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Special Issue: PepsiCo Seeks to Buy Two Big Bottlers.

Epochal Event: PepsiCo Offers to Acquire PBG and PepsiAmericas. \$6 Bil Deal.

Route-to-Market Changes? Pressure on Coke? Interview With CEO Nooyi. 'Great Partnership' With Independent Bottlers.

In stunning move, PepsiCo today made offers to acquire both Pepsi Bottling Group (PBG) and PepsiAmericas (PAS) in deal totaling \$6 bil. Ironically, offer comes just about 10 years after PBG (formerly known as Pepsi COBO) was spun off by PepsiCo as an independent public company. PBG and PAS are very large and important bottlers. At the end of 2008, PBG accounted for 55.7% of Pepsi's U.S. bottle/can volume, and PAS accounted for 18.9%. So, together, these two bottlers -- Pepsi's two biggest -- handle about 75% of Pepsi's CSD volume. Both bottlers also have significant international territories, with PBG, for example, operating in Russia, Spain, Mexico and Canada and PAS in eastern Europe. PepsiCo CEO Indra Nooyi says this deal would cause a "strategic transformation of the North American beverage business."

Ownership; terms of deal; 17.1% premium; stock prices. PepsiCo owns 33.1% of PBG and 43.2% of PAS. PAS chairman/CEO Bob Pohl and his affiliates own about 10.4% of PAS. Deal prices. At the end of the day on Friday, April 17th, PepsiCo's stock closed at \$52.13. PBG closed at \$25.20; PAS at \$19.88. The purchase prices for the bottlers are payable half in cash and half in stock. PepsiCo is offering \$29.50 per share for PBG, with \$14.75 payable in cash and with the issuance of 0.283 shares of PepsiCo. For PAS, PepsiCo is offering \$23.27, payable \$11.64 in cash and 0.223 shares of PepsiCo. PepsiCo says each of these acquisition prices represent a 17.1% premium over the closing price on Friday, April 17. The acquisitions of the bottlers is dependent on PepsiCo being able to buy both of them. At mid-morning Monday, April 20, the Dow was down -2.8%; PepsiCo was down -3.7%; PBG was up +20.9%; and PAS was up +20.9%. Consumer Edge Research analyst Bill Pecoriello raises issue of whether "PBG and PAS will accept the offer prices or find the offers inadequate." Both bottlers issued statements that they had received the proposals and will respond "in due course."

Perspective; issues; Crush; Dr Pepper. In a statement, Nooyi says rationale for deal is to reshape the North American beverage business model to improve competitiveness and growth prospects. In addition, over the last year, PBG and other large Pepsi bottlers have begun to take on some non-Pepsi brands, such as Dr Pepper Snapple's Crush and Muscle Milk. This, say sources, has caused some consternation inside PepsiCo. One un-answered issue of this transaction is: will PepsiCo-owned PBG and PAS operations keep Crush or drop it and take on Tropicana Twister or some other PepsiCo flavor line. Another issue is whether DPS will approve the transfers of PBG's and PAS's Dr Pepper franchises to PepsiCo, assuming these deals complete, or transfer them to independent system bottlers or to Coke bottlers. PBG is the #2 Dr Pepper bottler. PepsiAmericas is the #4 Dr Pepper bottler. Operating company. Beyond its beverage business, PepsiCo also owns the Frito-Lay snack food business, and therefore is already an operating company, producing the products and owning and operating the Frito DSD system.

Perspective: Gatorade. The Pepsi bottlers handle relatively little of PepsiCo's Gatorade brand, with most of it being warehouse-delivered. Sources have said that it would not have been financially advantageous in the past for PepsiCo to give the bottlers a great deal more Gatorade volume, given the cost and margin differences between warehouse delivery and DSD. However, if PepsiCo owns these two big bottlers -- and there is no longer a need for separate public company bottler profit pools -- that whole dynamic could change. Some sources anticipate that PepsiCo might move at least

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some Gatorade cold-channel volume into the bottling system, if this deal completes. Last fall, Pecoriello, then with Morgan Stanley, suggested that "a switch of Gatorade to the bottler network for small format stores can generate several benefits." But he suggested PepsiCo would have \$160 mil in higher costs than it does using warehouse delivery and the bottlers would gain \$350 mil, so the net benefit to the system would be \$190 mil. Now, most of that would flow to PepsiCo, he said, if the deal gets done and that change is made.

Coke system implications. There has been speculation on and off for several years that Coke might buy CCE and other U.S. bottlers. That was the focus of an internal Coke study several years ago. However, sources have said that both the Coke board and CEO Muhtar Kent have not favored that approach in the past. This deal by PepsiCo, though, could change things. With PepsiCo owning its two biggest bottlers, Coke may view that as giving PepsiCo a competitive advantage, and one analyst suggested that may put pressure on Coke to make a similar move. Pecoriello: "If PepsiCo is successful in dramatically changing its go-to-market strategy in beverages giving it a competitive advantage (both in execution and cost saves), Coke may have no choice but to ultimately buy CCE." One Coke bottler says he thinks Coke will "have to follow suit and should," but notes the "big imponderables" are what the board and Kent think. Adds, Coke "didn't spend the money in China" (the company's recently proposed \$2+ bil juice acquisition was turned down by Chinese antitrust authorities), "so this would make sense for them." But other source close to Coke says in the past Coke has not believed that buying CCE was value-creating for Coke. Several sources suggest that Coke will take a "long, hard look" before making any final decision.

