

PEPSICO INC  
Form 10-K  
February 22, 2010  
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**UNITED STATES**  
**SECURITIES AND EXCHANGE COMMISSION**

WASHINGTON, DC 20549

**FORM 10-K**

(Mark One)

**x ANNUAL REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934**

**For the fiscal year ended December 26, 2009**

**or**

**.. TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934**

**For the transition period from \_\_\_\_\_ to \_\_\_\_\_**

**Commission file number 1-1183**

**PepsiCo, Inc.**

(Exact Name of Registrant as Specified in Its Charter)

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**North Carolina**  
(State or Other Jurisdiction of

**13-1584302**  
(I.R.S. Employer

Incorporation or Organization)

Identification No.)

**700 Anderson Hill Road, Purchase, New York** (Address  
of Principal Executive Offices)

**10577**

(Zip Code)

**Registrant's telephone number, including area code: 914-253-2000**

**Securities registered pursuant to Section 12(b) of the Securities Exchange Act of 1934:**

| <b>Title of each class</b>                                                                   | <b>Name of each exchange<br/>on which registered</b> |
|----------------------------------------------------------------------------------------------|------------------------------------------------------|
| Common Stock, par value 1-2/3 cents per share                                                | New York and Chicago Stock Exchanges                 |
| Securities registered pursuant to Section 12(g) of the Securities Exchange Act of 1934: None |                                                      |

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Indicate by check mark if the registrant is a well-known seasoned issuer, as defined in Rule 405 of the Securities Act.  
Yes ☒ No ☐

Indicate by check mark if the registrant is not required to file reports pursuant to Section 13 or 15(d) of the Act. Yes ☐ No ☒

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. Yes ☒ No ☐

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (§ 232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). Yes ☒ No ☐

Indicate by check mark if disclosure of delinquent filers pursuant to Item 405 of Regulation S-K is not contained herein, and will not be contained, to the best of registrant's knowledge, in definitive proxy or information statements incorporated by reference in Part III of this Form 10-K or any amendment to this Form 10-K. ☐

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, or a smaller reporting company. See the definitions of "large accelerated filer," "accelerated filer" and "smaller reporting company" in Rule 12b-2 of the Exchange Act. (Check one):

Large accelerated filer ☒

Accelerated filer ☐

Non-accelerated filer ☐

Smaller reporting company ☐

(Do not check if a smaller reporting company)

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act). Yes ☐ No ☒

The aggregate market value of PepsiCo Common Stock held by nonaffiliates of PepsiCo (assuming for these purposes, but without conceding, that all executive officers and directors of PepsiCo are affiliates of PepsiCo) as of June 12, 2009, the last day of business of our most recently completed second fiscal quarter, was \$94,258,682,675 (based on the closing sale price of PepsiCo's Common Stock on that date as reported on the New York Stock Exchange).

The number of shares of PepsiCo Common Stock outstanding as of February 12, 2010 was 1,569,900,714.

**Documents of Which Portions  
Are Incorporated by Reference  
Proxy Statement for PepsiCo's May 5, 2010  
Annual Meeting of Shareholders**

**Parts of Form 10-K into Which Portion of  
Documents Are Incorporated  
III**

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**PepsiCo, Inc.**

**Form 10-K Annual Report**

**For the Fiscal Year Ended December 26, 2009**

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**PART I**

**Item 1. Business**

PepsiCo, Inc. was incorporated in Delaware in 1919 and was reincorporated in North Carolina in 1986. When used in this report, the terms we, us, our, PepsiCo and the Company mean PepsiCo, Inc. and its divisions and subsidiaries.

We are a leading global food, snack and beverage company. Our brands which include Quaker Oats, Tropicana, Gatorade, Frito-Lay and Pepsi are household names that stand for quality throughout the world. As a global company, we also have strong regional brands such as Walkers, Gamesa and Sabritas. Either independently or through contract manufacturers, we make, market and sell a variety of convenient, enjoyable and wholesome foods and beverages. Our portfolio includes oat, rice and grain-based snacks, as well as carbonated and non-carbonated beverages, in over 200 countries. Our largest operations are in North America (United States and Canada), Mexico and the United Kingdom.

We are united by our unique commitment to Performance with Purpose, which means delivering sustainable growth by investing in a healthier future for people and our planet. Our goal is to continue to build a balanced portfolio of enjoyable and wholesome foods and beverages, find innovative ways to reduce the use of energy, water and packaging and provide a great workplace for our employees. Additionally, we will respect, support and invest in the local communities where we operate by hiring local people, creating products designed for local tastes and partnering with local farmers, governments and community groups. We make this commitment because we are a responsible company, and a healthier future for all people and our planet means a more successful future for PepsiCo.

And in recognition of our continuing sustainability efforts, we were again included on the Dow Jones Sustainability North America Index and the Dow Jones Sustainability World Index in September 2009. These indices are compiled annually.

**Our Divisions**

We are organized into three business units, as follows:

1. PepsiCo Americas Foods (PAF), which includes Frito-Lay North America (FLNA), Quaker Foods North America (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 PepsiCo Beverages North America and all of our Latin American beverage businesses; and

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

Our three business units are comprised of six reportable segments (referred to as divisions), as follows:

FLNA,  
QFNA,  
LAF,  
PAB,  
Europe, and  
AMEA.

See Note 1 to our consolidated financial statements for financial information about our divisions and geographic areas.

***Frito-Lay North America***

Either independently or through contract manufacturers, FLNA makes, markets, sells and distributes branded snack foods. These foods include Lay's potato chips, Doritos tortilla chips, Cheetos cheese flavored snacks, Tostitos tortilla chips, branded dips, Fritos corn chips, Ruffles potato chips, Quaker Chewy granola bars and SunChips multigrain snacks. FLNA branded products are sold to independent distributors and retailers. In addition, FLNA's joint venture with Strauss Group makes, markets, sells and distributes Sabra refrigerated dips. FLNA's net revenue was \$13.2 billion in 2009, \$12.5 billion in 2008 and \$11.6 billion in 2007 and approximated 31% of our total net revenue in 2009 and 29% of our total net revenue in 2008 and 2007.

***Quaker Foods North America***

Either independently or through contract manufacturers, QFNA makes markets and sells cereals, rice, pasta and other branded products. QFNA's products include Quaker oatmeal, Aunt Jemima mixes and syrups, Cap'n Crunch cereal, Quaker grits, Life cereal, Rice-A-Roni, Pasta Roni and Near East side dishes. These branded products are sold to independent distributors and retailers. QFNA's net revenue was \$1.9 billion in 2009, 2008 and 2007 and approximated 4% of our total net revenue in both 2009 and 2008 and 5% of our total net revenue in 2007.

***Latin America Foods***

Either independently or through contract manufacturers, LAF makes, markets and sells a number of snack food brands including Gamesa, Doritos, Cheetos, Ruffles, Lay's and

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Sabritas, as well as many Quaker-brand cereals and snacks. These branded products are sold to independent distributors and retailers. LAF's net revenue was \$5.7 billion, \$5.9 billion and \$4.9 billion in 2009, 2008 and 2007, respectively and approximated 13%, 14% and 12% of our total net revenue in 2009, 2008 and 2007, respectively.

### ***PepsiCo Americas Beverages***

Either independently or through contract manufacturers, PAB makes, markets and sells beverage concentrates, fountain syrups and finished goods, under various beverage brands including Pepsi, Mountain Dew, Gatorade, 7UP (outside the U.S.), Tropicana Pure Premium, Sierra Mist, Mirinda, Mug, Propel, Manzanita Sol, Tropicana juice drinks, SoBe Lifewater, Dole, Amp Energy, Paso de los Toros, Naked juice and Izze. PAB also, either independently or through contract manufacturers, makes, 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, PAB licenses the Aquafina water brand to its bottlers and markets this brand. PAB sells concentrate and finished goods for some of these brands to authorized bottlers, and some of these branded finished goods are sold directly by us to independent distributors and retailers. The bottlers sell our brands as finished goods to independent distributors and retailers. PAB's net revenue was \$10.1 billion, \$10.9 billion and \$11.1 billion in 2009, 2008 and 2007, respectively, and approximated 23%, 25% and 28% of our total net revenue in 2009, 2008 and 2007, respectively.

See also Acquisition of Common Stock of PBG and PAS below.

### ***Europe***

Either independently or through contract manufacturers, Europe makes, markets and sells a number of leading snack foods including Lay's, Walkers, Doritos, Cheetos and Ruffles, as well as many Quaker-brand cereals and snacks, through consolidated businesses as well as through noncontrolled affiliates. Europe also, either independently or through contract manufacturers, makes, markets and sells beverage concentrates, fountain syrups and finished goods, under various beverage brands including Pepsi, 7UP and Tropicana. These brands are sold to authorized bottlers, independent distributors and retailers. In certain markets, however, Europe operates its own bottling plants and distribution facilities. In addition, Europe licenses the Aquafina water brand to certain of its authorized bottlers. Europe also, either independently or through contract manufacturers, makes, markets and sells ready-to-drink tea products through an international joint venture with Unilever (under the Lipton brand name). Europe's net revenue was \$6.7 billion, \$6.9 billion and \$5.9 billion in 2009, 2008 and 2007, respectively and approximated 16% of our total net revenue in 2009 and 2008 and 15% of our total net revenue in 2007.

See also Acquisition of Common Stock of PBG and PAS below.

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***Asia, Middle East & Africa***

AMEA makes, markets and sells a number of leading snack food brands including Lay's, Kurkure, Chippy, Doritos, Smith's, Cheetos, Red Rock Deli and Ruffles, through consolidated businesses as well as through noncontrolled affiliates. Further, either independently or through contract manufacturers, AMEA makes, markets and sells many Quaker-brand cereals and snacks. AMEA also makes, markets and sells beverage concentrates, fountain syrups and finished goods, under various beverage brands including Pepsi, Mirinda, 7UP and Mountain Dew. These brands are sold to authorized bottlers, independent distributors and retailers. However, in certain markets, AMEA operates its own bottling plants and distribution facilities. In addition, AMEA licenses the Aquafina water brand to certain of its authorized bottlers. AMEA also, either independently or through contract manufacturers, makes, markets and sells ready-to-drink tea products through an international joint venture with Unilever (under the Lipton brand name). AMEA's net revenue was \$5.6 billion, \$5.1 billion and \$4.2 billion in 2009, 2008 and 2007, respectively and approximated 13%, 12% and 11% of our total net revenue in 2009, 2008 and 2007, respectively.

**Acquisition of Common Stock of PBG and PAS**

On August 3, 2009, we entered into an Agreement and Plan of Merger with The Pepsi Bottling Group, Inc. (PBG) and Pepsi-Cola Metropolitan Bottling Company, Inc. (Metro), our wholly owned subsidiary (the PBG Merger Agreement) and a separate Agreement and Plan of Merger with PepsiAmericas, Inc. (PAS) and Metro (the PAS Merger Agreement).

The PBG Merger Agreement provides that, upon the terms and subject to the conditions set forth in the PBG Merger Agreement, PBG will be merged with and into Metro (the PBG Merger), with Metro continuing as the surviving corporation and our wholly owned subsidiary. At the effective time of the PBG Merger, each share of PBG common stock outstanding immediately prior to the effective time not held by us or any of our subsidiaries will be converted into the right to receive either 0.6432 of a share of PepsiCo common stock or, at the election of the holder, \$36.50 in cash, without interest, and in each case subject to proration procedures which provide that we will pay cash for a number of shares equal to 50% of the PBG common stock outstanding immediately prior to the effective time of the PBG Merger not held by us or any of our subsidiaries and issue shares of PepsiCo common stock for the remaining 50% of such shares. Each share of PBG common stock held by PBG as treasury stock, held by us or held by Metro, and each share of PBG Class B common stock held by us or Metro, in each case immediately prior to the effective time of the PBG Merger, will be canceled, and no payment will be made with respect thereto. Each share of PBG common stock and PBG Class B common stock owned by any subsidiary of ours other than Metro immediately prior to the effective time of the PBG Merger will automatically be converted into the right to receive 0.6432 of a share of PepsiCo common stock.

The PAS Merger Agreement provides that, upon the terms and subject to the conditions set forth in the PAS Merger Agreement, PAS will be merged with and into Metro (the PAS Merger, and together with the PBG Merger, the Mergers), with Metro continuing as

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the surviving corporation and our wholly owned subsidiary. At the effective time of the PAS Merger, each share of PAS common stock outstanding immediately prior to the effective time not held by us or any of our subsidiaries will be converted into the right to receive either 0.5022 of a share of PepsiCo common stock or, at the election of the holder, \$28.50 in cash, without interest, and in each case subject to proration procedures which provide that we will pay cash for a number of shares equal to 50% of the PAS common stock outstanding immediately prior to the effective time of the PAS Merger not held by us or any of our subsidiaries and issue shares of PepsiCo common stock for the remaining 50% of such shares. Each share of PAS common stock held by PAS as treasury stock, held by us or held by Metro, in each case, immediately prior to the effective time of the PAS Merger, will be canceled, and no payment will be made with respect thereto. Each share of PAS common stock owned by any subsidiary of ours other than Metro immediately prior to the effective time of the PAS Merger will automatically be converted into the right to receive 0.5022 of a share of PepsiCo common stock.

On February 17, 2010, the stockholders of PBG and PAS approved the PBG and PAS Mergers, respectively. Consummation of each of the Mergers is subject to various conditions, including the absence of legal prohibitions and the receipt of regulatory approvals. On February 17, 2010, we announced that we had refiled under the Hart-Scott-Rodino Antitrust Improvements Act of 1976 (HSR Act) with respect to the Mergers and signed a consent decree (Consent Decree) proposed by the Staff of the Federal Trade Commission (FTC) providing for the maintenance of the confidentiality of certain information we will obtain from Dr Pepper Snapple Group, Inc. (DPSG) in connection with the manufacture and distribution of certain DPSG products after the Mergers are completed. The Consent Decree is subject to review and approval by the Commissioners of the FTC. We hope to consummate the Mergers by the end of February, 2010.

We currently plan that at the closing of the Mergers we will form a new operating unit. This new operating unit will comprise all current PBG and PAS operations in the United States, Canada and Mexico, and will account for about three-quarters of the volume of PepsiCo's North American bottling system, with independent franchisees accounting for most of the rest. This new operating unit will be included within the PAB business unit. Current PBG and PAS operations in Europe, including Russia, will be managed by the Europe division when the Mergers are completed. See

Our Operations contained in Item 7. Management's Discussion and Analysis of Financial Condition and Results of Operations.

**Our Distribution Network**

Our products are brought to market through direct-store-delivery (DSD), customer warehouse and foodservice and vending distribution networks. The distribution system used depends on customer needs, product characteristics and local trade practices. These distribution systems are described under the heading Our Distribution Network contained in Item 7. Management's Discussion and Analysis of Financial Condition and Results of Operations.

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**Ingredients and Other Supplies**

The principal ingredients we use in our food and beverage businesses are apple and pineapple juice and other juice concentrates, aspartame, corn, corn sweeteners, flavorings, flour, grapefruits and other fruits, oats, oranges, potatoes, rice, seasonings, sucralose, sugar, vegetable and essential oils and wheat. Our key packaging materials include plastic resins including polyethylene terephthalate (PET) and polypropylene resins used for plastic beverage bottles and 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. These ingredients, raw materials and commodities are purchased mainly in the open market. We employ specialists to secure adequate supplies of many of these items and have not experienced any significant continuous shortages. The prices we pay for such items are subject to fluctuation. When prices increase, we may or may not pass on such increases to our customers. See Note 10 to our consolidated financial statements for additional information on how we manage our exposure to commodity costs.

**Our Brands**

We own numerous valuable trademarks which are essential to our worldwide businesses, including Alegro, Amp Energy, Aquafina, Aunt Jemima, Cap'n Crunch, Cheetos, Chester's Fries, Chipsy, Cracker Jack, Diet Pepsi, Doritos, Duyvis, Frito-Lay, Fritos, Fruktovy Sad, Frustyle, Gamesa, Gatorade, G2, Grandma's, Izze, Kurkure, Lay's, Life, Manzanita Sol, Matutano, Mirinda, Miss Vickie's, Mother's, Mountain Dew, Mug, Munchies Snack mix, Naked, Near East, Paso de los Toros, Pasta Roni, Pepsi, Pepsi Max, Pepsi One, Propel, Quaker, Quaker Chewy, Quakes, Red Rock Deli, Rice-A-Roni, Rold Gold, Ruffles, Sabritas, Sakata, 7UP and Diet 7UP (outside the United States), Santitas Tortilla Chips, Sierra Mist, Simba, Smartfood, Smith's, Snack a Jacks, SoBe, SoBe Lifewater, Sonrisas, Stacy's, SunChips, Tonus, Tostitos, Trop 50, Tropicana, Tropicana Pure Premium, Tropicana Twister, TrueNorth, V Water, Walkers and Ya. We also hold long-term licenses to use valuable trademarks in connection with our products, including Lipton, Starbucks, Dole and Ocean Spray. Trademarks remain valid so long as they are used properly for identification purposes, and we emphasize correct use of our trademarks. We have authorized, through licensing arrangements, the use of many of our trademarks in such contexts as snack food joint ventures and beverage bottling appointments. In addition, we license the use of our trademarks on promotional items for the primary purpose of enhancing brand awareness.

We either own or have licenses to use a number of patents which relate to some of our products, their packaging, the processes for their production and the design and operation of various equipment used in our businesses. Some of these patents are licensed to others.

**Seasonality**

Our beverage and food divisions are subject to seasonal variations. Our beverage sales are higher during the warmer months and certain food sales are higher in the cooler

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months. Weekly beverage and snack sales are generally highest in the third quarter due to seasonal and holiday-related patterns, and generally lowest in the first quarter. However, taken as a whole, seasonality does not have a material impact on our business.

## **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 us with the right to charge our bottlers for concentrate, finished goods and Aquafina royalties and specify the manufacturing process required for product quality.

Retail consolidation and the current economic environment continue to increase the importance of major customers. In 2009, sales to Wal-Mart Stores, Inc. (Wal-Mart), including Sam's Club (Sam's), represented approximately 13% of our total net revenue. Our top five retail customers represented approximately 33% of our 2009 North American net revenue, with Wal-Mart (including Sam's) representing approximately 19%. These percentages include concentrate sales to our bottlers which are used in finished goods sold by them to these retailers. In addition, sales to PBG represented approximately 6% of our total net revenue in 2009. See Acquisition of Common Stock of PBG and PAS above and Our Customers and Our Related Party Bottlers contained in Item 7. Management's Discussion and Analysis of Financial Condition and Results of Operations and Note 8 to our consolidated financial statements for more information on our customers, including our anchor bottlers.

## **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, our chief beverage competitor, The Coca-Cola Company, has a larger share of CSD (carbonated soft drinks) consumption, while we have a larger share of liquid refreshment beverages consumption. In addition, The Coca-Cola Company has a significant CSD share advantage in many markets outside the United States. Further, our snack brands hold significant leadership positions in the snack industry worldwide. Our snack brands face local, regional and private label 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, the introduction of new products and the effectiveness of our advertising campaigns, marketing programs and product packaging. 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.

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- (1) The categories and category share information in the charts above are as of December 2009 and are defined by the following source of the information: Information Resources, Inc. The above charts exclude data from certain customers such as Wal-Mart that do not report data to this service.

### **Research and Development**

We engage in a variety of research and development activities and continue to invest to accelerate growth in these activities. These activities principally involve the development of new products and improvement in the quality of existing products, including expanding our good-for-you products, improvement and modernization of production processes, and the development and implementation of new technologies to enhance the quality and value of both current and proposed product lines. Consumer research is excluded from research and development costs and included in other marketing costs. Research and development costs were \$414 million in 2009, \$388 million in 2008 and \$364 million in 2007 and are reported within selling, general and administrative expenses.

### **Regulatory Environment and Environmental Compliance**

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 where we operate. It is our policy to abide by the laws and regulations around the world that apply to our businesses.

In the United States, we are required to comply with federal laws, such as the Food, Drug and Cosmetic Act, the Occupational Safety and Health Act, the Clean Air Act, the Clean Water Act, the Resource Conservation and Recovery Act, the Federal Motor Carrier

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Safety Act, laws governing equal employment opportunity, customs and foreign trade laws and regulations, laws regulating the sales of products in schools, and various other federal statutes and regulations. We are also subject to various state and local statutes and regulations, including California Proposition 65 which requires that a specific warning appear on any product that contains a component listed by the State of California as having been found to cause cancer or birth defects. Many food and beverage producers who sell products in California, including PepsiCo, may be required to provide warning labels on their products. See also Risk Factors 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. In many jurisdictions, compliance with competition laws is of special importance to us due to our competitive position in those jurisdictions. We rely on legal and operational compliance programs, as well as local in-house and outside counsel, to guide our businesses in complying with applicable laws and regulations of the countries in which we do business.

Legislation has been enacted in certain U.S. states and in certain of the countries in which our products are sold that requires collection and recycling of containers or that prohibits the sale of our beverages in certain non-refillable containers unless a deposit or other fee is charged. It is possible that similar or more restrictive legal requirements may be proposed or enacted in the future. In addition, proposals have been introduced in certain jurisdictions in which we operate which would impose special taxes on products we sell.

The cost of compliance with U.S. and foreign laws does not have a material financial impact on our operations.

We are subject to national and local environmental laws in the United States and in the foreign countries in which we do business, including laws relating to water consumption and treatment. We are committed to meeting all applicable environmental compliance requirements. Environmental compliance costs have not had, and are not expected to have, a material impact on our capital expenditures, earnings or competitive position.

## **Employees**

As of December 26, 2009, we employed approximately 203,000 people worldwide, including approximately 65,000 people within the United States. Our employment levels are subject to seasonal variations. We believe that relations with our employees are generally good.

## **Available Information**

We are required to file annual, quarterly and current reports, proxy statements and other information with the U.S. Securities and Exchange Commission (SEC). The public may read and copy any materials that we file with the SEC at the SEC's Public Reference Room at 100 F Street, N.E., Washington, D.C. 20549. Information on the operation of the Public Reference Room may be obtained by calling the SEC at 1-800-SEC-0330. In addition, the SEC maintains an Internet site that contains reports, proxy and information statements, and other information regarding issuers that file electronically with the SEC at <http://www.sec.gov>.

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Our Annual Reports on Form 10-K, Quarterly Reports on Form 10-Q, Current Reports on Form 8-K, proxy statements and amendments to those reports filed or furnished pursuant to Section 13(a) or 15(d) of the Exchange Act, are also available free of charge on our internet website at <http://www.pepsico.com> as soon as reasonably practicable after such reports are electronically filed with or furnished to the SEC. The information on our website is not, and shall not be deemed to be, a part hereof or incorporated into this or any of our other filings with the SEC.

## **Item 1A. Risk Factors**

### ***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 below and elsewhere in this report is by no means all inclusive but is designed to highlight what we believe are important factors to consider when evaluating our future performance.*

### **Risks Relating to the Company and our Business**

***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 or any inability on our part to anticipate or 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, including concerns of consumers regarding health and wellness, 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

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companies in our industry, a downturn in economic conditions or taxes specifically targeting the consumption of our products. Any of these changes may reduce consumers' willingness to purchase our products. See also the discussions under "The global economic downturn has resulted in unfavorable economic conditions and increased volatility in foreign exchange rates and may have an adverse impact on our business results or financial condition." and "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."

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, marketing programs and product packaging. Although we devote significant resources to meet this goal, 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.

***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, including with respect to raw materials obtained from our suppliers, 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 use and waste management, or other sustainability issues, could jeopardize our reputation. In addition, water is a limited resource in many parts of the world. Our reputation could be damaged if we do not act responsibly with respect to water use. 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 result in decreased demand for our products and 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.

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***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 Wal-Mart, as well as other retailers and our 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 and the current economic environment continue to increase the importance of major customers. 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 and Our Related Party Bottlers contained in Item 7. Management's Discussion and Analysis of Financial Condition and Results of Operations and Note 8 to our consolidated financial statements for more information on our customers, including our anchor bottlers.

***If we are unable to hire or retain key employees or a highly skilled and diverse workforce, it could have a negative impact on our business.***

Our continued growth requires us to hire, retain and develop our leadership bench and a highly skilled and diverse workforce. We compete to hire new employees and then must train them and develop their skills and competencies. Any unplanned turnover or our failure to develop an adequate succession plan to backfill current leadership positions or to hire and retain a diverse workforce could deplete our institutional knowledge base and erode our competitive advantage. Furthermore, if any of our key employees or key employees of either PBG or PAS depart because of issues relating to the PBG Merger and the PAS Merger such as the uncertainty, difficulty of integration or a desire not to remain with the post-merger entity, our ongoing business could be harmed. In addition, our operating results could be adversely affected by increased costs due to increased competition for employees, higher employee turnover or increased employee benefit costs.

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***Our performance could be adversely affected as a result of unstable political conditions, civil unrest or other developments and risks in the countries where we operate or if we are unable to grow our business in developing and emerging markets.***

Our operations outside of the United States contribute significantly to our revenue and profitability. Unstable political conditions, civil unrest or other developments and risks in the countries where we operate could also have an adverse impact on our business results or financial condition. Factors that could adversely affect our business results in these countries include: import and export restrictions; foreign ownership restrictions; nationalization of our assets; regulations on the repatriation of funds which from time to time result in significant cash balances in countries such as Venezuela; and currency hyperinflation or devaluation. In addition, disruption in these markets due to political instability or civil unrest could result in a decline in consumer purchasing power, thereby reducing demand for our products.

We believe that our businesses in developing and emerging markets present an important future growth opportunity for us. If we are unable to expand our businesses in emerging and developing markets for any of the reasons described above, as a result of increased competition in these countries from multinationals or local competitors, or for any other reason, our growth rate could be adversely affected. See also Our performance could suffer if we are unable to compete effectively.

***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 may include changes in: food and drug laws; laws related to advertising and deceptive marketing practices; accounting standards; taxation requirements, including taxes specifically targeting the consumption of our products; 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.

Governmental entities or agencies in jurisdictions where we operate may also impose new labeling, product or production requirements, or other restrictions. For example, studies are underway by various regulatory authorities and others to assess the effect on humans due to acrylamide in the diet. 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. 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

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our products could decline and we could be subject to 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.

We are also subject to Proposition 65 in California, a law which requires that a specific warning appear on any product sold in California that contains a substance listed by that State as having been found to cause cancer or birth defects. If we were required to add warning labels to any of our products or place warnings in certain locations where our products are sold, sales of those products could suffer not only in those locations but elsewhere.

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. See also Regulatory Environment and Environmental Compliance.

***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 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.

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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.

***The global economic downturn has resulted in unfavorable economic conditions and increased volatility in foreign exchange rates and may have an adverse impact on our business results or financial condition.***

The global economic downturn has resulted in unfavorable economic conditions in many of the countries in which we operate. Our business or financial results may be adversely impacted by these unfavorable economic conditions, including: adverse changes in interest rates or tax rates; volatile commodity markets; contraction in the availability of credit in the marketplace potentially impairing our ability to access the capital markets on terms commercially acceptable to us; the effects of government initiatives to manage economic conditions; reduced demand for our products resulting from a slow-down in the general global economy or a shift in consumer preferences for economic reasons to private label products or to less profitable channels; or a further decrease in the fair value of pension assets that could increase future employee benefit costs and/or funding requirements of our pension plans. The global economic downturn has also resulted in increased foreign exchange rate volatility. We hold assets and incur liabilities, earn revenues and pay expenses in a variety of currencies other than the U.S. dollar. The financial statements of our foreign subsidiaries are translated into U.S. dollars. As a result, our profitability may be adversely impacted by an adverse change in foreign currency exchange rates. In addition, we cannot predict how current or worsening economic conditions will affect our critical customers, suppliers and distributors and any negative impact on our critical customers, suppliers or distributors may also have an adverse impact on our business results or financial condition.

***Our performance could suffer if we are unable to compete effectively.***

The food and beverage industries in which we operate are highly competitive. We compete with major international food and beverage companies that, like us, operate in multiple geographic areas, as well as regional, local and private label manufacturers. In many countries where we do business, including the United States, The Coca-Cola Company, is our primary beverage competitor. We compete on the basis of price, quality, product variety, distribution, marketing and promotional activity, and the ability to identify and satisfy consumer preferences. If we are unable to compete effectively, we may be unable to gain or maintain share of sales or gross margins in the global market or in various local markets. This may have a material adverse impact on our revenues and profit margins.

***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 apple and pineapple juice and other juice concentrates, aspartame,

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corn, corn sweeteners, flavorings, flour, grapefruits and other fruits, oats, oranges, potatoes, rice, seasonings, sucralose, sugar, vegetable and essential oils, and wheat. Our key packaging materials include plastic resins including polyethylene terephthalate (PET) and polypropylene resin used for plastic beverage 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. In addition, we use derivatives to hedge price risk associated with forecasted purchases of raw materials. Certain of these derivatives that do not qualify for hedge accounting treatment can result in increased volatility in our net earnings in any given period due to changes in the spot prices of the underlying commodities. See also the discussion under The global economic downturn has resulted in unfavorable economic conditions and increased volatility in foreign exchange rates and may have an adverse impact on our business results or financial condition , Market Risks contained in Item 7. Management's Discussion and Analysis of Financial Condition and Results of Operations and Note 1 to our consolidated financial statements.

***Disruption of our supply chain could have an adverse impact 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 adverse weather conditions, natural disaster, fire, terrorism, the outbreak or escalation of armed hostilities, pandemic, strikes and other labor disputes or other reasons beyond our or their control, 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.

***Climate change, or legal, regulatory or market measures to address climate change, may negatively affect our business and operations.***

There is growing concern that carbon dioxide and other greenhouse gases in the atmosphere may have an adverse impact on global temperatures, weather patterns and the frequency and severity of extreme weather and natural disasters. In the event that such climate change has a negative effect on agricultural productivity, we may be subject to decreased availability or less favorable pricing for certain commodities that are necessary for our products, such as sugar cane, corn, wheat, rice, oats, potatoes and various fruits.

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We may also be subjected to decreased availability or less favorable pricing for water as a result of such change, which could impact our manufacturing and distribution operations. In addition, natural disasters and extreme weather conditions may disrupt the productivity of our facilities or the operation of our supply chain. The increasing concern over climate change also may result in more regional, federal and/or global legal and regulatory requirements to reduce or mitigate the effects of greenhouse gases. In the event that such regulation is enacted and is more aggressive than the sustainability measures that currently we are undertaking to monitor our emissions and improve our energy efficiency, we and our bottling partners may experience significant increases in our costs of operation and delivery. In particular, increasing regulation of fuel emissions could substantially increase the distribution and supply chain costs associated with our products. As a result, climate change could negatively affect our business and operations. See also

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

**Risks Relating to the Mergers**

***Failure to complete the PBG Merger and the PAS Merger may adversely affect our results of operations and prevent us from realizing the full extent of the benefits and cost savings expected from either or both of the PBG Merger and the PAS Merger.***

The PBG Merger and the PAS Merger are each subject to the satisfaction or, to the extent permissible, waiver of certain conditions, including, but not limited to, receipt of the necessary consents and approvals. Although we expect to complete both of the Mergers, it is possible that either the PBG Merger or the PAS Merger may not be completed. Our relationship with PBG or PAS may suffer following a failure to complete the PBG Merger or the PAS Merger, as applicable, which could adversely affect our results of operations. Failure to complete either Merger will also prevent us from realizing the full extent of the benefits and cost savings that we expect to realize as a result of the completion of both Mergers. See also The Mergers are subject to the receipt of certain required clearances or approvals from governmental entities that could prevent or delay their completion or impose conditions that could have a material adverse effect on us.

***After completion of the Mergers, we may fail to realize the anticipated cost savings and other benefits expected therefrom, which could adversely affect the value of our common stock or other securities.***

The success of the Mergers will depend, in part, on our ability to successfully combine our business with the businesses of PBG and PAS and realize the anticipated benefits and cost savings from such combination. While we believe that these cost savings estimates are achievable, it is possible that we will be unable to achieve these objectives within the anticipated time frame, or at all. Our cost savings estimates also depend on our ability to combine our business with the businesses of PBG and PAS in a manner that permits those cost savings to be realized. If these estimates turn out to be incorrect or we are not able to combine our business with the businesses of PBG and PAS successfully, the anticipated cost savings and other benefits, including expected synergies, resulting from the Mergers may not be realized fully or at all or may take longer to realize than expected, and the value of our common stock or other securities may be adversely affected.

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Specifically, issues that must be addressed in integrating our operations with the operations of PBG and PAS in order to realize the anticipated benefits of the Mergers include, among other things:

integrating the manufacturing, distribution, sales and administrative support activities and information technology systems among the companies;

motivating, recruiting and retaining executives and key employees;

conforming standards, controls, procedures and policies, business cultures and compensation structures among the companies;

consolidating and streamlining corporate and administrative infrastructures;

consolidating sales and marketing operations;

retaining existing customers and attracting new customers;

identifying and eliminating redundant and underperforming operations and assets;

coordinating geographically dispersed organizations; and

managing tax costs or inefficiencies associated with integrating our operations following completion of the Mergers.

Delays encountered in the process of integrating our business with the businesses of PBG and PAS could have an adverse effect on our revenues, expenses, operating results and financial condition after completion of the Mergers. Although significant benefits, such as increased cost savings, are expected to result from the Mergers, there can be no assurance that we will realize any of these anticipated benefits after completion of either or both of the Mergers.

Additionally, significant costs are expected to be incurred in connection with consummating the Mergers and integrating the operations of the companies, with a significant portion of such costs being incurred through the first year after completion of the Mergers. We continue to assess the magnitude of these costs and additional unanticipated costs may be incurred in the integration of our business with the businesses of PBG and PAS. Although we believe that the elimination of duplicative costs, as well as the realization of other efficiencies related to the integration of the businesses, will offset incremental transaction and merger-related costs over time, no assurances can be given that this net benefit will be achieved in the near term, or at all.

Furthermore, the Mergers, and the related integration efforts, could result in the departure of key employees or distract management and employees from delivering against base strategies and objectives, which could have a negative

impact on our business, and, prior to the completion of the Mergers, the businesses of PBG or PAS.

***The Mergers are subject to the receipt of certain required clearances or approvals from governmental entities that could prevent or delay their completion or impose conditions that could have a material adverse effect on us.***

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Completion of each of the Mergers is conditioned upon the receipt of certain governmental clearances or approvals, including, but not limited to, the expiration or termination of the applicable waiting period under the HSR Act with respect to such Merger. There can be no assurance that these clearances and approvals will be obtained, and, additionally, government authorities from which these clearances and approvals are required may impose conditions on the completion of the PBG Merger or the PAS Merger or require changes to their respective terms. While under the terms of the Merger Agreements, neither we nor PBG or PAS is required, in connection with the PBG Merger or the PAS Merger, as applicable, to enter into any agreement or other undertaking with any such governmental authority with respect to any of our respective or our respective material subsidiaries' material businesses, assets or properties, we, PBG and PAS have each agreed to use reasonable best efforts to obtain governmental clearances or approvals necessary to complete the applicable Merger. If, in order to obtain any clearances or approvals required to complete either the PBG Merger or the PAS Merger, we become subject to any material conditions after completion of the PBG Merger or PAS Merger, as applicable, our business and results of operations after completion of the PBG Merger or PAS Merger, as applicable, may be adversely affected. In addition, there can be no assurances that the Commissioners of the FTC will approve the Consent Decree we signed that was proposed by the Staff of the FTC. If the Commissioners do not approve the Consent Decree, the Mergers could be prevented or delayed.

***Following completion of the Mergers, a greater portion of our workforce will belong to unions. Failure to successfully renew collective bargaining agreements, or strikes or work stoppages could cause our business to suffer.***

Over 25% of current PBG and PAS employees are covered by collective bargaining agreements. These agreements expire on various dates. Strikes or work stoppages and interruptions could occur if we are unable to renew these agreements on satisfactory terms, which could adversely impact our operating results. The terms and conditions of existing or renegotiated agreements could also increase our costs or otherwise affect our ability to fully implement future operational changes to enhance our efficiency after completion of the Mergers.

