreign tax matters.

In 2006, we recognized non-cash tax benefits of \$602 million, substantially all of which related to the Internal Revenue Service's (IRS) examination of our consolidated tax returns for the years 1998 through 2002.

PepsiCo Share of PBG Tax Settlement

In 2006, the IRS concluded its examination of PBG's consolidated income tax returns for the years 1999 through 2000 (PBG's Tax Settlement). Consequently, a non-cash benefit of \$21 million was included in bottling equity income as part of recording our share of PBG's financial results.

Results of Operations — Consolidated Review

In the discussions of net revenue and operating profit below, *effective net pricing* reflects the year-over-year impact of discrete pricing actions, sales incentive activities and mix resulting from selling varying products in different package sizes and in different countries.

Servings

Since our divisions each use different measures of physical unit volume (i.e., kilos, gallons, pounds and case sales), a common servings metric is necessary to reflect our consolidated physical unit volume. Our divisions' physical volume measures are converted into servings based on U.S. Food and Drug Administration guidelines for single-serving sizes of our products.

In 2007, total servings increased over 4% compared to 2006, as servings for beverages worldwide grew 4% and servings for snacks worldwide grew 6%. All of our divisions positively contributed to the total servings growth. In 2006, total servings increased 5.5% compared to 2005, as servings for beverages worldwide grew over 6% and servings for snacks worldwide grew 5%.

Net Revenue and Operating Profit

| | 2007 | 2006 | 2005 | Change | |
|---|----------|----------|----------|--------|------|
| | | | | 2007 | 2006 |
| Total net revenue | \$39,474 | \$35,137 | \$32,562 | 12% | 8% |
| Operating profit | | | | | |
| FLNA | \$2,845 | \$2,615 | \$2,529 | 9% | 3% |
| PBNA | 2,188 | 2,055 | 2,037 | 6% | 1% |
| PI | 2,322 | 2,016 | 1,661 | 15% | 21% |
| QFNA | 568 | 554 | 537 | 2.5% | 3% |
| Corporate unallocated | (753) | (738) | (780) | 2% | (5)% |
| Total operating profit | \$7,170 | \$6,502 | \$5,984 | 10% | 9% |
| Total operating profit margin | 18.2% | 18.5% | 18.4% | (0.3) | 0.1 |

2007

Net revenue increased 12% primarily reflecting favorable effective net pricing and volume growth. Effective net pricing contributed 4 percentage points and the volume gains contributed 3 percentage points to net revenue growth. The impact of acquisitions contributed 3 percentage points and foreign currency contributed 2 percentage points to net revenue growth.

Total operating profit increased 10% and margin decreased 0.3 percentage points. The operating profit performance reflects leverage from the revenue growth, offset by increased cost of sales, largely due to higher raw material costs. The impact of foreign currency contributed 2 percentage points to operating profit growth. There was no net impact of acquisitions and divestitures on operating profit growth.

2006

Net revenue increased 8% primarily reflecting higher volume and positive effective net pricing across all divisions. The volume gains and the effective net pricing each contributed 3 percentage points to net revenue growth. Acquisitions contributed 1 percentage point and foreign exchange contributed almost 1 percentage point to net revenue growth. The absence of the prior year's additional week reduced net revenue growth by over 1 percentage point and reduced volume growth by almost 1 percentage point.

Total operating profit increased 9% and margin increased 0.1 percentage points. The operating profit gains reflect the net revenue growth, partially offset by the impact of higher raw material and energy costs across all divisions. The absence of

the prior year's additional week reduced operating profit growth by over 1 percentage point.

Corporate Unallocated Expenses

Corporate unallocated expenses include the costs of our corporate headquarters, centrally managed initiatives, such as our ongoing business transformation initiative in North America, unallocated insurance and benefit programs, foreign exchange transaction gains and losses, and certain commodity derivative gains and losses, as well as profit-in-inventory elimination adjustments for our noncontrolled bottling affiliates and certain other items.

