PEPSICO 2006

PERFORMANCE WITH PURPOSE

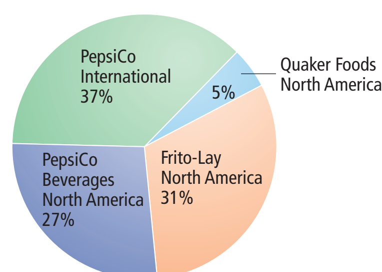
We believe Performance — achieving financial results — matters most when it is combined with Purpose — improving people's lives.

Financial Highlights

PepsiCo, Inc. and Subsidiaries
($ in millions except per share amounts; all per share amounts assume dilution)

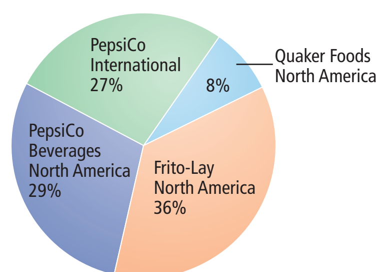
Net Revenue

Total: $35,137



Division Operating Profit

Total: $7,172



	2006	2005	% Chg[(a)]
Summary of Operations			
Total net revenue	**$35,137**	$32,562	8
Division operating profit[(b)]	**$7,172**	$6,710	7
Total operating profit	**$6,439**	$5,922	9
Net income[(c)]	**$5,065**	$4,536	12
Earnings per share[(c)]	**$3.00**	$2.66	13
Other Data			
Management operating cash flow[(d)]	**$4,065**	$4,204	(3)
Net cash provided by operating activities	**$6,084**	$5,852	4
Capital spending	**$2,068**	$1,736	19
Common share repurchases	**$3,000**	$3,012	–
Dividends paid	**$1,854**	$1,642	13
Long-term debt	**$2,550**	$2,313	10

(a) Percentage changes above and in text are based on unrounded amounts.
(b) Excludes corporate unallocated expenses. See page 82 for a reconciliation to the most directly comparable financial measure in accordance with GAAP.
(c) In 2006, excludes restructuring and impairment charges and certain tax items. In 2005, excludes the impact of the American Jobs Creation Act (AJCA) tax charge, the 53rd week and restructuring charges. See page 82 for a reconciliation to the most directly comparable financial measure in accordance with GAAP.
(d) Includes the impact of net capital spending. Also, see "Our Liquidity and Capital Resources" in Management's Discussion and Analysis.

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Primary Websites

PepsiCo, Inc. — www.pepsico.com
Frito-Lay North America — www.fritolay.com
Pepsi-Cola North America — www.pepsiworld.com
Tropicana North America — www.tropicana.com
Quaker Foods — www.quakeroats.com
Gatorade — www.gatorade.com
Smart Spot — www.smartspot.com
Walkers — www.walkers.co.uk
Sabritas — www.sabritas.com.mx
Gamesa — www.gamesa.com.mx
Frito-Lay Canada — www.fritolay.ca

When market or market share are referred to in this report, the markets and share are defined by the sources of the information, primarily Information Resources, Inc. and ACNielsen. The Measured Channel Information excludes Wal*Mart, as Wal*Mart does not report volume to these services.

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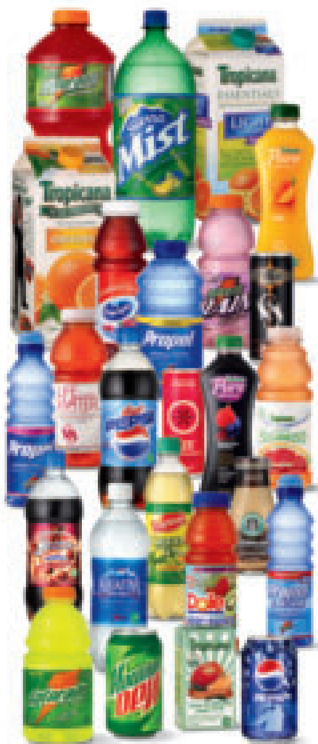
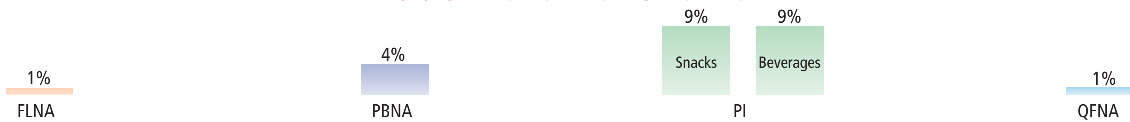
PepsiCo at a Glance ($ in Millions)