***Any downgrade of our credit rating could increase our future borrowing costs.***

Following the public announcement of the PBG Merger Agreement and the PAS Merger Agreement, Moody's Investors Service (Moody's) indicated that it was reviewing our ratings for possible downgrade. Moody's has noted that the additional debt involved in completing the Mergers and our consolidated level of indebtedness following completion of the Mergers could result in a rating lower than the current rating level. Also following the public announcement of the PBG Merger Agreement and the PAS Merger Agreement, Standard & Poor's Ratings Services (S&P) indicated that its outlook on PepsiCo was negative and it could lower our ratings. S&P has indicated that when additional information becomes available S&P will review whether, following completion of the PBG Merger and the PAS Merger, any of our senior unsecured debt will, in S&P's view, be structurally subordinated, which could result in a lower rating for PepsiCo's debt securities. A downgrade by either Moody's or S&P could increase our future borrowing costs.

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### **Item 1B. Unresolved Staff Comments**

We have received no written comments regarding our periodic or current reports from the staff of the SEC that were issued 180 days or more preceding the end of our 2009 fiscal year and that remain unresolved.

### **Item 2. Properties**

Our most significant corporate properties include our corporate headquarters building in Purchase, New York and our data center in Plano, Texas, both of which are owned. Leases of plants in North America generally are on a long-term basis, expiring at various times, with options to renew for additional periods. Most international plants are owned or leased on a long-term basis. We believe that our properties are in good operating condition and are suitable for the purposes for which they are being used.

#### ***Frito-Lay North America***

FLNA's most significant properties include its headquarters building and a research facility in Plano, Texas, both of which are owned. FLNA also owns or leases approximately 40 food manufacturing and processing plants and approximately 1,830 warehouses, distribution centers and offices. In addition, FLNA also utilizes approximately 55 plants and production processing facilities that are owned or leased by our contract manufacturers or co-packers. FLNA's joint venture with Strauss Group also utilizes three plant facilities and two warehouses and distribution centers which are co-owned or co-leased by the joint venture.

#### ***Quaker Foods North America***

QFNA owns a plant in Cedar Rapids, Iowa, which is its most significant property. QFNA also owns or leases two plants and production processing facilities in North America. In addition, QFNA utilizes approximately 25 manufacturing plants, production processing facilities and distribution centers that are owned or leased by our contract manufacturers or co-packers.

#### ***Latin America Foods***

LAF's most significant properties include a food plant in Celaya, Mexico and four snacks plants in the Mexican cities of Vallejo and Veracruz and the Brazilian city of Itu, all of which are owned. LAF also owns or leases approximately 50 food manufacturing and processing plants and approximately 640 warehouses, distribution centers and offices. In addition, LAF also utilizes properties owned by contract manufacturers or co-packers. LAF also utilizes one plant facility that is co-owned by a joint venture partner.

#### ***PepsiCo Americas Beverages***

PAB's most significant properties include the headquarters building it shares with QFNA in downtown Chicago, Illinois, which is leased, and its Tropicana facility in Bradenton,

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Florida, its concentrate plants in Cork, Ireland and its research and development facility in Valhalla, New York, all of which are owned. PAB also owns or leases approximately 20 plants and production processing facilities and approximately 65 warehouses, distribution centers and offices. In addition, authorized bottlers in which we have an ownership interest own or lease approximately 80 bottling plants and 220 distribution centers. PAB also utilizes approximately 55 plants and production processing facilities and approximately 50 warehouses and distribution centers that are owned or leased by our contract manufacturers or co-packers. PAB also utilizes three plants that are co-owned by a joint venture partner.

***Europe***

Europe's most significant properties are its snack manufacturing and processing plants located in Leicester, United Kingdom and Coventry, United Kingdom, each of which are leased. Europe also owns or leases approximately 40 plants and approximately 370 warehouses, distribution centers and offices. In addition, authorized bottlers in which we have an ownership interest own or lease eight plants and approximately 30 distribution centers. Europe also utilizes properties owned by contract manufacturers or co-packers. In addition, Europe utilizes one plant and production processing facility and two distribution centers that are co-owned by or co-leased with a joint venture partner.

***Asia, Middle East & Africa***

AMEA's most significant properties are its beverage plants located in Shenzhen, China and Amman, Jordan, its snack manufacturing and processing plants located in Sixth of October City, Egypt and Tingalpa, Australia, each of which are owned. AMEA also owns or leases approximately 80 plants and approximately 1,100 warehouses, distribution centers and offices. In addition, authorized bottlers in which we have an ownership interest own or lease approximately 20 plants and 100 distribution centers. AMEA also utilizes approximately 40 properties owned by contract manufacturers or co-packers. In addition, AMEA also utilizes approximately 25 plants and production processing facilities and approximately 15 distribution centers that are co-owned by or co-leased with our joint venture partners.

***Shared Properties***

QFNA shares three production facilities and three warehouses and distribution centers with FLNA, 13 warehouses and distribution centers with both FLNA and PAB, and 11 offices with both FLNA and PAB, including a research and development laboratory in Barrington, Illinois. PAB, Europe and AMEA share production facilities at two concentrate plants in Cork, Ireland. PAB and AMEA share a concentrate plant in Colonia, Uruguay.

**Item 3. Legal Proceedings**

We are party to a variety of legal proceedings arising in the normal course of business. While the results of proceedings cannot be predicted with certainty, management believes that the final outcome of these proceedings will not have a material adverse effect on our consolidated financial statements, results of operations or cash flows.

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**Item 4. Submission of Matters to a Vote of Security Holders**

Not applicable.

**Executive Officers of the Registrant**

The following is a list of names, ages and backgrounds of our current executive officers:

***Zein Abdalla***, 51, became Chief Executive Officer of PepsiCo Europe in November 2009. Mr. Abdalla joined PepsiCo in 1995 and has held a variety of senior positions. He has served as General Manager of Tropicana Europe and Franchise Vice President for Pakistan and the Gulf region. From 2005 to 2008 he led PepsiCo's continental Europe operations. In September 2008 he went on to lead the complete portfolio of PepsiCo business in Europe. Prior to joining PepsiCo, Mr. Abdalla worked for Mars Incorporated in engineering and manufacturing roles, as well as in sales, marketing, human resources and general management.

***Saad Abdul-Latif***, 56, was appointed to the role of Chief Executive Officer of PepsiCo Asia, Middle East and Africa (AMEA) in November 2009. Mr. Abdul-Latif began his career with PepsiCo in 1982 where he held a wide range of international roles in PepsiCo's food and beverage businesses. In 1998, he was appointed General Manager for PepsiCo's beverage business in the MENAPAK Business Unit. In 2001, his region was expanded to include Africa and Central Asia. In 2004, the snacks business in his region was included under his leadership, forming the consolidated Middle East and Africa (MEA) Region. In September 2008, his responsibilities were extended to Asia, forming the new AMEA Division of PepsiCo International where he acted as President of AMEA.

***Peter A. Bridgman***, 57, has been PepsiCo's Senior Vice President and Controller since August 2000. Mr. Bridgman began his career with PepsiCo at Pepsi-Cola International in 1985 and became Chief Financial Officer for Central Europe in 1990. He became Senior Vice President and Controller for Pepsi-Cola North America in 1992 and Senior Vice President and Controller for The Pepsi Bottling Group, Inc. in 1999.

***Albert P. Carey***, 58, was appointed President and Chief Executive Officer of Frito-Lay North America in June 2006. Mr. Carey began his career with Frito-Lay in 1981 where he spent 20 years in a variety of roles. He served as President, PepsiCo Sales from February 2003 until June 2006. Prior to that he served as Chief Operating Officer, PepsiCo Beverages & Foods North America from June 2002 to February 2003 and as PepsiCo's Senior Vice President, Sales and Retailer Strategies from August 1998 to June 2002.

***John C. Compton***, 48, has been Chief Executive Officer of PepsiCo Americas Foods since November 2007. Mr. Compton began his career at PepsiCo in 1983 as a Frito-Lay Production Supervisor in the Pulaski, Tennessee manufacturing plant. He has spent 26

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years at PepsiCo in various Sales, Marketing, Operations and General Management assignments. From March 2005 until September 2006, he was President and Chief Executive Officer of Quaker, Tropicana, Gatorade, and from September 2006 until November 2007, he was Chief Executive Officer of PepsiCo North America. Mr. Compton served as Vice Chairman and President of the North American Salty Snacks Division of Frito-Lay from March 2003 until March 2005. Prior to that, he served as Chief Marketing Officer of Frito-Lay's North American Salty Snacks Division from August 2001 until March 2003.

**Massimo Fasanella d'Amore**, 54, has been Chief Executive Officer of PepsiCo Americas Beverages since November 2007. Mr. d'Amore was formerly Executive Vice President, Commercial for PepsiCo International, a position he assumed in November 2005. Prior to that, he served as President, Latin America Region for PepsiCo Beverages International from February 2002 until November 2005 and as PepsiCo's Senior Vice President of Corporate Strategy and Development from August 2000 until February 2002. Mr. d'Amore began his career with the Company in 1995 as Vice President, Marketing for Pepsi-Cola International and was promoted to Senior Vice President and Chief Marketing Officer of Pepsi-Cola International in 1998. Before joining PepsiCo, he was with Procter & Gamble for 15 years in various international operations, marketing and general management positions.

**Richard Goodman**, 61, has been PepsiCo's Chief Financial Officer since October 2006. From 2003 until October 2006, Mr. Goodman was Senior Vice President and Chief Financial Officer of PepsiCo International. Prior to that, he served as Senior Vice President and Chief Financial Officer of PepsiCo Beverages International from 2001 to 2003 and as Vice President and General Auditor of PepsiCo from 2000 to 2001. Mr. Goodman joined PepsiCo in 1992 as Vice President of Corporate Strategic Planning, International and held a number of senior financial positions with PepsiCo and its affiliates until 1997 when he left PepsiCo to pursue other opportunities. Before joining PepsiCo, Mr. Goodman was with W.R. Grace & Co. in a variety of global chief financial officer positions.

**Hugh F. Johnston**, 48, was appointed Executive Vice President, Global Operations in November 2009. He previously held the position of President of Pepsi-Cola North America since November 2007. He was formerly PepsiCo's Executive Vice President, Operations, a position he held from October 2006 until November 2007. From April 2005 until October 2006, Mr. Johnston was PepsiCo's Senior Vice President, Transformation. Prior to that, he served as Senior Vice President and Chief Financial Officer of PepsiCo Beverages and Foods from November 2002 through March 2005, and as PepsiCo's Senior Vice President of Mergers and Acquisitions from March 2002 until November 2002. Mr. Johnston joined PepsiCo in 1987 as a Business Planner and held various finance positions until 1999 when he left to join Merck & Co., Inc. as Vice President, Retail, a position which he held until he rejoined PepsiCo in 2002. Prior to joining PepsiCo in 1987, Mr. Johnston was with General Electric Company in a variety of finance positions.

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**Indra K. Nooyi**, 54, has been PepsiCo's Chief Executive Officer since October 2006 and assumed the role of Chairman of PepsiCo's Board of Directors on May 2, 2007. She was elected to PepsiCo's Board of Directors and became President and Chief Financial Officer in May 2001, after serving as Senior Vice President and Chief Financial Officer since February 2000. Ms. Nooyi also served as PepsiCo's Senior Vice President, Corporate Strategy and Development from 1996 until February 2000, and as PepsiCo's Senior Vice President, Strategic Planning from 1994 until 1996. Prior to joining PepsiCo, Ms. Nooyi spent four years as Senior Vice President of Strategy, Planning and Strategic Marketing for Asea Brown Boveri, Inc. She was also Vice President and Director of Corporate Strategy and Planning at Motorola, Inc.

**Larry D. Thompson**, 64, became PepsiCo's Senior Vice President, Government Affairs, General Counsel and Secretary in November 2004. Prior to joining PepsiCo, Mr. Thompson served as a Senior Fellow with the Brookings Institution in Washington, D.C. and served as Deputy Attorney General in the U.S. Department of Justice. In 2002, he was named to lead the National Security Coordination Council and was also named by President Bush to head the Corporate Fraud Task Force. In April 2000, Mr. Thompson was selected by Congress to chair the bipartisan Judicial Review Commission on Foreign Asset Control. Prior to his government career, he was a partner in the law firm of King & Spalding, a position he held from 1986 to 2001.

**Cynthia M. Trudell**, 56, has been PepsiCo's Senior Vice President, Chief Personnel Officer since February 2007. Ms. Trudell served as a director of PepsiCo from January 2000 until her appointment to her current position. She was formerly Vice President of Brunswick Corporation and President of Sea Ray Group from 2001 until 2006. From 1999 until 2001, Ms. Trudell served as General Motors' Vice President, and Chairman and President of Saturn Corporation, a wholly owned subsidiary of GM. Ms. Trudell began her career with the Ford Motor Co. as a chemical process engineer. In 1981, she joined GM and held various engineering and manufacturing supervisory positions. In 1995, she became plant manager at GM's Wilmington Assembly Center in Delaware. In 1996, she became President of IBC Vehicles in Luton, England, a joint venture between General Motors and Isuzu.

Executive officers are elected by our Board of Directors, and their terms of office continue until the next annual meeting of the Board or until their successors are elected and have qualified. There are no family relationships among our executive officers.

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**PART II**

**Item 5. Market for Registrant's Common Equity, Related Stockholder Matters and Issuer Purchases of Equity Securities**

Stock Trading Symbol PEP

Stock Exchange Listings The New York Stock Exchange is the principal market for our common stock, which is also listed on the Chicago and Swiss Stock Exchanges.

Stock Prices The composite quarterly high, low and closing prices for PepsiCo common stock for each fiscal quarter of 2009 and 2008 are contained in our Selected Financial Data included on page 117.

Shareholders At February 12, 2010, there were approximately 174,200 shareholders of record of our common stock.

Dividends Dividends are usually declared in late January or early February, May, July and November and paid at the end of March, June and September and the beginning of January. The dividend record dates for these payments are, subject to approval of the Board of Directors, expected to be March 5, June 4, September 3, and December 3, 2010. We have paid consecutive quarterly cash dividends since 1965. Information with respect to the quarterly dividends declared in 2009 and 2008 is contained in our Selected Financial Data.

For information on securities authorized for issuance under our equity compensation plans, see Item 12. Security Ownership of Certain Beneficial Owners and Management and Related Stockholder Matters.

During the fourth quarter of 2009, there were no common stock repurchases under the \$8.0 billion repurchase program authorized by our Board of Directors and publicly announced on May 2, 2007 and expiring on June 30, 2010.

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PepsiCo also repurchases shares of its convertible preferred stock from an employee stock ownership plan (ESOP) fund established by Quaker in connection with share redemptions by ESOP participants. The following table summarizes our convertible preferred share repurchases during the fourth quarter.

**Issuer Purchases of Convertible Preferred Stock**

| Period            | Total<br>Number of<br>Shares<br>Repurchased | Average<br>Price Paid Per<br>Share | Total Number<br>of Shares<br>Purchased as<br>Part of Publicly<br>Announced<br>Plans or<br>Programs | Maximum<br>Number (or<br>Approximate<br>Dollar Value) of<br>Shares that May<br>Yet Be<br>Purchased<br>Under the Plans<br>or Programs |
|-------------------|---------------------------------------------|------------------------------------|----------------------------------------------------------------------------------------------------|--------------------------------------------------------------------------------------------------------------------------------------|
| 9/5/09            |                                             |                                    |                                                                                                    |                                                                                                                                      |
| 9/6/09 10/3/09    | 2,200                                       | \$ 302.07                          | N/A                                                                                                | N/A                                                                                                                                  |
| 10/4/09 10/31/09  |                                             |                                    | N/A                                                                                                | N/A                                                                                                                                  |
| 11/1/09 11/28/09  | 2,700                                       | \$ 310.65                          | N/A                                                                                                | N/A                                                                                                                                  |
| 11/29/09 12/26/09 | 2,400                                       | \$ 305.29                          | N/A                                                                                                | N/A                                                                                                                                  |
| Total             | 7,300                                       | \$ 306.30                          | N/A                                                                                                | N/A                                                                                                                                  |

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### **Item 6. Selected Financial Data**

Selected Financial Data is included on page 117.

### **Item 7. Management's Discussion and Analysis of Financial Condition and Results of Operations**

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*Our discussion and analysis is an integral part of understanding our financial results. Definitions of key terms can be found in the glossary beginning on page 121. 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 BUSINESS**

### **Executive Overview**

We are a leading global food, snack and beverage company. Our brands — which include Quaker Oats, Tropicana, Gatorade, Frito-Lay and Pepsi — are household names that stand for quality throughout the world. As a global company, we also have strong regional brands such as Walkers, Gamesa and Sabritas. Either independently or through contract manufacturers, we make, market and sell a variety of convenient, enjoyable and wholesome foods and beverages. Our portfolio includes oat, rice and grain-based snacks, as well as carbonated and non-carbonated beverages, in over 200 countries. Our largest operations are in North America (United States and Canada), Mexico and the United Kingdom. Additional information concerning our divisions and geographic areas is presented in Note 1.

We are united by our unique commitment to Performance with Purpose, which means delivering sustainable growth by investing in a healthier future for people and our planet. Our goal is to continue to build a balanced portfolio of enjoyable and wholesome foods and beverages, find innovative ways to reduce the use of energy, water and packaging and provide a great workplace for our employees. Additionally, we will respect, support and invest in the local communities where we operate by hiring local people, creating products designed for local tastes and partnering with local farmers, governments and community groups. We make this commitment because we are a responsible company and a healthier future for all people and our planet means a more successful future for PepsiCo.

And in recognition of our continuing sustainability efforts, we were again included on the Dow Jones Sustainability North America Index and the Dow Jones Sustainability World Index in September 2009. These indices are compiled annually.

Our management monitors a variety of key indicators to evaluate our business results and financial conditions. These indicators include market share, volume, net revenue, operating profit, management operating cash flow, earnings per share and return on invested capital.

### ***Key Challenges and Strategies for Driving Growth***

We remain focused on growing our business with the objectives of improving our financial results and increasing returns for our shareholders. We continue to focus on delivering top-quartile financial performance in both the near term and the long term, while making global investments in key regions and targeted product categories to drive

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sustainable growth. We have identified the following key challenges and related competitive strategies for driving growth that we believe will enable us to achieve our objectives:

*1. Expand the Global Leadership Position of our Snacks Business*

Expanding our snacks businesses in developing and emerging markets is important to our growth. In 2009, we were the global snacks leader, with the #1 savory category share position in virtually every key region across the globe. We had advantaged positions across the entire value chain in more than 40 developed and developing regions in which we operate and were able to capitalize on local manufacturing and optimize go-to-market capabilities in each region, as well as introduce locally relevant products using global capabilities. And we have significant growth opportunities as we work to expand our current snacks businesses in these regions, extend our reach into new geographies and enter adjacent categories. We also intend to continue to make our core snacks healthier through innovations in heart-healthy oil, sodium reduction and the addition of whole grains, nuts and seeds.

*2. Ensure Sustainable, Profitable Growth in Global Beverages*

The U.S. liquid refreshment beverage category and challenging economic conditions facing consumers continue to place pressure on our global beverage business. In the face of this pressure, we are taking action to ensure sustainable, profitable growth in our global beverage business. We expect that the mergers with PBG and PAS will create a lean, agile organization in North America with an optimized supply chain, a flexible go-to-market system and enhanced innovation capabilities. When combined with the actions we are taking to refresh our brands across the entire beverage category, we believe this game-changing transaction will enable us to accelerate our top-line growth and also improve our profitability. There continue to be significant areas of global beverage growth, particularly in developing markets and in evolving categories. We will invest in those attractive opportunities, concentrating in geographies and categories in which we are the leader or a close second, or where the competitive game remains wide open. Additionally, we intend to use our research and development capabilities to develop low- and zero-calorie beverages that taste great and add positive nutrition such as fiber, vitamins and calcium.

*3. Unleash the Power of Power of One*

Retail consolidation continues to increase the importance of our key customers. We must maintain mutually beneficial relationships with our key customers, as well as retailers and our bottling partners, to effectively compete. We are in the unique position to leverage two extraordinary consumer categories that have special relevance to retailers across the globe. Our snacks and beverages are both high velocity categories; both generate retail traffic; both are profitable; and both deliver strong cash flow. The combination of snacks and beverages with our must have global and local brands makes us an essential partner for large-format as well as small-format retailers. We expect to increasingly use this portfolio and the high coincidence of consumption of these

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products through integrated offerings (products, marketing and merchandising) to create value for consumers and deliver greater top-line growth for retailers. We intend to accelerate Power of One supply chain and back-office synergies in many regions to improve profitability and enhance customer service.

*4. Rapidly Expand our Good for You Portfolio*

Consumer tastes and preferences are constantly changing and our success depends on our ability to respond to consumer trends, including responding to consumers' desire for healthier choices. We currently have a roughly \$10 billion core of good-for-you products anchored by: Tropicana, Naked Juice, Lebedyansky, Sandora and our other juice brands; Aquafina; Quaker Oats; Gatorade (for athletes); the new dairy joint venture with Almarai; and local good-for-you products and brands. We intend to build on this core with an increasing stream of science-based innovation derived from the research and development capabilities that we have been ramping up over the past couple of years, as well as from targeted acquisitions and joint ventures. We will be investing to accelerate the growth of these platforms, and we will use the knowledge from these initiatives to improve our core snack and beverage offerings and also to develop highly nutritious products for undernourished people across the world.

*5. Continue to Deliver on Our Environmental Sustainability Goals and Commitments*

Consumers and government officials are increasingly focused on the impact companies have on the environment. We are committed to protecting the earth's natural resources and are well on our way to meeting our public goals for meaningful reductions in water, electricity and fuel usage. Our businesses around the world are implementing innovative approaches to be significantly more efficient in the use of land, energy, water, and packaging and we are actively working with the communities in which we operate to be responsive to their resource needs. In 2009, we formalized our commitment to water as a human right, and we will focus not only on world-class efficiency in our operations, but also in preserving water resources and enabling access to safe water. Our climate change focus is on reducing our carbon footprint, including the reduction in absolute greenhouse gas emissions and continued improvement in energy use efficiency. We actively work with our farmers to promote sustainable agriculture and we are developing new packaging alternatives in both snacks and beverages to reduce our impact on the environment.

*6. Cherish our Employees and Develop the Leadership to Sustain Our Growth*

Our continued growth requires us to hire, retain and develop our leadership bench and a highly skilled and diverse workforce. This will be especially important during 2010 in connection with the integration efforts related to the proposed mergers with PBG and PAS. We have an extraordinary talent base across our global organization in our manufacturing facilities, our sales and distribution organizations, our marketing groups, our staff functions, and with our general managers. As we expand our businesses, we are placing heightened focus on ensuring that we maintain an inclusive environment and on developing the careers of our associates all with the goal of continuing to have the

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leadership talent, capabilities and experience necessary to grow our businesses well into the future. As an example, we are implementing tailored training programs to provide our managers and senior executives with the strategic and leadership capabilities required in a rapidly changing environment.

At PepsiCo, everything we do is underpinned by our commitment to Performance with Purpose. This means we deliver sustainable growth by investing in a healthier future for people and our planet. For instance, in addition to the long-term sustainability and talent-related commitments referenced above, we also intend to respect, support and invest in the local communities where we operate by hiring local people, creating products designed for local tastes and partnering with local farmers, governments and community groups.

Performance with Purpose has been the fundamental underpinning to our success in 2009 and has been recognized by publications and organizations from Fortune Magazine's Most Admired Companies to Newsweek Green Rankings to the Boston College Center for Corporate Citizenship. By staying true to this foundation and executing on our strategy, we believe we will be able to achieve our objectives of improving financial results and increase return for our shareholders.

## **Our Operations**

We are organized into three business units, as follows:

- (1) PepsiCo Americas Foods (PAF), which includes Frito-Lay North America (FLNA), Quaker Foods North America (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 PepsiCo Beverages North America and all of our Latin American beverage businesses; and
- (3) PepsiCo International (PI), which includes all PepsiCo businesses in Europe and all PepsiCo businesses in Asia, Middle East and Africa (AMEA).

Our three business units are comprised of six reportable segments (referred to as divisions), as follows:

FLNA,

QFNA,

LAF,

PAB,

Europe, and

AMEA.

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***Frito-Lay North America***

Either independently or through contract manufacturers, FLNA makes, markets, sells and distributes branded snack foods. These foods include Lay's potato chips, Doritos tortilla chips, Cheetos cheese flavored snacks, Tostitos tortilla chips, branded dips, Fritos corn chips, Ruffles potato chips, Quaker Chewy granola bars and SunChips multigrain snacks. FLNA branded products are sold to independent distributors and retailers. In addition, FLNA's joint venture with Strauss Group makes, markets, sells and distributes Sabra refrigerated dips.

***Quaker Foods North America***

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

***Latin America Foods***

Either independently or through contract manufacturers, LAF makes, markets and sells a number of snack food brands including Gamesa, Doritos, Cheetos, Ruffles, Lay's and Sabritas, as well as many Quaker-brand cereals and snacks. These branded products are sold to independent distributors and retailers.

***PepsiCo Americas Beverages***

Either independently or through contract manufacturers, PAB makes, markets and sells beverage concentrates, fountain syrups and finished goods, under various beverage brands including Pepsi, Mountain Dew, Gatorade, 7UP (outside the U.S.), Tropicana Pure Premium, Sierra Mist, Mirinda, Mug, Propel, Manzanita Sol, Tropicana juice drinks, SoBe Lifewater, Dole, Amp Energy, Paso de los Toros, Naked juice and Izze. PAB also, either independently or through contract manufacturers, makes, 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, PAB licenses the Aquafina water brand to its bottlers and markets this brand. PAB sells concentrate and finished goods for some of these brands to authorized bottlers, and some of these branded finished goods are sold directly by us to independent distributors and retailers. The bottlers sell our brands as finished goods to independent distributors and retailers. PAB'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. 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 quantifies the sell-through of our products at the consumer level.

See also Acquisition of Common Stock of PBG and PAS below.

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***Europe***

Either independently or through contract manufacturers, Europe makes, markets and sells a number of leading snack foods including Lay's, Walkers, Doritos, Cheetos and Ruffles, as well as many Quaker-brand cereals and snacks, through consolidated businesses as well as through noncontrolled affiliates. Europe also, either independently or through contract manufacturers, makes, markets and sells beverage concentrates, fountain syrups and finished goods under various beverage brands including Pepsi, 7UP and Tropicana. These brands are sold to authorized bottlers, independent distributors and retailers. In certain markets, however, Europe operates its own bottling plants and distribution facilities. In addition, Europe licenses the Aquafina water brand to certain of its authorized bottlers. Europe also, either independently or through contract manufacturers, makes, markets and sells ready-to-drink tea products through an international joint venture with Unilever (under the Lipton brand name).

Europe reports two measures of volume. Snacks 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 (see PepsiCo Americas Beverages above).

See also Acquisition of Common Stock of PBG and PAS below.

***Asia, Middle East & Africa***

AMEA makes, markets and sells a number of leading snack food brands including Lay's, Kurkure, Chipsy, Doritos, Smith's, Cheetos, Red Rock Deli and Ruffles, through consolidated businesses as well as through noncontrolled affiliates. Further, either independently or through contract manufacturers, AMEA makes, markets and sells many Quaker-brand cereals and snacks. AMEA also makes, markets and sells beverage concentrates, fountain syrups and finished goods, under various beverage brands including Pepsi, Mirinda, 7UP and Mountain Dew. These brands are sold to authorized bottlers, independent distributors and retailers. However, in certain markets, AMEA operates its own bottling plants and distribution facilities. In addition, AMEA licenses the Aquafina water brand to certain of its authorized bottlers. AMEA also, either independently or through contract manufacturers, makes, markets and sells ready-to-drink tea products through an international joint venture with Unilever (under the Lipton brand name). AMEA reports two measures of volume (see Europe above).

***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 us with the right to charge our bottlers for concentrate, finished goods and Aquafina royalties and specify the manufacturing process required for product quality.

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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 and the current economic environment continue to increase the importance of major customers. In 2009, sales to Wal-Mart (including Sam's) represented approximately 13% of our total net revenue. Our top five retail customers represented approximately 33% of our 2009 North American net revenue, with Wal-Mart (including Sam's) representing approximately 19%. These percentages include concentrate sales to our bottlers which are used in finished goods sold by them to these retailers. In addition, sales to PBG represented approximately 6% of our total net revenue in 2009. See "Acquisition of Common Stock of PBG and PAS", "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 have designated three related party bottlers, PBG, PAS and Pepsi Bottling Ventures LLC (PBV), as our anchor bottlers. We include our share of their net income based on our percentage of economic ownership in our income statement as bottling equity income. Our anchor bottlers distribute approximately 60% of our North American beverage volume and approximately 16% of our beverage volume outside of North America. Our anchor bottlers participate in the bottler funding programs described above. Approximately 8% of our total 2009 sales incentives were related to these bottlers. See Note 8 for additional information on these related parties and related party commitments and guarantees. Our share of income or loss from other noncontrolled affiliates is recorded as a component of selling, general and administrative expenses. See "Acquisition of Common Stock of PBG and PAS" for more information on our related party bottlers.

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### **Our Distribution Network**

Our products are brought to market through DSD, customer 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.

#### ***Customer 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 restaurants, businesses, schools, stadiums 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, our chief beverage competitor, The Coca-Cola Company, has a larger share of CSD consumption, while we have a larger share of liquid refreshment beverages consumption. In addition, The Coca-Cola Company has a significant CSD share advantage in many markets outside the United States. Further, our snack brands hold significant leadership positions in the snack industry worldwide. Our snack brands face local, regional and private label 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, the introduction of new products and the effectiveness of our advertising campaigns, marketing programs and product packaging. 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.

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### **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**

We are subject to risks in the normal course of business. See **Risk Factors** in Item 1A. and **Executive Overview** above and **Market Risks** below for more information about these risks.

### ***Risk Management Framework***

The achievement of our strategic and operating objectives will necessarily involve taking risks. Our risk management 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 Risk Committee (PRC), comprised of a cross-functional, geographically diverse, senior management group which meets regularly to identify, assess, prioritize and address strategic and reputational risks;

Division Risk Committees (DRCs), comprised of cross-functional senior management teams which meet regularly 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 PRC 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 Department, which leads and coordinates our compliance policies and practices.

### ***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.

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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. See Note 9 for further information on our non-cancelable purchasing commitments. Our hedging strategies include the use of derivatives. Certain 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. Cash flows from derivatives used to manage commodity, foreign exchange or interest risks are classified as operating activities. We do not use derivative instruments for trading or speculative purposes. We perform assessments of our counterparty credit risk regularly, including a review of credit ratings, credit default swap rates and potential nonperformance of the counterparty. Based on our most recent assessment of our counterparty credit risk, we consider this risk to be low. In addition, we enter into derivative contracts with a variety of financial institutions that we believe are creditworthy in order to reduce our concentration of credit risk and generally settle with these financial institutions on a net basis.

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 market fluctuations.

Inflationary, deflationary and recessionary conditions impacting these market risks also impact the demand for and pricing of our products. See *Risk Factors* in Item 1A. for further discussion.

*Commodity Prices*

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

Our open commodity derivative contracts that qualify for hedge accounting had a face value of \$151 million as of December 26, 2009 and \$303 million as of December 27, 2008. These contracts resulted in net unrealized losses of \$29 million as of December 26, 2009 and \$117 million as of December 27, 2008. At the end of 2009, the potential change in fair value of commodity derivative instruments, assuming a 10% decrease in the underlying commodity price, would have increased our net unrealized losses in 2009 by \$13 million.

Our open commodity derivative contracts that do not qualify for hedge accounting had a face value of \$231 million as of December 26, 2009 and \$626 million as of December 27, 2008. These contracts resulted in net losses of \$57 million in 2009 and \$343 million in 2008. At the end of 2009, the potential change in fair value of commodity derivative instruments, assuming a 10% decrease in the underlying commodity price, would have increased our net losses in 2009 by \$17 million.

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*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 48% of our net revenue, with Mexico, Canada and the United Kingdom comprising 16% of our net revenue. As a result, we are exposed to foreign currency risks. During 2009, net unfavorable foreign currency, primarily due to depreciation of the Mexican peso, British pound, euro and Russian ruble, reduced net revenue growth by 5 percentage points. Currency declines against the U.S. dollar which are not offset could adversely impact our future results.

In addition, we continue to use the official exchange rate to translate the financial statements of our snack and beverage businesses in Venezuela. We use the official rate as we currently intend to remit dividends solely through the government-operated Foreign Exchange Administration Board (CADIVI). As of the beginning of our 2010 fiscal year, the results of our Venezuelan businesses will be reported under hyperinflationary accounting. This determination was made based upon Venezuela's National Consumer Price Index (NCPI) which indicated cumulative inflation in Venezuela in excess of 100% for the three-year period ended November 30, 2009. Consequently, the functional currency of our Venezuelan entities will be changed from the bolivar fuerte (bolivar) to the U.S. dollar. Effective January 11, 2010, the Venezuelan government devalued the bolivar by resetting the official exchange rate from 2.15 bolivars per dollar to 4.3 bolivars per dollar; however, certain activities would be permitted to access an exchange rate of 2.6 bolivars per dollar. In 2010, we expect that the majority of our transactions will be conducted at the 4.3 exchange rate, and as a result of the change to hyperinflationary accounting and the devaluation of the bolivar, we expect to record a one-time charge of approximately \$125 million in the first quarter of 2010. In 2009, our operations in Venezuela comprised 7% of our cash and cash equivalents balance and generated less than 2% of our net revenue.

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, primarily forward contracts with terms of no more than two years, to manage our exposure to foreign currency transaction risk. Our foreign currency derivatives had a total face value of \$1.2 billion as of December 26, 2009 and \$1.4 billion as of December 27, 2008. The contracts that qualify for hedge accounting resulted in net unrealized losses of \$20 million as of December 26, 2009 and net unrealized gains of \$111 million as of December 27, 2008. At the end of 2009, we estimate that an unfavorable 10% change in the exchange rates would have increased our net unrealized losses by \$86 million. The contracts that do not qualify for hedge accounting resulted in net gains of \$1 million in 2009 and net losses of \$28 million in 2008. All losses and gains were offset by changes in the underlying hedged items, resulting in no net material impact on earnings.

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*Interest Rates*

We centrally manage our debt and investment portfolios considering investment opportunities and risks, tax consequences and overall financing strategies. We use various interest rate derivative instruments including, but not limited to, interest rate swaps, cross currency interest rate swaps, Treasury locks and swap locks to manage our overall interest expense and foreign exchange risk. These instruments effectively change the interest rate and currency of specific debt issuances. Our interest rate and cross currency swaps are generally entered into concurrently with the issuance of the debt that they modified. The notional amount, interest payment and maturity date of the interest rate and cross currency swaps match the principal, interest payment and maturity date of the related debt. Our Treasury locks and swap locks are entered into to protect against unfavorable interest rate changes relating to forecasted debt transactions.

Assuming year-end 2009 variable rate debt and investment levels, a 1-percentage-point increase in interest rates would have increased net interest expense by \$3 million in 2009.

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**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 certain 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 certain warehouse-distributed products is to replace damaged and out-of-date products. Based on our 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 and storerooms limiting the quantity of product. For product delivered through our other distribution networks, we monitor customer inventory levels.

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 \$12.9 billion in 2009, \$12.5 billion in 2008 and \$11.3 billion in 2007. 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



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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. Payments made to obtain these rights are recognized over the shorter of the economic or contractual life, as a reduction of revenue, and the remaining balances of \$296 million at year-end 2009 and \$333 million at year-end 2008 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 and collectibility, the aging of accounts receivable and our analysis of customer data. 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.

Perpetual brands and goodwill, including the goodwill that is part of our noncontrolled 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

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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 "Risk Factors" in Item 1A and "Our Business Risks."

We did not recognize any impairment charges for perpetual brands or goodwill in the years presented. As of December 26, 2009, we had \$8.3 billion of perpetual brands and goodwill, of which approximately 60% related to our Lebedyansky, Tropicana and Walkers businesses.