In 2007, corporate unallocated expenses increased 2% primarily reflecting \$35 million of increased research and development costs, partially offset by lower pension costs of \$18 million. Gains

of \$19 million from certain mark-to-market derivatives (compared to \$18 million of losses in the prior year) were fully offset by the absence of certain other favorable corporate items in the prior year.

In 2006, corporate unallocated expenses decreased \$42 million primarily

reflecting the absence of a non-recurring charge of \$55 million in the prior year to conform our method of accounting across all divisions, primarily for warehouse and freight costs. Higher costs associated with our ongoing business transformation initiative of \$35 million, as well as the

unfavorable comparison to the prior year's \$25 million gain in connection with the settlement of a class action lawsuit, were offset by the favorable impact of certain other corporate items.

Other Consolidated Results

| | 2007 | 2006 | 2005 | Change | |
|---------------------------------------|---------|---------|---------|--------|------|
| | | | | 2007 | 2006 |
| Bottling equity income | \$560 | \$553 | \$495 | 1% | 12% |
| Interest expense, net | \$(99) | \$(66) | \$(97) | \$(33) | \$31 |
| Annual tax rate | 25.9% | 19.3% | 36.1% | | |
| Net income | \$5,658 | \$5,642 | \$4,078 | — | 38% |
| Net income per common share — diluted | \$3.41 | \$3.34 | \$2.39 | 2% | 40% |

Bottling equity income includes our share of the net income or loss of our anchor bottlers as described in "Our Customers." Our interest in these bottling investments may change from time to time. Any gains or losses from these changes, as well as other transactions related to our bottling investments, are also included on a pre-tax basis. During 2007, we continued to sell shares of PBG stock to reduce our economic ownership to the level at the time of PBG's initial public offering, since our ownership has increased as a result of PBG's share repurchase program. We sold 9.5 million and 10.0 million shares of PBG stock in 2007 and 2006, respectively. The resulting lower ownership percentage reduces the equity income from PBG that we recognize. In November 2007, our Board of Directors approved the sale of additional PBG stock to an economic ownership level of 35%, as well as the sale of PAS stock to the ownership level at the time of the merger with Whitman Corporation in 2000 of about 37%.

2007

Bottling equity income increased 1% reflecting higher earnings from our anchor bottlers, partially offset by the impact of our reduced ownership level in 2007 and lower pre-tax gains on our sale of PBG stock.

Net interest expense increased \$33 million primarily reflecting the impact of lower investment balances and higher average rates on our debt, partially offset by higher average interest rates on our investments and lower average debt balances.

The tax rate increased 6.6 percentage points compared to the prior year primarily reflecting an unfavorable comparison to the prior year's non-cash tax benefits.

Net income remained flat and the related net income per share increased 2%. Our solid operating profit growth was offset by unfavorable comparisons to the non-cash tax benefits and restructuring and impairment charges in the prior year. Additionally, net income per share was favorably impacted by our share repurchases.

2006

Bottling equity income increased 12% primarily reflecting a \$186 million pre-tax gain on our sale of PBG stock, which compared favorably to a \$126 million pre-tax gain in the prior year. The non-cash gain of \$21 million from our share of PBG's Tax Settlement was fully offset by lower equity income from our anchor bottlers in the current year, primarily resulting from the impact of their respective adoptions of SFAS 123R in 2006.

Net interest expense decreased \$31 million primarily reflecting higher average rates on our investments and lower debt balances, partially offset by lower investment balances and the impact of higher average rates on our borrowings.

The tax rate decreased 16.8 percentage points compared to prior year primarily reflecting the non-cash tax benefits recorded in 2006, the absence of the 2005 tax charge related to the American Jobs Creation Act of 2004 (AJCA) and the resolution of certain state income tax audits in the current year.

Net income increased 38% and the related net income per share increased 40%. These increases primarily reflect the non-cash tax benefits recorded in 2006, the absence of the AJCA tax charge and our solid operating profit growth.