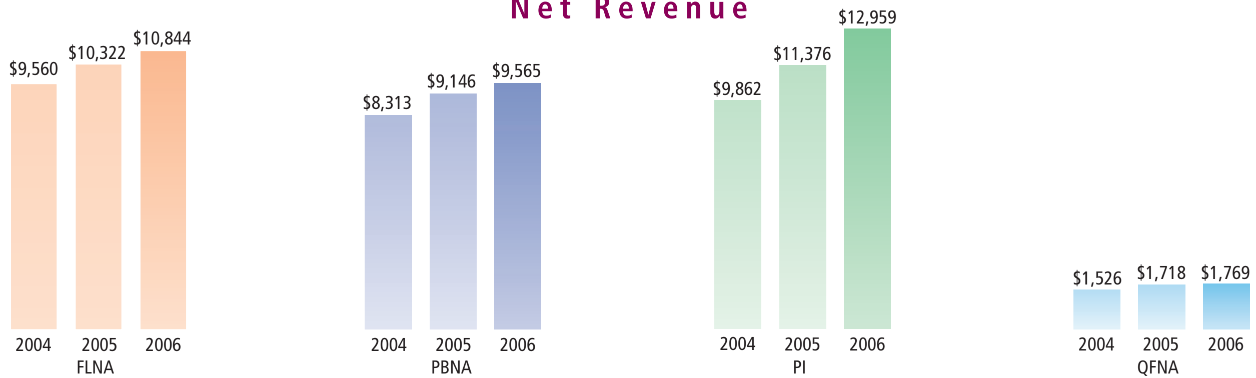
Frito-Lay North America	PepsiCo Beverages North America	PepsiCo International	Quaker Foods North America



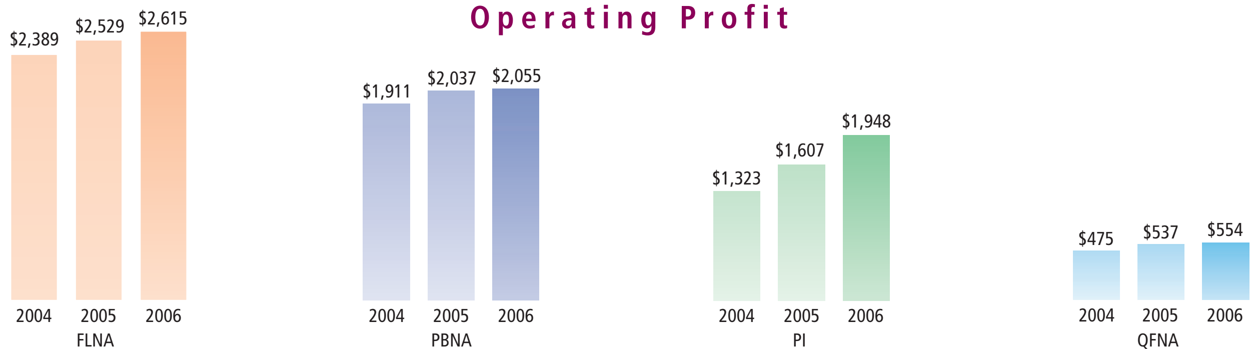
2006 Volume Growth



Net Revenue



Operating Profit



Dear Shareholders:

Generating healthy financial returns and making important strides in responsible corporate citizenship, PepsiCo delivered a very strong 2006:

- Volume grew 5.5%.
- Net revenue grew 8%.
- Division operating profit grew 7%.*
- Earnings per share grew 13%.*
- Total return to shareholders was 8%.
- Return on invested capital was 26%.*
- Cash flow from operations was $6.1 billion and management operating cash flow was $4.1 billion.**

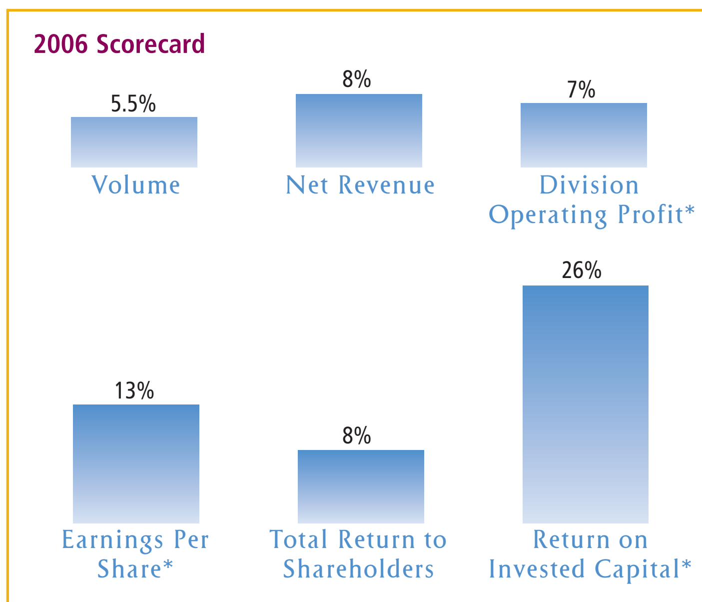
Indra Nooyi
Chairman Elect and Chief Executive Officer

Steve Reinemund
Executive Chairman and Chairman of the Board

These financial results tell only part of the PepsiCo story. As we achieve success with profitable growth, we're continuously giving back to the communities we serve, delivering what we call *Performance with Purpose*.

This annual report shows just how we're achieving the balance between providing you with solid returns on your investments and working to create a defining corporation for the new millennium — one that strives to *do better by doing better*.

Importantly, PepsiCo's business performance in 2006 is consistent with very strong performance over the last several years and — we believe — evidence of our ability to continue delivering strong results going forward. Over the last five years, your company has led the industry with over 8% top line growth, double-digit EPS growth and approximately $26 billion in operating cash flow. During this period, we've returned approximately $20 billion to you, our shareholders.



* See page 82.
** See page 53.

What allows us to deliver these kinds of consistent results? It's an ideal match of PepsiCo people, capabilities and great brands with opportunity. Specifically, this includes our *structural advantages*, *capability advantages* and our *unique people culture*. For example:

- We sit squarely in the sweet spot of the Food and Beverage space — convenience.
- We have a big global reach — with tremendous opportunity for continued growth.
- Our go-to-market systems provide us with a mosaic of distribution arms that reach everywhere we operate cost effectively and with great efficiency and speed — ensuring our products are always available.
- We have demonstrated that we have the strategic acuity to spot shifting consumer interests, such as the move to non-carbonated beverages and the increasing focus on health and wellness.
- We know how to build a brand's personality and leverage our mega-brands, not only into line extensions but also into entirely new platforms.
- We have a track record of success in acquiring attractive tuck-in businesses and then integrating them quickly and efficiently.
- Our people provide an overwhelming advantage. They are passionate about what they do and pride themselves on results. Add to this the diversity we cultivate and the personal ownership our associates take in the business, and you have a sense of our unique culture.

We, and all our associates across the globe, believe PepsiCo is delivering more than just financial performance. We are a

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company with an increasingly deep sense of awareness of the world around us and the needs of its inhabitants. We believe this is a company with a heart, and recognize the role leading companies like ours play in society. It inspires us to focus on delivering *Performance with Purpose* — something we intend to continue doing.

Human Sustainability

It's not about growing a business for the next quarter or the next year. It's about growing a business profitably for the long term.

We believe we can do this in ways directly related to our business, beginning with our products. We have a fundamental belief that humans need to be *nourished* in multiple dimensions — ranging from simple treats to healthier eats.