**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

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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 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 2009, our annual tax rate was 26.0% compared to 26.7% in 2008 as discussed in Other Consolidated Results. The tax rate in 2009 decreased 0.7 percentage points primarily due to the favorable resolution of certain foreign tax matters and lower taxes on foreign results in the current year. In 2010, our annual tax rate is expected to be approximately the same as in 2009.

**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 which vary based upon years of service, with retirees contributing the remainder of the cost.

***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.



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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. Prior to 2008, we used the Moody's Aa Corporate Bond Index yield in the U.S. and adjusted 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 U.S. discount rate is 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. The Mercer Yield Curve includes bonds that closely match the timing and amount of our expected benefit payments.

The expected return on pension plan assets is based on our pension plan investment strategy, our expectations for long-term rates of return and our historical experience. We also review current levels of interest rates and inflation to assess the reasonableness of the long-term rates. Our pension plan investment strategy includes the use of actively-managed securities and is reviewed annually based upon plan liabilities, an evaluation of market conditions, tolerance for risk and cash requirements for benefit payments. Our investment objective is to ensure that funds are available to meet the plans' benefit obligations when they become due. Our overall investment strategy is to prudently invest plan assets in high-quality and diversified equity and debt securities to achieve our long-term return expectations. Our investment policy also permits the use of derivative instruments which are primarily used to reduce risk. Our expected long-term rate of return on U.S. plan assets is 7.8%, reflecting estimated long-term rates of return of 8.9% from our equity allocations and 6.3% from our fixed income allocations. Our target investment allocation is 40% for U.S. equity allocations, 20% for international equity allocations and 40% for fixed income allocations. Actual investment allocations may vary from our target investment allocations due to prevailing market conditions. We regularly review our actual investment allocations and periodically rebalance our investments to our target allocations. To calculate the expected return on pension plan assets, we use a market-related valuation method that recognizes investment gains or losses (the difference between the expected and actual return based on the market-related value of assets) for securities included in our equity allocations over a five-year period. This has the effect of reducing year-to-year volatility. For all other asset categories, the actual fair value is used for the market-related value of assets.

The difference between the actual return on plan assets and the expected return on plan assets is added to, or subtracted from, other gains and losses resulting from actual experience differing from our assumptions and from changes in our assumptions determined at each measurement date. If this net accumulated gain or loss exceeds 10% of the greater of the market-related value of plan assets or plan 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 10 years for pension expense and approximately 12 years for retiree medical expense.

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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:

|                                        | 2010 | 2009 | 2008 |
|----------------------------------------|------|------|------|
| <b><i>Pension</i></b>                  |      |      |      |
| Expense discount rate                  | 6.1% | 6.2% | 6.3% |
| Expected rate of return on plan assets | 7.6% | 7.6% | 7.6% |
| Expected rate of salary increases      | 4.4% | 4.4% | 4.4% |
| <b><i>Retiree medical</i></b>          |      |      |      |
| Expense discount rate                  | 6.1% | 6.2% | 6.4% |
| Current health care cost trend rate    | 7.5% | 8.0% | 8.5% |

Based on our assumptions, we expect our pension expense to increase in 2010, as a result of assumption changes and an increase in experience loss amortization partially offset by expected asset returns on 2010 contributions. The most significant assumption changes result from the use of lower discount rates. Further, we expect our pension expense to increase in 2010 as a result of our pending mergers with PBG and PAS.

***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 2010 pension expense is an increase of approximately \$32 million. The estimated impact on 2010 pension expense of a 25-basis-point decrease in the expected rate of return is an increase of approximately \$20 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 tax deductible.

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Our pension contributions for 2009 were \$1.2 billion, of which \$1 billion was discretionary. In 2010, we expect to make contributions of approximately \$700 million with up to approximately \$600 million expected to be discretionary. Our cash payments for retiree medical benefits are estimated to be approximately \$100 million in 2010. 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 December 2007, the Financial Accounting Standards Board (FASB) amended its guidance on accounting for business combinations to improve, simplify and converge internationally the accounting for business combinations. The new accounting guidance continues the movement toward the greater use of fair value in financial reporting and increased transparency through expanded disclosures. We adopted the provisions of the new guidance as of the beginning of our 2009 fiscal year. The new accounting guidance changes how business acquisitions are accounted for and will impact financial statements both on the acquisition date and in subsequent periods. Additionally, under the new guidance, transaction costs are expensed rather than capitalized. Future adjustments made to valuation allowances on deferred taxes and acquired tax contingencies associated with acquisitions that closed prior to the beginning of our 2009 fiscal year apply the new provisions and will be evaluated based on the outcome of these matters.

In December 2007, the FASB issued new accounting and disclosure guidance on noncontrolling interests in consolidated financial statements. This guidance amends the accounting literature to establish new standards that will govern the accounting for and reporting of (1) noncontrolling interests in partially owned consolidated subsidiaries and (2) the loss of control of subsidiaries. We adopted the accounting provisions of the new guidance on a prospective basis as of the beginning of our 2009 fiscal year, and the adoption did not have a material impact on our financial statements. In addition, we adopted the presentation and disclosure requirements of the new guidance on a retrospective basis in the first quarter of 2009.

In June 2009, the FASB amended its accounting guidance on the consolidation of variable interest entities (VIE). Among other things, the new guidance requires a qualitative rather than a quantitative assessment to determine the primary beneficiary of a VIE based on whether the entity (1) has the power to direct matters that most significantly impact the activities of the VIE and (2) has the obligation to absorb losses or the right to receive benefits of the VIE that could potentially be significant to the VIE. In addition, the amended guidance requires an ongoing reconsideration of the primary beneficiary. The provisions of this new guidance are effective as of the beginning of our 2010 fiscal year, and we do not expect the adoption to have a material impact on our financial statements.

**Table of Contents****OUR FINANCIAL RESULTS****Items Affecting Comparability**

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

|                                                                           | 2009      | 2008      | 2007      |
|---------------------------------------------------------------------------|-----------|-----------|-----------|
| <b><i>Operating profit</i></b>                                            |           |           |           |
| Mark-to-market net impact (gain/(loss))                                   | \$ 274    | \$ (346)  | \$ 19     |
| Restructuring and impairment charges                                      | \$ (36)   | \$ (543)  | \$ (102)  |
| PBG/PAS merger costs                                                      | \$ (50)   |           |           |
| <b><i>Bottling equity income</i></b>                                      |           |           |           |
| PBG/PAS merger costs                                                      | \$ (11)   |           |           |
| <b><i>Net income attributable to PepsiCo</i></b>                          |           |           |           |
| Mark-to-market net impact (gain/(loss))                                   | \$ 173    | \$ (223)  | \$ 12     |
| Restructuring and impairment charges                                      | \$ (29)   | \$ (408)  | \$ (70)   |
| Tax benefits                                                              |           |           | \$ 129    |
| PepsiCo share of PBG restructuring and impairment charges                 |           | \$ (114)  |           |
| PBG/PAS merger costs                                                      | \$ (44)   |           |           |
| <b><i>Net income attributable to PepsiCo per common share diluted</i></b> |           |           |           |
| Mark-to-market net impact (gain/(loss))                                   | \$ 0.11   | \$ (0.14) | \$ 0.01   |
| Restructuring and impairment charges                                      | \$ (0.02) | \$ (0.25) | \$ (0.04) |
| Tax benefits                                                              |           |           | \$ 0.08   |
| PepsiCo share of PBG restructuring and impairment charges                 |           | \$ (0.07) |           |
| PBG/PAS merger costs                                                      | \$ (0.03) |           |           |
| <b><i>Mark-to-Market Net Impact</i></b>                                   |           |           |           |

We centrally manage commodity derivatives on behalf of our divisions. These commodity derivatives include energy, fruit and other raw materials. Certain of these commodity derivatives do not qualify for hedge accounting treatment and are marked to market with the resulting gains and losses recognized in corporate unallocated expenses. These gains and losses are subsequently reflected in division results when the divisions take delivery of the underlying commodity. Therefore, the divisions realize the economic effects of the derivative without experiencing any resulting mark-to-market volatility, which remains in corporate unallocated expenses.

In 2009, we recognized \$274 million (\$173 million after-tax or \$0.11 per share) of mark-to-market net gains on commodity hedges in corporate unallocated expenses.

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In 2008, we recognized \$346 million (\$223 million after-tax or \$0.14 per share) of mark-to-market net losses on commodity hedges in corporate unallocated expenses.

In 2007, we recognized \$19 million (\$12 million after-tax or \$0.01 per share) of mark-to-market net gains on commodity hedges in corporate unallocated expenses.

### ***Restructuring and Impairment Charges***

In 2009, we incurred a charge of \$36 million (\$29 million after-tax or \$0.02 per share) in conjunction with our Productivity for Growth program that began in 2008. The program includes actions in all divisions of the business, including the closure of six plants that we believe will increase cost competitiveness across the supply chain, upgrade and streamline our product portfolio, and simplify the organization for more effective and timely decision-making. These initiatives were completed in the second quarter of 2009.

In 2008, we incurred a charge of \$543 million (\$408 million after-tax or \$0.25 per share) in conjunction with our Productivity for Growth program.

In 2007, we incurred a charge of \$102 million (\$70 million after-tax or \$0.04 per share) in conjunction with restructuring actions primarily to close certain plants and rationalize other production lines.

### ***Tax Benefits***

In 2007, we recognized \$129 million (\$0.08 per share) of non-cash tax benefits related to the favorable resolution of certain foreign tax matters.

### ***PepsiCo Share of PBG's Restructuring and Impairment Charges***

In 2008, PBG implemented a restructuring initiative across all of its geographic segments. In addition, PBG recognized an asset impairment charge related to its business in Mexico. Consequently, a non-cash charge of \$138 million was included in bottling equity income (\$114 million after-tax or \$0.07 per share) as part of recording our share of PBG's financial results.

### ***PBG/PAS Merger Costs***

In 2009, we incurred \$50 million of costs associated with the proposed mergers with PBG and PAS, as well as an additional \$11 million of costs, representing our share of the respective merger costs of PBG and PAS, recorded in bottling equity income. In total, these costs had an after-tax impact of \$44 million or \$0.03 per share.

**Table of Contents****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. Additionally, *acquisitions* reflect all mergers and acquisitions activity, including the impact of acquisitions, divestitures and changes in ownership or control in consolidated subsidiaries. The impact of acquisitions related to our non-consolidated equity investees is reflected in our volume and, excluding our anchor bottlers, in our operating profit.

**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 2009, total servings increased slightly compared to 2008, as servings for snacks increased 1% while servings for beverages decreased 1%. In 2008, total servings increased 3% compared to 2007, as servings for both snacks and beverages worldwide grew 3%.

**Net Revenue and Operating Profit**

|                                                            | 2009      | 2008      | 2007      | Change |       |
|------------------------------------------------------------|-----------|-----------|-----------|--------|-------|
|                                                            |           |           |           | 2009   | 2008  |
| Total net revenue                                          | \$ 43,232 | \$ 43,251 | \$ 39,474 | %      | 10%   |
| Operating profit                                           |           |           |           |        |       |
| FLNA                                                       | \$ 3,258  | \$ 2,959  | \$ 2,845  | 10%    | 4%    |
| QFNA                                                       | 628       | 582       | 568       | 8%     | 2.5%  |
| LAF                                                        | 904       | 897       | 714       | 1%     | 26%   |
| PAB                                                        | 2,172     | 2,026     | 2,487     | 7%     | (19)% |
| Europe                                                     | 932       | 910       | 855       | 2%     | 6%    |
| AMEA                                                       | 716       | 592       | 466       | 21%    | 27%   |
| Corporate net impact of mark-to-market on commodity hedges | 274       | (346)     | 19        | n/m    | n/m   |
| Corporate PBG/PAS merger costs                             | (49)      |           |           | n/m    | n/m   |
| Corporate restructuring                                    |           | (10)      |           | n/m    | n/m   |
| Corporate other                                            | (791)     | (651)     | (772)     | 21%    | (16)% |
| Total operating profit                                     | \$ 8,044  | \$ 6,959  | \$ 7,182  | 16%    | (3)%  |
| Total operating profit margin                              | 18.6%     | 16.1%     | 18.2%     | 2.5    | (2.1) |

*n/m represents year-over-year changes that are not meaningful.*

**Table of Contents****2009**

Total operating profit increased 16% and operating margin increased 2.5 percentage points. These increases were driven by the net favorable mark-to-market impact of our commodity hedges and lower restructuring and impairment charges related to our Productivity for Growth program, collectively contributing 17 percentage points to operating profit growth, partially offset by 1 percentage point from costs associated with the proposed mergers with PBG and PAS. Foreign currency reduced operating profit growth by 6 percentage points, and acquisitions contributed 2 percentage points to the operating profit growth.

Other corporate unallocated expenses increased 21%, primarily reflecting deferred compensation losses, compared to gains in the prior year. The deferred compensation losses are offset (as an increase to interest income) by gains on investments used to economically hedge these costs.

**2008**

Total operating profit decreased 3% and margin decreased 2.1 percentage points. The unfavorable net mark-to-market impact of our commodity hedges and increased restructuring and impairment charges contributed 11 percentage points to the operating profit decline and 1.8 percentage points to the margin decline. Leverage from the revenue growth was offset by the impact of higher commodity costs. Acquisitions and foreign currency each positively contributed 1 percentage point to operating profit performance.

Other corporate unallocated expenses decreased 16%. The favorable impact of certain employee-related items, including lower deferred compensation and pension costs were partially offset by higher costs associated with our global SAP implementation and increased research and development costs. The decrease in deferred compensation costs are offset by a decrease in interest income from losses on investments used to economically hedge these costs.

***Other Consolidated Results***

|                                                             | <b>2009</b>     | 2008     | 2007     | Change         |          |
|-------------------------------------------------------------|-----------------|----------|----------|----------------|----------|
|                                                             |                 |          |          | <b>2009</b>    | 2008     |
| Bottling equity income                                      | <b>\$ 365</b>   | \$ 374   | \$ 560   | <b>(2)%</b>    | (33)%    |
| Interest expense, net                                       | <b>\$ (330)</b> | \$ (288) | \$ (99)  | <b>\$ (42)</b> | \$ (189) |
| Annual tax rate                                             | <b>26.0%</b>    | 26.7%    | 25.8%    |                |          |
| Net income attributable to PepsiCo                          | <b>\$ 5,946</b> | \$ 5,142 | \$ 5,658 | <b>16%</b>     | (9)%     |
| Net income attributable to PepsiCo per common share diluted | <b>\$ 3.77</b>  | \$ 3.21  | \$ 3.41  | <b>17%</b>     | (6)%     |

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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. 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%. Consequently, we sold 8.8 million shares of PBG stock and 3.3 million shares of PAS stock in 2008. The resulting lower ownership percentages reduced the equity income from PBG and PAS that we recognized subsequent to those sales. We did not sell any PBG or PAS stock in 2009. Substantially all of our bottling equity income is derived from our equity investments in PBG and PAS. Also see Acquisition of Common Stock of PBG and PAS.

2009

Bottling equity income decreased 2%, primarily reflecting pre-tax gains on our sales of PBG and PAS stock in the prior year, mostly offset by a prior year non-cash charge of \$138 million related to our share of PBG's 2008 restructuring and impairment charges.

Net interest expense increased \$42 million, primarily reflecting lower average rates on our investment balances and higher average debt balances. This increase was partially offset by gains in the market value of investments used to economically hedge a portion of our deferred compensation costs.

The tax rate decreased 0.7 percentage points compared to the prior year, primarily due to the favorable resolution of certain foreign tax matters and lower taxes on foreign results in the current year.

Net income attributable to PepsiCo increased 16% and net income attributable to PepsiCo per common share increased 17%. The favorable net mark-to-market impact of our commodity hedges and lower restructuring and impairment charges in the current year were partially offset by the PBG/PAS merger costs; these items affecting comparability increased net income attributable to PepsiCo by 16 percentage points and net income attributable to PepsiCo per common share by 17 percentage points. Net income attributable to PepsiCo per common share was also favorably impacted by share repurchases in the prior year.

2008

Bottling equity income decreased 33%, primarily reflecting a non-cash charge of \$138 million related to our share of PBG's restructuring and impairment charges. Additionally, lower pre-tax gains on our sales of PBG stock contributed to the decline.

Net interest expense increased \$189 million, primarily reflecting higher average debt balances and losses on investments used to economically hedge our deferred compensation costs, partially offset by lower average rates on our borrowings.

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The tax rate increased 0.9 percentage points compared to the prior year, primarily due to \$129 million of tax benefits recognized in the prior year related to the favorable resolution of certain foreign tax matters, partially offset by lower taxes on foreign results in the current year.

Net income attributable to PepsiCo decreased 9% and the related net income attributable to PepsiCo per common share decreased 6%. The unfavorable net mark-to-market impact of our commodity hedges, the absence of the tax benefits recognized in the prior year, our increased restructuring and impairment charges and our share of PBG's restructuring and impairment charges collectively contributed 15 percentage points to both the decline in net income attributable to PepsiCo and net income attributable to PepsiCo per common share. Additionally, net income attributable to PepsiCo per common share was favorably impacted by our share repurchases.

## **Results of Operations   Division Review**

The results and discussions below are based on how our Chief Executive Officer monitors the performance of our divisions. In addition, our operating profit and growth, excluding the impact of restructuring and impairment charges and costs associated with the proposed mergers with PBG and PAS, are not measures defined by accounting principles generally accepted in the U.S. However, we believe investors should consider these measures as they are more indicative of our ongoing performance and with how management evaluates our operating results and trends. For additional information on our divisions, see Note 1 and for additional information on our restructuring and impairment charges, see Note 3.

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|                                      | <b>FLNA</b>      | <b>QFNA</b>     | <b>LAF</b>      | <b>PAB</b>       | <b>Europe</b>   | <b>AMEA</b>     | <b>Total</b>     |
|--------------------------------------|------------------|-----------------|-----------------|------------------|-----------------|-----------------|------------------|
| <b>Net Revenue, 2009</b>             | <b>\$ 13,224</b> | <b>\$ 1,884</b> | <b>\$ 5,703</b> | <b>\$ 10,116</b> | <b>\$ 6,727</b> | <b>\$ 5,578</b> | <b>\$ 43,232</b> |
| Net Revenue, 2008                    | \$ 12,507        | \$ 1,902        | \$ 5,895        | \$ 10,937        | \$ 6,891        | \$ 5,119        | \$ 43,251        |
| <i>% Impact of:</i>                  |                  |                 |                 |                  |                 |                 |                  |
| Volume <sup>(a)</sup>                | 1%               | %               | (2)%            | (7)%             | (3)%            | 7%              | (1)%             |
| Effective net pricing <sup>(b)</sup> | 5.5              |                 | 12              |                  | 5               | 4               | 5                |
| Foreign exchange                     | (1)              | (1)             | (14)            | (1)              | (12)            | (3)             | (5)              |
| Acquisitions                         |                  |                 |                 |                  | 8               | 1               | 1.5              |
| <i>% Change<sup>(c)</sup></i>        |                  |                 |                 |                  |                 |                 |                  |
|                                      | 6%               | (1)%            | (3)%            | (8)%             | (2)%            | 9%              | %                |

|                                      | <b>FLNA</b> | <b>QFNA</b> | <b>LAF</b> | <b>PAB</b> | <b>Europe</b> | <b>AMEA</b> | <b>Total</b> |
|--------------------------------------|-------------|-------------|------------|------------|---------------|-------------|--------------|
| Net Revenue, 2008                    | \$ 12,507   | \$ 1,902    | \$ 5,895   | \$ 10,937  | \$ 6,891      | \$ 5,119    | \$ 43,251    |
| Net Revenue, 2007                    | \$ 11,586   | \$ 1,860    | \$ 4,872   | \$ 11,090  | \$ 5,896      | \$ 4,170    | \$ 39,474    |
| <i>% Impact of:</i>                  |             |             |            |            |               |             |              |
| Volume <sup>(a)</sup>                | %           | (1.5)%      | %          | (4.5)%     | 4%            | 14%         | 1%           |
| Effective net pricing <sup>(b)</sup> | 7           | 4           | 11         | 3          | 4             | 6           | 6            |
| Foreign exchange                     |             |             |            |            | 2             | 1           | 1            |
| Acquisitions                         |             |             | 9          |            | 7             | 2           | 2            |
| <i>% Change<sup>(c)</sup></i>        |             |             |            |            |               |             |              |
|                                      | 8%          | 2%          | 21%        | (1)%       | 17%           | 23%         | 10%          |

- (a) Excludes the impact of acquisitions. In certain instances, volume growth varies from the amounts disclosed in the following divisional discussions due to non-consolidated joint venture volume, and, for our beverage businesses, temporary timing differences between BCS and CSE. Our net revenue excludes non-consolidated joint venture volume, and, for our beverage businesses, 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.

**Table of Contents****Frito-Lay North America**

|                                                                  | <b>2009</b>      | <b>2008</b> | <b>2007</b> | <b>% Change</b> |             |
|------------------------------------------------------------------|------------------|-------------|-------------|-----------------|-------------|
|                                                                  | <b>2009</b>      | <b>2008</b> | <b>2007</b> | <b>2009</b>     | <b>2008</b> |
| Net revenue                                                      | <b>\$ 13,224</b> | \$ 12,507   | \$ 11,586   | <b>6</b>        | 8           |
| Operating profit                                                 | <b>\$ 3,258</b>  | \$ 2,959    | \$ 2,845    | <b>10</b>       | 4           |
| Impact of restructuring and impairment charges                   | <b>2</b>         | 108         | 28          |                 |             |
| Operating profit, excluding restructuring and impairment charges | <b>\$ 3,260</b>  | \$ 3,067    | \$ 2,873    | <b>6</b>        | 7           |

**2009**

Net revenue grew 6% and pound volume increased 1%. The volume growth reflects high-single-digit growth in dips, double-digit growth from our Sabra joint venture, and low-single-digit growth in trademark Lay's. These volume gains were partially offset by high-single-digit declines in trademark Ruffles. Net revenue growth also benefited from effective net pricing. Foreign currency reduced net revenue growth by almost 1 percentage point.

Operating profit grew 10%, primarily reflecting the net revenue growth, partially offset by higher commodity costs, primarily cooking oil and potatoes. Lower restructuring and impairment charges in the current year related to our Productivity for Growth program increased operating profit growth by nearly 4 percentage points.

**2008**

Net revenue grew 8% and pound volume grew 1%. The volume growth reflects our 2008 Sabra joint venture and mid-single-digit growth in trademark Cheetos, Ruffles and dips. These volume gains were largely offset by mid-single-digit declines in trademark Lay's and Doritos. Net revenue growth benefited from pricing actions. Foreign currency had a nominal impact on net revenue growth.

Operating profit grew 4%, reflecting the net revenue growth. This growth was partially offset by higher commodity costs, primarily cooking oil and fuel. Operating profit growth was negatively impacted by 3 percentage points, resulting from higher fourth quarter restructuring and impairment charges in 2008 related to our Productivity for Growth program. Foreign currency and acquisitions each had a nominal impact on operating profit growth. Operating profit, excluding restructuring and impairment charges, grew 7%.

**Table of Contents****Quaker Foods North America**

|                                                                  |                 |          |          | % Change   |      |
|------------------------------------------------------------------|-----------------|----------|----------|------------|------|
|                                                                  | 2009            | 2008     | 2007     | 2009       | 2008 |
| Net revenue                                                      | <b>\$ 1,884</b> | \$ 1,902 | \$ 1,860 | <b>(1)</b> | 2    |
| Operating profit                                                 | <b>\$ 628</b>   | \$ 582   | \$ 568   | <b>8</b>   | 2.5  |
| Impact of restructuring and impairment charges                   | <b>1</b>        | 31       |          |            |      |
| Operating profit, excluding restructuring and impairment charges | <b>\$ 629</b>   | \$ 613   | \$ 568   | <b>3</b>   | 8    |

**2009**

Net revenue declined 1% and volume was flat. Low-single-digit volume declines in Oatmeal and high-single-digit declines in trademark Roni were offset by high-single-digit growth in ready-to-eat cereals. Favorable net pricing, driven by price increases taken last year, was offset by unfavorable mix. Unfavorable foreign currency reduced net revenue growth by 1 percentage point.

Operating profit increased 8%, primarily reflecting the absence of prior year restructuring and impairment charges related to our Productivity for Growth program, which increased operating profit growth by 5 percentage points. Lower advertising and marketing, and selling and distribution expenses, also contributed to the operating profit growth.

**2008**

Net revenue increased 2% and volume declined 1.5%, partially reflecting the negative impact of the Cedar Rapids flood that occurred at the end of the second quarter. The volume decrease reflects a low-single-digit decline in Quaker Oatmeal and ready-to-eat cereals. The net revenue growth reflects favorable effective net pricing, due primarily to price increases, partially offset by the volume decline. Foreign currency had a nominal impact on net revenue growth.

Operating profit increased 2.5%, reflecting the net revenue growth and lower advertising and marketing costs, partially offset by increased commodity costs. The negative impact of the flood was mitigated by related business disruption insurance recoveries, which contributed 5 percentage points to operating profit. The fourth quarter restructuring and impairment charges related to our Productivity for Growth program reduced operating profit growth by 5 percentage points. Foreign currency had a nominal impact on operating profit growth. Operating profit, excluding restructuring and impairment charges, grew 8%.

**Table of Contents****Latin America Foods**

|                                                                  |                 |          |          | % Change   |      |
|------------------------------------------------------------------|-----------------|----------|----------|------------|------|
|                                                                  | 2009            | 2008     | 2007     | 2009       | 2008 |
| Net revenue                                                      | <b>\$ 5,703</b> | \$ 5,895 | \$ 4,872 | <b>(3)</b> | 21   |
| Operating profit                                                 | <b>\$ 904</b>   | \$ 897   | \$ 714   | <b>1</b>   | 26   |
| Impact of restructuring and impairment charges                   | <b>3</b>        | 40       | 39       |            |      |
| Operating profit, excluding restructuring and impairment charges | <b>\$ 907</b>   | \$ 937   | \$ 753   | <b>(3)</b> | 24   |

**2009**

Volume declined 2%, largely reflecting pricing actions to cover commodity inflation. A mid-single-digit decline at Sabritas in Mexico and a low-single-digit decline at Gamesa in Mexico was partially offset by mid-single-digit growth in Brazil.

Net revenue declined 3%, primarily reflecting an unfavorable foreign currency impact of 14 percentage points. Favorable effective net pricing was partially offset by the volume declines.

Operating profit grew 1%, reflecting favorable effective net pricing, partially offset by the higher commodity costs. Unfavorable foreign currency reduced operating profit by 17 percentage points. Operating profit growth benefited from lower restructuring and impairment charges in the current year related to our Productivity for Growth program.

**2008**

Volume grew 3%, primarily reflecting an acquisition in Brazil, which contributed nearly 3 percentage points to the volume growth. A mid-single-digit decline at Sabritas in Mexico, largely resulting from weight-outs, was offset by mid-single digit growth at Gamesa in Mexico and double-digit growth in certain other markets.

Net revenue grew 21%, primarily reflecting favorable effective net pricing. Gamesa experienced double-digit growth due to favorable pricing actions. Acquisitions contributed 9 percentage points to the net revenue growth, while foreign currency had a nominal impact on net revenue growth.

Operating profit grew 26%, driven by the net revenue growth, partially offset by increased commodity costs. An insurance recovery contributed 3 percentage points to the operating profit growth. The impact of the fourth quarter restructuring and impairment charges in 2008 related to our Productivity for Growth program was offset by prior year restructuring charges. Acquisitions contributed 4 percentage points and foreign currency contributed 1 percentage point to the operating profit growth. Operating profit, excluding restructuring and impairment charges, grew 24%.

**Table of Contents****PepsiCo Americas Beverages**

|                                                                  | 2009             | 2008      | 2007      | % Change     |      |
|------------------------------------------------------------------|------------------|-----------|-----------|--------------|------|
|                                                                  | 2009             | 2008      | 2007      | 2009         | 2008 |
| Net revenue                                                      | <b>\$ 10,116</b> | \$ 10,937 | \$ 11,090 | <b>(8)</b>   | (1)  |
| Operating profit                                                 | <b>\$ 2,172</b>  | \$ 2,026  | \$ 2,487  | <b>7</b>     | (19) |
| Impact of restructuring and impairment charges                   | <b>16</b>        | 289       | 12        |              |      |
| Operating profit, excluding restructuring and impairment charges | <b>\$ 2,188</b>  | \$ 2,315  | \$ 2,499  | <b>(5.5)</b> | (7)  |

**2009**

BCS volume declined 6%, reflecting continued softness in the North America liquid refreshment beverage category.

In North America, non-carbonated beverage volume declined 11%, primarily driven by double-digit declines in Gatorade sports drinks and in our base Aquafina water business. CSD volumes declined 5%.

Net revenue declined 8%, primarily reflecting the volume declines. Unfavorable foreign currency contributed over 1 percentage point to the net revenue decline.

Operating profit increased 7%, primarily reflecting lower restructuring and impairment charges in the current year related to our Productivity for Growth program. Excluding restructuring and impairment charges, operating profit declined 5.5%, primarily reflecting the net revenue performance. Operating profit was also negatively impacted by unfavorable foreign currency which reduced operating profit growth by almost 3 percentage points.

**2008**

BCS volume declined 3%, reflecting a 5% decline in North America, partially offset by a 4% increase in Latin America.

Our North American business navigated a challenging year in the U.S., where the liquid refreshment beverage category declined on a year-over-year basis. In North America, CSD volume declined 4%, driven by a mid-single-digit decline in trademark Pepsi and a low-single-digit decline in trademark Sierra Mist, offset in part by a slight increase in trademark Mountain Dew. Non-carbonated beverage volume declined 6%.

Net revenue declined 1 percent, reflecting the volume declines in North America, partially offset by favorable effective net pricing. The effective net pricing reflects positive mix and price increases taken primarily on concentrate and fountain products this year. Foreign currency had a nominal impact on the net revenue decline.

Operating profit declined 19%, primarily reflecting higher fourth quarter restructuring and impairment charges in 2008 related to our Productivity for Growth program, which

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contributed 11 percentage points to the operating profit decline. In addition, higher product costs and higher selling and delivery costs, primarily due to higher fuel costs, contributed to the decline. Foreign currency had a nominal impact on the operating profit decline. Operating profit, excluding restructuring and impairment charges, declined 7%.

**Europe**

|                                                |          |          | % Change |      |
|------------------------------------------------|----------|----------|----------|------|
|                                                | 2009     | 2008     | 2009     | 2008 |
| Net revenue                                    | \$ 6,727 | \$ 6,891 | (2)      | 17   |
| Operating profit                               | \$ 932   | \$ 910   | 2        | 6    |
| Impact of restructuring and impairment charges | 1        | 50       |          |      |
| Impact of PBG/PAS merger costs                 | 1        |          |          |      |
| Operating profit, excluding above items        | \$ 934   | \$ 960   | (3)      | 11   |

**2009**

Snacks volume declined 1%, reflecting continued macroeconomic challenges and planned weight outs in response to higher input costs. High-single-digit declines in Spain and Turkey and a double-digit decline in Poland were partially offset by low-single-digit growth in Russia. Additionally, Walkers in the United Kingdom declined at a low-single-digit rate. Our acquisition in the fourth quarter of 2008 of a snacks company in Serbia positively contributed 2 percentage points to the volume performance.

Beverage volume grew 3.5%, primarily reflecting our acquisition of Lebedyansky in Russia in the fourth quarter of 2008 which contributed 8 percentage points to volume growth. A high-single-digit increase in Germany and mid-single-digit increases in the United Kingdom and Poland were more than offset by double-digit declines in Russia and the Ukraine.

Net revenue declined 2%, primarily reflecting adverse foreign currency which contributed 12 percentage points to the decline, partially offset by acquisitions which positively contributed 8 percentage points to net revenue performance. Favorable effective net pricing positively contributed to the net revenue performance.

Operating profit grew 2%, primarily reflecting the favorable effective net pricing and lower restructuring and impairment costs in the current year related to our Productivity for Growth program. Acquisitions positively contributed 5 percentage points to the operating profit growth and adverse foreign currency reduced operating profit growth by 17 percentage points.

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2008

Snacks volume grew 6%, reflecting broad-based increases led by double-digit growth in Russia. Additionally, Walkers in the United Kingdom, as well as the Netherlands, grew at low-single-digit rates and Spain increased slightly. Acquisitions contributed 2 percentage points to the volume growth.

Beverage volume grew 15%, primarily reflecting the expansion of the Pepsi Lipton Joint Venture and the Sandora and Lebedyansky acquisitions, which contributed 14 percentage points to the growth. CSDs increased slightly and non-carbonated beverages grew at a double-digit rate.

Net revenue grew 17%, reflecting favorable effective net pricing and volume growth. Acquisitions contributed 7 percentage points and foreign currency contributed 2 percentage points to the net revenue growth.

Operating profit grew 6%, driven by the net revenue growth, partially offset by increased commodity costs. Acquisitions contributed 5 percentage points and foreign currency contributed 3 percentage points to the operating profit growth. Operating profit growth was negatively impacted by 5 percentage points, resulting from higher fourth quarter restructuring and impairment charges in 2008 related to our Productivity for Growth program. Operating profit, excluding restructuring and impairment charges, grew 11%.

**Asia, Middle East & Africa**

|                                                                  |          |          |          | % Change |      |
|------------------------------------------------------------------|----------|----------|----------|----------|------|
|                                                                  | 2009     | 2008     | 2007     | 2009     | 2008 |
| Net revenue                                                      | \$ 5,578 | \$ 5,119 | \$ 4,170 | 9        | 23   |
| Operating profit                                                 | \$ 716   | \$ 592   | \$ 466   | 21       | 27   |
| Impact of restructuring and impairment charges                   | 13       | 15       | 14       |          |      |
| Operating profit, excluding restructuring and impairment charges | \$ 729   | \$ 607   | \$ 480   | 20       | 26   |

2009

Snacks volume grew 9%, reflecting broad-based increases driven by double-digit growth in India and the Middle East, partially offset by a low-single-digit decline in China. Additionally, South Africa grew volume at a low-single-digit rate and Australia grew volume slightly. The net impact of acquisitions and divestitures contributed 2 percentage points to the snacks volume growth.

Beverage volume grew 8%, reflecting broad-based increases driven by double-digit growth in India and high-single-digit growth in Pakistan. Additionally, the Middle East grew at a mid-single-digit rate and China grew at a low-single-digit rate. Acquisitions had a nominal impact on the beverage volume growth rate.

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Net revenue grew 9%, reflecting volume growth and favorable effective net pricing. Foreign currency reduced net revenue growth by over 3 percentage points. The net impact of acquisitions and divestitures contributed 1 percentage point to the net revenue growth.

Operating profit grew 21%, driven primarily by the net revenue growth. The net impact of acquisitions and divestitures contributed 11 percentage points to the operating profit growth and included a one-time gain associated with the contribution of our snacks business in Japan to form a joint venture with Calbee, the snacks market leader in Japan. Foreign currency reduced operating profit growth by 3 percentage points.

2008

Snacks volume grew 11%, reflecting broad-based increases led by double-digit growth in China, the Middle East and South Africa. Additionally, Australia experienced low-single-digit growth and India grew at a high-single-digit rate.

Beverage volume grew 12%, reflecting broad-based increases driven by double-digit growth in China, the Middle East and India, partially offset by low-single-digit declines in Thailand and the Philippines. Acquisitions had a nominal impact on beverage volume growth. CSDs grew at a high-single-digit rate and non-carbonated beverages grew at a double-digit rate.

Net revenue grew 23%, reflecting volume growth and favorable effective net pricing. Acquisitions contributed 2 percentage points and foreign currency contributed 1 percentage point to the net revenue growth.

Operating profit grew 27%, driven by the net revenue growth, partially offset by increased commodity costs. Foreign currency and acquisitions each contributed 2 percentage points to the operating profit growth. The impact of the fourth quarter restructuring and impairment charges in 2008 related to our Productivity for Growth program was offset by prior year restructuring charges. Operating profit, excluding restructuring and impairment charges, grew 26%.