Results of Operations — Division Review

The results and discussions below are based on how our Chief Executive Officer monitors the performance of our divisions. For additional information on these items and our divisions, see Note 1.

| | FLNA | PBNA | PI | QFNA | Total |
|--|-----------------|-----------------|-----------------|----------------|-----------------|
| Net Revenue, 2007 | \$11,586 | \$10,230 | \$15,798 | \$1,860 | \$39,474 |
| Net Revenue, 2006..... | \$10,844 | \$9,565 | \$12,959 | \$1,769 | \$35,137 |
| <i>% Impact of:</i> | | | | | |
| Volume ^(a) | 3% | (2)% | 7% | 2% | 3% |
| Effective net pricing ^(b) | 4 | 6 | 3.5 | 3 | 4 |
| Foreign exchange..... | 0.5 | — | 6 | 1 | 2 |
| Acquisitions/divestitures..... | — | 2 | 6 | — | 3 |
| % Change^(c) | 7% | 7% | 22% | 5% | 12% |

| | FLNA | PBNA | PI | QFNA | Total |
|--|-----------|-----------|------------|-----------|-----------|
| Net Revenue, 2006..... | \$10,844 | \$9,565 | \$12,959 | \$1,769 | \$35,137 |
| Net Revenue, 2005..... | \$10,322 | \$9,146 | \$11,376 | \$1,718 | \$32,562 |
| <i>% Impact of:</i> | | | | | |
| Volume ^(a) | 1% | 3% | 6% | 1% | 3% |
| Effective net pricing ^(b) | 3 | 1 | 4 | 2 | 3 |
| Foreign exchange..... | 0.5 | — | 1 | 1 | 1 |
| Acquisitions/divestitures..... | 0.5 | — | 3 | — | 1 |
| % Change^(c) | 5% | 5% | 14% | 3% | 8% |

(a) Excludes the impact of acquisitions and divestitures. For PBNA and PI, volume growth varies from the amounts disclosed in the following divisional discussions due primarily to non-consolidated joint venture volume and temporary timing differences between BCS and CSE. Our net revenue for PBNA and PI excludes non-consolidated joint venture volume and is based on CSE.

(b) Includes the year-over-year impact of discrete pricing actions, sales incentive activities and mix resulting from selling varying products in different package sizes and in different countries.

(c) Amounts may not sum due to rounding.

Frito-Lay North America

| | 2007 | 2006 | 2005 | % Change | |
|------------------|----------|----------|----------|----------|------|
| | | | | 2007 | 2006 |
| Net revenue | \$11,586 | \$10,844 | \$10,322 | 7 | 5 |
| Operating profit | \$2,845 | \$2,615 | \$2,529 | 9 | 3 |

2007

Net revenue grew 7% reflecting volume growth of 3% and positive effective net pricing due to pricing actions and favorable mix. Pound volume grew primarily due to high-single-digit growth in trademark Doritos and double-digit growth in dips, SunChips and multipack. These

In 2007, FLNA volume grew primarily due to high-single-digit growth in trademark Doritos and double-digit growth in dips, SunChips and multipack.

volume gains were partially offset by a mid-single-digit decline in trademark Lay's.

Operating profit grew 9% primarily reflecting the net revenue growth, as well as a favorable casualty insurance actuarial adjustment reflecting improved safety performance. This growth was partially offset by higher commodity costs, as well as increased advertising and marketing expenses. Operating profit benefited almost 2 percentage points from the

impact of lower restructuring and impairment charges in the current year related to the continued consolidation of the manufacturing network.

Smart Spot eligible products represented approximately 16% of net revenue. These products experienced double-digit revenue growth, while the balance of the portfolio had mid-single-digit revenue growth.

2006

Net revenue grew 5% reflecting volume growth of 1% and positive effective net pricing due to salty snack pricing actions and favorable mix. Pound volume grew primarily due to double-digit growth in SunChips, Multipack and Quaker

Rice Cakes. These volume gains were partially offset by low-single-digit declines in trademark Lay's and Doritos. The Stacy's Pita Chip Company acquisition contributed approximately 0.5 percentage points to both revenue and volume growth. The absence of the prior year's additional week reduced volume and net revenue growth by 2 percentage points.