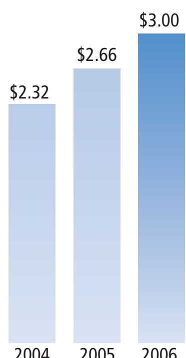
We call this *human sustainability*, and we're continuously transforming our portfolio of products to meet consumer needs. We've improved the nutritional profiles of our global, flagship brands by changing to healthier oils, reducing sugar and sodium content, and by expanding the range of products we offer. This includes products ranging from indulgences — or treats — to good-for-you products that offer functional benefits like hydration or heart health.

In fact, our products that can contribute to healthier lifestyles — what we call "Smart Spot" eligible products — represented over two-thirds of our growth in North America in 2006. These products meet authoritative nutrition statements set by the National Academy of Sciences and the U.S. Food and Drug Administration or provide other functional benefits. And we've set a goal of deriving 50% of all our U.S. revenues with Smart Spot eligible products by 2010.

We're supplementing our portfolio transformation with efforts to educate consumers about the importance of active lifestyles and nutritional balance. We've committed to helping them understand that, along with the calories they put in their bodies, they must ensure they're burning calories as well.

And we're proactively collaborating with policy makers to help consumers live healthier lives. In 2006, PepsiCo worked with the Clinton Foundation, the American Heart Association and its partners in the American Beverage Association to develop policies for selling beverages in U.S. schools, and followed up with a

Earnings Per Share*



Management Operating Cash Flow **
$ in Millions

* See page 82.
** See page 53.

A Very Special Thanks

In 2007, we celebrate a lifetime of leadership for a very prominent member of the PepsiCo family. Earning his place in PepsiCo history as a world-class Chairman and Chief Executive Officer, Steve Reinemund is leaving a legacy of growth through his work in transforming our portfolio to address health and wellness consumer needs, building a diverse and inclusive environment for our people and driving the company's Power of One capabilities. And as he's done each of these, he's reinforced a culture committed to driving business results the right way: connected to clearly articulated values. It was under Steve's leadership that PepsiCo defined our Values, so we now have a common commitment and understanding of the principles that guide us. He's been an excellent partner and superb mentor, as well as a great friend. We will all miss him when he steps down as Chairman in May, along with three other directors who are retiring. Each has made a lasting contribution to our success.

Steve Reinemund

Steve began his career with PepsiCo in 1984 at Pizza Hut, which was then part of our restaurant division. He served as Chief Executive Officer there before going on to lead Frito-Lay North America and then our worldwide snack operations. He moved to headquarters as PepsiCo's President and Chief Operating Officer in 1999, and then served as Chairman and Chief Executive Officer from 2001 to 2006. During this time, he increased PepsiCo revenues by more than $11 billion, and net income and earnings per share more than doubled. In the process, the annual dividend doubled and the company's market capitalization surpassed $100 billion.

Board of Directors

Retiring this year are three members of the Board of Directors who have been with us a total of 46 years combined: Bob Allen, John Akers and Frank Thomas. Bob served on our Board for 17 years, and since 2000 he has been Presiding Director. He set a high standard for this critical new role with his firm and steady direction. John joined our Board 16 years ago and was Chair of our Compensation Committee and a continuous source of sage advice. Frank provided 13 years of service and was a chief contributor to our business strategies and people planning, and was an invaluable source of counsel to all of us. Each of these individuals has provided excellent counsel and perspective and has given us the full value of his experience. We shall miss them greatly. We're pleased to have the depth of experience of Sharon Rockefeller, who will become Presiding Director.

In addition, we announced in February that Cynthia Trudell left our Board to become PepsiCo's Senior Vice President and Chief Personnel Officer, a role she has already assumed. We thank her for her years of service on the Board and look forward to her continued contributions to PepsiCo as she uses her experience to drive our business growth while motivating, developing and caring for the employees who make our businesses successful.

similar agreement for snacks in U.S. schools. In fact, PepsiCo is the only company to have participated in the development of both policies.