**Our Liquidity and Capital Resources**

Global capital and credit markets, including the commercial paper markets, experienced considerable volatility in 2009. This volatility did not have a material unfavorable impact on our liquidity, and we continue to have access to the capital and credit markets. In addition, we have revolving credit facilities that are discussed in Note 9. We believe that our cash generating capability and financial condition, together with our revolving credit facilities and other available methods of debt financing, will be adequate to meet our operating, investing and financing needs. However, there can be no assurance that continued or increased volatility in the global capital and credit markets will not impair our ability to access these markets on terms commercially acceptable to us. See also The global economic downturn has resulted in unfavorable economic conditions and increased volatility in foreign exchange rates and may have an adverse impact on our business results or financial condition. and Any downgrade of our credit rating could increase our future borrowing costs. in Item 1A. Risk Factors.

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In addition, currency restrictions enacted by the government in Venezuela have impacted our ability to pay dividends from our snack and beverage operations in Venezuela outside of the country. As of December 26, 2009, our operations in Venezuela comprised 7% of our cash and cash equivalents balance.

Furthermore, 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. On a continuing basis, we consider various transactions to increase shareholder value and enhance our business results, including acquisitions, divestitures, joint ventures and share repurchases. These transactions may result in future cash proceeds or payments.

### ***Operating Activities***

In 2009, our operations provided \$6.8 billion of cash, compared to \$7.0 billion in the prior year, reflecting a \$1.0 billion (\$0.6 billion after-tax) discretionary pension contribution to our U.S. pension plans, \$196 million of restructuring payments related to our Productivity for Growth program and \$49 million of PBG/PAS merger cost payments. Operating cash flow also reflected net favorable working capital comparisons to the prior year.

In 2008, our operations provided \$7.0 billion of cash, compared to \$6.9 billion in the prior year, primarily reflecting our solid business results. Our operating cash flow in 2008 reflects restructuring payments of \$180 million, including \$159 million related to our Productivity for Growth program, and pension and retiree medical contributions of \$219 million, of which \$23 million were discretionary.

### ***Investing Activities***

In 2009, net cash used for investing activities was \$2.4 billion, primarily reflecting \$2.1 billion for capital spending and \$0.5 billion for acquisitions.

In 2008, we used \$2.7 billion for our investing activities, primarily reflecting \$2.4 billion for capital spending and \$1.9 billion for acquisitions. Significant acquisitions included our joint acquisition with PBG of Lebedyansky in Russia and the acquisition of a snacks company in Serbia. The use of cash was partially offset by net proceeds from sales of short-term investments of \$1.3 billion and proceeds from sales of PBG and PAS stock of \$358 million.

We anticipate net capital spending of about \$3.6 billion in 2010. Additionally, in connection with our December 7, 2009 agreement with Dr Pepper Snapple Group, Inc. (DPSG) to manufacture and distribute certain DPSG products in the territories where they are currently sold by PBG and PAS, we will make an upfront payment of \$900 million to DPSG upon closing of the proposed mergers with PBG and PAS.

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***Financing Activities***

In 2009, net cash used for financing activities was \$2.5 billion, primarily reflecting the return of operating cash flow to our shareholders through dividend payments of \$2.7 billion. Net proceeds from issuances of long-term debt of \$0.8 billion and stock option proceeds of \$0.4 billion were mostly offset by net repayments of short-term borrowings of \$1.0 billion.

In 2008, we used \$3.0 billion for our financing activities, primarily reflecting the return of operating cash flow to our shareholders through common share repurchases of \$4.7 billion and dividend payments of \$2.5 billion. The use of cash was partially offset by proceeds from issuances of long-term debt, net of payments, of \$3.1 billion, stock option proceeds of \$620 million and net proceeds from short-term borrowings of \$445 million.

Subsequent to year-end 2009, we issued \$4.25 billion of fixed and floating rate notes. We intend to use the net proceeds from this offering to finance a portion of the purchase price for the PBG and PAS mergers and to pay related fees and expenses in connection with the mergers. See Note 9 for further information regarding financing in connection with the PBG and PAS mergers.

We annually review our capital structure with our Board, including our dividend policy and share repurchase activity. In the second quarter of 2009, our Board of Directors approved a 6% dividend increase from \$1.70 to \$1.80 per share. We did not repurchase any shares in 2009 under our \$8.0 billion repurchase program authorized by the Board of Directors in the second quarter of 2007 and expiring on June 30, 2010. The current \$8.0 billion authorization has approximately \$6.4 billion remaining for repurchase. We anticipate that in 2010 share repurchases together with a voluntary \$600 million pre-tax pension plan contribution will total about \$5 billion.

***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. Therefore, this measure is not, and should not be viewed as, a substitute for U.S. GAAP cash flow measures. 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. Additionally, we consider certain items, including the impact of a discretionary pension contribution in the first quarter of 2009, net of tax, restructuring-related cash payments, net of tax, and PBG/PAS merger cost payments in 2009 in evaluating management operating cash flow. We believe investors should consider these items in evaluating our management operating cash flow results. The table below reconciles net cash provided by operating activities, as reflected in our cash flow statement, to our management operating cash flow excluding the impact of the above items.

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|                                                      | 2009     | 2008     | 2007     |
|------------------------------------------------------|----------|----------|----------|
| Net cash provided by operating activities            | \$ 6,796 | \$ 6,999 | \$ 6,934 |
| Capital spending                                     | (2,128)  | (2,446)  | (2,430)  |
| Sales of property, plant and equipment               | 58       | 98       | 47       |
| Management operating cash flow                       | 4,726    | 4,651    | 4,551    |
| Discretionary pension contribution (after-tax)       | 640      |          |          |
| Restructuring payments (after-tax)                   | 168      | 180      | 22       |
| PBG/PAS merger cost payments                         | 49       |          |          |
| Management operating cash flow excluding above items | \$ 5,583 | \$ 4,831 | \$ 4,573 |

In 2009, management operating cash flow was used primarily to pay dividends. In 2008 and 2007, 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 **Risk Factors** in Item 1A. and **Our Business Risks** for certain factors that may impact our operating cash flows.

**Credit Ratings**

Our objective is to maintain short-term credit ratings that provide us with ready access to global capital and credit markets at favorable interest rates. As anticipated, following the public announcement of the PBG merger agreement and the PAS merger agreement, Moody's Investors Service (Moody's) indicated that it was reviewing our ratings for possible downgrade and Standard & Poor's Ratings Services (S&P) indicated that its outlook on PepsiCo was negative and it could lower our ratings. Moody's has noted that the additional debt involved in completing the PBG merger and the PAS merger and our consolidated level of indebtedness following completion of the PBG merger and the PAS merger could result in a rating lower than the current rating level. S&P has indicated that when additional information becomes available, S&P will review whether, following completion of the PBG merger and the PAS merger, any of our senior unsecured debt will, in S&P's view, be structurally subordinated, which could result in a lower rating for PepsiCo's debt. Our current long-term debt rating is Aa2 at Moody's and A+ at S&P. 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 its respective ranking system. These ratings also reflect the impact of our anchor bottlers' cash flows and debt. See also **Risk Factors** in Item 1A.

**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, at the time of the separation of our bottling operations from us, various guarantees were necessary to facilitate the separation. In 2008, we extended our guarantee of a portion of Bottling Group LLC's long-term debt in connection with the refinancing of a corresponding portion of the underlying debt. As of December 26, 2009, we believe it is remote that these guarantees would require any cash



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payment. Neither the merger with PBG nor the merger with PAS will affect our guarantee of a portion of Bottling Group, LLC's long-term debt. 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.

### **Acquisition of Common Stock of PBG and PAS**

On August 3, 2009, we entered into an Agreement and Plan of Merger with PBG and Pepsi-Cola Metropolitan Bottling Company, Inc. (Metro), our wholly owned subsidiary (the PBG Merger Agreement) and a separate Agreement and Plan of Merger with PAS and Metro (the PAS Merger Agreement).

The PBG Merger Agreement provides that, upon the terms and subject to the conditions set forth in the PBG Merger Agreement, PBG will be merged with and into Metro (the PBG Merger), with Metro continuing as the surviving corporation and our wholly owned subsidiary. At the effective time of the PBG Merger, each share of PBG common stock outstanding immediately prior to the effective time not held by us or any of our subsidiaries will be converted into the right to receive either 0.6432 of a share of PepsiCo common stock or, at the election of the holder, \$36.50 in cash, without interest, and in each case subject to proration procedures which provide that we will pay cash for a number of shares equal to 50% of the PBG common stock outstanding immediately prior to the effective time of the PBG Merger not held by us or any of our subsidiaries and issue shares of PepsiCo common stock for the remaining 50% of such shares. Each share of PBG common stock held by PBG as treasury stock, held by us or held by Metro, and each share of PBG Class B common stock held by us or Metro, in each case immediately prior to the effective time of the PBG Merger, will be canceled, and no payment will be made with respect thereto. Each share of PBG common stock and PBG Class B common stock owned by any subsidiary of ours other than Metro immediately prior to the effective time of the PBG Merger will automatically be converted into the right to receive 0.6432 of a share of PepsiCo common stock.

The PAS Merger Agreement provides that, upon the terms and subject to the conditions set forth in the PAS Merger Agreement, PAS will be merged with and into Metro (the PAS Merger, and together with the PBG Merger, the Mergers), with Metro continuing as the surviving corporation and our wholly owned subsidiary. At the effective time of the PAS Merger, each share of PAS common stock outstanding immediately prior to the effective time not held by us or any of our subsidiaries will be converted into the right to receive either 0.5022 of a share of PepsiCo common stock or, at the election of the holder, \$28.50 in cash, without interest, and in each case subject to proration procedures which provide that we will pay cash for a number of shares equal to 50% of the PAS common stock outstanding immediately prior to the effective time of the PAS Merger not held by us or any of our subsidiaries and issue shares of PepsiCo common stock for the remaining 50% of such shares. Each share of PAS common stock held by PAS as treasury stock, held by us or held by Metro, in each case, immediately prior to the effective time of the PAS Merger, will be canceled, and no payment will be made with respect thereto. Each share of PAS common stock owned by any subsidiary of ours other than Metro immediately prior to the effective time of the PAS Merger will automatically be converted into the right to receive 0.5022 of a share of PepsiCo common stock.

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On February 17, 2010, the stockholders of PBG and PAS approved the PBG and PAS Mergers, respectively. Consummation of each of the Mergers is subject to various conditions, including the absence of legal prohibitions and the receipt of regulatory approvals. On February 17, 2010, we announced that we had refiled under the Hart-Scott-Rodino Antitrust Improvements Act of 1976 (HSR Act) with respect to the Mergers and signed a consent decree (Consent Decree) proposed by the Staff of the Federal Trade Commission (FTC) providing for the maintenance of the confidentiality of certain information we will obtain from DPSG in connection with the manufacture and distribution of certain DPSG products after the Mergers are completed. The Consent Decree is subject to review and approval by the Commissioners of the FTC. We hope to consummate the Mergers by the end of February, 2010.

We currently plan that at the closing of the Mergers we will form a new operating unit. This new operating unit will comprise all current PBG and PAS operations in the United States, Canada and Mexico, and will account for about three-quarters of the volume of PepsiCo's North American bottling system, with independent franchisees accounting for most of the rest. This new operating unit will be included within the PAB business unit. Current PBG and PAS operations in Europe, including Russia, will be managed by the Europe division when the Mergers are completed.

**Table of Contents****Consolidated Statement of Income**

PepsiCo, Inc. and Subsidiaries

Fiscal years ended December 26, 2009, December 27, 2008 and December 29, 2007

(in millions except per share amounts)

|                                                            | 2009             | 2008      | 2007      |
|------------------------------------------------------------|------------------|-----------|-----------|
| <b>Net Revenue</b>                                         | <b>\$ 43,232</b> | \$ 43,251 | \$ 39,474 |
| Cost of sales                                              | 20,099           | 20,351    | 18,038    |
| Selling, general and administrative expenses               | 15,026           | 15,877    | 14,196    |
| Amortization of intangible assets                          | 63               | 64        | 58        |
| <b>Operating Profit</b>                                    | <b>8,044</b>     | 6,959     | 7,182     |
| Bottling equity income                                     | 365              | 374       | 560       |
| Interest expense                                           | (397)            | (329)     | (224)     |
| Interest income                                            | 67               | 41        | 125       |
| <b>Income before Income Taxes</b>                          | <b>8,079</b>     | 7,045     | 7,643     |
| <b>Provision for Income Taxes</b>                          | <b>2,100</b>     | 1,879     | 1,973     |
| <b>Net Income</b>                                          | <b>5,979</b>     | 5,166     | 5,670     |
| Less: Net income attributable to noncontrolling interests  | 33               | 24        | 12        |
| <b>Net Income Attributable to PepsiCo</b>                  | <b>\$ 5,946</b>  | \$ 5,142  | \$ 5,658  |
| <b>Net Income Attributable to PepsiCo per Common Share</b> |                  |           |           |
| <b>Basic</b>                                               | <b>\$ 3.81</b>   | \$ 3.26   | \$ 3.48   |
| <b>Diluted</b>                                             | <b>\$ 3.77</b>   | \$ 3.21   | \$ 3.41   |

See accompanying notes to consolidated financial statements.

**Table of Contents****Consolidated Statement of Cash Flows**

PepsiCo, Inc. and Subsidiaries

Fiscal years ended December 26, 2009, December 27, 2008 and December 29, 2007

(in millions)

|                                                           | 2009           | 2008           | 2007           |
|-----------------------------------------------------------|----------------|----------------|----------------|
| <b>Operating Activities</b>                               |                |                |                |
| Net income                                                | \$ 5,979       | \$ 5,166       | \$ 5,670       |
| Depreciation and amortization                             | 1,635          | 1,543          | 1,426          |
| Stock-based compensation expense                          | 227            | 238            | 260            |
| Restructuring and impairment charges                      | 36             | 543            | 102            |
| Cash payments for restructuring charges                   | (196)          | (180)          | (22)           |
| PBG/PAS merger costs                                      | 50             |                |                |
| Cash payments for PBG/PAS merger costs                    | (49)           |                |                |
| Excess tax benefits from share-based payment arrangements | (42)           | (107)          | (208)          |
| Pension and retiree medical plan contributions            | (1,299)        | (219)          | (310)          |
| Pension and retiree medical plan expenses                 | 423            | 459            | 535            |
| Bottling equity income, net of dividends                  | (235)          | (202)          | (441)          |
| Deferred income taxes and other tax charges and credits   | 284            | 573            | 118            |
| Change in accounts and notes receivable                   | 188            | (549)          | (405)          |
| Change in inventories                                     | 17             | (345)          | (204)          |
| Change in prepaid expenses and other current assets       | (127)          | (68)           | (16)           |
| Change in accounts payable and other current liabilities  | (133)          | 718            | 522            |
| Change in income taxes payable                            | 319            | (180)          | 128            |
| Other, net                                                | (281)          | (391)          | (221)          |
| <b>Net Cash Provided by Operating Activities</b>          | <b>6,796</b>   | <b>6,999</b>   | <b>6,934</b>   |
| <b>Investing Activities</b>                               |                |                |                |
| Capital spending                                          | (2,128)        | (2,446)        | (2,430)        |
| Sales of property, plant and equipment                    | 58             | 98             | 47             |
| Proceeds from finance assets                              |                |                | 27             |
| Acquisitions and investments in noncontrolled affiliates  | (500)          | (1,925)        | (1,320)        |
| Divestitures                                              | 99             | 6              |                |
| Cash restricted for pending acquisitions                  | 15             | (40)           |                |
| Cash proceeds from sale of PBG and PAS stock              |                | 358            | 315            |
| Short-term investments, by original maturity              |                |                |                |
| More than three months purchases                          | (29)           | (156)          | (83)           |
| More than three months maturities                         | 71             | 62             | 113            |
| Three months or less, net                                 | 13             | 1,376          | (413)          |
| <b>Net Cash Used for Investing Activities</b>             | <b>(2,401)</b> | <b>(2,667)</b> | <b>(3,744)</b> |

(Continued on following page)

**Table of Contents****Consolidated Statement of Cash Flows (continued)**

PepsiCo, Inc. and Subsidiaries

Fiscal years ended December 26, 2009, December 27, 2008 and December 29, 2007

(in millions)

|                                                              | 2009            | 2008            | 2007           |
|--------------------------------------------------------------|-----------------|-----------------|----------------|
| <b>Financing Activities</b>                                  |                 |                 |                |
| Proceeds from issuances of long-term debt                    | \$ 1,057        | \$ 3,719        | \$ 2,168       |
| Payments of long-term debt                                   | (226)           | (649)           | (579)          |
| Short-term borrowings, by original maturity                  |                 |                 |                |
| More than three months proceeds                              | 26              | 89              | 83             |
| More than three months payments                              | (81)            | (269)           | (133)          |
| Three months or less, net                                    | (963)           | 625             | (345)          |
| Cash dividends paid                                          | (2,732)         | (2,541)         | (2,204)        |
| Share repurchases common                                     |                 | (4,720)         | (4,300)        |
| Share repurchases preferred                                  | (7)             | (6)             | (12)           |
| Proceeds from exercises of stock options                     | 413             | 620             | 1,108          |
| Excess tax benefits from share-based payment arrangements    | 42              | 107             | 208            |
| Other financing                                              | (26)            |                 |                |
| <b>Net Cash Used for Financing Activities</b>                | <b>(2,497)</b>  | <b>(3,025)</b>  | <b>(4,006)</b> |
| Effect of exchange rate changes on cash and cash equivalents | (19)            | (153)           | 75             |
| <b>Net Increase/(Decrease) in Cash and Cash Equivalents</b>  | <b>1,879</b>    | <b>1,154</b>    | <b>(741)</b>   |
| <b>Cash and Cash Equivalents, Beginning of Year</b>          | <b>2,064</b>    | <b>910</b>      | <b>1,651</b>   |
| <b>Cash and Cash Equivalents, End of Year</b>                | <b>\$ 3,943</b> | <b>\$ 2,064</b> | <b>\$ 910</b>  |

See accompanying notes to consolidated financial statements.

**Table of Contents****Consolidated Balance Sheet**

PepsiCo, Inc. and Subsidiaries

December 26, 2009 and December 27, 2008

(in millions except per share amounts)

|                                                                                                   | 2009             | 2008             |
|---------------------------------------------------------------------------------------------------|------------------|------------------|
| <b>ASSETS</b>                                                                                     |                  |                  |
| <b>Current Assets</b>                                                                             |                  |                  |
| Cash and cash equivalents                                                                         | \$ 3,943         | \$ 2,064         |
| Short-term investments                                                                            | 192              | 213              |
| Accounts and notes receivable, net                                                                | 4,624            | 4,683            |
| Inventories                                                                                       | 2,618            | 2,522            |
| Prepaid expenses and other current assets                                                         | 1,194            | 1,324            |
| <b>Total Current Assets</b>                                                                       | <b>12,571</b>    | <b>10,806</b>    |
| <b>Property, Plant and Equipment, net</b>                                                         | <b>12,671</b>    | <b>11,663</b>    |
| <b>Amortizable Intangible Assets, net</b>                                                         | <b>841</b>       | <b>732</b>       |
| Goodwill                                                                                          | 6,534            | 5,124            |
| Other nonamortizable intangible assets                                                            | 1,782            | 1,128            |
| <b>Nonamortizable Intangible Assets</b>                                                           | <b>8,316</b>     | <b>6,252</b>     |
| <b>Investments in Noncontrolled Affiliates</b>                                                    | <b>4,484</b>     | <b>3,883</b>     |
| <b>Other Assets</b>                                                                               | <b>965</b>       | <b>2,658</b>     |
| <b>Total Assets</b>                                                                               | <b>\$ 39,848</b> | <b>\$ 35,994</b> |
| <b>LIABILITIES AND EQUITY</b>                                                                     |                  |                  |
| <b>Current Liabilities</b>                                                                        |                  |                  |
| Short-term obligations                                                                            | \$ 464           | \$ 369           |
| Accounts payable and other current liabilities                                                    | 8,127            | 8,273            |
| Income taxes payable                                                                              | 165              | 145              |
| <b>Total Current Liabilities</b>                                                                  | <b>8,756</b>     | <b>8,787</b>     |
| <b>Long-Term Debt Obligations</b>                                                                 | <b>7,400</b>     | <b>7,858</b>     |
| <b>Other Liabilities</b>                                                                          | <b>5,591</b>     | <b>6,541</b>     |
| <b>Deferred Income Taxes</b>                                                                      | <b>659</b>       | <b>226</b>       |
| <b>Total Liabilities</b>                                                                          | <b>22,406</b>    | <b>23,412</b>    |
| Commitments and Contingencies                                                                     |                  |                  |
| <b>Preferred Stock, no par value</b>                                                              | <b>41</b>        | <b>41</b>        |
| <b>Repurchased Preferred Stock</b>                                                                | <b>(145)</b>     | <b>(138)</b>     |
| <b>PepsiCo Common Shareholders Equity</b>                                                         |                  |                  |
| Common stock, par value $1\frac{2}{3}$ ¢ per share (authorized 3,600 shares, issued 1,782 shares) | 30               | 30               |

|                                                                      |                  |                  |
|----------------------------------------------------------------------|------------------|------------------|
| Capital in excess of par value                                       | 250              | 351              |
| Retained earnings                                                    | 33,805           | 30,638           |
| Accumulated other comprehensive loss                                 | (3,794)          | (4,694)          |
| Repurchased common stock, at cost (217 and 229 shares, respectively) | (13,383)         | (14,122)         |
| <b>Total PepsiCo Common Shareholders' Equity</b>                     | <b>16,908</b>    | <b>12,203</b>    |
| Noncontrolling interests                                             | 638              | 476              |
| <b>Total Equity</b>                                                  | <b>17,442</b>    | <b>12,582</b>    |
| <b>Total Liabilities and Equity</b>                                  | <b>\$ 39,848</b> | <b>\$ 35,994</b> |

See accompanying notes to consolidated financial statements.

**Table of Contents****Consolidated Statement of Equity**

PepsiCo, Inc. and Subsidiaries

Fiscal years ended December 26, 2009, December 27, 2008 and December 29, 2007

(in millions)

|                                                                    | 2009         |              | 2008         |              | 2007         |              |
|--------------------------------------------------------------------|--------------|--------------|--------------|--------------|--------------|--------------|
|                                                                    | Shares       | Amount       | Shares       | Amount       | Shares       | Amount       |
| <b>Preferred Stock</b>                                             | <b>0.8</b>   | <b>\$ 41</b> | <b>0.8</b>   | <b>\$ 41</b> | <b>0.8</b>   | <b>\$ 41</b> |
| <b>Repurchased Preferred Stock</b>                                 |              |              |              |              |              |              |
| Balance, beginning of year                                         | (0.5)        | (138)        | (0.5)        | (132)        | (0.5)        | (120)        |
| Redemptions                                                        | (0.1)        | (7)          | ( )          | (6)          | ( )          | (12)         |
| Balance, end of period                                             | (0.6)        | (145)        | (0.5)        | (138)        | (0.5)        | (132)        |
| <b>Common Stock</b>                                                | <b>1,782</b> | <b>30</b>    | <b>1,782</b> | <b>30</b>    | <b>1,782</b> | <b>30</b>    |
| <b>Capital in Excess of Par Value</b>                              |              |              |              |              |              |              |
| Balance, beginning of year                                         |              | 351          |              | 450          |              | 584          |
| Stock-based compensation expense                                   |              | 227          |              | 238          |              | 260          |
| Stock option exercises/RSUs converted <sup>(a)</sup>               |              | (292)        |              | (280)        |              | (347)        |
| Withholding tax on RSUs converted                                  |              | (36)         |              | (57)         |              | (47)         |
| Balance, end of year                                               |              | 250          |              | 351          |              | 450          |
| <b>Retained Earnings</b>                                           |              |              |              |              |              |              |
| Balance, beginning of year                                         |              | 30,638       |              | 28,184       |              | 24,837       |
| Adoption of guidance on accounting for uncertainty in income taxes |              |              |              |              |              | 7            |
| Measurement date change                                            |              |              |              | (89)         |              |              |
| Adjusted balance, beginning of year                                |              | 30,638       |              | 28,095       |              | 24,844       |
| Net income attributable to PepsiCo                                 |              | 5,946        |              | 5,142        |              | 5,658        |
| Cash dividends declared common                                     |              | (2,768)      |              | (2,589)      |              | (2,306)      |
| Cash dividends declared preferred                                  |              | (2)          |              | (2)          |              | (2)          |
| Cash dividends declared RSUs                                       |              | (9)          |              | (8)          |              | (10)         |
| Balance, end of year                                               |              | 33,805       |              | 30,638       |              | 28,184       |
| <b>Accumulated Other Comprehensive Loss</b>                        |              |              |              |              |              |              |
| Balance, beginning of year                                         |              | (4,694)      |              | (952)        |              | (2,246)      |

|                                                                  |          |                  |          |                  |          |                  |
|------------------------------------------------------------------|----------|------------------|----------|------------------|----------|------------------|
| Measurement date change                                          |          |                  |          | 51               |          |                  |
| Adjusted balance, beginning of year                              | (4,694)  |                  | (901)    |                  | (2,246)  |                  |
| Currency translation adjustment                                  | 800      |                  | (2,484)  |                  | 719      |                  |
| Cash flow hedges, net of tax:                                    |          |                  |          |                  |          |                  |
| Net derivative (losses)/gains                                    | (55)     |                  | 16       |                  | (60)     |                  |
| Reclassification of losses to net income                         | 28       |                  | 5        |                  | 21       |                  |
| Pension and retiree medical, net of tax:                         |          |                  |          |                  |          |                  |
| Net pension and retiree medical gains/(losses)                   | 86       |                  | (1,376)  |                  | 464      |                  |
| Reclassification of net losses to net income                     | 21       |                  | 73       |                  | 135      |                  |
| Unrealized gains/(losses) on securities, net of tax              | 20       |                  | (21)     |                  | 9        |                  |
| Other                                                            |          |                  | (6)      |                  | 6        |                  |
| Balance, end of year                                             | (3,794)  |                  | (4,694)  |                  | (952)    |                  |
| <b>Repurchased Common Stock</b>                                  |          |                  |          |                  |          |                  |
| Balance, beginning of year                                       | (229)    | (14,122)         | (177)    | (10,387)         | (144)    | (7,758)          |
| Share repurchases                                                |          |                  | (68)     | (4,720)          | (64)     | (4,300)          |
| Stock option exercises                                           | 11       | 649              | 15       | 883              | 28       | 1,582            |
| Other, primarily RSUs converted                                  | 1        |                  |          |                  |          |                  |
|                                                                  |          | 90               | 1        | 102              | 3        | 89               |
| Balance, end of year                                             | (217)    | (13,383)         | (229)    | (14,122)         | (177)    | (10,387)         |
| <b>Total Common Shareholders Equity</b>                          |          | <b>16,908</b>    |          | <b>12,203</b>    |          | <b>17,325</b>    |
| <b>Noncontrolling Interests</b>                                  |          |                  |          |                  |          |                  |
| Balance, beginning of year                                       |          | 476              |          | 62               |          | 45               |
| Net income attributable to noncontrolling interests              |          | 33               |          | 24               |          | 12               |
| Purchase of subsidiary shares from noncontrolling interests, net |          | 150              |          | 450              |          | 9                |
| Currency translation adjustment                                  |          | (12)             |          | (48)             |          | 2                |
| Other                                                            |          | (9)              |          | (12)             |          | (6)              |
| Balance, end of year                                             |          | 638              |          | 476              |          | 62               |
| <b>Total Equity</b>                                              |          | <b>\$ 17,442</b> |          | <b>\$ 12,582</b> |          | <b>\$ 17,296</b> |
| <b>Comprehensive Income</b>                                      |          |                  |          |                  |          |                  |
| Net income                                                       | \$ 5,979 |                  | \$ 5,166 |                  | \$ 5,670 |                  |
| Other Comprehensive Income/(Loss)                                |          |                  |          |                  |          |                  |
| Currency translation adjustment                                  | 788      |                  | (2,532)  |                  | 721      |                  |
| Cash flow hedges, net of tax                                     | (27)     |                  | 21       |                  | (39)     |                  |
| Pension and retiree medical, net of tax                          |          |                  |          |                  |          |                  |
| Net prior service (cost)/credit                                  | (3)      |                  | 55       |                  | (105)    |                  |
| Net gains/(losses)                                               | 110      |                  | (1,358)  |                  | 704      |                  |
|                                                                  | 20       |                  | (21)     |                  | 9        |                  |

|                                                                      |                 |                 |                 |
|----------------------------------------------------------------------|-----------------|-----------------|-----------------|
| Unrealized gains/(losses) on securities, net of tax                  |                 |                 |                 |
| Other                                                                |                 | (6)             | 6               |
|                                                                      | <b>888</b>      | <b>(3,841)</b>  | <b>1,296</b>    |
| Comprehensive Income                                                 | <b>6,867</b>    | <b>1,325</b>    | <b>6,966</b>    |
| Comprehensive (income)/loss attributable to noncontrolling interests | <b>(21)</b>     | <b>24</b>       | <b>(14)</b>     |
| <b>Comprehensive Income Attributable to PepsiCo</b>                  | <b>\$ 6,846</b> | <b>\$ 1,349</b> | <b>\$ 6,952</b> |

(a) Includes total tax benefits of \$31 million in 2009, \$95 million in 2008 and \$216 million in 2007. See accompanying notes to consolidated financial statements.

**Table of Contents****Notes to Consolidated Financial Statements****Note 1 Basis of Presentation and Our Divisions*****Basis of Presentation***

Our financial statements include the consolidated accounts of PepsiCo, Inc. and the affiliates that we control. In addition, we include our share of the results of certain other affiliates based on our economic ownership interest. We do not control these other affiliates, as our ownership in these other affiliates is generally less than 50%. Equity income or loss from our anchor bottlers is recorded as bottling equity income in our income statement. Bottling equity income also includes any changes in our ownership interests of our anchor bottlers. Bottling equity income includes \$147 million of pre-tax gains on our sales of PBG and PAS stock in 2008 and \$174 million of pre-tax gains on our sales of PBG stock in 2007. There were no sales of PBG or PAS stock in 2009. See Notes 8 and 15 for additional information on our significant noncontrolled bottling affiliates. Income or loss from other noncontrolled affiliates is recorded as a component of selling, general and administrative expenses. Intercompany balances and transactions are eliminated. Our fiscal year ends on the last Saturday of each December, resulting in an additional week of results every five or six years.

Raw materials, direct labor and plant overhead, as well as purchasing and receiving costs, costs directly related to production planning, inspection costs and raw material handling facilities, are included in cost of sales. The costs of moving, storing and delivering finished product are included in selling, general and administrative expenses.

The preparation of our consolidated financial statements in conformity with generally accepted accounting principles requires us to make estimates and assumptions that affect reported amounts of assets, liabilities, revenues, expenses and disclosure of contingent assets and liabilities. Estimates are used in determining, among other items, sales incentives accruals, tax reserves, stock-based compensation, pension and retiree medical accruals, useful lives for intangible assets, and future cash flows associated with impairment testing for perpetual brands, goodwill and other long-lived assets. We evaluate our estimates on an on-going basis using our historical experience, as well as other factors we believe appropriate under the circumstances, such as current economic conditions, and adjust or revise our estimates as circumstances change. As future events and their effect cannot be determined with precision, actual results could differ significantly from these estimates.

While the majority of our results are reported on a weekly calendar basis, most of our international operations report on a monthly calendar basis. The following chart details our quarterly reporting schedule:

| Quarter        | U.S. and Canada | International                                |
|----------------|-----------------|----------------------------------------------|
| First Quarter  | 12 weeks        | January, February                            |
| Second Quarter | 12 weeks        | March, April and May                         |
| Third Quarter  | 12 weeks        | June, July and August                        |
| Fourth Quarter | 16 weeks        | September, October,<br>November and December |

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See *Our Divisions* below and for additional unaudited information on items affecting the comparability of our consolidated results, see *Items Affecting Comparability* in Management's Discussion and Analysis of Financial Condition and Results of Operations.

Tabular dollars are 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. Certain reclassifications were made to prior years amounts to conform to the 2009 presentation.

***Our Divisions***

We manufacture or use contract manufacturers, market and sell a variety of salty, convenient, sweet and grain-based snacks, carbonated and non-carbonated beverages, and foods in over 200 countries with our largest operations in North America (United States and Canada), Mexico and the United Kingdom. Division results are based on how our Chief Executive Officer assesses the performance of and allocates resources to our divisions. For additional unaudited information on our divisions, see *Our Operations* in Management's Discussion and Analysis of Financial Condition and Results of Operations. The accounting policies for the divisions are the same as those described in Note 2, except for the following allocation methodologies:

stock-based compensation expense,

pension and retiree medical expense, and

derivatives.

***Stock-Based Compensation Expense***

Our divisions are held accountable for stock-based compensation expense and, therefore, this expense is allocated to our divisions as an incremental employee compensation cost. The allocation of stock-based compensation expense in 2009 was approximately 27% to FLNA, 3% to QFNA, 6% to LAF, 21% to PAB, 13% to Europe, 13% to AMEA and 17% to corporate unallocated expenses. We had similar allocations of stock-based compensation expense to our divisions in 2008 and 2007. The expense allocated to our divisions excludes any impact of changes in our assumptions during the year which reflect market conditions over which division management has no control. Therefore, any variances between allocated expense and our actual expense are recognized in corporate unallocated expenses.

***Pension and Retiree Medical Expense***

Pension and retiree medical service costs measured at a fixed discount rate, as well as amortization of gains and losses due to demographics, including salary experience, are reflected in division results for North American employees. Division results also include interest costs, measured at a fixed discount rate, for retiree medical plans. Interest costs for the pension plans, pension asset returns and the impact of pension funding, and gains and losses other than those due to demographics, are all reflected in corporate unallocated expenses. In addition, corporate unallocated expenses include the difference between the



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service costs measured at a fixed discount rate (included in division results as noted above) and the total service costs determined using the Plans' discount rates as disclosed in Note 7.

*Derivatives*

We centrally manage commodity derivatives on behalf of our divisions. These commodity derivatives include energy, fruit and other raw materials. Certain of these commodity derivatives do not qualify for hedge accounting treatment and are marked to market with the resulting gains and losses reflected in corporate unallocated expenses. These gains and losses are subsequently reflected in division results when the divisions take delivery of the underlying commodity. Therefore, the divisions realize the economic effects of the derivative without experiencing any resulting mark-to-market volatility, which remains in corporate unallocated expenses. These derivatives hedge underlying commodity price risk and were not entered into for speculative purposes.

In 2007, we expanded our commodity hedging program to include derivative contracts used to mitigate our exposure to price changes associated with our purchases of fruit. In addition, in 2008, we entered into additional contracts to further reduce our exposure to price fluctuations in our raw material and energy costs. The majority of these contracts do not qualify for hedge accounting treatment and are marked to market with the resulting gains and losses recognized in corporate unallocated expenses within selling, general and administrative expenses. These gains and losses are subsequently reflected in division results.

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|                                                            | 2009               | 2008      | 2007      | 2009                                  | 2008     | 2007     |
|------------------------------------------------------------|--------------------|-----------|-----------|---------------------------------------|----------|----------|
|                                                            | <i>Net Revenue</i> |           |           | <i>Operating Profit<sup>(a)</sup></i> |          |          |
| FLNA                                                       | <b>\$ 13,224</b>   | \$ 12,507 | \$ 11,586 | <b>\$ 3,258</b>                       | \$ 2,959 | \$ 2,845 |
| QFNA                                                       | <b>1,884</b>       | 1,902     | 1,860     | <b>628</b>                            | 582      | 568      |
| LAF                                                        | <b>5,703</b>       | 5,895     | 4,872     | <b>904</b>                            | 897      | 714      |
| PAB                                                        | <b>10,116</b>      | 10,937    | 11,090    | <b>2,172</b>                          | 2,026    | 2,487    |
| Europe                                                     | <b>6,727</b>       | 6,891     | 5,896     | <b>932</b>                            | 910      | 855      |
| AMEA                                                       | <b>5,578</b>       | 5,119     | 4,170     | <b>716</b>                            | 592      | 466      |
| Total division                                             | <b>43,232</b>      | 43,251    | 39,474    | <b>8,610</b>                          | 7,966    | 7,935    |
| Corporate net impact of mark-to-market on commodity hedges |                    |           |           | <b>274</b>                            | (346)    | 19       |
| Corporate PBG/PAS merger costs                             |                    |           |           | <b>(49)</b>                           |          |          |
| Corporate restructuring                                    |                    |           |           |                                       | (10)     |          |
| Corporate other                                            |                    |           |           | <b>(791)</b>                          | (651)    | (772)    |
|                                                            | <b>\$ 43,232</b>   | \$ 43,251 | \$ 39,474 | <b>\$ 8,044</b>                       | \$ 6,959 | \$ 7,182 |

(a) For information on the impact of restructuring and impairment charges on our divisions, see Note 3.