Operating profit grew 3% reflecting the net revenue growth. This growth was partially offset by higher commodity costs, primarily cooking oil and energy. Operating profit was also negatively impacted by almost 3 percentage points as a result of a fourth quarter charge for the consolidation of the manufacturing network, including the closure of two plants and rationalization of other manufacturing assets. The absence of the prior year's additional week, which reduced operating profit growth by 2 percentage points, was largely offset by the impact of restructuring charges in the prior year to reduce costs in our operations, principally through headcount reductions.

FLNA's Smart Spot eligible products experienced double-digit revenue growth in both 2007 and 2006.

Smart Spot eligible products represented approximately 15% of net revenue. These products experienced double-digit revenue growth, while the balance of the portfolio had low-single-digit revenue growth.

PepsiCo Beverages North America

| | 2007 | 2006 | 2005 | % Change | |
|------------------|----------|---------|---------|----------|------|
| | | | | 2007 | 2006 |
| Net revenue | \$10,230 | \$9,565 | \$9,146 | 7 | 5 |
| Operating profit | \$2,188 | \$2,055 | \$2,037 | 6 | 1 |

2007

BCS volume was flat due to a 3% decline in CSDs, entirely offset by a 5% increase in non-carbonated beverages. The decline in the CSD portfolio reflects a mid-single-digit decline in trademark Pepsi offset slightly by a low-single-digit increase in trademark Sierra Mist. Trademark Mountain Dew volume was flat. Across the brands, regular CSDs experienced a mid-single-digit decline and diet CSDs experienced a low-single-digit decline. The non-carbonated portfolio performance was driven by double-digit growth in Lipton ready-to-drink teas, double-digit growth in waters and enhanced waters under the Aquafina, Propel and SoBe Life Water trademarks and low-single-digit growth in Gatorade, partially offset by a mid-single-digit decline in our juice and juice drinks portfolio as a result of previous price increases.

Net revenue grew 7% driven by effective net pricing, primarily reflecting price increases on Tropicana Pure Premium and CSD concentrate and growth in finished goods beverages. Acquisitions contributed 2 percentage points to net revenue growth.

Operating profit increased 6% reflecting the net revenue growth, partially offset by higher cost of sales, mainly due to increased fruit costs, as well as higher general and administrative costs. The impact of restructuring actions taken in the fourth quarter was fully offset by the favorable impact of Canadian exchange rates during the year. Operating profit was also positively impacted by the absence of amortization expense related to a prior acquisition, partially offset by the absence of a \$29 million favorable insurance settlement, both recorded in 2006. The impact of acquisitions reduced operating profit by less than 1 percentage point.

Smart Spot eligible products represented over 70% of net revenue. These products experienced mid-single-digit net revenue growth, while the balance of the portfolio grew in the high-single-digit range.

2006

BCS volume grew 4%. The volume increase was driven by a 14% increase in non-carbonated beverages, partially offset by a 2% decline in CSDs. The non-carbonated portfolio performance was driven by double-digit growth in trademark Aquafina, Gatorade, Lipton ready-to-drink teas, Tropicana juice drinks and Propel. Tropicana Pure Premium experienced a low-single-digit decline in volume. The decline in CSDs reflects a low-single-digit decline in trademark Pepsi, partially offset by a mid-single-digit increase in trademark Sierra Mist and a low-single-digit increase in trademark Mountain Dew. Across the brands, regular CSDs experienced a low-single-digit decline and diet CSDs declined slightly. The additional week in 2005 had no significant impact on volume growth as bottler volume is reported based on a calendar month.

Net revenue grew 5%. Positive mix contributed to the revenue growth, reflecting the strength of non-carbonated beverages. Price increases taken in 2006, primarily on concentrate, Tropicana Pure Premium and fountain, were offset by overall higher trade spending. The absence of the prior year's additional week reduced net revenue growth by 1 percentage point.

Operating profit increased 1% primarily reflecting the net revenue growth and lower advertising and marketing expenses. Higher raw material costs,

primarily oranges, increased supply chain costs in Gatorade and higher energy costs substantially offset the operating profit increase. Total marketplace spending for the year increased, reflecting a shift from advertising and marketing spending to trade spending. Additionally, the impact of more-favorable settlements of trade spending accruals in 2005 was mostly offset by a favorable insurance settlement of \$29 million in 2006. The absence of the prior year's additional week, which reduced operating profit growth by

Smart Spot eligible products represented over 70% of PBNAs total revenue in both 2007 and 2006.