Interview with Nooyi. BD asks Nooyi: What is the rationale for this deal?

"Strategic transformation of the North American beverage business. In a category that is flat to declining, where the fundamentals of the category have changed so much now with proliferation of competition, consolidation of retailers, the fact that we own hot-fill and Gatorade -- all of that said that we need to create one cohesive supply chain and business model."

Do you plan to try and acquire other U.S. bottlers? "We are very happy with our relationships with our independent bottlers, and at this point our plan is to work very constructively with them to make the entire Pepsi -- the PepsiCo beverage system -- a competitively advantaged system."

Was the act of PBG and PAS taking on Crush and Muscle Milk a factor in your decision?

"No, those are small products. That is not the reason that we're doing this. We're doing this because of the big picture of creating a fully integrated supply chain and go-to-market business model."

Will there be changes in route-to-market for some products in some channels? "We'll look at all options to create sustainable advantage for the North American beverage business. Nothing is off the table."

Do you anticipate some changes in Gatorade distribution? "As I said, all options are on the table. We'll look at everything and do what's right. We have the ability now to flex our DSD and our warehouse delivery systems to really create advantages. The most important thing is that we can incubate products (using) warehouse delivery and move them to DSD. We can keep warehouse for large format, we can leverage DSD for small format. It gives us infinite flexibility."

Will there be changes in bottler management? Employee headcount reductions? "We have an outstanding team at both PBG and PAS ... People who came out of PepsiCo. We know them well. They're consistent with our values. We think we'll have the luxury of having more good leaders to pick from than not enough." Headcount reduction? "As with any acquisition, there will be some re-structuring paring back of people. However, this is not going to impact the front-line, people who manufacture, make, sell and deliver. That will continue. It's much more how we alter the super-structure."

More from Nooyi. In conference call with investors April 20, Nooyi declared deal will enable PepsiCo "to compete more effectively in the North American market." Also notes that deal gives PepsiCo flexibility to "shift products more easily between DSD and

warehouse." Says new structure will enable PepsiCo to bring "innovation to the market much faster" without "negotiating profit splits" with the big bottlers. She says PepsiCo will be able to transfer some of Frito-Lay's technology to its beverage system. She reiterated, as she did in the interview, that Pepsi independent bottlers "will continue to play an important role" and that PepsiCo will work closely with them to increase efficiencies and decrease costs. Adds, "we have a great partnership with our independent bottlers."

Views: bottlers and Wall Street. Bottlers. BD asked several independent Pepsi bottlers for their views in the wake of the announcement of this transaction. There did not appear to be unanimity of perspective. One top-10 bottler wondered if PepsiCo will eventually seek to buy at least some other bottlers, and he said he thought this would be the case. He suggested the a future Pepsi U.S. bottling system might consist of Pepsi's owned operations and a few larger independent bottlers. Asked about the impact on the system short-term, he said, "it's a win for the independents, because PepsiCo will be on the same page as the bottlers with a common perspective." He added that, "PepsiCo will do things for the system to help take costs out." He further added that he thinks it will be easier for the independents to deal with PepsiCo than with PBG. But another bottler had a very different view. He praised PBG's operational "excellence" and said when PBG's operations were Pepsi COBO, those operations were less strong than they have been under PBG.

Wall Street. Pecoriello says, "don't underestimate that Gatorade is one of the key drivers" behind PepsiCo's offers to buy the bottlers. Adds with this deal, there could be "execution risks." But notes, "there are clear positives if (deal) is executed well." Credit Suisse analyst Carlos Laboy: "PepsiCo has taken a major leap forward to fix the dysfunctional North American bottler-supplier beverage model by acquiring its two largest bottlers PBG and PAS." JP Morgan's John Faucher said this move represents going "back to the future." He called the offer "truly a shock." But he notes, the deal highlights the "changing realities of the North American beverage business" and adds, strategically, there are reasons to do this." Kaumil Gajrawala of UBS: "We are positive on the deal. We expect 'NewCo' to be substantially more dominant in the U.S., as the company combines its distribution/manufacturing into one entity and drives profit growth through a 'one-portfolio' approach."

Plus. PepsiCo says that its financial advisors on this deal were Centerview Partners, Banc of America Securities and Merrill Lynch. One of the partners in Centerview is Jim Kilts, former CEO of Gillette who in 2004 was believed to be in the running for the top job at Coke, which eventually went to Neville Isdell.