**Corporate**

Corporate includes costs of our corporate headquarters, centrally managed initiatives, such as our ongoing business transformation initiative and research and development projects, unallocated insurance and benefit programs, foreign exchange transaction gains and losses, certain commodity derivative gains and losses and certain other items.

**Table of Contents*****Other Division Information***

|                                    | <b>2009</b>                | <b>2008</b>      | <b>2007</b>      | <b>2009</b>                    | <b>2008</b>     | <b>2007</b>     |
|------------------------------------|----------------------------|------------------|------------------|--------------------------------|-----------------|-----------------|
|                                    | <b><i>Total Assets</i></b> |                  |                  | <b><i>Capital Spending</i></b> |                 |                 |
| FLNA                               | <b>\$ 6,337</b>            | <b>\$ 6,284</b>  | <b>\$ 6,270</b>  | <b>\$ 490</b>                  | <b>\$ 553</b>   | <b>\$ 624</b>   |
| QFNA                               | <b>997</b>                 | <b>1,035</b>     | <b>1,002</b>     | <b>33</b>                      | <b>43</b>       | <b>41</b>       |
| LAF                                | <b>3,575</b>               | <b>3,023</b>     | <b>3,084</b>     | <b>310</b>                     | <b>351</b>      | <b>326</b>      |
| PAB                                | <b>7,670</b>               | <b>7,673</b>     | <b>7,780</b>     | <b>182</b>                     | <b>344</b>      | <b>450</b>      |
| Europe                             | <b>9,321</b>               | <b>8,840</b>     | <b>7,330</b>     | <b>357</b>                     | <b>401</b>      | <b>369</b>      |
| AMEA                               | <b>4,937</b>               | <b>3,756</b>     | <b>3,683</b>     | <b>585</b>                     | <b>479</b>      | <b>393</b>      |
| Total division                     | <b>32,837</b>              | <b>30,611</b>    | <b>29,149</b>    | <b>1,957</b>                   | <b>2,171</b>    | <b>2,203</b>    |
| Corporate <sup>(a)</sup>           | <b>3,933</b>               | <b>2,729</b>     | <b>2,124</b>     | <b>171</b>                     | <b>275</b>      | <b>227</b>      |
| Investments in bottling affiliates | <b>3,078</b>               | <b>2,654</b>     | <b>3,355</b>     |                                |                 |                 |
|                                    | <b>\$ 39,848</b>           | <b>\$ 35,994</b> | <b>\$ 34,628</b> | <b>\$ 2,128</b>                | <b>\$ 2,446</b> | <b>\$ 2,430</b> |

- (a) Corporate assets consist principally of cash and cash equivalents, short-term investments, derivative instruments and property, plant and equipment.

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|                | <b>2009</b>                              | <b>2008</b> | <b>2007</b> | <b>2009</b>                                | <b>2008</b> | <b>2007</b> |
|----------------|------------------------------------------|-------------|-------------|--------------------------------------------|-------------|-------------|
|                | <i>Amortization of Intangible Assets</i> |             |             | <i>Depreciation and Other Amortization</i> |             |             |
| FLNA           | \$ 7                                     | \$ 9        | \$ 9        | \$ 440                                     | \$ 441      | \$ 437      |
| QFNA           |                                          |             |             | 36                                         | 34          | 34          |
| LAF            | 5                                        | 6           | 4           | 189                                        | 194         | 166         |
| PAB            | 18                                       | 16          | 16          | 345                                        | 334         | 321         |
| Europe         | 22                                       | 23          | 20          | 227                                        | 210         | 190         |
| AMEA           | 11                                       | 10          | 9           | 248                                        | 213         | 189         |
| Total division | 63                                       | 64          | 58          | 1,485                                      | 1,426       | 1,337       |
| Corporate      |                                          |             |             | 87                                         | 53          | 31          |
|                | \$ 63                                    | \$ 64       | \$ 58       | \$ 1,572                                   | \$ 1,479    | \$ 1,368    |

|                     | <b>2009</b>                      | <b>2008</b> | <b>2007</b> | <b>2009</b>                            | <b>2008</b> | <b>2007</b> |
|---------------------|----------------------------------|-------------|-------------|----------------------------------------|-------------|-------------|
|                     | <i>Net Revenue<sup>(a)</sup></i> |             |             | <i>Long-Lived Assets<sup>(b)</sup></i> |             |             |
| U.S.                | \$ 22,446                        | \$ 22,525   | \$ 21,978   | \$ 12,496                              | \$ 12,095   | \$ 12,498   |
| Mexico              | 3,210                            | 3,714       | 3,498       | 1,044                                  | 904         | 1,067       |
| Canada              | 1,996                            | 2,107       | 1,961       | 688                                    | 556         | 699         |
| United Kingdom      | 1,826                            | 2,099       | 1,987       | 1,358                                  | 1,509       | 2,090       |
| All other countries | 13,754                           | 12,806      | 10,050      | 10,726                                 | 7,466       | 6,441       |
|                     | \$ 43,232                        | \$ 43,251   | \$ 39,474   | \$ 26,312                              | \$ 22,530   | \$ 22,795   |

(a) Represents net revenue from businesses operating in these countries.

(b) Long-lived assets represent property, plant and equipment, nonamortizable intangible assets, amortizable intangible assets, and investments in noncontrolled affiliates. These assets are reported in the country where they are primarily used.

**Table of Contents****Note 2 Our Significant Accounting Policies*****Revenue Recognition***

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 certain chilled products is to remove and replace damaged and out-of-date products from store shelves to ensure that our consumers receive the product quality and freshness that they expect. Similarly, our policy for certain warehouse-distributed products is to replace damaged and out-of-date products. Based on our experience with this practice, we have reserved for anticipated damaged and out-of-date products. For additional unaudited information on our revenue recognition and related policies, including our policy on bad debts, see *Our Critical Accounting Policies* in Management's Discussion and Analysis of Financial Condition and Results of Operations. We are exposed to concentration of credit risk by our customers, Wal-Mart and PBG. In 2009, Wal-Mart (including Sam's) represented approximately 13% of our total net revenue, including concentrate sales to our bottlers which are used in finished goods sold by them to Wal-Mart; and PBG represented approximately 6%. We have not experienced credit issues with these customers.

***Sales Incentives and Other Marketplace Spending***

We offer sales incentives and discounts through various programs to our customers and consumers. Sales incentives and discounts are accounted for as a reduction of revenue and totaled \$12.9 billion in 2009, \$12.5 billion in 2008 and \$11.3 billion in 2007. While most of these incentive arrangements have terms of no more than one year, certain arrangements, such as fountain pouring rights, may extend beyond one year. Costs incurred to obtain these arrangements are recognized over the shorter of the economic or contractual life, as a reduction of revenue, and the remaining balances of \$296 million as of December 26, 2009 and \$333 million as of December 27, 2008 are included in current assets and other assets on our balance sheet. For additional unaudited information on our sales incentives, see *Our Critical Accounting Policies* in Management's Discussion and Analysis of Financial Condition and Results of Operations.

Other marketplace spending, which includes the costs of advertising and other marketing activities, totaled \$2.8 billion in 2009 and \$2.9 billion in both 2008 and 2007 and is reported as selling, general and administrative expenses. Included in these amounts were advertising expenses of \$1.7 billion in both 2009 and 2008 and \$1.8 billion in 2007. Deferred advertising costs are not expensed until the year first used and consist of:

media and personal service prepayments,

promotional materials in inventory, and

production costs of future media advertising.

Deferred advertising costs of \$143 million and \$172 million at year-end 2009 and 2008, respectively, are classified as prepaid expenses on our balance sheet.

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### ***Distribution Costs***

Distribution costs, including the costs of shipping and handling activities, are reported as selling, general and administrative expenses. Shipping and handling expenses were \$5.6 billion in both 2009 and 2008 and \$5.2 billion in 2007.

### ***Cash Equivalents***

Cash equivalents are investments with original maturities of three months or less which we do not intend to rollover beyond three months.

### ***Software Costs***

We capitalize certain computer software and software development costs incurred in connection with developing or obtaining computer software for internal use when both the preliminary project stage is completed and it is probable that the software will be used as intended. Capitalized software costs include only (i) external direct costs of materials and services utilized in developing or obtaining computer software, (ii) compensation and related benefits for employees who are directly associated with the software project and (iii) interest costs incurred while developing internal-use computer software. Capitalized software costs are included in property, plant and equipment on our balance sheet and amortized on a straight-line basis when placed into service over the estimated useful lives of the software, which approximate five to ten years. Software amortization totaled \$119 million in 2009, \$58 million in 2008 and \$30 million in 2007. Net capitalized software and development costs were \$1.1 billion as of December 26, 2009 and \$940 million as of December 27, 2008.

### ***Commitments and Contingencies***

We are subject to various claims and contingencies related to lawsuits, certain taxes and environmental matters, as well as commitments under contractual and other commercial obligations. We recognize liabilities for contingencies and commitments when a loss is probable and estimable. For additional information on our commitments, see Note 9.

### ***Research and Development***

We engage in a variety of research and development activities. These activities principally involve the development of new products, improvement in the quality of existing products, improvement and modernization of production processes, and the development and implementation of new technologies to enhance the quality and value of both current and proposed product lines. Consumer research is excluded from research and development costs and included in other marketing costs. Research and development costs were \$414 million in 2009, \$388 million in 2008 and \$364 million in 2007 and are reported within selling, general and administrative expenses.

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***Other Significant Accounting Policies***

Our other significant accounting policies are disclosed as follows:

*Property, Plant and Equipment and Intangible Assets* Note 4, and for additional unaudited information on brands and goodwill, see *Our Critical Accounting Policies* in Management's Discussion and Analysis of Financial Condition and Results of Operations.

*Income Taxes* Note 5, and for additional unaudited information, see *Our Critical Accounting Policies* in Management's Discussion and Analysis of Financial Condition and Results of Operations.

*Stock-Based Compensation* Note 6.

*Pension, Retiree Medical and Savings Plans* Note 7, and for additional unaudited information, see *Our Critical Accounting Policies* in Management's Discussion and Analysis of Financial Condition and Results of Operations.

*Financial Instruments* Note 10, and for additional unaudited information, see *Our Business Risks* in Management's Discussion and Analysis of Financial Condition and Results of Operations.

***Recent Accounting Pronouncements***

In December 2007, the FASB amended its guidance on accounting for business combinations to improve, simplify and converge internationally the accounting for business combinations. The new accounting guidance continues the movement toward the greater use of fair value in financial reporting and increased transparency through expanded disclosures. We adopted the provisions of the new guidance as of the beginning of our 2009 fiscal year. The new accounting guidance changes how business acquisitions are accounted for and will impact financial statements both on the acquisition date and in subsequent periods. Additionally, under the new guidance, transaction costs are expensed rather than capitalized. Future adjustments made to valuation allowances on deferred taxes and acquired tax contingencies associated with acquisitions that closed prior to the beginning of our 2009 fiscal year apply the new provisions and will be evaluated based on the outcome of these matters.

In December 2007, the FASB issued new accounting and disclosure guidance on noncontrolling interests in consolidated financial statements. This guidance amends the accounting literature to establish new standards that will govern the accounting for and reporting of (1) noncontrolling interests in partially owned consolidated subsidiaries and (2) the loss of control of subsidiaries. We adopted the accounting provisions of the new guidance on a prospective basis as of the beginning of our 2009 fiscal year, and the adoption did not have a material impact on our financial statements. In addition, we adopted the presentation and disclosure requirements of the new guidance on a retrospective basis in the first quarter of 2009.

In June 2009, the FASB amended its accounting guidance on the consolidation of VIEs. Among other things, the new guidance requires a qualitative rather than a quantitative assessment to determine the primary beneficiary of a VIE based on whether the entity (1) has the power to direct matters that most significantly impact the activities of the VIE

and

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(2) has the obligation to absorb losses or the right to receive benefits of the VIE that could potentially be significant to the VIE. In addition, the amended guidance requires an ongoing reconsideration of the primary beneficiary. The provisions of this new guidance are effective as of the beginning of our 2010 fiscal year, and we do not expect the adoption to have a material impact on our financial statements.

**Note 3 Restructuring and Impairment Charges*****2009 and 2008 Restructuring and Impairment Charges***

In 2009, we incurred a charge of \$36 million (\$29 million after-tax or \$0.02 per share) in conjunction with our Productivity for Growth program that began in 2008. The program includes actions in all divisions of the business, including the closure of six plants that we believe will increase cost competitiveness across the supply chain, upgrade and streamline our product portfolio, and simplify the organization for more effective and timely decision-making. These charges were recorded in selling, general and administrative expenses. These initiatives were completed in the second quarter of 2009, and substantially all cash payments related to these charges are expected to be paid by 2010.

In 2008, we incurred a charge of \$543 million (\$408 million after-tax or \$0.25 per share) in conjunction with our Productivity for Growth program. Approximately \$455 million of the charge was recorded in selling, general and administrative expenses, with the remainder recorded in cost of sales.

A summary of the restructuring and impairment charge in 2009 is as follows:

|        | Severance and Other<br>Employee<br>Costs <sup>(a)</sup> | Other Costs | Total |
|--------|---------------------------------------------------------|-------------|-------|
| FLNA   | \$                                                      | \$ 2        | \$ 2  |
| QFNA   |                                                         | 1           | 1     |
| LAF    | 3                                                       |             | 3     |
| PAB    | 6                                                       | 10          | 16    |
| Europe | 1                                                       |             | 1     |
| AMEA   | 7                                                       | 6           | 13    |
|        | \$ 17                                                   | \$ 19       | \$ 36 |

(a) Primarily reflects termination costs for approximately 410 employees.

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A summary of the restructuring and impairment charge in 2008 is as follows:

|           | Severance and Other<br>Employee Costs | Asset Impairments | Other Costs | Total  |
|-----------|---------------------------------------|-------------------|-------------|--------|
| FLNA      | \$ 48                                 | \$ 38             | \$ 22       | \$ 108 |
| QFNA      | 14                                    | 3                 | 14          | 31     |
| LAF       | 30                                    | 8                 | 2           | 40     |
| PAB       | 68                                    | 92                | 129         | 289    |
| Europe    | 39                                    | 6                 | 5           | 50     |
| AMEA      | 11                                    | 2                 | 2           | 15     |
| Corporate | 2                                     |                   | 8           | 10     |
|           | \$ 212                                | \$ 149            | \$ 182      | \$ 543 |

Severance and other employee costs primarily reflect termination costs for approximately 3,500 employees. Asset impairments relate to the closure of six plants and changes to our beverage product portfolio. Other costs include contract exit costs and third-party incremental costs associated with upgrading our product portfolio and our supply chain.

A summary of our Productivity for Growth program activity is as follows:

|                                          | Severance and Other<br>Employee Costs | Asset Impairments | Other Costs | Total  |
|------------------------------------------|---------------------------------------|-------------------|-------------|--------|
| 2008 restructuring and impairment charge | \$ 212                                | \$ 149            | \$ 182      | \$ 543 |
| Cash payments                            | (50)                                  |                   | (109)       | (159)  |
| Non-cash charge                          | (27)                                  | (149)             | (9)         | (185)  |
| Currency translation                     | (1)                                   |                   |             | (1)    |
| Liability as of December 27, 2008        | 134                                   |                   | 64          | 198    |
| 2009 restructuring and impairment charge | 17                                    | 12                | 7           | 36     |
| Cash payments                            | (128)                                 |                   | (68)        | (196)  |
| Currency translation and other           | (14)                                  | (12)              | 25          | (1)    |
| Liability as of December 26, 2009        | \$ 9                                  | \$                | \$ 28       | \$ 37  |

**2007 Restructuring and Impairment Charge**

In 2007, we incurred a charge of \$102 million (\$70 million after-tax or \$0.04 per share) in conjunction with restructuring actions primarily to close certain plants and rationalize other production lines across FLNA, LAF, PAB, Europe and AMEA. The charge was recorded in selling, general and administrative expenses. All cash payments related to this charge were paid by the end of 2008.



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A summary of the restructuring and impairment charge is as follows:

|        | Severance and Other<br>Employee Costs | Asset Impairments | Other Costs | Total  |
|--------|---------------------------------------|-------------------|-------------|--------|
| FLNA   | \$                                    | \$ 19             | \$ 9        | \$ 28  |
| LAF    | 14                                    | 25                |             | 39     |
| PAB    | 12                                    |                   |             | 12     |
| Europe | 2                                     | 4                 | 3           | 9      |
| AMEA   | 5                                     | 9                 |             | 14     |
|        | \$ 33                                 | \$ 57             | \$ 12       | \$ 102 |

Severance and other employee costs primarily reflect termination costs for approximately 1,100 employees.

**Note 4 Property, Plant and Equipment and Intangible Assets**

|                                                       | Average     |        |           |           |          |
|-------------------------------------------------------|-------------|--------|-----------|-----------|----------|
|                                                       | Useful Life |        | 2009      | 2008      | 2007     |
| <i>Property, plant and equipment, net</i>             |             |        |           |           |          |
| Land and improvements                                 | 10          | 34yrs. | \$ 1,208  | \$ 868    |          |
| Buildings and improvements                            | 20          | 44     | 5,080     | 4,738     |          |
| Machinery and equipment, including fleet and software | 5           | 14     | 17,183    | 15,173    |          |
| Construction in progress                              |             |        | 1,441     | 1,773     |          |
|                                                       |             |        | 24,912    | 22,552    |          |
| Accumulated depreciation                              |             |        | (12,241)  | (10,889)  |          |
|                                                       |             |        | \$ 12,671 | \$ 11,663 |          |
| Depreciation expense                                  |             |        | \$ 1,500  | \$ 1,422  | \$ 1,304 |
| <i>Amortizable intangible assets, net</i>             |             |        |           |           |          |
| Brands                                                | 5           | 40     | \$ 1,465  | \$ 1,411  |          |
| Other identifiable intangibles                        | 10          | 24     | 505       | 360       |          |
|                                                       |             |        | 1,970     | 1,771     |          |
| Accumulated amortization                              |             |        | (1,129)   | (1,039)   |          |
|                                                       |             |        | \$ 841    | \$ 732    |          |
| Amortization expense                                  |             |        | \$ 63     | \$ 64     | \$ 58    |

Property, plant and equipment is recorded at historical cost. Depreciation and amortization are recognized on a straight-line basis over an asset's estimated useful life. Land is not depreciated and construction in progress is not

depreciated until ready for service. Amortization of intangible assets for each of the next five years, based on existing intangible assets as of December 26, 2009 and using average 2009 foreign exchange rates, is expected to be \$65 million in both 2010 and 2011, \$61 million in 2012, \$58 million in 2013 and \$52 million in 2014.

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Depreciable and amortizable assets are only evaluated for impairment upon a significant change in the operating or macroeconomic environment. In these circumstances, if an evaluation of the undiscounted cash flows indicates impairment, the asset is written down to its estimated fair value, which is based on discounted future cash flows. Useful lives are periodically evaluated to determine whether events or circumstances have occurred which indicate the need for revision. For additional unaudited information on our amortizable brand policies, see Our Critical Accounting Policies in Management's Discussion and Analysis of Financial Condition and Results of Operations.

**Nonamortizable Intangible Assets**

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. No impairment charges resulted from these impairment evaluations. The change in the book value of nonamortizable intangible assets is as follows:

|               | Balance,<br>Beginning<br>2008 | Acquisitions | Translation<br>and Other | Balance,<br>End of<br>2008 | Acquisitions | Translation<br>and Other | Balance,<br>End of<br>2009 |
|---------------|-------------------------------|--------------|--------------------------|----------------------------|--------------|--------------------------|----------------------------|
| <b>FLNA</b>   |                               |              |                          |                            |              |                          |                            |
| Goodwill      | \$ 311                        | \$           | \$ (34)                  | \$ 277                     | \$ 6         | \$ 23                    | \$ 306                     |
| Brands        |                               |              |                          |                            | 26           | 4                        | 30                         |
|               | 311                           |              | (34)                     | 277                        | 32           | 27                       | 336                        |
| <b>QFNA</b>   |                               |              |                          |                            |              |                          |                            |
| Goodwill      | 175                           |              |                          | 175                        |              |                          | 175                        |
| <b>LAF</b>    |                               |              |                          |                            |              |                          |                            |
| Goodwill      | 147                           | 338          | (61)                     | 424                        | 17           | 38                       | 479                        |
| Brands        | 22                            | 118          | (13)                     | 127                        | 1            | 8                        | 136                        |
|               | 169                           | 456          | (74)                     | 551                        | 18           | 46                       | 615                        |
| <b>PAB</b>    |                               |              |                          |                            |              |                          |                            |
| Goodwill      | 2,369                         |              | (14)                     | 2,355                      | 62           | 14                       | 2,431                      |
| Brands        | 59                            |              |                          | 59                         | 48           | 5                        | 112                        |
|               | 2,428                         |              | (14)                     | 2,414                      | 110          | 19                       | 2,543                      |
| <b>Europe</b> |                               |              |                          |                            |              |                          |                            |
| Goodwill      | 1,642                         | 45           | (218)                    | 1,469                      | 1,291        | (136)                    | 2,624                      |
| Brands        | 1,041                         | 14           | (211)                    | 844                        | 572          | (38)                     | 1,378                      |
|               | 2,683                         | 59           | (429)                    | 2,313                      | 1,863        | (174)                    | 4,002                      |
| <b>AMEA</b>   |                               |              |                          |                            |              |                          |                            |
| Goodwill      | 525                           | 1            | (102)                    | 424                        | 4            | 91                       | 519                        |

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|                |          |        |          |          |          |       |                 |
|----------------|----------|--------|----------|----------|----------|-------|-----------------|
| Brands         | 126      |        | (28)     | 98       |          | 28    | <b>126</b>      |
|                | 651      | 1      | (130)    | 522      | 4        | 119   | <b>645</b>      |
| Total goodwill | 5,169    | 384    | (429)    | 5,124    | 1,380    | 30    | <b>6,534</b>    |
| Total brands   | 1,248    | 132    | (252)    | 1,128    | 647      | 7     | <b>1,782</b>    |
|                | \$ 6,417 | \$ 516 | \$ (681) | \$ 6,252 | \$ 2,027 | \$ 37 | <b>\$ 8,316</b> |

**Table of Contents****Note 5 Income Taxes**

|                                                     | 2009     | 2008     | 2007     |
|-----------------------------------------------------|----------|----------|----------|
| <b><i>Income before income taxes</i></b>            |          |          |          |
| U.S.                                                | \$ 4,209 | \$ 3,274 | \$ 4,085 |
| Foreign                                             | 3,870    | 3,771    | 3,558    |
|                                                     | \$ 8,079 | \$ 7,045 | \$ 7,643 |
| <b><i>Provision for income taxes</i></b>            |          |          |          |
| Current: U.S. Federal                               | \$ 1,238 | \$ 815   | \$ 1,422 |
| Foreign                                             | 473      | 732      | 489      |
| State                                               | 124      | 87       | 104      |
|                                                     | 1,835    | 1,634    | 2,015    |
| Deferred: U.S. Federal                              | 223      | 313      | 22       |
| Foreign                                             | 21       | (69)     | (66)     |
| State                                               | 21       | 1        | 2        |
|                                                     | 265      | 245      | (42)     |
|                                                     | \$ 2,100 | \$ 1,879 | \$ 1,973 |
| <b><i>Tax rate reconciliation</i></b>               |          |          |          |
| U.S. Federal statutory tax rate                     | 35.0%    | 35.0%    | 35.0%    |
| State income tax, net of U.S. Federal tax benefit   | 1.2      | 0.8      | 0.9      |
| Lower taxes on foreign results                      | (7.9)    | (8.0)    | (6.6)    |
| Tax settlements                                     |          |          | (1.7)    |
| Other, net                                          | (2.3)    | (1.1)    | (1.8)    |
| Annual tax rate                                     | 26.0%    | 26.7%    | 25.8%    |
| <b><i>Deferred tax liabilities</i></b>              |          |          |          |
| Investments in noncontrolled affiliates             | \$ 1,120 | \$ 1,193 |          |
| Property, plant and equipment                       | 1,056    | 881      |          |
| Intangible assets other than nondeductible goodwill | 417      | 295      |          |
| Other                                               | 68       | 73       |          |
| Gross deferred tax liabilities                      | 2,661    | 2,442    |          |
| <b><i>Deferred tax assets</i></b>                   |          |          |          |
| Net carryforwards                                   | 624      | 682      |          |
| Stock-based compensation                            | 410      | 410      |          |
| Retiree medical benefits                            | 508      | 495      |          |
| Other employee-related benefits                     | 442      | 428      |          |

|                                            |               |          |
|--------------------------------------------|---------------|----------|
| Pension benefits                           | <b>179</b>    | 345      |
| Deductible state tax and interest benefits | <b>256</b>    | 230      |
| Other                                      | <b>560</b>    | 677      |
| Gross deferred tax assets                  | <b>2,979</b>  | 3,267    |
| Valuation allowances                       | <b>(586)</b>  | (657)    |
| Deferred tax assets, net                   | <b>2,393</b>  | 2,610    |
| Net deferred tax liabilities/(assets)      | <b>\$ 268</b> | \$ (168) |

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|                                                | 2009   | 2008   | 2007   |
|------------------------------------------------|--------|--------|--------|
| Deferred taxes included within:                |        |        |        |
| Assets:                                        |        |        |        |
| Prepaid expenses and other current assets      | \$ 391 | \$ 372 | \$ 325 |
| Other assets                                   |        | \$ 22  |        |
| Liabilities:                                   |        |        |        |
| Deferred income taxes                          | \$ 659 | \$ 226 | \$ 646 |
| <b><i>Analysis of valuation allowances</i></b> |        |        |        |
| Balance, beginning of year                     | \$ 657 | \$ 695 | \$ 624 |
| (Benefit)/provision                            | (78)   | (5)    | 39     |
| Other additions/(deductions)                   | 7      | (33)   | 32     |
| Balance, end of year                           | \$ 586 | \$ 657 | \$ 695 |

For additional unaudited information on our income tax policies, including our reserves for income taxes, see Our Critical Accounting Policies in Management's Discussion and Analysis of Financial Condition and Results of Operations.

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

***Reserves***

A number of years may elapse before a particular matter, for which we have established a reserve, is audited and finally resolved. The number of years with open tax audits varies depending on the tax jurisdiction. Our major taxing jurisdictions and the related open tax audits are as follows:

U.S. continue to dispute one matter related to tax years 1998 through 2002. Our U.S. tax returns for the years 2003 through 2005 are currently under audit. In 2008, the IRS initiated its audit of our U.S. tax returns for the years 2006 through 2007;

Mexico audits have been substantially completed for all taxable years through 2005;

United Kingdom audits have been completed for all taxable years prior to 2007; and

Canada audits have been completed for all taxable years through 2006. The Canadian tax return for 2007 is currently under audit.

While it is often difficult to predict the final outcome or the timing of resolution of any particular tax matter, we believe that our reserves reflect the probable outcome of known tax contingencies. We adjust these reserves, as well as the related interest, in light of changing facts and circumstances. Settlement of any particular issue would usually require the use of cash. Favorable resolution would be recognized as a reduction to our annual tax rate in the year of resolution. For further unaudited information on the impact of the resolution of open tax issues, see Other Consolidated Results.



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As of December 26, 2009, the total gross amount of reserves for income taxes, reported in other liabilities, was \$1.7 billion. Any prospective adjustments to these reserves will be recorded as an increase or decrease to our provision for income taxes and would impact our effective tax rate. In addition, we accrue interest related to reserves for income taxes in our provision for income taxes and any associated penalties are recorded in selling, general and administrative expenses. The gross amount of interest accrued, reported in other liabilities, was \$461 million as of December 26, 2009, of which \$30 million was recognized in 2009. The gross amount of interest accrued was \$427 million as of December 27, 2008, of which \$95 million was recognized in 2008.

A rollforward of our reserves for all federal, state and foreign tax jurisdictions, is as follows:

|                                                         | 2009     | 2008     |
|---------------------------------------------------------|----------|----------|
| Balance, beginning of year                              | \$ 1,711 | \$ 1,461 |
| Additions for tax positions related to the current year | 238      | 272      |
| Additions for tax positions from prior years            | 79       | 76       |
| Reductions for tax positions from prior years           | (236)    | (14)     |
| Settlement payments                                     | (64)     | (30)     |
| Statute of limitations expiration                       | (4)      | (20)     |
| Translation and other                                   | 7        | (34)     |
| Balance, end of year                                    | \$ 1,731 | \$ 1,711 |

***Carryforwards and Allowances***

Operating loss carryforwards totaling \$6.4 billion at year-end 2009 are being carried forward in a number of foreign and state jurisdictions where we are permitted to use tax operating losses from prior periods to reduce future taxable income. These operating losses will expire as follows: \$0.2 billion in 2010, \$5.5 billion between 2011 and 2029 and \$0.7 billion may be carried forward indefinitely. 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.

***Undistributed International Earnings***

As of December 26, 2009, we had approximately \$21.9 billion of undistributed international earnings. We intend to continue to reinvest earnings outside the U.S. for the foreseeable future and, therefore, have not recognized any U.S. tax expense on these earnings.

**Note 6 Stock-Based Compensation**

Our stock-based compensation program is a broad-based program designed to attract and retain employees while also aligning employees' interests with the interests of our shareholders. A majority of our employees participate in our stock-based compensation program. This program includes both our broad-based SharePower program which was established in 1989 to grant an annual award of stock options to eligible employees, based upon job level or classification and tenure (internationally), as well as our executive long-term awards program. Stock options and restricted stock units (RSU) are



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granted to employees under the shareholder-approved 2007 Long-Term Incentive Plan (LTIP), our only active stock-based plan. Stock-based compensation expense was \$227 million in 2009, \$238 million in 2008 and \$260 million in 2007. Related income tax benefits recognized in earnings were \$67 million in 2009, \$71 million in 2008 and \$77 million in 2007. Stock-based compensation cost capitalized in connection with our ongoing business transformation initiative was \$2 million in 2009, \$4 million in 2008 and \$3 million in 2007. At year-end 2009, 42 million shares were available for future stock-based compensation grants.

***Method of Accounting and Our Assumptions***

We account for our employee stock options, which include grants under our executive program and our broad-based SharePower program, under the fair value method of accounting using a Black-Scholes valuation model to measure stock option expense at the date of grant. All stock option grants have an exercise price equal to the fair market value of our common stock on the date of grant and generally have a 10-year term. We do not backdate, reprice or grant stock-based compensation awards retroactively. Repricing of awards would require shareholder approval under the LTIP.

The fair value of stock option grants is amortized to expense over the vesting period, generally three years. Executives who are awarded long-term incentives based on their performance are offered the choice of stock options or RSUs. Executives who elect RSUs receive one RSU for every four stock options that would have otherwise been granted. Senior officers do not have a choice and are granted 50% stock options and 50% performance-based RSUs. Vesting of RSU awards for senior officers is contingent upon the achievement of pre-established performance targets approved by the Compensation Committee of the Board of Directors. RSU expense is based on the fair value of PepsiCo stock on the date of grant and is amortized over the vesting period, generally three years. Each RSU is settled in a share of our stock after the vesting period.

Our weighted-average Black-Scholes fair value assumptions are as follows:

|                         | 2009   | 2008   | 2007   |
|-------------------------|--------|--------|--------|
| Expected life           | 6 yrs. | 6 yrs. | 6 yrs. |
| Risk free interest rate | 2.8%   | 3.0%   | 4.8%   |
| Expected volatility     | 17%    | 16%    | 15%    |
| Expected dividend yield | 3.0%   | 1.9%   | 1.9%   |

The expected life is the period over which our employee groups are expected to hold their options. It is based on our historical experience with similar grants. The risk free interest rate is based on the expected U.S. Treasury rate over the expected life. Volatility reflects movements in our stock price over the most recent historical period equivalent to the expected life. Dividend yield is estimated over the expected life based on our stated dividend policy and forecasts of net income, share repurchases and stock price.

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A summary of our stock-based compensation activity for the year ended December 26, 2009 is presented below:

***Our Stock Option Activity***

|                                  | Options <sup>(a)</sup> | Average Price <sup>(b)</sup> | Average Life (years) <sup>(c)</sup> | Aggregate Intrinsic Value <sup>(d)</sup> |
|----------------------------------|------------------------|------------------------------|-------------------------------------|------------------------------------------|
| Outstanding at December 27, 2008 | 103,672                | \$ 50.42                     |                                     |                                          |
| Granted                          | 15,466                 | 53.09                        |                                     |                                          |
| Exercised                        | (10,546)               | 39.48                        |                                     |                                          |
| Forfeited/expired                | (2,581)                | 59.49                        |                                     |                                          |
| Outstanding at December 26, 2009 | 106,011                | \$ 51.68                     | 4.91                                | \$ 1,110,793                             |
| Exercisable at December 26, 2009 | 68,272                 | \$ 46.86                     | 3.21                                | \$ 965,661                               |

(a) Options are in thousands and include options previously granted under Quaker plans. No additional options or shares may be granted under the Quaker plans.

(b) Weighted-average exercise price.

(c) Weighted-average contractual life remaining.

(d) In thousands.

***Our RSU Activity***

|                                  | RSUs <sup>(a)</sup> | Average Intrinsic Value <sup>(b)</sup> | Average Life (years) <sup>(c)</sup> | Aggregate Intrinsic Value <sup>(d)</sup> |
|----------------------------------|---------------------|----------------------------------------|-------------------------------------|------------------------------------------|
| Outstanding at December 27, 2008 | 6,151               | \$ 63.18                               |                                     |                                          |
| Granted                          | 2,653               | 53.22                                  |                                     |                                          |
| Converted                        | (2,232)             | 57.48                                  |                                     |                                          |
| Forfeited/expired                | (480)               | 62.57                                  |                                     |                                          |
| Outstanding at December 26, 2009 | 6,092               | \$ 60.98                               | 1.33                                | \$ 371,364                               |

(a) RSUs are in thousands.

(b) Weighted-average intrinsic value at grant date.

(c) Weighted-average contractual life remaining.

(d) In thousands.

***Other Stock-Based Compensation Data***

|                                                           | 2009       | 2008       | 2007       |
|-----------------------------------------------------------|------------|------------|------------|
| <b><i>Stock Options</i></b>                               |            |            |            |
| Weighted-average fair value of options granted            | \$ 7.02    | \$ 11.24   | \$ 13.56   |
| Total intrinsic value of options exercised <sup>(a)</sup> | \$ 194,545 | \$ 410,152 | \$ 826,913 |
| <b><i>RSUs</i></b>                                        |            |            |            |
| Total number of RSUs granted <sup>(a)</sup>               | 2,653      | 2,135      | 2,342      |
| Weighted-average intrinsic value of RSUs granted          | \$ 53.22   | \$ 68.73   | \$ 65.21   |
| Total intrinsic value of RSUs converted <sup>(a)</sup>    | \$ 124,193 | \$ 180,563 | \$ 125,514 |

(a) In thousands.

As of December 26, 2009, there was \$227 million of total unrecognized compensation cost related to nonvested share-based compensation grants. This unrecognized compensation is expected to be recognized over a weighted-average period of 1.7 years.