1 percentage point, was fully offset by the impact of charges taken in the fourth quarter of 2005 to reduce costs in our operations, principally through headcount reductions.

Smart Spot eligible products represented over 70% of net revenue. These products experienced high-single-digit revenue growth, while the balance of the portfolio declined in the low-single-digit range.

PepsiCo International

| | 2007 | 2006 | 2005 | % Change | |
|------------------|----------|----------|----------|----------|------|
| | | | | 2007 | 2006 |
| Net revenue | \$15,798 | \$12,959 | \$11,376 | 22 | 14 |
| Operating profit | \$2,322 | \$2,016 | \$1,661 | 15 | 21 |

2007

International snacks volume grew 9% reflecting double-digit growth in Russia, the Middle East and Turkey, partially offset by low-single-digit declines at Sabritas in Mexico and Walkers in the United Kingdom. Additionally, Gamesa in Mexico, India and China all grew at double-digit rates. Overall, the Europe, Middle East & Africa region grew 9%, the Latin America region grew 6% and the Asia Pacific region grew 20%. Acquisitions in Europe, New Zealand and Brazil increased the Europe, Middle East & Africa region volume growth by 1 percentage point, the Asia Pacific region volume growth by 7 percentage points and the Latin America region volume growth by 0.5 percentage points, respectively. In aggregate, acquisitions contributed almost 2 percentage points to the reported total PepsiCo International snack volume growth rate.

PI experienced double-digit revenue and operating profit growth in both 2007 and 2006.

Beverage volume grew 8% led by double-digit growth in the Middle East, China and Pakistan, partially offset by a low-single-digit decline in Mexico and a high-single-digit decline in Thailand. Additionally, Russia and Brazil grew at double-digit rates. The Europe, Middle East & Africa region grew 11%, the Asia Pacific region grew 8% and the Latin America region grew 4%. The acquisition of a business in Europe increased the Europe, Middle East & Africa region volume growth by 1 percentage point and the total PepsiCo International beverage volume growth by nearly 1 percentage

point. CSDs grew at a high-single-digit rate while non-carbonated beverages grew at a double-digit rate.

Net revenue grew 22% reflecting the volume growth and favorable effective net pricing. Foreign currency contributed 6 percentage points of growth primarily reflecting the favorable euro, British pound and Brazilian real. The net impact of acquisitions and divestitures also contributed 6 percentage points to net revenue growth.

Operating profit grew 15% driven largely by the volume growth and favorable effective net pricing, partially offset by increased raw material costs. Foreign currency contributed 5 percentage points of growth primarily reflecting the favorable British pound, euro and Brazilian real. The net impact of acquisitions and divestitures on operating profit was minimal. The impact of restructuring actions taken in the fourth quarter to reduce costs in our operations, rationalize capacity and realign our organizational structure reduced operating profit growth by 3 percentage points.

2006

International snacks volume grew 9% reflecting double-digit growth in Russia, Turkey, Egypt and India and single-digit growth at Sabritas in Mexico. Overall, the Europe, Middle East & Africa region grew 17%, the Latin America region grew 2.5% and the Asia Pacific region grew 12%. Acquisitions of two businesses in Europe in 2006 increased the Europe, Middle East & Africa region volume growth by nearly 6 percentage points. The acquisition of a business in Australia increased the Asia Pacific region volume growth by 1 percentage point. In aggregate, acquisitions contributed 2 percentage points to the reported total PepsiCo

International snack volume growth rate. The absence of the prior year's additional week reduced the growth rate by 1 percentage point.

Beverage volume grew 9% reflecting broad-based increases led by double-digit growth in the Middle East, China, Argentina, Russia and Venezuela. The Europe, Middle East & Africa region grew 11%, the Asia Pacific region grew 9% and the Latin America region grew 7%. Acquisitions contributed 1 percentage point to the Europe, Middle East & Africa region volume growth rate and contributed slightly to the reported total PepsiCo International beverage volume growth rate. CSDs grew at a high-single-digit rate while non-carbonated beverages grew at a double-digit rate.

Net revenue grew 14% primarily as a result of the broad-based volume growth and favorable effective net pricing. The net impact of acquisitions and divestitures contributed nearly 3 percentage points to net revenue growth. Foreign currency contributed 1 percentage point of growth. The absence of the prior year's additional week reduced net revenue growth by 1 percentage point.

Operating profit grew 21% driven primarily by the net revenue growth, partially offset by increased raw material and energy costs. The net impact of acquisitions and divestitures contributed 1 percentage point of growth. Foreign currency also contributed 1 percentage point of growth. The absence of the prior year's additional week, which reduced the operating profit growth rate by 1 percentage point, was fully offset by the impact of charges taken in 2005 to reduce costs in our operations and rationalize capacity.

Quaker Foods North America

| | 2007 | 2006 | 2005 | % Change | |
|------------------|---------|---------|---------|----------|------|
| | | | | 2007 | 2006 |
| Net revenue | \$1,860 | \$1,769 | \$1,718 | 5 | 3 |
| Operating profit | \$568 | \$554 | \$537 | 2.5 | 3 |

2007

Net revenue increased 5% and volume increased 2%. The volume increase reflects mid-single-digit growth in Oatmeal and Life cereal, as well as low-single-digit growth in Cap'n Crunch cereal. These increases were partially offset by a double-digit decline in Rice-A-Roni. The increase in net revenue primarily reflects price increases taken earlier in the year, as well as the volume growth. Favorable Canadian exchange rates contributed nearly 1 percentage point to net revenue growth.

Operating profit increased 2.5% primarily reflecting the net revenue growth partially offset by increased raw material costs.

Smart Spot eligible products represented over half of net revenue and experienced mid-single-digit net revenue growth. The balance of the portfolio also grew in the mid-single-digit range.

2006

Net revenue grew 3% and volume increased 1%. The volume increase reflects mid-single-digit growth in Oatmeal, high-single-digit growth in Life cereal and low-single-digit growth in Cap'n Crunch cereal. These increases were partially offset by a low-single-digit decline in Aunt Jemima syrup and mix and a mid-single-digit decline in Rice-A-Roni. Net revenue growth was also driven by favorable effective net pricing, which contributed almost 2 percentage points to net revenue growth, and favorable Canadian foreign exchange rates which contributed almost 1 percentage point. The absence of the prior year's additional week reduced both net revenue and volume growth by approximately 2 percentage points.

Operating profit increased 3% primarily reflecting the net revenue growth. Increased cost of sales, primarily driven

by higher raw material and energy costs, were largely offset by lower advertising and marketing expenses. The absence of the prior year's additional week reduced operating profit growth by approximately 2 percentage points.

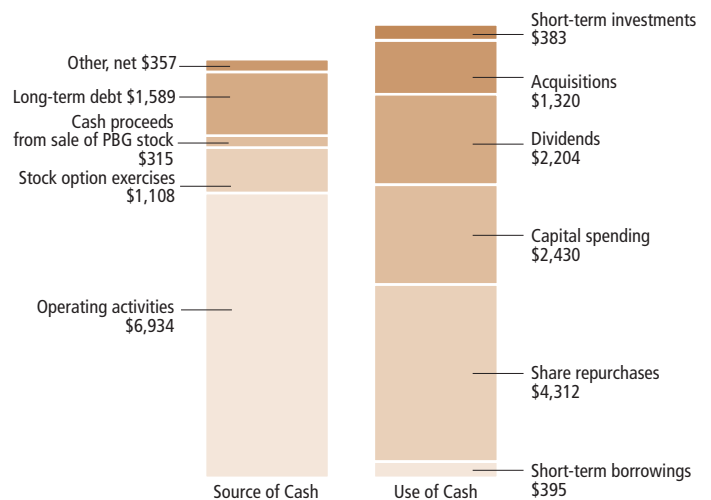
QFNA's revenue and volume growth accelerated in 2007 to 5% and 2%, respectively.