**Table of Contents****Note 7 Pension, Retiree Medical and Savings 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, which vary based upon years of service, with retirees contributing the remainder of the costs.

Gains and losses resulting from actual experience differing from our assumptions, including the difference between the actual return on plan assets and the expected return on plan assets, 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 the market-related value of plan assets or plan 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 10 years for pension expense and approximately 12 years for retiree medical expense.

Our adoption of the standard on accounting for defined benefit pension and other postretirement plans required 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 of the beginning of our 2008 fiscal year, we changed 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 recorded an after-tax \$39 million decrease to 2008 opening shareholders' equity, as follows:

|                                      | <b>Pension</b> | <b>Retiree<br/>Medical</b> | <b>Total</b>   |
|--------------------------------------|----------------|----------------------------|----------------|
| Retained earnings                    | \$ (63)        | \$ (20)                    | \$ (83)        |
| Accumulated other comprehensive loss | 12             | 32                         | 44             |
| <b>Total</b>                         | <b>\$ (51)</b> | <b>\$ 12</b>               | <b>\$ (39)</b> |

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Selected financial information for our pension and retiree medical plans is as follows:

|                                                     | 2009       | Pension<br>2008 | 2009          | 2008     | Retiree Medical<br>2009 | 2008       |
|-----------------------------------------------------|------------|-----------------|---------------|----------|-------------------------|------------|
|                                                     | U.S.       |                 | International |          |                         |            |
| <b><i>Change in projected benefit liability</i></b> |            |                 |               |          |                         |            |
| Liability at beginning of year                      | \$ 6,217   | \$ 6,048        | \$ 1,270      | \$ 1,595 | \$ 1,370                | \$ 1,354   |
| Measurement date change                             |            | (199)           |               | 113      |                         | (37)       |
| Service cost                                        | 238        | 244             | 54            | 61       | 44                      | 45         |
| Interest cost                                       | 373        | 371             | 82            | 88       | 82                      | 82         |
| Plan amendments                                     |            | (20)            |               | 2        |                         | (47)       |
| Participant contributions                           |            |                 | 10            | 17       |                         |            |
| Experience loss/(gain)                              | 70         | 28              | 221           | (165)    | (63)                    | 58         |
| Benefit payments                                    | (296)      | (277)           | (50)          | (51)     | (80)                    | (70)       |
| Settlement/curtailment loss                         |            | (9)             | (8)           | (15)     |                         | (2)        |
| Special termination benefits                        |            | 31              |               | 2        |                         | 3          |
| Foreign currency adjustment                         |            |                 | 130           | (376)    | 6                       | (10)       |
| Other                                               | 4          |                 |               | (1)      |                         | (6)        |
| Liability at end of year                            | \$ 6,606   | \$ 6,217        | \$ 1,709      | \$ 1,270 | \$ 1,359                | \$ 1,370   |
| <b><i>Change in fair value of plan assets</i></b>   |            |                 |               |          |                         |            |
| Fair value at beginning of year                     | \$ 3,974   | \$ 5,782        | \$ 1,165      | \$ 1,595 | \$                      | \$         |
| Measurement date change                             |            | (136)           |               | 97       |                         |            |
| Actual return on plan assets                        | 697        | (1,434)         | 159           | (241)    | 2                       |            |
| Employer contributions/funding                      | 1,041      | 48              | 167           | 101      | 91                      | 70         |
| Participant contributions                           |            |                 | 10            | 17       |                         |            |
| Benefit payments                                    | (296)      | (277)           | (50)          | (51)     | (80)                    | (70)       |
| Settlement/curtailment loss                         |            | (9)             | (8)           | (11)     |                         |            |
| Foreign currency adjustment                         |            |                 | 118           | (341)    |                         |            |
| Other                                               | 4          |                 |               | (1)      |                         |            |
| Fair value at end of year                           | \$ 5,420   | \$ 3,974        | \$ 1,561      | \$ 1,165 | \$ 13                   | \$         |
| Funded status                                       | \$ (1,186) | \$ (2,243)      | \$ (148)      | \$ (105) | \$ (1,346)              | \$ (1,370) |

*Amounts included in accumulated other comprehensive loss (pre-tax)*

**Components of the (decrease)/increase in net loss**

|                                              |          |          |          |          |
|----------------------------------------------|----------|----------|----------|----------|
| Liability at end of year for service to date | \$ 5,784 | \$ 5,413 | \$ 1,414 | \$ 1,013 |
|----------------------------------------------|----------|----------|----------|----------|

|                                             | Pension |        |        | Retiree Medical |       |       |
|---------------------------------------------|---------|--------|--------|-----------------|-------|-------|
|                                             | 2009    | 2008   | 2007   | 2009            | 2008  | 2007  |
|                                             |         | U.S.   |        | International   |       |       |
| <i>Components of benefit expense</i>        |         |        |        |                 |       |       |
| Service cost                                | \$ 238  | \$ 244 | \$ 244 | \$ 54           | \$ 61 | \$ 59 |
| Interest cost                               | 373     | 371    | 338    | 82              | 88    | 81    |
| Expected return on plan assets              | (462)   | (416)  | (399)  | (105)           | (112) | (97)  |
| Amortization of prior service cost/(credit) | 12      | 19     | 5      | 2               | 3     | 3     |
| Amortization of net loss                    | 110     | 55     | 136    | 9               | 19    | 30    |
|                                             | 271     | 273    | 324    | 42              | 59    | 76    |
|                                             |         |        |        | 120             | 121   | 130   |

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|                                    |               |        |        |              |       |       |               |        |        |  |
|------------------------------------|---------------|--------|--------|--------------|-------|-------|---------------|--------|--------|--|
| Settlement/curtailment (gain)/loss | <b>(13)</b>   | 3      |        | <b>3</b>     | 3     |       |               |        |        |  |
| Special termination benefits       |               | 31     | 5      |              | 2     |       |               |        | 3      |  |
| Total                              | <b>\$ 258</b> | \$ 307 | \$ 329 | <b>\$ 45</b> | \$ 64 | \$ 76 | <b>\$ 120</b> | \$ 124 | \$ 130 |  |

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The estimated amounts to be amortized from accumulated other comprehensive loss into benefit expense in 2010 for our pension and retiree medical plans are as follows:

|                             | <b>Pension</b> |                      | <b>Retiree Medical</b> |
|-----------------------------|----------------|----------------------|------------------------|
|                             | <b>U.S.</b>    | <b>International</b> |                        |
| Net loss                    | \$ 108         | \$ 24                | \$ 5                   |
| Prior service cost/(credit) | 12             | 2                    | (17)                   |
| <b>Total</b>                | <b>\$ 120</b>  | <b>\$ 26</b>         | <b>\$ (12)</b>         |

The following table provides the weighted-average assumptions used to determine projected benefit liability and benefit expense for our pension and retiree medical plans:

|                                     |             |      | Pension |               |      | Retiree Medical |             |      |      |
|-------------------------------------|-------------|------|---------|---------------|------|-----------------|-------------|------|------|
|                                     | 2009        | 2008 | 2007    | 2009          | 2008 | 2007            | 2009        | 2008 | 2007 |
|                                     |             | U.S. |         | International |      |                 |             |      |      |
| <i>Weighted-average assumptions</i> |             |      |         |               |      |                 |             |      |      |
| Liability discount rate             | <b>6.1%</b> | 6.2% | 6.2%    | <b>5.9%</b>   | 6.3% | 5.8%            | <b>6.1%</b> | 6.2% | 6.1% |
| Expense discount rate               | <b>6.2%</b> | 6.5% | 5.8%    | <b>6.3%</b>   | 5.6% | 5.2%            | <b>6.2%</b> | 6.5% | 5.8% |
| Expected return on plan assets      | <b>7.8%</b> | 7.8% | 7.8%    | <b>7.1%</b>   | 7.2% | 7.3%            |             |      |      |
| Rate of salary increases            | <b>4.4%</b> | 4.6% | 4.7%    | <b>4.2%</b>   | 3.9% | 3.9%            |             |      |      |

The following table provides selected information about plans with liability for service to date and total benefit liability in excess of plan assets:

|                                                                                                   | <b>2009</b> | <b>2008</b>       | <b>Pension</b> |                      | <b>2009</b> | <b>2008</b> | <b>Retiree Medical</b> |             |
|---------------------------------------------------------------------------------------------------|-------------|-------------------|----------------|----------------------|-------------|-------------|------------------------|-------------|
|                                                                                                   |             | <b>U.S.</b>       |                | <b>International</b> |             |             | <b>2009</b>            | <b>2008</b> |
| <b>Selected information for plans with liability for service to date in excess of plan assets</b> |             |                   |                |                      |             |             |                        |             |
| Liability for service to date                                                                     |             | <b>\$ (2,695)</b> | \$ (5,411)     | <b>\$ (342)</b>      | \$ (49)     |             |                        |             |
| Fair value of plan assets                                                                         |             | <b>\$ 2,220</b>   | \$ 3,971       | <b>\$ 309</b>        | \$ 30       |             |                        |             |
| <b>Selected information for plans with benefit liability in excess of plan assets</b>             |             |                   |                |                      |             |             |                        |             |
| Benefit liability                                                                                 |             | <b>\$ (6,603)</b> | \$ (6,217)     | <b>\$ (1,566)</b>    | \$ (1,049)  |             | <b>\$ (1,359)</b>      | \$ (1,370)  |
| Fair value of plan assets                                                                         |             | <b>\$ 5,417</b>   | \$ 3,974       | <b>\$ 1,368</b>      | \$ 916      |             | <b>\$ 13</b>           | \$          |

Of the total projected pension benefit liability at year-end 2009, \$564 million relates to plans that we do not fund because the funding of such plans does not receive favorable tax treatment.

**Future Benefit Payments and Funding**

Our estimated future benefit payments are as follows:

|                                | 2010   | 2011   | 2012   | 2013   | 2014   | 2015-19  |
|--------------------------------|--------|--------|--------|--------|--------|----------|
| Pension                        | \$ 340 | \$ 360 | \$ 395 | \$ 415 | \$ 450 | \$ 2,825 |
| Retiree medical <sup>(a)</sup> | \$ 110 | \$ 120 | \$ 125 | \$ 125 | \$ 130 | \$ 695   |

- (a) Expected future benefit payments for our retiree medical plans do not reflect any estimated subsidies expected to be received under the 2003 Medicare Act. Subsidies are expected to be approximately \$10 million for each of the years from 2010 through 2014 and approximately \$70 million in total for 2015 through 2019. These future benefits to beneficiaries include payments from both funded and unfunded pension plans.

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In 2010, we will make pension contributions of approximately \$700 million, with up to approximately \$600 million expected to be discretionary. Our net cash payments for retiree medical are estimated to be approximately \$100 million in 2010.

***Pension Assets***

Our pension plan investment strategy includes the use of actively-managed securities and is reviewed annually based upon plan liabilities, an evaluation of market conditions, tolerance for risk and cash requirements for benefit payments. Our investment objective is to ensure that funds are available to meet the plans' benefit obligations when they become due. Our overall investment strategy is to prudently invest plan assets in high-quality and diversified equity and debt securities to achieve our long-term return expectations. Our investment policy also permits the use of derivative instruments which are primarily used to reduce risk. Our expected long-term rate of return on U.S. plan assets is 7.8%, reflecting estimated long-term rates of return of 8.9% from our equity allocation and 6.3% from our fixed income allocation. Our target investment allocation is 40% for U.S. equity allocations, 20% for international equity allocations and 40% for fixed income allocations. Actual investment allocations may vary from our target investment allocations due to prevailing market conditions. We regularly review our actual investment allocations and periodically rebalance our investments to our target allocations.

The expected return on pension plan assets is based on our pension plan investment strategy, our expectations for long-term rates of return and our historical experience. We also review current levels of interest rates and inflation to assess the reasonableness of the long-term rates. To calculate the expected return on pension plan assets, we use a market-related valuation method that recognizes investment gains or losses (the difference between the expected and actual return based on the market-related value of assets) for securities included in our equity strategies over a five-year period. This has the effect of reducing year-to-year volatility. For all other asset categories, the actual fair value is used for the market-related value of assets.

We adopted the new accounting guidance on employer's disclosures about postretirement benefit plan assets which requires that we categorize pension assets into three levels based upon the assumptions (inputs) used to price the assets. Level 1 provides the most reliable measure of fair value, whereas Level 3 generally requires significant management judgment. The three levels are defined as follows:

Level 1: Unadjusted quoted prices in active markets for identical assets.

Level 2: Observable inputs other than those included in Level 1. For example, quoted prices for similar assets in active markets or quoted prices for identical assets in inactive markets.

Level 3: Unobservable inputs reflecting assumptions about the inputs used in pricing the asset.

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Plan assets measured at fair value are categorized as follows:

|                                                   |          | 2009     |          |         | 2008     |
|---------------------------------------------------|----------|----------|----------|---------|----------|
|                                                   | Total    | Level 1  | Level 2  | Level 3 | Total    |
| <b><i>U.S. plan assets</i></b>                    |          |          |          |         |          |
| Equity securities:                                |          |          |          |         |          |
| PepsiCo common stock <sup>(a)</sup>               | \$ 332   | \$ 332   | \$       | \$      | \$ 302   |
| U.S. common stock <sup>(a)</sup>                  | 229      | 229      |          |         | 103      |
| U.S. commingled funds <sup>(b)</sup>              | 1,387    |          | 1,387    |         | 513      |
| International common stock <sup>(a)</sup>         | 700      | 700      |          |         | 463      |
| International commingled fund <sup>(c)</sup>      | 114      |          | 114      |         | 47       |
| Preferred stock <sup>(d)</sup>                    | 4        |          | 4        |         | 6        |
| Fixed income securities:                          |          |          |          |         |          |
| Government securities <sup>(d)</sup>              | 741      |          | 741      |         | 724      |
| Corporate bonds <sup>(d)</sup>                    | 1,214    |          | 1,198    | 16      | 592      |
| Mortgage-backed securities <sup>(d)</sup>         | 201      |          | 195      | 6       | 250      |
| Fixed income commingled fund <sup>(e)</sup>       |          |          |          |         | 647      |
| Other:                                            |          |          |          |         |          |
| Derivative instruments                            |          |          |          |         | (9)      |
| Contracts with insurance companies <sup>(f)</sup> | 9        |          |          | 9       | 15       |
| Dividends and interest receivable                 | 32       |          |          | 32      | 19       |
| Cash and cash equivalents                         | 457      | 457      |          |         | 302      |
| Total U.S. plan assets                            | \$ 5,420 | \$ 1,718 | \$ 3,639 | \$ 63   | \$ 3,974 |
| <b><i>International plan assets</i></b>           |          |          |          |         |          |
| Equity securities:                                |          |          |          |         |          |
| U.S. commingled funds <sup>(b)</sup>              | \$ 180   | \$       | \$ 180   | \$      | \$ 128   |
| International commingled funds <sup>(c)</sup>     | 661      |          | 661      |         | 429      |
| Fixed income securities:                          |          |          |          |         |          |
| Government securities <sup>(d)</sup>              | 139      |          | 139      |         | 123      |
| Corporate bonds <sup>(d)</sup>                    | 128      |          | 128      |         | 103      |
| Fixed income commingled funds <sup>(e)</sup>      | 363      |          | 363      |         | 310      |
| Other:                                            |          |          |          |         |          |
| Contracts with insurance companies <sup>(f)</sup> | 29       |          |          | 29      | 26       |
| Currency commingled funds <sup>(g)</sup>          | 44       |          | 44       |         | 17       |
| Cash and cash equivalents                         | 17       | 17       |          |         | 29       |
| Total international plan assets                   | \$ 1,561 | \$ 17    | \$ 1,515 | \$ 29   | \$ 1,165 |

(a) Based on quoted market prices in active markets.

- (b) Based on the fair value of the investments owned by these funds that track various U.S. large- and mid-cap company indices. Includes one fund that represents 25% of total U.S. plan assets.
- (c) Based on the fair value of the investments owned by these funds that track various non-U.S. equity indices.
- (d) Based on quoted bid prices for comparable securities in the marketplace and broker/dealer quotes that are not observable.
- (e) Based on the fair value of the investments owned by these funds that track various government and corporate bond indices.
- (f) Based on the fair value of the contracts as determined by the insurance companies using inputs that are not observable.
- (g) Based on the fair value of the investments owned by these funds. Includes managed hedge funds that invest primarily in derivatives to reduce currency exposure.

**Table of Contents*****Retiree Medical Cost Trend Rates***

An average increase of 7.5% in the cost of covered retiree medical benefits is assumed for 2010. This average increase is then projected to decline gradually to 5% in 2014 and thereafter. These assumed health care cost trend rates have an impact on the retiree medical plan expense and liability. However, the cap on our share of retiree medical costs limits the impact. A 1-percentage-point change in the assumed health care trend rate would have the following effects:

|                                           | 1%<br>Increase | 1%<br>Decrease |
|-------------------------------------------|----------------|----------------|
| 2009 service and interest cost components | \$ 4           | \$ (3)         |
| 2009 benefit liability                    | \$ 30          | \$ (26)        |

***Savings Plan***

Our U.S. employees are eligible to participate in 401(k) savings plans, which are voluntary defined contribution plans. The plans are designed to help employees accumulate additional savings for retirement. We make matching contributions on a portion of eligible pay based on years of service. In 2009 and 2008, our matching contributions were \$72 million and \$70 million, respectively.

For additional unaudited information on our pension and retiree medical plans and related accounting policies and assumptions, see *Our Critical Accounting Policies* in Management's Discussion and Analysis.

**Note 8 Noncontrolled Bottling Affiliates**

Our most significant noncontrolled bottling affiliates are PBG and PAS. Sales to PBG represented approximately 6% of our total net revenue in 2009 and 7% of our total net revenue in both 2008 and 2007.

See Note 15 for information regarding our pending mergers with PBG and PAS.

***The Pepsi Bottling Group***

In addition to approximately 32% and 33% of PBG's outstanding common stock that we owned at year-end 2009 and 2008, respectively, we owned 100% of PBG's class B common stock and approximately 7% of the equity of Bottling Group, LLC, PBG's principal operating subsidiary.

PBG's summarized financial information is as follows:

|                        | 2009      | 2008      | 2007 |
|------------------------|-----------|-----------|------|
| Current assets         | \$ 3,412  | \$ 3,141  |      |
| Noncurrent assets      | 10,158    | 9,841     |      |
| Total assets           | \$ 13,570 | \$ 12,982 |      |
| Current liabilities    | \$ 1,965  | \$ 3,083  |      |
| Noncurrent liabilities | 7,896     | 7,408     |      |

|                                |                  |           |           |
|--------------------------------|------------------|-----------|-----------|
| Total liabilities              | <b>\$ 9,861</b>  | \$ 10,491 |           |
| Our investment                 | <b>\$ 1,775</b>  | \$ 1,457  |           |
| Net revenue                    | <b>\$ 13,219</b> | \$ 13,796 | \$ 13,591 |
| Gross profit                   | <b>\$ 5,840</b>  | \$ 6,210  | \$ 6,221  |
| Operating income               | <b>\$ 1,048</b>  | \$ 649    | \$ 1,071  |
| Net income attributable to PBG | <b>\$ 612</b>    | \$ 162    | \$ 532    |

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Our investment in PBG, which includes the related goodwill, was \$463 million and \$536 million higher than our ownership interest in their net assets less noncontrolling interests at year-end 2009 and 2008, respectively. Based upon the quoted closing price of PBG shares at year-end 2009, the calculated market value of our shares in PBG exceeded our investment balance, excluding our investment in Bottling Group, LLC, by approximately \$1.4 billion.

Additionally, in 2007, we formed a joint venture with PBG, comprising our concentrate and PBG's bottling businesses in Russia. PBG holds a 60% majority interest in the joint venture and consolidates the entity. We account for our interest of 40% under the equity method of accounting.

During 2008, together with PBG, we jointly acquired Russia's leading branded juice company, Lebedyansky. Lebedyansky is owned 25% and 75% by PBG and us, respectively. See Note 14 for further information on this acquisition.

***PepsiAmericas***

At year-end 2009 and 2008, we owned approximately 43%, respectively, of the outstanding common stock of PAS.

PAS summarized financial information is as follows:

|                                | 2009            | 2008            | 2007     |
|--------------------------------|-----------------|-----------------|----------|
| Current assets                 | \$ 952          | \$ 906          |          |
| Noncurrent assets              | 4,141           | 4,148           |          |
| <b>Total assets</b>            | <b>\$ 5,093</b> | <b>\$ 5,054</b> |          |
| Current liabilities            | \$ 669          | \$ 1,048        |          |
| Noncurrent liabilities         | 2,493           | 2,175           |          |
| <b>Total liabilities</b>       | <b>\$ 3,162</b> | <b>\$ 3,223</b> |          |
| <b>Our investment</b>          | <b>\$ 1,071</b> | <b>\$ 972</b>   |          |
| Net sales                      | \$ 4,421        | \$ 4,937        | \$ 4,480 |
| Gross profit                   | \$ 1,767        | \$ 1,982        | \$ 1,823 |
| Operating income               | \$ 381          | \$ 473          | \$ 436   |
| Net income attributable to PAS | \$ 181          | \$ 226          | \$ 212   |

Our investment in PAS, which includes the related goodwill, was \$322 million and \$318 million higher than our ownership interest in their net assets less noncontrolling interests at year-end 2009 and 2008, respectively. Based upon the quoted closing price of PAS shares at year-end 2009, the calculated market value of our shares in PAS exceeded our investment balance by approximately \$515 million.

Additionally, in 2007, we completed the joint purchase of Sandora, LLC, a juice company in the Ukraine, with PAS. PAS holds a 60% majority interest in the joint venture and consolidates the entity. We account for our interest of 40% under the equity method of accounting.



**Table of Contents*****Related Party Transactions***

Our significant related party transactions are with our noncontrolled bottling affiliates. The transactions primarily consist of (1) selling concentrate to these affiliates, which they use in the production of CSDs and non-carbonated beverages, (2) selling certain finished goods to these affiliates, (3) receiving royalties for the use of our trademarks for certain products and (4) paying these affiliates to act as our manufacturing and distribution agent for product associated with our national account fountain customers. Sales of concentrate and finished goods are reported net of bottler funding. For further unaudited information on these bottlers, see *Our Customers* in *Management's Discussion and Analysis of Financial Condition and Results of Operations*. These transactions with our bottling affiliates are reflected in our consolidated financial statements as follows:

|                                              | 2009     | 2008     | 2007     |
|----------------------------------------------|----------|----------|----------|
| Net revenue                                  | \$ 3,922 | \$ 4,049 | \$ 4,020 |
| Cost of sales                                | \$ 634   | \$ 660   | \$ 625   |
| Selling, general and administrative expenses | \$ 24    | \$ 30    | \$ 33    |
| Accounts and notes receivable                | \$ 254   | \$ 248   |          |
| Accounts payable and other liabilities       | \$ 285   | \$ 198   |          |

Such amounts are settled on terms consistent with other trade receivables and payables. See Note 9 regarding our guarantee of certain PBG debt.

We also coordinate, on an aggregate basis, the contract negotiations of sweeteners and other raw material requirements for certain of our bottlers. Once we have negotiated the contracts, the bottlers order and take delivery directly from the supplier and pay the suppliers directly. Consequently, these transactions are not reflected in our consolidated financial statements. As the contracting party, we could be liable to these suppliers in the event of any nonpayment by our bottlers, but we consider this exposure to be remote.

In addition, our joint ventures with Unilever (under the Lipton brand name) and Starbucks sell finished goods (ready-to-drink teas, coffees and water products) to our noncontrolled bottling affiliates. Consistent with accounting for equity method investments, our joint venture revenue is not included in our consolidated net revenue and therefore is not included in the above table.

**Table of Contents****Note 9 Debt Obligations and Commitments**

|                                                        | 2009            | 2008            |
|--------------------------------------------------------|-----------------|-----------------|
| <b>Short-term debt obligations</b>                     |                 |                 |
| Current maturities of long-term debt                   | \$ 102          | \$ 273          |
| Commercial paper (0.7%)                                |                 | 846             |
| Other borrowings (6.7% and 10.0%)                      | 362             | 509             |
| Amounts reclassified to long-term debt                 |                 | (1,259)         |
|                                                        | <b>\$ 464</b>   | <b>\$ 369</b>   |
| <b>Long-term debt obligations</b>                      |                 |                 |
| Short-term borrowings, reclassified                    | \$              | \$ 1,259        |
| Notes due 2012-2026 (4.5% and 5.8%)                    | 7,160           | 6,382           |
| Zero coupon notes, \$225 million due 2010-2012 (13.3%) | 192             | 242             |
| Other, due 2010-2019 (8.4% and 5.3%)                   | 150             | 248             |
|                                                        | <b>7,502</b>    | <b>8,131</b>    |
| Less: current maturities of long-term debt obligations | <b>(102)</b>    | <b>(273)</b>    |
|                                                        | <b>\$ 7,400</b> | <b>\$ 7,858</b> |

*The interest rates in the above table reflect weighted-average rates at year-end.*

In the first quarter of 2009, we issued \$1.0 billion of senior unsecured notes, bearing interest at 3.75% per year and maturing in 2014. We used the proceeds from the issuance of these notes for general corporate purposes.

In the third quarter of 2009, we entered into a new 364-day unsecured revolving credit agreement which enables us to borrow up to \$1.975 billion, subject to customary terms and conditions, and expires in June 2010. We may request renewal of this facility for an additional 364-day period or convert any amounts outstanding into a term loan for a period of up to one year, which would mature no later than June 2011. This agreement replaced a \$1.8 billion 364-day unsecured revolving credit agreement we entered into during the fourth quarter of 2008. Funds borrowed under this agreement may be used to repay outstanding commercial paper issued by us or our subsidiaries and for other general corporate purposes, including working capital, capital investments and acquisitions. This agreement is in addition to our existing \$2.0 billion unsecured revolving credit agreement which expires in 2012. Our lines of credit remain unused as of December 26, 2009.

In addition, as of December 26, 2009, \$396 million of our debt related to borrowings from various lines of credit that are maintained for our international divisions. These lines of credit are subject to normal banking terms and conditions and are fully committed to the extent of our borrowings.

Subsequent to year-end 2009, we issued \$4.25 billion of fixed and floating rate notes. The issuance was comprised of \$1.25 billion of floating rate notes maturing in 2011 (the 2011 Floating Rates Notes), \$1.0 billion of 3.10% senior unsecured notes maturing in 2015, \$1.0 billion of 4.50% senior unsecured notes maturing in 2020 and \$1.0 billion of 5.50% senior unsecured notes maturing in 2040. The 2011 Floating Rate Notes bear interest at a rate equal to the three-month London Inter-Bank Offered Rate (LIBOR) plus 3 basis points.

We intend to use the net proceeds from this offering to finance a portion of the purchase price for the mergers with PBG and PAS and to pay related fees and expenses in

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connection with the mergers with PBG and PAS. Pending such use we invested the net proceeds in short-term, high-quality securities. If one or both of the mergers with PBG and PAS is not completed, we intend to use the remaining net proceeds from this offering for general corporate purposes, which may include the financing of future acquisitions, capital expenditures, additions to working capital, repurchase, repayment or refinancing of debt or stock repurchases.

Concurrently with the debt issuance after year-end, we terminated the commitments from lenders to provide us with up to \$4.0 billion in bridge financing to fund the mergers with PBG and PAS.

Also subsequent to year-end 2009, we entered into amendments to PBG's revolving credit facility (the Amended PBG Credit Facility) and PAS's revolving credit facility (the Amended PAS Credit Facility). Under the Amended PBG Credit Facility, subject to the satisfaction of certain conditions to effectiveness, at the closing of the merger with PBG, Metro will be able to borrow up to \$1,080 million from time to time. Borrowings under the Amended PBG Credit Facility, which expires in October 2012, are guaranteed by us. Under the Amended PAS Credit Facility, subject to the satisfaction of certain conditions to effectiveness, at the closing of the merger with PAS, Metro will be able to borrow up to \$540 million from time to time. Borrowings under the Amended PAS Credit Facility, which expires in June 2011, are guaranteed by us.

***Long-Term Contractual Commitments<sup>(a)</sup>***

|                                             | Payments Due by Period |          |              |              |                       |
|---------------------------------------------|------------------------|----------|--------------|--------------|-----------------------|
|                                             | Total                  | 2010     | 2011<br>2012 | 2013<br>2014 | 2015<br>and<br>beyond |
| Long-term debt obligations <sup>(b)</sup>   | \$ 7,400               | \$       | \$ 1,332     | \$ 2,063     | \$ 4,005              |
| Interest on debt obligations <sup>(c)</sup> | 2,386                  | 347      | 666          | 500          | 873                   |
| Operating leases                            | 1,076                  | 282      | 356          | 203          | 235                   |
| Purchasing commitments                      | 2,066                  | 801      | 960          | 260          | 45                    |
| Marketing commitments                       | 793                    | 260      | 314          | 78           | 141                   |
|                                             | \$ 13,721              | \$ 1,690 | \$ 3,628     | \$ 3,104     | \$ 5,299              |

(a) Reflects non-cancelable commitments as of December 26, 2009 based on year-end foreign exchange rates and excludes any reserves for uncertain tax positions as we are unable to reasonably predict the ultimate amount or timing of settlement.

(b) Excludes current maturities of long-term debt obligations of \$102 million. Includes \$151 million of principal and accrued interest related to our zero coupon notes.

(c) Interest payments on floating-rate debt are estimated using interest rates effective as of December 26, 2009. Most long-term contractual commitments, except for our long-term debt obligations, are not recorded on our balance sheet. Non-cancelable operating leases primarily represent building leases. Non-cancelable purchasing commitments

are primarily for oranges and orange juice, packaging materials and cooking oil. Non-cancelable marketing commitments are primarily for sports marketing. Bottler funding is not reflected in our long-term contractual commitments as it is negotiated on an annual basis. See Note 7 regarding our pension and retiree medical obligations and discussion below regarding our commitments to noncontrolled bottling affiliates.

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**Table of Contents*****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, at the time of the separation of our bottling operations from us various guarantees were necessary to facilitate the transactions. We have guaranteed an aggregate of \$2.3 billion of Bottling Group, LLC's long-term debt (\$1.0 billion of which matures in 2012 and \$1.3 billion of which matures in 2014). In the first quarter of 2009, we extended our guarantee of \$1.3 billion of Bottling Group, LLC's long-term debt in connection with the refinancing of a corresponding portion of the underlying debt. The terms of our Bottling Group, LLC debt guarantee are intended to preserve the structure of PBG's separation from us and our payment obligation would be triggered if Bottling Group, LLC failed to perform under these debt obligations or the structure significantly changed. Neither the merger with PBG nor the merger with PAS will trigger our payment obligation under our guarantee of a portion of Bottling Group, LLC's debt. As of December 26, 2009, we believe it is remote that these guarantees would require any cash payment. See Note 8 regarding contracts related to certain of our bottlers.

See **Our Liquidity and Capital Resources** in **Management's Discussion and Analysis of Financial Condition and Results of Operations** for further unaudited information on our borrowings.

**Note 10 Financial Instruments**

In March 2008, the FASB issued new disclosure guidance on derivative instruments and hedging activities, which amends and expands the disclosure requirements of previously issued guidance on accounting for derivative instruments and hedging activities, to provide an enhanced understanding of the use of derivative instruments, how they are accounted for and their effect on financial position, financial performance and cash flows. We adopted the disclosure provisions of the new guidance in the first quarter of 2009.

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

commodity prices, affecting the cost of our raw materials and energy,

foreign exchange risks, and

interest rates.

In the normal course of business, we manage these risks through a variety of strategies, including the use of derivatives. Certain 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. Cash flows from derivatives used to manage commodity, foreign exchange or interest risks are classified as operating activities. See

**Our Business Risks** in **Management's Discussion and Analysis of Financial Condition and Results of Operations** for further unaudited information on our business risks.

For cash flow hedges, changes in fair value are deferred in accumulated other comprehensive loss within common shareholders' equity until the underlying hedged item is recognized in net income. For fair value hedges, changes in fair value are recognized immediately in earnings, consistent with the underlying hedged item. Hedging transactions are limited to an underlying exposure. As a result, any change in the value of our derivative instruments would be substantially offset by an opposite



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change in the value of the underlying hedged items. Hedging ineffectiveness and a net earnings impact occur when the change in the value of the hedge does not offset the change in the value of the underlying hedged item. Ineffectiveness of our hedges is not material. If the derivative instrument is terminated, we continue to defer the related gain or loss and then include it as a component of the cost of the underlying hedged item. Upon determination that the underlying hedged item will not be part of an actual transaction, we recognize the related gain or loss in net income immediately.

We also use derivatives that do not qualify for hedge accounting treatment. We account for such derivatives at market value with the resulting gains and losses reflected in our income statement. We do not use derivative instruments for trading or speculative purposes. We perform assessments of our counterparty credit risk regularly, including a review of credit ratings, credit default swap rates and potential nonperformance of the counterparty. Based on our most recent assessment of our counterparty credit risk, we consider this risk to be low. In addition, we enter into derivative contracts with a variety of financial institutions that we believe are creditworthy in order to reduce our concentration of credit risk and generally settle with these financial institutions on a net basis.

***Commodity Prices***

We are subject to commodity price risk because our ability to recover increased costs through higher pricing may be limited in the competitive environment in which we operate. This risk is managed through the use of fixed-price purchase orders, pricing agreements, geographic diversity and derivatives. We use derivatives, with terms of no more than three years, to economically hedge price fluctuations related to a portion of our anticipated commodity purchases, primarily for natural gas and diesel fuel. For those derivatives that qualify for hedge accounting, any ineffectiveness is recorded immediately. We classify both the earnings and cash flow impact from these derivatives consistent with the underlying hedged item. During the next 12 months, we expect to reclassify net losses of \$124 million related to these hedges from accumulated other comprehensive loss into net income. Derivatives used to hedge commodity price risk that do not qualify for hedge accounting are marked to market each period and reflected in our income statement.

Our open commodity derivative contracts that qualify for hedge accounting had a face value of \$151 million as of December 26, 2009 and \$303 million as of December 27, 2008. These contracts resulted in net unrealized losses of \$29 million as of December 26, 2009 and \$117 million as of December 27, 2008.

Our open commodity derivative contracts that do not qualify for hedge accounting had a face value of \$231 million as of December 26, 2009 and \$626 million as of December 27, 2008. These contracts resulted in net losses of \$57 million in 2009 and \$343 million in 2008.

***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 common shareholders equity as currency translation adjustment.

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Our operations outside of the U.S. generate 48% of our net revenue, with Mexico, Canada and the United Kingdom comprising 16% of our net revenue. As a result, we are exposed to foreign currency risks. On occasion, we may enter into derivatives, primarily forward contracts with terms of no more than two years, to manage our exposure to foreign currency transaction risk. Exchange rate gains or losses related to foreign currency transactions are recognized as transaction gains or losses in our income statement as incurred.

Our foreign currency derivatives had a total face value of \$1.2 billion as of December 26, 2009 and \$1.4 billion as of December 27, 2008. The contracts that qualify for hedge accounting resulted in net unrealized losses of \$20 million as of December 26, 2009 and net unrealized gains of \$111 million as of December 27, 2008. During the next 12 months, we expect to reclassify net losses of \$20 million related to these hedges from accumulated other comprehensive loss into net income. The contracts that do not qualify for hedge accounting resulted in a net gain of \$1 million in 2009 and net losses of \$28 million in 2008. 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 use various interest rate derivative instruments including, but not limited to, interest rate swaps, cross currency interest rate swaps, Treasury locks and swap locks to manage our overall interest expense and foreign exchange risk. These instruments effectively change the interest rate and currency of specific debt issuances. Our interest rate and cross currency swaps are generally entered into concurrently with the issuance of the debt that they modify. The notional amount, interest payment and maturity date of the interest rate and cross currency swaps match the principal, interest payment and maturity date of the related debt. Our Treasury locks and swap locks are entered into to protect against unfavorable interest rate changes relating to forecasted debt transactions.

The notional amounts of the interest rate derivative instruments outstanding as of December 26, 2009 and December 27, 2008 were \$5.75 billion and \$2.75 billion, respectively. For those interest rate derivative instruments that qualify for cash flow hedge accounting, any ineffectiveness is recorded immediately. We classify both the earnings and cash flow impact from these interest rate derivative instruments consistent with the underlying hedged item. During the next 12 months, we expect to reclassify net losses of \$6 million related to these hedges from accumulated other comprehensive loss into net income.

Concurrently with the debt issuance after year-end, we terminated \$1.5 billion of interest rate derivative instruments, and the realized loss will be amortized into interest expense over the duration of the debt term.

As of December 26, 2009, approximately 57% of total debt, after the impact of the related interest rate derivative instruments, was exposed to variable rates compared to 58% as of December 27, 2008. In addition to variable rate long-term debt, all debt with maturities of less than one year is categorized as variable for purposes of this measure.

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***Fair Value Measurements***

In September 2006, the FASB issued new accounting guidance on fair value measurements, which defines fair value, establishes a framework for measuring fair value, and expands disclosures about fair value measurements. We adopted the new guidance as of the beginning of our 2008 fiscal year as it relates to recurring financial assets and liabilities. As of the beginning of our 2009 fiscal year, we adopted the new guidance as it relates to nonrecurring fair value measurement requirements for nonfinancial assets and liabilities. These include goodwill, other nonamortizable intangible assets and unallocated purchase price for recent acquisitions which are included within other assets. Our adoption did not have a material impact on our financial statements. See Note 7 for the fair value framework.

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The fair values of our financial assets and liabilities as of December 26, 2009 are categorized as follows:

|                                                           |               | <b>2009</b>    |                |                |
|-----------------------------------------------------------|---------------|----------------|----------------|----------------|
|                                                           | <b>Total</b>  | <b>Level 1</b> | <b>Level 2</b> | <b>Level 3</b> |
| <b>Assets<sup>(a)</sup></b>                               |               |                |                |                |
| Available-for-sale securities <sup>(b)</sup>              | \$ 71         | \$ 71          | \$             | \$             |
| Short-term investments index funds <sup>(c)</sup>         | \$ 120        | \$ 120         | \$             | \$             |
| <b>Derivatives designated as hedging instruments:</b>     |               |                |                |                |
| Forward exchange contracts <sup>(d)</sup>                 | \$ 11         | \$             | \$ 11          | \$             |
| Interest rate derivatives <sup>(e)</sup>                  | 177           |                | 177            |                |
| Prepaid forward contracts <sup>(f)</sup>                  | 46            |                | 46             |                |
| Commodity contracts other <sup>(g)</sup>                  | 8             |                | 8              |                |
|                                                           | \$ 242        | \$             | \$ 242         | \$             |
| <b>Derivatives not designated as hedging instruments:</b> |               |                |                |                |
| Forward exchange contracts <sup>(d)</sup>                 | \$ 4          | \$             | \$ 4           | \$             |
| Commodity contracts other <sup>(g)</sup>                  | 7             |                | 7              |                |
|                                                           | \$ 11         | \$             | \$ 11          | \$             |
| Total asset derivatives at fair value                     | \$ 253        | \$             | \$ 253         | \$             |
| <b>Total assets at fair value</b>                         | <b>\$ 444</b> | <b>\$ 191</b>  | <b>\$ 253</b>  | <b>\$</b>      |
| <b>Liabilities<sup>(a)</sup></b>                          |               |                |                |                |
| Deferred compensation <sup>(h)</sup>                      | \$ 461        | \$ 121         | \$ 340         | \$             |
| <b>Derivatives designated as hedging instruments:</b>     |               |                |                |                |
| Forward exchange contracts <sup>(d)</sup>                 | \$ 31         | \$             | \$ 31          | \$             |
| Interest rate derivatives <sup>(e)</sup>                  | 43            |                | 43             |                |
| Commodity contracts other <sup>(g)</sup>                  | 5             |                | 5              |                |
| Commodity contracts futures <sup>(i)</sup>                | 32            | 32             |                |                |
|                                                           | \$ 111        | \$ 32          | \$ 79          | \$             |
| <b>Derivatives not designated as hedging instruments:</b> |               |                |                |                |
| Forward exchange contracts <sup>(d)</sup>                 | \$ 2          | \$             | \$ 2           | \$             |
| Commodity contracts other <sup>(g)</sup>                  | 60            |                | 60             |                |
| Commodity contracts futures <sup>(i)</sup>                | 3             | 3              |                |                |
|                                                           | \$ 65         | \$ 3           | \$ 62          | \$             |
| Total liability derivatives at fair value                 | \$ 176        | \$ 35          | \$ 141         | \$             |
| <b>Total liabilities at fair value</b>                    | <b>\$ 637</b> | <b>\$ 156</b>  | <b>\$ 481</b>  | <b>\$</b>      |

- (a) Financial assets are classified on our balance sheet within other assets, with the exception of short-term investments. Financial liabilities are classified on our balance sheet within other current liabilities and other liabilities.
- (b) Based on the price of common stock.
- (c) Based on price changes in index funds used to manage a portion of market risk arising from our deferred compensation liability.
- (d) Based on observable market transactions of spot and forward rates.
- (e) Based on LIBOR and recently reported transactions in the marketplace.
- (f) Based primarily on the price of our common stock.
- (g) Based on recently reported transactions in the marketplace, primarily swap arrangements.
- (h) Based on the fair value of investments corresponding to employees' investment elections.
- (i) Based on average prices on futures exchanges.

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The effective portion of the pre-tax (gains)/losses on our derivative instruments are categorized in the tables below.

|                                           | 2009                                                      |                                                                            |                                                                                                               |
|-------------------------------------------|-----------------------------------------------------------|----------------------------------------------------------------------------|---------------------------------------------------------------------------------------------------------------|
|                                           | (Gains)/Losses<br>Recognized<br>in<br>Income<br>Statement | Losses/(Gains)<br>Recognized in<br>Accumulated Other<br>Comprehensive Loss | (Gains)/Losses<br>Reclassified from<br>Accumulated Other<br>Comprehensive<br>Loss into<br>Income<br>Statement |
| <b>Fair Value/Non-designated Hedges</b>   |                                                           |                                                                            |                                                                                                               |
| Forward exchange contracts <sup>(a)</sup> | \$ (29)                                                   |                                                                            |                                                                                                               |
| Interest rate derivatives <sup>(b)</sup>  | 206                                                       |                                                                            |                                                                                                               |
| Prepaid forward contracts <sup>(a)</sup>  | (5)                                                       |                                                                            |                                                                                                               |
| Commodity contracts <sup>(a)</sup>        | (274)                                                     |                                                                            |                                                                                                               |
| Total                                     | \$ (102)                                                  |                                                                            |                                                                                                               |
| <b>Cash Flow Hedges</b>                   |                                                           |                                                                            |                                                                                                               |
| Forward exchange contracts <sup>(c)</sup> |                                                           | \$ 75                                                                      | \$ (64)                                                                                                       |
| Commodity contracts <sup>(c)</sup>        |                                                           | (1)                                                                        | 90                                                                                                            |
| Interest rate derivatives <sup>(b)</sup>  |                                                           | 32                                                                         |                                                                                                               |
| Total                                     |                                                           | \$ 106                                                                     | \$ 26                                                                                                         |

(a) Included in corporate unallocated expenses.

(b) Included in interest expense in our income statement.

(c) Included in cost of sales in our income statement.

The fair values of our financial assets and liabilities as of December 27, 2008 are categorized as follows:

|                                                   | 2008  |         |         |         |
|---------------------------------------------------|-------|---------|---------|---------|
|                                                   | Total | Level 1 | Level 2 | Level 3 |
| <b>Assets<sup>(a)</sup></b>                       |       |         |         |         |
| Available-for-sale securities <sup>(b)</sup>      | \$ 41 | \$ 41   | \$      | \$      |
| Short-term investments index funds <sup>(c)</sup> | 98    | 98      |         |         |
| Forward exchange contracts <sup>(d)</sup>         | 139   |         | 139     |         |
| Interest rate derivatives <sup>(e)</sup>          | 372   |         | 372     |         |

|                                            |        |        |        |    |
|--------------------------------------------|--------|--------|--------|----|
| Prepaid forward contracts <sup>(f)</sup>   | 41     |        | 41     |    |
| Total assets at fair value                 | \$ 691 | \$ 139 | \$ 552 | \$ |
| <b>Liabilities<sup>(a)</sup></b>           |        |        |        |    |
| Forward exchange contracts <sup>(d)</sup>  | \$ 56  | \$     | \$ 56  | \$ |
| Commodity contracts other <sup>(g)</sup>   | 345    |        | 345    |    |
| Commodity contracts futures <sup>(i)</sup> | 115    | 115    |        |    |
| Deferred compensation <sup>(h)</sup>       | 447    | 99     | 348    |    |
| Total liabilities at fair value            | \$ 963 | \$ 214 | \$ 749 | \$ |

- (a) Financial assets are classified on our balance sheet within other assets, with the exception of short-term investments. Financial liabilities are classified on our balance sheet within other current liabilities and other liabilities.
- (b) Based on the price of common stock.
- (c) Based on price changes in index funds used to manage a portion of market risk arising from our deferred compensation liability.
- (d) Based on observable market transactions of spot and forward rates.
- (e) Based on LIBOR and recently reported transactions in the marketplace.
- (f) Based primarily on the price of our common stock.
- (g) Based on recently reported transactions in the marketplace, primarily swap arrangements.
- (h) Based on the fair value of investments corresponding to employees' investment elections.
- (i) Based on average prices on futures exchanges.

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The carrying amounts of our cash and cash equivalents and short-term investments approximate fair value due to the short-term maturity. Short-term investments consist principally of short-term time deposits and index funds of \$120 million as of December 26, 2009 and \$98 million as of December 27, 2008 used to manage a portion of market risk arising from our deferred compensation liability. The fair value of our debt obligations as of December 26, 2009 and December 27, 2008 was \$8.6 billion and \$8.8 billion, respectively, based upon prices of similar instruments in the marketplace.

The table above excludes guarantees, including our guarantee aggregating \$2.3 billion of Bottling Group, LLC's long-term debt. The guarantee had a fair value of \$20 million as of December 26, 2009 and \$117 million as of December 27, 2008 based on our estimate of the cost to us of transferring the liability to an independent financial institution. See Note 9 for additional information on our guarantees.

**Note 11 Net Income Attributable to PepsiCo per Common Share**

Basic net income attributable to PepsiCo per common share is net income available for PepsiCo common shareholders divided by the weighted average of common shares outstanding during the period. Diluted net income attributable to PepsiCo per common share is calculated using the weighted average of common shares outstanding adjusted to include the effect that would occur if in-the-money employee stock options were exercised and RSUs and preferred shares were converted into common shares. Options to purchase 39.0 million shares in 2009, 9.8 million shares in 2008 and 2.7 million shares in 2007 were not included in the calculation of diluted earnings per common share because these options were out-of-the-money. Out-of-the-money options had average exercise prices of \$61.52 in 2009, \$67.59 in 2008 and \$65.18 in 2007.

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The computations of basic and diluted net income attributable to PepsiCo per common share are as follows:

|                                                             | 2009     |                       | 2008     |                       | 2007     |                       |
|-------------------------------------------------------------|----------|-----------------------|----------|-----------------------|----------|-----------------------|
|                                                             | Income   | Shares <sup>(a)</sup> | Income   | Shares <sup>(a)</sup> | Income   | Shares <sup>(a)</sup> |
| Net income attributable to PepsiCo                          | \$ 5,946 |                       | \$ 5,142 |                       | \$ 5,658 |                       |
| Preferred shares:                                           |          |                       |          |                       |          |                       |
| Dividends                                                   | (1)      |                       | (2)      |                       | (2)      |                       |
| Redemption premium                                          | (5)      |                       | (6)      |                       | (10)     |                       |
| Net income available for PepsiCo common shareholders        | \$ 5,940 | 1,558                 | \$ 5,134 | 1,573                 | \$ 5,646 | 1,621                 |
| Basic net income attributable to PepsiCo per common share   | \$ 3.81  |                       | \$ 3.26  |                       | \$ 3.48  |                       |
| Net income available for PepsiCo common shareholders        | \$ 5,940 | 1,558                 | \$ 5,134 | 1,573                 | \$ 5,646 | 1,621                 |
| Dilutive securities:                                        |          |                       |          |                       |          |                       |
| Stock options and RSUs                                      |          | 17                    |          | 27                    |          | 35                    |
| ESOP convertible preferred stock                            | 6        | 2                     | 8        | 2                     | 12       | 2                     |
| Diluted                                                     | \$ 5,946 | 1,577                 | \$ 5,142 | 1,602                 | \$ 5,658 | 1,658                 |
| Diluted net income attributable to PepsiCo per common share | \$ 3.77  |                       | \$ 3.21  |                       | \$ 3.41  |                       |

(a) Weighted-average common shares outstanding.

**Note 12 Preferred Stock**

As of December 26, 2009 and December 27, 2008, there were 3 million shares of convertible preferred stock authorized. The preferred stock was issued only for an ESOP established by Quaker and these shares are redeemable for common stock by the ESOP participants. The preferred stock accrues dividends at an annual rate of \$5.46 per share. At year-end 2009 and 2008, there were 803,953 preferred shares issued and 243,553 and 266,253 shares outstanding, respectively. The outstanding preferred shares had a fair value of \$73 million as of December 26, 2009 and \$72 million as of December 27, 2008. Each share is convertible at the option of the holder into 4.9625 shares of common stock. The preferred shares may be called by us upon written notice at \$78 per share plus accrued and unpaid dividends. Quaker made the final award to its ESOP plan in June 2001.

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|                                    | 2009       |               | 2008       |               | 2007       |               |
|------------------------------------|------------|---------------|------------|---------------|------------|---------------|
|                                    | Shares     | Amount        | Shares     | Amount        | Shares     | Amount        |
| <b>Preferred stock</b>             | <b>0.8</b> | <b>\$ 41</b>  | <b>0.8</b> | <b>\$ 41</b>  | <b>0.8</b> | <b>\$ 41</b>  |
| <b>Repurchased preferred stock</b> |            |               |            |               |            |               |
| Balance, beginning of year         | <b>0.5</b> | <b>\$ 138</b> | <b>0.5</b> | <b>\$ 132</b> | <b>0.5</b> | <b>\$ 120</b> |
| Redemptions                        | <b>0.1</b> | <b>7</b>      |            | <b>6</b>      |            | <b>12</b>     |
| Balance, end of year               | <b>0.6</b> | <b>\$ 145</b> | <b>0.5</b> | <b>\$ 138</b> | <b>0.5</b> | <b>\$ 132</b> |

**Note 13 Accumulated Other Comprehensive Loss Attributable to PepsiCo**

Comprehensive income is a measure of income which includes both net income and other comprehensive income or loss. Other comprehensive income or loss results from items deferred from recognition into our income statement. Accumulated other comprehensive loss is separately presented on our balance sheet as part of common shareholders equity. Other comprehensive income/(loss) attributable to PepsiCo was \$900 million in 2009, \$(3,793) million in 2008 and \$1,294 million in 2007. The accumulated balances for each component of other comprehensive loss attributable to PepsiCo were as follows:

|                                                                    | 2009              | 2008              | 2007            |
|--------------------------------------------------------------------|-------------------|-------------------|-----------------|
| Currency translation adjustment                                    | <b>\$ (1,471)</b> | <b>\$ (2,271)</b> | <b>\$ 213</b>   |
| Cash flow hedges, net of tax <sup>(a)</sup>                        | <b>(42)</b>       | <b>(14)</b>       | <b>(35)</b>     |
| Unamortized pension and retiree medical, net of tax <sup>(b)</sup> | <b>(2,328)</b>    | <b>(2,435)</b>    | <b>(1,183)</b>  |
| Unrealized gain on securities, net of tax                          | <b>47</b>         | <b>28</b>         | <b>49</b>       |
| Other                                                              |                   | <b>(2)</b>        | <b>4</b>        |
| Accumulated other comprehensive loss attributable to PepsiCo       | <b>\$ (3,794)</b> | <b>\$ (4,694)</b> | <b>\$ (952)</b> |

(a) Includes \$23 million after-tax gain in 2009, \$17 million after-tax loss in 2008 and \$3 million after-tax gain in 2007 for our share of our equity investees' accumulated derivative activity.

(b) Net of taxes of \$1,211 million in 2009, \$1,288 million in 2008 and \$645 million in 2007. Includes \$51 million decrease to the opening balance of accumulated other comprehensive loss attributable to PepsiCo in 2008 due to the change in measurement date. See Note 7.

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|                                          | 2009     | 2008     | 2007  |
|------------------------------------------|----------|----------|-------|
| <b><i>Accounts receivable</i></b>        |          |          |       |
| Trade receivables                        | \$ 4,026 | \$ 3,784 |       |
| Other receivables                        | 688      | 969      |       |
|                                          | 4,714    | 4,753    |       |
| Allowance, beginning of year             | 70       | 69       | \$ 64 |
| Net amounts charged to expense           | 40       | 21       | 5     |
| Deductions <sup>(a)</sup>                | (21)     | (16)     | (7)   |
| Other <sup>(b)</sup>                     | 1        | (4)      | 7     |
| Allowance, end of year                   | 90       | 70       | \$ 69 |
| Net receivables                          | \$ 4,624 | \$ 4,683 |       |
| <b><i>Inventories</i></b> <sup>(c)</sup> |          |          |       |
| Raw materials                            | \$ 1,274 | \$ 1,228 |       |
| Work-in-process                          | 165      | 169      |       |
| Finished goods                           | 1,179    | 1,125    |       |
|                                          | \$ 2,618 | \$ 2,522 |       |

(a) Includes accounts written off.

(b) Includes currency translation effects and other adjustments.

(c) Inventories are valued at the lower of cost or market. Cost is determined using the average, first-in, first-out (FIFO) or last-in, first-out (LIFO) methods. Approximately 10% in 2009 and 11% in 2008 of the inventory cost was computed using the LIFO method. The differences between LIFO and FIFO methods of valuing these inventories were not material.

|                                                    | 2009   | 2008   |
|----------------------------------------------------|--------|--------|
| <b><i>Other assets</i></b>                         |        |        |
| Noncurrent notes and accounts receivable           | \$ 118 | \$ 115 |
| Deferred marketplace spending                      | 182    | 219    |
| Unallocated purchase price for recent acquisitions | 143    | 1,594  |
| Pension plans                                      | 64     | 28     |
| Other                                              | 458    | 702    |

|                                                       |                 |                 |
|-------------------------------------------------------|-----------------|-----------------|
|                                                       | <b>\$ 965</b>   | <b>\$ 2,658</b> |
| <i>Accounts payable and other current liabilities</i> |                 |                 |
| Accounts payable                                      | <b>\$ 2,881</b> | <b>\$ 2,846</b> |
| Accrued marketplace spending                          | <b>1,656</b>    | <b>1,574</b>    |
| Accrued compensation and benefits                     | <b>1,291</b>    | <b>1,269</b>    |
| Dividends payable                                     | <b>706</b>      | <b>660</b>      |
| Other current liabilities                             | <b>1,593</b>    | <b>1,924</b>    |
|                                                       | <b>\$ 8,127</b> | <b>\$ 8,273</b> |

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|                                                  | 2009     | 2008     | 2007     |
|--------------------------------------------------|----------|----------|----------|
| <b><i>Other supplemental information</i></b>     |          |          |          |
| Rent expense                                     | \$ 412   | \$ 357   | \$ 303   |
| Interest paid                                    | \$ 456   | \$ 359   | \$ 251   |
| Income taxes paid, net of refunds                | \$ 1,498 | \$ 1,477 | \$ 1,731 |
| <b><i>Acquisitions<sup>(a)</sup></i></b>         |          |          |          |
| Fair value of assets acquired                    | \$ 851   | \$ 2,907 | \$ 1,611 |
| Cash paid                                        | (466)    | (1,925)  | (1,320)  |
| Liabilities and noncontrolling interests assumed | \$ 385   | \$ 982   | \$ 291   |

(a) During 2008, together with PBG, we jointly acquired Lebedyansky, for a total purchase price of \$1.8 billion. Lebedyansky is owned 25% and 75% by PBG and us, respectively.

**Note 15 Acquisition of Common Stock of PBG and PAS**

On August 3, 2009, we entered into the PBG Merger Agreement and the PAS Merger Agreement.

The PBG Merger Agreement provides that, upon the terms and subject to the conditions set forth in the PBG Merger Agreement, PBG will be merged with and into Metro (the PBG Merger), with Metro continuing as the surviving corporation and our wholly owned subsidiary. At the effective time of the PBG Merger, each share of PBG common stock outstanding immediately prior to the effective time not held by us or any of our subsidiaries will be converted into the right to receive either 0.6432 of a share of PepsiCo common stock or, at the election of the holder, \$36.50 in cash, without interest, and in each case subject to proration procedures which provide that we will pay cash for a number of shares equal to 50% of the PBG common stock outstanding immediately prior to the effective time of the PBG Merger not held by us or any of our subsidiaries and issue shares of PepsiCo common stock for the remaining 50% of such shares. Each share of PBG common stock held by PBG as treasury stock, held by us or held by Metro, and each share of PBG Class B common stock held by us or Metro, in each case immediately prior to the effective time of the PBG Merger, will be canceled, and no payment will be made with respect thereto. Each share of PBG common stock and PBG Class B common stock owned by any subsidiary of ours other than Metro immediately prior to the effective time of the PBG Merger will automatically be converted into the right to receive 0.6432 of a share of PepsiCo common stock.

The PAS Merger Agreement provides that, upon the terms and subject to the conditions set forth in the PAS Merger Agreement, PAS will be merged with and into Metro (the PAS Merger, and together with the PBG Merger, the Mergers), with Metro continuing as the surviving corporation and our wholly owned subsidiary. At the effective time of the PAS Merger, each share of PAS common stock outstanding immediately prior to the effective time not held by us or any of our subsidiaries will be converted into the right to receive either 0.5022 of a share of PepsiCo common stock or, at the election of the holder, \$28.50 in cash, without interest, and in each case subject to proration procedures which provide that we will pay cash for a number of shares equal to 50% of the PAS common stock outstanding immediately prior to the effective time of the PAS Merger not held by us or any of our subsidiaries and issue shares of PepsiCo common stock for the remaining 50% of such shares. Each share of PAS common stock held by PAS as treasury stock, held by us or held by Metro, in each case, immediately prior to the effective time of the PAS Merger, will be canceled, and no payment will be made with respect thereto. Each share of



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PAS common stock owned by any subsidiary of ours other than Metro immediately prior to the effective time of the PAS Merger will automatically be converted into the right to receive 0.5022 of a share of PepsiCo common stock.

On February 17, 2010, the stockholders of PBG and PAS approved the PBG and PAS Mergers, respectively. Consummation of each of the Mergers is subject to various conditions, including the absence of legal prohibitions and the receipt of regulatory approvals. On February 17, 2010, we announced that we had refiled under the HSR Act with respect to the Mergers and signed a Consent Decree proposed by the Staff of the FTC providing for the maintenance of the confidentiality of certain information we will obtain from DPSG in connection with the manufacture and distribution of certain DPSG products after the Mergers are completed. The Consent Decree is subject to review and approval by the Commissioners of the FTC. We hope to consummate the Mergers by the end of February 2010.

We currently plan that at the closing of the Mergers we will form a new operating unit. This new operating unit will comprise all current PBG and PAS operations in the United States, Canada and Mexico, and will account for about three-quarters of the volume of PepsiCo's North American bottling system, with independent franchisees accounting for most of the rest. This new operating unit will be included within the PAB business unit. Current PBG and PAS operations in Europe, including Russia, will be managed by the Europe division when the Mergers are completed.

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**Management's Responsibility for Financial Reporting**

To Our Shareholders:

At PepsiCo, our actions – the actions of all our associates – are governed by our Worldwide Code of Conduct. This Code is clearly aligned with our stated values – a commitment to sustained growth, through empowered people, operating with responsibility and building trust. Both the Code and our core values enable us to operate with integrity – both within the letter and the spirit of the law. Our Code of Conduct is reinforced consistently at all levels and in all countries. We have maintained strong governance policies and practices for many years.

The management of PepsiCo is responsible for the objectivity and integrity of our consolidated financial statements. The Audit Committee of the Board of Directors has engaged independent registered public accounting firm, KPMG LLP, to audit our consolidated financial statements, and they have expressed an unqualified opinion.

We are committed to providing timely, accurate and understandable information to investors. Our commitment encompasses the following:

**Maintaining strong controls over financial reporting.** Our system of internal control is based on the control criteria framework of the Committee of Sponsoring Organizations of the Treadway Commission published in their report titled *Internal Control – Integrated Framework*. The system is designed to provide reasonable assurance that transactions are executed as authorized and accurately recorded; that assets are safeguarded; and that accounting records are sufficiently reliable to permit the preparation of financial statements that conform in all material respects with accounting principles generally accepted in the U.S. We maintain disclosure controls and procedures designed to ensure that information required to be disclosed in reports under the Securities Exchange Act of 1934 is recorded, processed, summarized and reported within the specified time periods. We monitor these internal controls through self-assessments and an ongoing program of internal audits. Our internal controls are reinforced through our Worldwide Code of Conduct, which sets forth our commitment to conduct business with integrity, and within both the letter and the spirit of the law.

**Exerting rigorous oversight of the business.** We continuously review our business results and strategies. This encompasses financial discipline in our strategic and daily business decisions. Our Executive Committee is actively involved – from understanding strategies and alternatives to reviewing key initiatives and financial performance. The intent is to ensure we remain objective in our assessments, constructively challenge our approach to potential business opportunities and issues, and monitor results and controls.

**Engaging strong and effective Corporate Governance from our Board of Directors.** We have an active, capable and diligent Board that meets the required standards for independence, and we welcome the Board's oversight as a representative of our shareholders. Our Audit Committee is comprised of independent directors with the financial literacy, knowledge and experience to provide appropriate oversight. We review our critical accounting policies, financial reporting and internal control matters with them and encourage their direct communication with KPMG LLP, with our General Auditor, and with our General Counsel. We also have a Compliance Department to coordinate our compliance policies and practices.

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**Providing investors with financial results that are complete, transparent and understandable.** The consolidated financial statements and financial information included in this report are the responsibility of management. This includes preparing the financial statements in accordance with accounting principles generally accepted in the U.S., which require estimates based on management's best judgment.

**PepsiCo has a strong history of doing what's right.** We realize that great companies are built on trust, strong ethical standards and principles. Our financial results are delivered from that culture of accountability, and we take responsibility for the quality and accuracy of our financial reporting.

/S/ PETER A. BRIDGMAN  
Peter A. Bridgman  
Senior Vice President and Controller

/S/ RICHARD GOODMAN  
Richard Goodman  
Chief Financial Officer

/S/ INDRA K. NOOYI  
Indra K. Nooyi  
Chairman of the Board of Directors and  
Chief Executive Officer

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**Report of Independent Registered Public Accounting Firm**

The Board of Directors and Shareholders

PepsiCo, Inc.:

We have audited the accompanying Consolidated Balance Sheets of PepsiCo, Inc. and subsidiaries (PepsiCo, Inc. or the Company) as of December 26, 2009 and December 27, 2008, and the related Consolidated Statements of Income, Cash Flows and Equity for each of the fiscal years in the three-year period ended December 26, 2009. We also have audited PepsiCo, Inc.'s internal control over financial reporting as of December 26, 2009, based on criteria established in *Internal Control – Integrated Framework* issued by the Committee of Sponsoring Organizations of the Treadway Commission (COSO). PepsiCo, Inc.'s management is responsible for these consolidated financial statements, for maintaining effective internal control over financial reporting, and for its assessment of the effectiveness of internal control over financial reporting, included in the accompanying Management's Annual Report on Internal Control over Financial Reporting appearing under Item 9A. Our responsibility is to express an opinion on these consolidated financial statements and an opinion on the Company's internal control over financial reporting based on our audits.

We conducted our audits in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audits to obtain reasonable assurance about whether the financial statements are free of material misstatement and whether effective internal control over financial reporting was maintained in all material respects. Our audits of the consolidated financial statements included examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements, assessing the accounting principles used and significant estimates made by management, and evaluating the overall financial statement presentation. Our audit of internal control over financial reporting included obtaining an understanding of internal control over financial reporting, assessing the risk that a material weakness exists, and testing and evaluating the design and operating effectiveness of internal control based on the assessed risk. Our audits also included performing such other procedures as we considered necessary in the circumstances. We believe that our audits provide a reasonable basis for our opinions.

A company's internal control over financial reporting is a process designed to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles. A company's internal control over financial reporting includes those policies and procedures that (1) pertain to the maintenance of records that, in reasonable detail, accurately and fairly reflect the transactions and dispositions of the assets of the company; (2) provide reasonable assurance that transactions are recorded as necessary to permit preparation of financial statements in accordance with generally accepted accounting principles, and that receipts and expenditures of the company are being made only in accordance with authorizations of management and directors of the company; and (3) provide reasonable assurance regarding prevention or timely detection of unauthorized acquisition, use, or disposition of the company's assets that could have a material effect on the financial statements.

Because of its inherent limitations, internal control over financial reporting may not prevent or detect misstatements. Also, projections of any evaluation of effectiveness to future periods are subject to the risk that controls may become inadequate because of changes in conditions, or that the degree of compliance with the policies or procedures may deteriorate.

In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the financial position of PepsiCo, Inc. as of December 26, 2009 and December 27, 2008, and the results of its operations and its cash flows for each of the fiscal years in the three-year period ended December 26, 2009, in conformity with

U.S. generally accepted accounting principles. Also in our opinion, PepsiCo, Inc. maintained, in all material respects, effective internal control over financial reporting as of December 26, 2009, based on criteria established in *Internal Control - Integrated Framework* issued by COSO.

As discussed in Note 2 to the consolidated financial statements, the Company changed its method of accounting for business combinations and noncontrolling interests in 2009.

/s/ KPMG LLP  
New York, New York  
February 22, 2010

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(in millions except per share amounts, unaudited)

| <b>Quarterly</b>                                                                        | <b>First<br/>Quarter</b> | <b>Second<br/>Quarter</b> | <b>Third<br/>Quarter</b> | <b>Fourth<br/>Quarter</b> |
|-----------------------------------------------------------------------------------------|--------------------------|---------------------------|--------------------------|---------------------------|
| <b><i>Net revenue</i></b>                                                               |                          |                           |                          |                           |
| 2009                                                                                    | \$ 8,263                 | \$ 10,592                 | \$ 11,080                | \$ 13,297                 |
| 2008                                                                                    | \$ 8,333                 | \$ 10,945                 | \$ 11,244                | \$ 12,729                 |
| <b><i>Gross profit</i></b>                                                              |                          |                           |                          |                           |
| 2009                                                                                    | \$ 4,519                 | \$ 5,711                  | \$ 5,899                 | \$ 7,004                  |
| 2008                                                                                    | \$ 4,499                 | \$ 5,867                  | \$ 5,976                 | \$ 6,558                  |
| <b><i>Restructuring and impairment charges <sup>(a)</sup></i></b>                       |                          |                           |                          |                           |
| 2009                                                                                    | \$ 25                    | \$ 11                     |                          |                           |
| 2008                                                                                    |                          |                           |                          | \$ 543                    |
| <b><i>Mark-to-market net impact <sup>(b)</sup></i></b>                                  |                          |                           |                          |                           |
| 2009                                                                                    | \$ (62)                  | \$ (100)                  | \$ (29)                  | \$ (83)                   |
| 2008                                                                                    | \$ 4                     | \$ (61)                   | \$ 176                   | \$ 227                    |
| <b><i>PepsiCo portion of PBG restructuring and impairment charge <sup>(c)</sup></i></b> |                          |                           |                          |                           |
| 2008                                                                                    |                          |                           |                          | \$ 138                    |
| <b><i>PBG/PAS merger costs <sup>(d)</sup></i></b>                                       |                          |                           |                          |                           |
| 2009                                                                                    |                          |                           | \$ 9                     | \$ 52                     |
| <b><i>Net income attributable to PepsiCo</i></b>                                        |                          |                           |                          |                           |
| 2009                                                                                    | \$ 1,135                 | \$ 1,660                  | \$ 1,717                 | \$ 1,434                  |
| 2008                                                                                    | \$ 1,148                 | \$ 1,699                  | \$ 1,576                 | \$ 719                    |
| <b><i>Net income attributable to PepsiCo per common share basic</i></b>                 |                          |                           |                          |                           |
| 2009                                                                                    | \$ 0.73                  | \$ 1.06                   | \$ 1.10                  | \$ 0.92                   |
| 2008                                                                                    | \$ 0.72                  | \$ 1.07                   | \$ 1.01                  | \$ 0.46                   |
| <b><i>Net income attributable to PepsiCo per common share diluted</i></b>               |                          |                           |                          |                           |
| 2009                                                                                    | \$ 0.72                  | \$ 1.06                   | \$ 1.09                  | \$ 0.90                   |
| 2008                                                                                    | \$ 0.70                  | \$ 1.05                   | \$ 0.99                  | \$ 0.46                   |
| <b><i>Cash dividends declared per common share</i></b>                                  |                          |                           |                          |                           |
| 2009                                                                                    | \$ 0.425                 | \$ 0.45                   | \$ 0.45                  | \$ 0.45                   |
| 2008                                                                                    | \$ 0.375                 | \$ 0.425                  | \$ 0.425                 | \$ 0.425                  |
| <b><i>2009 stock price per share <sup>(e)</sup></i></b>                                 |                          |                           |                          |                           |
| High                                                                                    | \$ 56.93                 | \$ 56.95                  | \$ 59.64                 | \$ 64.48                  |
| Low                                                                                     | \$ 43.78                 | \$ 47.50                  | \$ 52.11                 | \$ 57.33                  |
| Close                                                                                   | \$ 50.02                 | \$ 53.65                  | \$ 57.54                 | \$ 60.96                  |
| <b><i>2008 stock price per share <sup>(e)</sup></i></b>                                 |                          |                           |                          |                           |
| High                                                                                    | \$ 79.79                 | \$ 72.35                  | \$ 70.83                 | \$ 75.25                  |
| Low                                                                                     | \$ 66.30                 | \$ 64.69                  | \$ 63.28                 | \$ 49.74                  |
| Close                                                                                   | \$ 71.19                 | \$ 67.54                  | \$ 68.92                 | \$ 54.56                  |

(a) The restructuring and impairment charge in 2009 was \$36 million (\$29 million after-tax or \$0.02 per share). The restructuring and impairment charge in 2008 was \$543 million (\$408 million after-tax or \$0.25 per share). See

Note 3.

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- (b) In 2009, we recognized \$274 million (\$173 million after-tax or \$0.11 per share) of mark-to-market net gains on commodity hedges in corporate unallocated expenses. In 2008, we recognized \$346 million (\$223 million after-tax or \$0.14 per share) of mark-to-market net losses on commodity hedges in corporate unallocated expenses.
- (c) In 2008, we recognized a non-cash charge of \$138 million (\$114 million after-tax or \$0.07 per share) included in bottling equity income as part of recording our share of PBG's financial results.
- (d) In 2009, we recognized \$50 million of costs associated with the proposed mergers with PBG and PAS, as well as an additional \$11 million of costs in bottling equity income representing our share of the respective merger costs of PBG and PAS. In total, these costs had an after-tax impact of \$44 million or \$0.03 per share.
- (e) Represents the composite high and low sales price and quarterly closing prices for one share of PepsiCo common stock.