Smart Spot eligible products represented approximately 55% of net revenue and had mid-single-digit net revenue growth. The balance of the portfolio experienced a low-single-digit decline. The absence of the prior year's additional week negatively impacted these results.

Our Liquidity and Capital Resources

Our strong cash-generating capability and financial condition give us ready access to capital markets throughout the world. Our principal source of liquidity is our operating cash flow. This cash-generating capability is one of our fundamental strengths and provides us with substantial financial flexibility in meeting operating, investing and financing needs. In addition, we have revolving credit facilities that are further discussed in Note 9. Our cash provided from operating activities is somewhat impacted by seasonality. Working capital needs are impacted by weekly sales, which are generally highest in the third quarter due to seasonal and holiday-related sales patterns, and generally lowest in the first quarter.

2007 Cash Utilization



Operating Activities

In 2007, our operations provided \$6.9 billion of cash, compared to \$6.1 billion in the prior year, primarily reflecting our solid business results. Our operating cash flow in 2006 also reflects a tax payment of \$420 million related to our repatriation of international cash in connection with the AJCA.

Investing Activities

In 2007, we used \$3.7 billion for our investing activities primarily reflecting capital spending of \$2.4 billion and acquisitions of \$1.3 billion. Acquisitions primarily included the remaining interest in a snacks joint venture in Latin America, Naked Juice Company and Bluebird Foods, and the acquisition of a minority interest in a juice company in the Ukraine through a joint venture with PAS. Proceeds from our sale of PBG stock of \$315 million were offset by net purchases of short-term investments of \$383 million. In 2006, capital spending of \$2.1 billion and acquisitions of \$522 million were mostly offset by net sales of short-term investments of \$2.0 billion and proceeds from our sale of PBG stock of \$318 million.

We anticipate net capital spending of approximately \$2.7 billion in 2008, which is expected to be within our net capital spending target of approximately 5% to 7% of net revenue. Planned capital spending in 2008 includes investments to increase capacity in our snack and beverage businesses to support growth in developing and emerging markets, investments in North America to support growth in key trademarks, and investments in our ongoing business transformation initiative. New capital projects are evaluated on a case-by-case basis and must meet certain payback and internal rate of return targets.

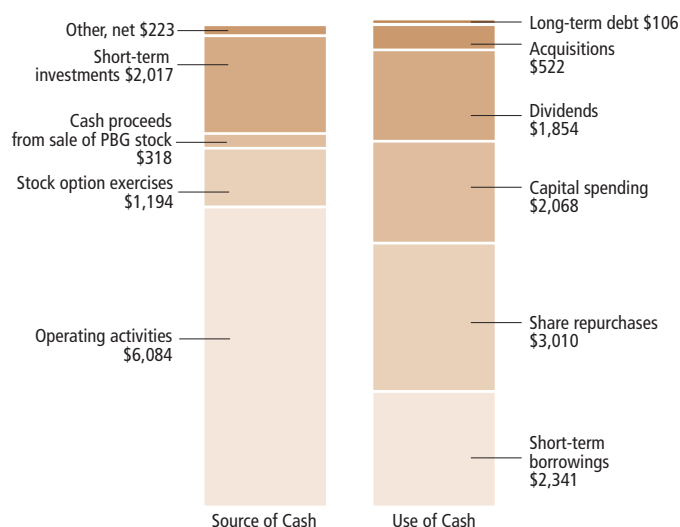
Financing Activities

In 2007, we used \$4.0 billion for our financing activities, primarily reflecting the return of operating cash flow to our shareholders through common share repurchases of \$4.3 billion and dividend payments of \$2.2 billion, as well as net repayments of short-term borrowings of \$395 million. The use of cash was partially offset by stock option proceeds of \$1.1 billion and net proceeds from issuances of long-term debt of \$1.6 billion.