**Table of Contents****Five-Year Summary**

(unaudited)

|                                                             | 2009             | 2008      | 2007      |
|-------------------------------------------------------------|------------------|-----------|-----------|
| Net revenue                                                 | \$ <b>43,232</b> | \$ 43,251 | \$ 39,474 |
| Net income attributable to PepsiCo                          | \$ <b>5,946</b>  | \$ 5,142  | \$ 5,658  |
| Net income attributable to PepsiCo per common share basic   | \$ <b>3.81</b>   | \$ 3.26   | \$ 3.48   |
| Net income attributable to PepsiCo per common share diluted | \$ <b>3.77</b>   | \$ 3.21   | \$ 3.41   |
| Cash dividends declared per common share                    | \$ <b>1.775</b>  | \$ 1.65   | \$ 1.425  |
| Total assets                                                | \$ <b>39,848</b> | \$ 35,994 | \$ 34,628 |
| Long-term debt                                              | \$ <b>7,400</b>  | \$ 7,858  | \$ 4,203  |
| Return on invested capital <sup>(a)</sup>                   | <b>27.2%</b>     | 25.5%     | 28.9%     |

|                                                             | 2006      | 2005      |
|-------------------------------------------------------------|-----------|-----------|
| Net revenue                                                 | \$ 35,137 | \$ 32,562 |
| Net income attributable to PepsiCo                          | \$ 5,642  | \$ 4,078  |
| Net income attributable to PepsiCo per common share basic   | \$ 3.42   | \$ 2.43   |
| Net income attributable to PepsiCo per common share diluted | \$ 3.34   | \$ 2.39   |
| Cash dividends declared per common share                    | \$ 1.16   | \$ 1.01   |
| Total assets                                                | \$ 29,930 | \$ 31,727 |
| Long-term debt                                              | \$ 2,550  | \$ 2,313  |
| Return on invested capital <sup>(a)</sup>                   | 30.4%     | 22.7%     |

- (a) Return on invested capital is defined as adjusted net income attributable to PepsiCo divided by the sum of average common shareholders' equity and average total debt. Adjusted net income attributable to PepsiCo is defined as net income attributable to PepsiCo plus net interest expense after-tax. Net interest expense after-tax was \$211 million in 2009, \$184 million in 2008, \$63 million in 2007, \$72 million in 2006 and \$62 million in 2005.

Includes restructuring and impairment charges of:

|           | 2009           | 2008    | 2007    | 2006    | 2005    |
|-----------|----------------|---------|---------|---------|---------|
| Pre-tax   | \$ <b>36</b>   | \$ 543  | \$ 102  | \$ 67   | \$ 83   |
| After-tax | \$ <b>29</b>   | \$ 408  | \$ 70   | \$ 43   | \$ 55   |
| Per share | \$ <b>0.02</b> | \$ 0.25 | \$ 0.04 | \$ 0.03 | \$ 0.03 |

Includes mark-to-market net (income)/expense of:

|           | 2009            | 2008   | 2007    | 2006  |
|-----------|-----------------|--------|---------|-------|
| Pre-tax   | \$ <b>(274)</b> | \$ 346 | \$ (19) | \$ 18 |
| After-tax | \$ <b>(173)</b> | \$ 223 | \$ (12) | \$ 12 |

|           |           |         |           |         |
|-----------|-----------|---------|-----------|---------|
| Per share | \$ (0.11) | \$ 0.14 | \$ (0.01) | \$ 0.01 |
|-----------|-----------|---------|-----------|---------|

In 2009, we recognized \$50 million of costs associated with the proposed mergers with PBG and PAS, as well as an additional \$11 million of costs in bottling equity income representing our share of the respective merger costs of PBG and PAS. In total, these costs had an after-tax impact of \$44 million or \$0.03 per share.

In 2008, we recognized \$138 million (\$114 million after-tax or \$0.07 per share) of our share of PBG's restructuring and impairment charges.

In 2007, we recognized \$129 million (\$0.08 per share) 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 (\$0.36 per share) primarily in connection with the IRS's examination of our consolidated income tax returns for the years 1998 through 2002. In 2005, we recorded income tax expense of \$460 million (\$0.27 per share) related to our repatriation of earnings in connection with the American Job Creation Act of 2004.

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On December 30, 2006, we adopted guidance from the FASB on accounting for pension and other postretirement benefits which reduced total assets by \$2,016 million, total common shareholders' equity by \$1,643 million and total liabilities by \$373 million.

The 2005 fiscal year consisted of 53 weeks compared to 52 weeks in our normal fiscal year. The 53<sup>rd</sup> week increased 2005 net revenue by an estimated \$418 million and net income attributable to PepsiCo by an estimated \$57 million (\$0.03 per share).

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**GLOSSARY**

**Acquisitions:** reflect all mergers and acquisitions activity, including the impact of acquisitions, divestitures and changes in ownership or control in consolidated subsidiaries. The impact of acquisitions related to our non-consolidated equity investees is reflected in our volume and, excluding our anchor bottlers, in our operating profit.

**Anchor bottlers:** The Pepsi Bottling Group (PBG), PepsiAmericas (PAS) and Pepsi Bottling Ventures (PBV).

**Bottlers:** customers to whom we have granted exclusive contracts to sell and manufacture certain beverage products bearing our trademarks within a specific geographical area.

**Bottler Case Sales (BCS):** measure of physical beverage volume shipped to retailers and independent distributors from both PepsiCo and our bottlers.

**Bottler funding:** financial incentives we give to our bottlers to assist in the distribution and promotion of our beverage products.

**Concentrate Shipments and Equivalents (CSE):** measure of our physical beverage volume shipments to bottlers, retailers and independent distributors. This measure is reported on our fiscal year basis.

**Consumers:** people who eat and drink our products.

**CSD:** carbonated soft drinks.

**Customers:** authorized bottlers and independent distributors and retailers.

**Derivatives:** financial instruments, such as futures, swaps, Treasury locks, options and forward contracts, that we use to manage our risk arising from changes in commodity prices, interest rates, foreign exchange rates and stock prices.

**Direct-Store-Delivery (DSD):** delivery system used by us and our bottlers to deliver snacks and beverages directly to retail stores where our products are merchandised.

**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.

**Hedge accounting:** treatment for qualifying hedges that allows fluctuations in a hedging instrument's fair value to offset corresponding fluctuations in the hedged item in the same reporting period. Hedge accounting is allowed only in cases where the hedging relationship between the hedging instruments and hedged items is highly effective, and only prospectively from the date a hedging relationship is formally documented.

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**Management operating cash flow:** net cash provided by operating activities less capital spending plus sales of property, plant and equipment. It is our primary measure used to monitor cash flow performance.

**Mark-to-market net gain or loss or impact:** the change in market value for commodity contracts, that we purchase to mitigate the volatility in costs of energy and raw materials that we consume. The market value is determined based on average prices on national exchanges and recently reported transactions in the marketplace.

**Marketplace spending:** sales incentives offered through various programs to our customers and consumers (trade spending), as well as advertising and other marketing activities.

**Servings:** common metric reflecting our consolidated physical unit volume. Our divisions' physical unit measures are converted into servings based on U.S. Food and Drug Administration guidelines for single-serving sizes of our products.

**Transaction gains and losses:** the impact on our consolidated financial statements of exchange rate changes arising from specific transactions.

**Translation adjustment:** the impact of converting our foreign affiliates' financial statements into U.S. dollars for the purpose of consolidating our financial statements.

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**Item 7A. Quantitative and Qualitative Disclosures About Market Risk**

Included in Item 7. Management's Discussion and Analysis of Financial Condition and Results of Operations Our Business Risks.

**Item 8. Financial Statements and Supplementary Data**

See Item 15. Exhibits and Financial Statement Schedules.

**Item 9. Changes in and Disagreements With Accountants on Accounting and Financial Disclosure**

Not applicable.

**Item 9A. Controls and Procedures**

**(a) Disclosure Controls and Procedures.** As of the end of the period covered by this report, we carried out an evaluation, under the supervision and with the participation of our management, including our Chief Executive Officer and Chief Financial Officer, of the effectiveness of the design and operation of our disclosure controls and procedures, as such term is defined in Rules 13a-15(e) and 15d-15(e) of the Exchange Act. Based upon that evaluation, our Chief Executive Officer and Chief Financial Officer concluded that as of the end of the period covered by this report our disclosure controls and procedures were effective to ensure that information required to be disclosed by us in reports we file or submit under the Exchange Act is (1) recorded, processed, summarized and reported within the time periods specified in SEC rules and forms, and (2) accumulated and communicated to our management, including our Chief Executive Officer and Chief Financial Officer, to allow timely decisions regarding required disclosure.

**(b) Management's Annual Report on Internal Control over Financial Reporting.** Our management is responsible for establishing and maintaining adequate internal control over financial reporting, as such term is defined in Rule 13a-15(f) of the Exchange Act. Under the supervision and with the participation of our management, including our Chief Executive Officer and Chief Financial Officer, we conducted an evaluation of the effectiveness of our internal control over financial reporting based upon the framework in *Internal Control - Integrated Framework* issued by the Committee of Sponsoring Organizations of the Treadway Commission. Based on that evaluation, our management concluded that our internal control over financial reporting is effective as of December 26, 2009.

**Attestation Report of the Registered Public Accounting Firm.** KPMG LLP, an independent registered public accounting firm, has audited the consolidated financial statements included in this Annual Report on Form 10-K and, as part of their audit, has issued their report, included herein, on the effectiveness of our internal control over financial reporting.

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**(c) Changes in Internal Control over Financial Reporting.** During our fourth fiscal quarter of 2009, we continued migrating certain of our financial processing systems to SAP software. This software implementation is part of our ongoing global business transformation initiative, and we plan to continue implementing such software throughout other parts of our businesses over the course of the next few years. In connection with the SAP implementation and resulting business process changes, we continue to enhance the design and documentation of our internal control processes to ensure suitable controls over our financial reporting.

Except as described above, there were no changes in our internal control over financial reporting during our fourth fiscal quarter of 2009 that have materially affected, or are reasonably likely to materially affect, our internal control over financial reporting.

**Item 9B. Other Information**

Not applicable.

**PART III**

**Item 10. Directors, Executive Officers and Corporate Governance**

The name, age and background of each of our directors nominated for election are contained under the caption Election of Directors in our Proxy Statement for our 2010 Annual Meeting of Shareholders and are incorporated herein by reference. Pursuant to Item 401(b) of Regulation S-K, information about our executive officers is reported under the caption Executive Officers of the Registrant in Part I of this report.

Information on the beneficial ownership reporting for our directors and executive officers is contained under the caption Section 16(a) Beneficial Ownership Reporting Compliance in our Proxy Statement for our 2010 Annual Meeting of Shareholders and is incorporated herein by reference.

We have a written code of conduct that applies to all of our employees, including our directors, Chairman of the Board and Chief Executive Officer, Chief Financial Officer and Controller. Our Worldwide Code of Conduct is distributed to all employees, is available on our website at <http://www.pepsico.com> and is included as Exhibit 14 to this Annual Report on Form 10-K. A copy of our Worldwide Code of Conduct may be obtained free of charge by writing to Investor Relations, PepsiCo, Inc., 700 Anderson Hill Road, Purchase, New York 10577.

Our business and affairs are overseen by our Board of Directors pursuant to the North Carolina Business Corporation Act and our By-Laws. The Board of Directors has three separately designated standing committees: Audit, Compensation and Nominating and Corporate Governance. The charters of these committees are available free of charge on our website at <http://www.pepsico.com>. The names of each of our Audit Committee members are contained in our Proxy Statement for our 2010 Annual Meeting of Shareholders under the caption Committees of the Board of Directors and is

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incorporated herein by reference. Information on our Audit Committee and Audit Committee financial expertise and financial literacy is contained in our Proxy Statement for our 2010 Annual Meeting of Shareholders under the captions The Audit Committee and Financial Expertise and Financial Literacy and is incorporated herein by reference. The names of each of our Nominating and Corporate Governance Committee members are contained in our Proxy Statement for our 2010 Annual Meeting of Shareholders under the caption Committees of the Board of Directors and are incorporated herein by reference. Information on our Nominating and Corporate Governance Committee and director nomination process can be found in our Proxy Statement for our 2010 Annual Meeting of Shareholders under the captions The Nominating and Corporate Governance Committee and Process for Selection and Nomination of Directors; Consideration of Director Diversity and is incorporated herein by reference.

**Item 11. Executive Compensation**

Information on compensation of our directors and executive officers and Compensation Committee interlocks is contained in our Proxy Statement for our 2010 Annual Meeting of Shareholders under the captions 2009 Director Compensation, Executive Compensation, and Compensation Committee Interlocks and Insider Participation, respectively, and is incorporated herein by reference.

The names of each of our Compensation Committee members are contained in our Proxy Statement for our 2010 Annual Meeting of Shareholders under the caption Committees of the Board of Directors and are incorporated herein by reference. Information on our Compensation Committee can be found under the caption The Compensation Committee in our Proxy Statement for our 2010 Annual Meeting of Shareholders and is incorporated by reference herein.

**Item 12. Security Ownership of Certain Beneficial Owners and Management and Related Stockholder Matters**

Information with respect to securities authorized for issuance under equity compensation plans can be found under the caption Securities Authorized for Issuance Under Equity Compensation Plans in our Proxy Statement for our 2010 Annual Meeting of Shareholders and is incorporated herein by reference.

Information on the number of shares of PepsiCo Common Stock beneficially owned by each director and named executive officer and by all directors and executive officers as a group is contained under the caption Ownership of PepsiCo Common Stock by Directors and Executive Officers in our Proxy Statement for our 2010 Annual Meeting of Shareholders and is incorporated herein by reference. As far as we know, no person beneficially owns more than 5% of the outstanding shares of PepsiCo Common or Convertible Preferred Stock.

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**Item 13. Certain Relationships and Related Transactions, and Director Independence**

***Transactions with Related Persons.*** Information with respect to transactions with related persons, if any, is contained under the caption *Review and Approval of Transactions with Related Persons* in our Proxy Statement for our 2010 Annual Meeting of Shareholders and is incorporated herein by reference.

***Review, Approval or Ratification of Transactions with Related Persons.*** Information with respect to the review, approval or ratification of transactions with related persons is contained under the caption *Review and Approval of Transactions with Related Persons* in our Proxy Statement for our 2010 Annual Meeting of Shareholders and is incorporated herein by reference.

***Promoters and Certain Control Persons.*** Not applicable.

***Director Independence.*** The name of each director that is independent is contained under the caption *Director Independence* in our Proxy Statement for our 2010 Annual Meeting of Shareholders and is incorporated herein by reference.

**Item 14. Principal Accountant Fees and Services**

Information on our Audit Committee's pre-approval policy for audit services, and information on our principal accountant fees and services is contained in our Proxy Statement for our 2010 Annual Meeting of Shareholders under the captions *Audit Committee Report* and *Audit and Non-Audit Fees*, and is incorporated herein by reference.

**PART IV**

**Item 15. Exhibits and Financial Statement Schedules**

(a)1. Financial Statements

The following consolidated financial statements of PepsiCo, Inc. and its affiliates are included herein by reference to the pages indicated on the index appearing in *Item 7. Management's Discussion and Analysis of Financial Condition and Results of Operations* :

Consolidated Statement of Income    Fiscal years ended December 26, 2009, December 27, 2008 and December 29, 2007.

Consolidated Statement of Cash Flows    Fiscal years ended December 26, 2009, December 27, 2008 and December 29, 2007.

Consolidated Balance Sheet    December 26, 2009 and December 27, 2008.

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Consolidated Statement of Equity    Fiscal years ended December 26, 2009, December 27, 2008 and December 29, 2007.

Notes to Consolidated Financial Statements, and

Report of Independent Registered Public Accounting Firm.

(a)2. Financial Statement Schedules

These schedules are omitted because they are not required or because the information is set forth in the financial statements or the notes thereto.

(a)3. Exhibits

See Index to Exhibits.

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**SIGNATURES**

Pursuant to the requirements of Section 13 or 15(d) of the Securities Exchange Act of 1934, PepsiCo has duly caused this report to be signed on its behalf by the undersigned, thereunto duly authorized.

Dated: February 22, 2010

PepsiCo, Inc.

By: /s/ Indra K. Nooyi  
Indra K. Nooyi  
Chairman of the Board of Directors and  
Chief Executive Officer

Pursuant to the requirements of the Securities Exchange Act of 1934, this report has been signed below by the following persons on behalf of PepsiCo and in the capacities and on the date indicated.

| <b>SIGNATURE</b>                           | <b>TITLE</b>                                                           | <b>DATE</b>       |
|--------------------------------------------|------------------------------------------------------------------------|-------------------|
| /s/ Indra K. Nooyi<br>Indra K. Nooyi       | Chairman of the Board of Directors and<br>Chief Executive Officer      | February 22, 2010 |
| /s/ Richard Goodman<br>Richard Goodman     | Chief Financial Officer                                                | February 22, 2010 |
| /s/ Peter A. Bridgman<br>Peter A. Bridgman | Senior Vice President and Controller<br>(Principal Accounting Officer) | February 22, 2010 |
| /s/ Shona L. Brown<br>Shona L. Brown       | Director                                                               | February 22, 2010 |
| /s/ Ian M. Cook<br>Ian M. Cook             | Director                                                               | February 22, 2010 |
| /s/ Dina Dublon<br>Dina Dublon             | Director                                                               | February 22, 2010 |

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|                                                          |          |                   |
|----------------------------------------------------------|----------|-------------------|
| /s/ Victor J. Dzau<br>Victor J. Dzau, M.D.               | Director | February 22, 2010 |
| /s/ Ray L. Hunt<br>Ray L. Hunt                           | Director | February 22, 2010 |
| /s/ Alberto Ibargüen<br>Alberto Ibargüen                 | Director | February 22, 2010 |
| /s/ Arthur C. Martinez<br>Arthur C. Martinez             | Director | February 22, 2010 |
| /s/ Sharon Percy Rockefeller<br>Sharon Percy Rockefeller | Director | February 22, 2010 |
| /s/ James J. Schiro<br>James J. Schiro                   | Director | February 22, 2010 |
| /s/ Lloyd G. Trotter<br>Lloyd G. Trotter                 | Director | February 22, 2010 |
| /s/ Daniel Vasella<br>Daniel Vasella                     | Director | February 22, 2010 |

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**INDEX TO EXHIBITS**

**ITEM 15(a)(3)**

The following is a list of the exhibits filed as part of this Form 10-K. The documents incorporated by reference are located in the SEC's Public Reference Room in Washington, D.C. in the SEC's file no. 1-1183.

**EXHIBIT**

- 2.1 Agreement and Plan of Merger dated as of August 3, 2009, among PepsiCo, Inc., The Pepsi Bottling Group, Inc. and Pepsi-Cola Metropolitan Bottling Company, Inc. (the schedules have been omitted pursuant to Item 601(b)(2) of Regulation S-K), which is incorporated herein by reference to Exhibit 2.1 to PepsiCo's Current Report on Form 8-K dated August 3, 2009.
- 2.2 Agreement and Plan of Merger dated as of August 3 2009, among PepsiCo, Inc., PepsiAmericas, Inc. and Pepsi-Cola Metropolitan Bottling Company, Inc. (the schedules have been omitted pursuant to Item 601(b)(2) of Regulation S-K), which is incorporated herein by reference to Exhibit 2.2 to PepsiCo's Current Report on Form 8-K dated August 3, 2009.
- 3.1 Amended and Restated Articles of Incorporation of PepsiCo, Inc., which are incorporated herein by reference to Exhibit 4.1 to PepsiCo, Inc.'s Registration Statement on Form S-8 (Registration No. 333-66632).
- 3.2 By-Laws of PepsiCo, Inc., as amended on February 5, 2010, which are incorporated herein by reference to Exhibit 3.2 to PepsiCo's Current Report on Form 8-K dated February 5, 2010.
- 4.1 PepsiCo, Inc. agrees to furnish to the SEC, upon request, a copy of any instrument defining the rights of holders of long-term debt of PepsiCo, Inc. and all of its subsidiaries for which consolidated or unconsolidated financial statements are required to be filed with the Securities and Exchange Commission.
- 4.2 Indenture dated May 21, 2007 between PepsiCo, Inc. and The Bank of New York, as trustee, which is incorporated herein by reference to Exhibit 4.1 to PepsiCo's Current Report on Form 8-K dated May 25, 2007.
- 4.3 Form of 5.15% Senior Note due 2012, which is incorporated herein by reference to Exhibit 4.2 to PepsiCo's Current Report on Form 8-K dated May 25, 2007.
- 4.4 Form of 4.65% Senior Note due 2013, which is incorporated herein by reference to Exhibit 4.2 to PepsiCo's Current Report on Form 8-K dated December 3, 2007.

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|      |                                                                                                                                                                                                                                                                                        |
|------|----------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------|
| 4.5  | Form of 5.00% Senior Note due 2018, which is incorporated herein by reference to Exhibit 4.2 to PepsiCo's Current Report on Form 8-K dated May 21, 2008.                                                                                                                               |
| 4.6  | Form of 7.90% Senior Note due 2018, which is incorporated herein by reference to Exhibit 4.1 to PepsiCo's Current Report on Form 8-K dated October 24, 2008.                                                                                                                           |
| 4.7  | Form of 3.75% Senior Note due 2014, which is incorporated herein by reference to Exhibit 4.1 to PepsiCo's Current Report on Form 8-K dated February 25, 2009.                                                                                                                          |
| 4.8  | Form of Floating Rate Note due 2011, which is incorporated herein by reference to Exhibit 4.1 to PepsiCo's Current Report on Form 8-K dated January 11, 2010.                                                                                                                          |
| 4.9  | Form of 3.10% Senior Note due 2015, which is incorporated herein by reference to Exhibit 4.2 to PepsiCo's Current Report on Form 8-K dated January 11, 2010.                                                                                                                           |
| 4.10 | Form of 4.50% Senior Note due 2020, which is incorporated herein by reference to Exhibit 4.3 to PepsiCo's Current Report on Form 8-K dated January 11, 2010.                                                                                                                           |
| 4.11 | Form of 5.50% Senior Note due 2040, which is incorporated herein by reference to Exhibit 4.4 to PepsiCo's Current Report on Form 8-K dated January 11, 2010.                                                                                                                           |
| 4.12 | Indenture dated as of October 24, 2008 among PepsiCo, Bottling Group, LLC and The Bank of New York Mellon, as Trustee, which is incorporated herein by reference to Exhibit 4.2 to PepsiCo's Current Report on Form 8-K dated October 24, 2008.                                        |
| 4.13 | Form of PepsiCo Guarantee of 6.95% Senior Note due 2014 of Bottling Group, LLC, which is incorporated herein by reference to Exhibit 4.4 to PepsiCo's Current Report on Form 8-K dated October 24, 2008.                                                                               |
| 10.1 | PepsiCo, Inc. 1994 Long-Term Incentive Plan, as amended and restated effective October 1, 1999, which is incorporated herein by reference to Exhibit 10.6 to PepsiCo's Annual Report on Form 10-K for the fiscal year ended December 25, 1999.*                                        |
| 10.2 | PepsiCo Executive Income Deferral Program (Plan Document for the Pre-409A Program), amended and restated effective July 1, 1997, which is incorporated herein by reference to Exhibit 10.1 to PepsiCo's Quarterly Report on Form 10-Q for the fiscal quarter ended September 6, 2008.* |

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- 10.3 PepsiCo Pension Equalization Plan, restated effective August 29, 1997, which is incorporated herein by reference to Exhibit 10.9 to PepsiCo's Annual Report on Form 10-K for the fiscal year ended December 27, 1997.\*
- 10.4 PepsiCo SharePower Stock Option Plan, as amended and restated effective August 3, 2001, which is incorporated herein by reference to Exhibit 10.13 to PepsiCo's Annual Report on Form 10-K for the fiscal year ended December 28, 2002.\*
- 10.5 PepsiCo, Inc. 1995 Stock Option Incentive Plan (as amended and restated effective August 2, 2001), which is incorporated herein by reference to Exhibit 10.14 to PepsiCo's Annual Report on Form 10-K for the fiscal year ended December 28, 2002.\*
- 10.6 The Quaker Long-Term Incentive Plan of 1990, which is incorporated herein by reference to Exhibit 10.16 to PepsiCo's Annual Report on Form 10-K for the fiscal year ended December 28, 2002.\*
- 10.7 The Quaker Long-Term Incentive Plan of 1999, which is incorporated herein by reference to Exhibit 10.17 to PepsiCo's Annual Report on Form 10-K for the fiscal year ended December 28, 2002.\*
- 10.8 PepsiCo, Inc. 2003 Long-Term Incentive Plan, as amended and restated effective September 12, 2008, which is incorporated herein by reference to Exhibit 10.4 to PepsiCo's Quarterly Report on Form 10-Q for the fiscal quarter ended September 6, 2008.\*
- 10.9 PepsiCo, Inc. 2004 Executive Incentive Compensation Plan, which is incorporated herein by reference to Exhibit D to PepsiCo's Proxy Statement for its 2004 Annual Meeting of Shareholders.\*
- 10.10 Form of Regular Performance-Based Long-Term Incentive Award Agreement, which is incorporated herein by reference to Exhibit 99.1 to PepsiCo's Current Report on Form 8-K dated as of January 28, 2005.\*
- 10.11 Form of Regular Long-Term Incentive Award Agreement, which is incorporated herein by reference to Exhibit 99.2 to PepsiCo's Current Report on Form 8-K dated as of January 28, 2005.\*
- 10.12 Form of Special Long-Term Incentive Award Agreement (Restricted Stock Units Terms and Conditions), which is incorporated herein by reference to Exhibit 99.3 to PepsiCo's Current Report on Form 8-K dated as of January 28, 2005.\*
- 10.13 Form of Special Long-Term Incentive Award Agreement (Stock Option Agreement), which is incorporated herein by reference to Exhibit 99.4 to PepsiCo's Current Report on Form 8-K dated as of January 28, 2005.\*

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| 10.14 | Form of Non-Employee Director Restricted Stock Unit Agreement, which is incorporated herein by reference to Exhibit 99.5 to PepsiCo's Current Report on Form 8-K dated as of January 28, 2005.*                                                                                             |
| 10.15 | Form of Non-Employee Director Stock Option Agreement, which is incorporated herein by reference to Exhibit 99.6 to PepsiCo's Current Report on Form 8-K dated as of January 28, 2005.*                                                                                                      |
| 10.16 | Form of PepsiCo, Inc. Director Indemnification Agreement, which is incorporated herein by reference to Exhibit 10.20 to PepsiCo's Annual Report on Form 10-K for the fiscal year ended December 25, 2004.*                                                                                  |
| 10.17 | Severance Plan for Executive Employees of PepsiCo, Inc. and Affiliates, which is incorporated herein by reference to Exhibit 10.5 to PepsiCo's Quarterly Report on Form 10-Q for the fiscal quarter ended September 6, 2008.*                                                               |
| 10.18 | Form of Annual Long-Term Incentive Award Agreement, which is incorporated herein by reference to Exhibit 99.1 to PepsiCo's Current Report on Form 8-K dated as of February 2, 2006.*                                                                                                        |
| 10.19 | Form of Performance-Based Long-Term Incentive Award Agreement, which is incorporated herein by reference to Exhibit 99.2 to PepsiCo's Current Report on Form 8-K dated as of February 2, 2006.*                                                                                             |
| 10.20 | Form of Pro Rata Performance-Based Long-Term Incentive Award Agreement, which is incorporated herein by reference to Exhibit 99.3 to PepsiCo's Current Report on Form 8-K dated as of February 2, 2006.*                                                                                    |
| 10.21 | Form of Restricted Stock Unit Retention Award Agreement, which is incorporated herein by reference to Exhibit 99.5 to PepsiCo's Current Report on Form 8-K dated as of February 2, 2006.*                                                                                                   |
| 10.22 | Form of Stock Option Retention Award Agreement, which is incorporated herein by reference to Exhibit 99.4 to PepsiCo's Current Report on Form 8-K dated as of February 2, 2006.*                                                                                                            |
| 10.23 | PepsiCo Executive Income Deferral Program (Plan Document for the 409A Program), amended and restated effective as of January 1, 2005, which is incorporated herein by reference to Exhibit 10.2 to PepsiCo's Quarterly Report on Form 10-Q for the fiscal quarter ended September 6, 2008.* |
| 10.24 | PepsiCo Director Deferral Program, effective as of January 1, 2005, which is incorporated herein by reference to Exhibit 10.3 to PepsiCo's Quarterly Report on Form 10-Q for the fiscal quarter ended September 6, 2008.*                                                                   |

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- 10.25 Amendments to the PepsiCo, Inc. 2003 Long-Term Incentive Plans, the PepsiCo, Inc. 1994 Long-Term Incentive Plan, the PepsiCo, Inc. 1995 Stock Option Incentive Plan, the PepsiCo SharePower Stock Option Plan, the PepsiCo, Inc. 1987 Incentive Plan effective as of December 31, 2005, which are incorporated herein by reference to Exhibit 10.31 to PepsiCo's Annual Report on Form 10-K for the fiscal year ended December 31, 2005.\*
- 10.26 Amendments to the PepsiCo, Inc. 2003 Long-Term Incentive Plan, the PepsiCo SharePower Stock Option Plan, the PepsiCo, Inc. 1995 Stock Option Incentive Plan, the Quaker Long-Term Incentive Plan of 1999, the Quaker Long-Term Incentive Plan of 1990 and the PepsiCo, Inc. Director Stock Plan, effective as of November 17, 2006, which are incorporated herein by reference to Exhibit 10.31 to PepsiCo's Annual Report on Form 10-K for the fiscal year ended December 30, 2006.\*
- 10.27 Form of Non-Employee Director Long-Term Incentive Award Agreement, which is incorporated herein by reference to Exhibit 10.2 to PepsiCo's Quarterly Report on Form 10-Q for the fiscal quarter ended September 9, 2006.\*
- 10.28 US \$1,500,000,000 Five Year Credit Agreement, dated as of May 22, 2006, which is incorporated herein by reference to Exhibit 10.1 of PepsiCo's Quarterly Report on Form 10-Q for the fiscal quarter ended June 17, 2006.
- 10.29 Form of Annual Long-Term Incentive Award Agreement, which is incorporated herein by reference to Exhibit 10.2 to PepsiCo's Current Report on Form 8-K dated as of February 7, 2007.\*
- 10.30 Form of Performance-Based Long-Term Incentive Award Agreement, which is incorporated herein by reference to Exhibit 10.3 to PepsiCo's Current Report on Form 8-K dated as of February 7, 2007.\*
- 10.31 Amendment to the PepsiCo, Inc. 1994 Long-Term Incentive Plan, the PepsiCo, Inc. 1995 Stock Option Incentive Plan, the PepsiCo SharePower Stock Option Plan and the PepsiCo, Inc. 1987 Incentive Plan, effective as of February 2, 2007, which is incorporated herein by reference to Exhibit 10.41 to PepsiCo's Annual Report on Form 10-K for the fiscal year ended December 30, 2006.\*
- 10.32 Form of Pro Rata Long-Term Incentive Award Agreement, which is incorporated herein by reference to Exhibit 10.2 to PepsiCo's Current Report on Form 8-K dated as of May 8, 2007.\*
- 10.33 Form of Stock Option Retention Award Agreement, which is incorporated herein by reference to Exhibit 10.3 to PepsiCo's Current Report on Form 8-K dated as of May 8, 2007.\*

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- 10.34 Form of Restricted Stock Unit Retention Award Agreement, which is incorporated herein by reference to Exhibit 10.4 to PepsiCo's Current Report on Form 8-K dated as of May 8, 2007.\*
- 10.35 Letter Agreement effective May 2, 2007 extending Five-Year Credit Agreement dated as of May 22, 2006 among PepsiCo, Inc., as Borrower, the Lenders named therein, and Citibank, N.A., as Administrative Agent, to May 22, 2012, which is incorporated herein by reference to Exhibit 10.1 to PepsiCo's Quarterly Report on Form 10-Q for the fiscal quarter ended June 16, 2007.
- 10.36 Amendment effective August 1, 2007 to Five-Year Credit Agreement dated as of May 22, 2006 among PepsiCo, Inc., as Borrower, the Lenders named therein, and Citibank, N.A., as Administrative Agent, which is incorporated herein by reference to Exhibit 10.1 to PepsiCo's Current Report on Form 8-K dated as of August 2, 2007.
- 10.37 PepsiCo, Inc. 2007 Long-Term Incentive Plan, as amended and restated effective September 12, 2008, which is incorporated herein by reference to Exhibit 10.6 to PepsiCo's Quarterly Report on Form 10-Q for the fiscal quarter ended September 6, 2008.\*
- 10.38 Form of Annual Long-Term Incentive Award Agreement, which is incorporated by reference to Exhibit 10.1 to PepsiCo's Current Report on Form 8-K dated as of February 7, 2008.\*
- 10.39 Form of Performance-Based Long-Term Incentive Award Agreement, which is incorporated herein by reference to Exhibit 10.2 to PepsiCo's Current Report on Form 8-K dated as of February 7, 2008.\*
- 10.40 Form of Annual Long-Term Incentive Award Agreement, which is incorporated herein by reference to Exhibit 10.1 to PepsiCo's Current Report on Form 8-K dated as of February 11, 2009.\*
- 10.41 Form of Performance-Based Long-Term Incentive Award Agreement, which is incorporated herein by reference to Exhibit 10.2 to PepsiCo's Current Report on Form 8-K dated as of February 11, 2009.\*
- 10.42 Form of Pro Rata Long-Term Incentive Award Agreement, which is incorporated herein by reference to Exhibit 10.3 to PepsiCo's Current Report on Form 8-K dated as of February 11, 2009.\*
- 10.43 Form of Stock Option Retention Award Agreement, which is incorporated herein by reference to Exhibit 10.4 to PepsiCo's Current Report on Form 8-K dated as of February 11, 2009.\*

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| 10.44 | Form of Restricted Stock Unit Retention Award Agreement which is incorporated herein by reference to Exhibit 10.5 to PepsiCo's Current Report on Form 8-K dated as of February 11, 2009.*                                                                                                                                                                                                                                                 |
| 10.45 | PepsiCo Pension Equalization Plan (Plan Document for the 409A Plan), amended and restated effective January 1, 2005, which is incorporated herein by reference to Exhibit 10.46 to PepsiCo's Annual Report on Form 10-K for the fiscal year ended December 27, 2008.*                                                                                                                                                                     |
| 10.46 | Form of Aircraft Time Sharing Agreement, which is incorporated herein by reference to Exhibit 10 to PepsiCo's Quarterly Report on Form 10-Q for the fiscal quarter ended March 21, 2009.*                                                                                                                                                                                                                                                 |
| 10.47 | PepsiCo Pension Equalization Plan (Plan Document for the Pre-Section 409A Program), January 1, 2005 Restatement, As Amended Through December 31, 2008, which is incorporated herein by reference to Exhibit 10.1 to PepsiCo's Quarterly Report on Form 10-Q for the fiscal quarter ended June 13, 2009.*                                                                                                                                  |
| 12    | Computation of Ratio of Earnings to Fixed Charges.                                                                                                                                                                                                                                                                                                                                                                                        |
| 14    | Worldwide Code of Conduct.                                                                                                                                                                                                                                                                                                                                                                                                                |
| 21    | Subsidiaries of PepsiCo, Inc.                                                                                                                                                                                                                                                                                                                                                                                                             |
| 23    | Consent of KPMG LLP.                                                                                                                                                                                                                                                                                                                                                                                                                      |
| 24    | Power of Attorney executed by Indra K. Nooyi, Richard Goodman, Peter A. Bridgman, Shona L. Brown, Ian M. Cook, Dina Dublon, Victor J. Dzau, M.D., Ray L. Hunt, Alberto Ibargüen, Arthur C. Martinez, Sharon Percy Rockefeller, James J. Schiro, Lloyd G. Trotter and Daniel Vasella.                                                                                                                                                      |
| 31    | Certification of our Chief Executive Officer and our Chief Financial Officer pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.                                                                                                                                                                                                                                                                                                   |
| 32    | Certification of our Chief Executive Officer and our Chief Financial Officer pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.                                                                                                                                                                                                                                                                                                   |
| 101   | The following materials from PepsiCo Inc.'s Annual Report on Form 10-K for the fiscal year ended December 26, 2009 formatted in XBRL (eXtensible Business Reporting Language): (i) the Consolidated Statement of Income, (ii) the Consolidated Statement of Cash Flows, (iii) the Consolidated Balance Sheet, (iv) the Consolidated Statement of Equity and (v) Notes to the Consolidated Financial Statements, tagged as blocks of text. |

\* Management contracts and compensatory plans or arrangements required to be filed as exhibits pursuant to Item 15(a)(3) of this report.