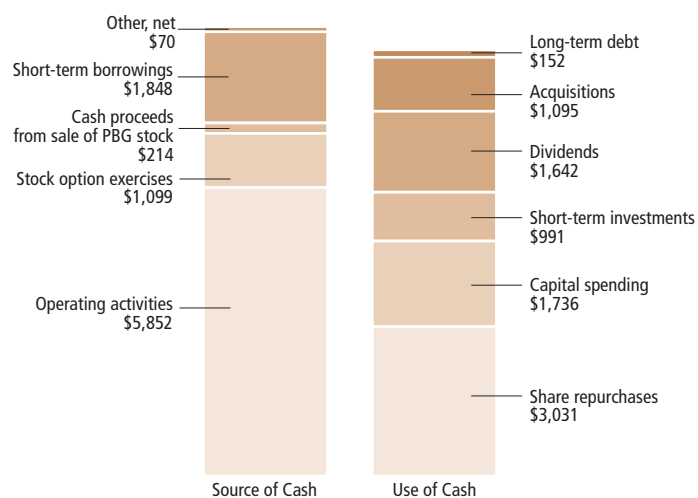
In 2006, we used \$6.0 billion for our financing activities, primarily reflecting the return of operating cash flow to our shareholders through common share repurchases of \$3.0 billion and dividend payments of \$1.9 billion. Net repayments of short-term borrowings of \$2.3 billion were partially offset by stock option proceeds of \$1.2 billion.

We annually review our capital structure with our Board, including our dividend policy and share repurchase activity. In the second quarter of 2007, our Board of Directors approved an increase in our targeted dividend payout rate from 45% to 50% of prior year's earnings, excluding certain items. The Board of Directors also authorized stock repurchases of up to an additional \$8 billion through June 30, 2010, once the current share repurchase authorization is complete. The current \$8.5 billion authorization began in 2006 and has approximately \$3.1 billion remaining. We have historically repurchased significantly more shares each year than we have issued under our stock-based compensation plans, with average net annual repurchases of 1.4% of outstanding shares for the last five years.

2006 Cash Utilization



2005 Cash Utilization



| | 2007 | 2006 | 2005 |
|---|----------|----------|----------|
| Net cash provided by operating activities | \$ 6,934 | \$ 6,084 | \$ 5,852 |
| Capital spending | (2,430) | (2,068) | (1,736) |
| Sales of property, plant and equipment | 47 | 49 | 88 |
| Management operating cash flow | \$ 4,551 | \$ 4,065 | \$ 4,204 |

Management Operating Cash Flow

We focus on management operating cash flow as a key element in achieving maximum shareholder value, and it is the primary measure we use to monitor cash flow performance. However, it is not a measure provided by accounting principles generally accepted in the U.S. Since net capital spending is essential to our product innovation initiatives and maintaining our operational capabilities, we believe that it is a recurring and necessary use of cash. As such, we believe investors should also consider net capital spending when evaluating our cash from operating activities. The table above reconciles the net cash provided by operating activities, as reflected in our cash flow statement, to our management operating cash flow.

Management operating cash flow was used primarily to repurchase shares and pay dividends. We expect to continue to return approximately all of our management operating cash flow to our shareholders through dividends and share repurchases. However, see "Our Business Risks" for certain factors that may impact our operating cash flows.

Credit Ratings

Our debt ratings of Aa2 from Moody's and A+ from Standard & Poor's contribute to our ability to access global capital markets. We have maintained strong investment grade ratings for over a decade. Each rating is considered strong investment grade and is in the first quartile of their respective ranking systems. These ratings also reflect the impact of our anchor bottlers' cash flows and debt.

Credit Facilities and Long-Term Contractual Commitments

See Note 9 for a description of our credit facilities and long-term contractual commitments.

Off-Balance-Sheet Arrangements

It is not our business practice to enter into off-balance-sheet arrangements, other than in the normal course of business. However, certain guarantees were necessary to facilitate the separation of our bottling and restaurant operations from us. At year-end 2007, we believe it is remote that these guarantees would require any cash payment. We do not enter into off-balance-sheet transactions specifically structured to provide income or tax benefits or to avoid recognizing or disclosing assets or liabilities. See Note 9 for a description of our off-balance-sheet arrangements.