We are introducing health and wellness programs in markets around the world. And in countries such as Mexico, the United Kingdom and Brazil, we've established advisory boards to help guide our efforts.

No matter where we are, the safety and integrity of our products is our single highest priority. It's our duty as a responsible company. People buy our brands because they know they can count on consistent quality — every time. We follow very rigorous standards of safety and quality. Our standards are equally rigorous in New York, London and Beijing as they are wherever else we operate. We stand behind each and every product we sell.

Environmental Sustainability

The second way PepsiCo can give back to the global community it serves is through its work with *environmental sustainability*. By fully understanding our environmental impact, we can find ways to conserve and *replenish* the planet's natural resources. In doing what's right for the business, we can do what's right for the global community.

PepsiCo has focused its environmental sustainability efforts on water, energy and packaging — areas where we can make the biggest impact. Reducing waste water, establishing rainwater collection capabilities, using more recyclable materials in our packaging and using alternative energy sources are just a few of the priorities we've set for ourselves. Success with each of them translates into financial benefits for the business.

Our accountability as a global corporate citizen extends to other social issues as well. We've established programs to help our associates and communities combat HIV/AIDS. Our associates are volunteering in our communities, and PepsiCo continually responds to calls for humanitarian aid.

Talent Sustainability

The third area of sustainability that we've chosen to focus on is *talent sustainability* — reflecting our belief that people hold the key to PepsiCo's success. Our company is known to many as an academy company, a place where people grow and business leaders develop. We are also committed to building a work environment where all of our associates can achieve a better quality of life and know that, as a business, we *cherish* them.

The transitions we announced this year, starting with the CEO and including several other senior executive roles, show that we are not only committed to developing and retaining deep bench strength, but that we're equally passionate about ensuring seamless transitions. And while we certainly weren't looking for external recognition, *BusinessWeek* bestowed its 2006 "smoothest handover" honors to PepsiCo, saying, "…the transition in October from Steven S Reinemund to Indra K. Nooyi at the $33 billion PepsiCo was noticeably angst-free."

Whether it's managing transitions or running the business day-to-day, PepsiCo's culture is renowned for its "can-do" spirit, something we consider part of our DNA. Look no further than the marketplace challenges of any year to see our level of commitment to getting the job done. In 2006, whether it was skyrocketing fruit costs, or ever-increasing competitive activity in categories or markets across the globe, our people proved they're among the world's best.

Our focus on people has never been more critical; the global competition for talent intensifies each year, and the companies that win will be those that provide the most opportunity for personal and professional growth.

We firmly believe that PepsiCo's commitment to diversity and inclusion is creating that kind of environment. To attract and retain the best and brightest, we're working harder than ever to ensure our culture grows in its inclusive nature — that it becomes known as a premier place to work because every associate can bring his or her whole self to work. When that happens, we unleash the power of our people on innovative solutions that will grow your company.

Looking ahead, our work plan is clear: we have a mandate to deliver *Performance with Purpose*. We're well positioned to deliver financial performance, consistent with our guidance, and to do it with the goals of *nourishing* consumers, *replenishing* the environment in which we operate and *cherishing* our people. Our capabilities and strategies to deliver on this priority are highlighted in the pages that follow.

While we have much more to do, we're making progress on delivering on our commitment to Purpose and are proud to share details with you in this publication. As a result of our efforts, the Dow Jones Sustainability North American Index — an investment fund comprised of North American companies that excel in managing economic, environmental and social results — added PepsiCo to its list in 2006.

Our True North – Our Values

Of course, guiding our people and our culture is a set of values that helps ensure we achieve all results with integrity — the right way. We want PepsiCo to continue to be viewed as a high-integrity company, and we recognize and reward leaders who deliver results in ways that are consistent with our True North — our Values.

Since PepsiCo was formed in 1965, each of the company's leaders — beginning with Don Kendall, and including Wayne Calloway and Roger Enrico — has been passionately committed to operating a business with integrity, one that delivers strong, sustainable financial returns.

As we have co-authored PepsiCo's strategy over the last several years, and conclude our own CEO transition, above all we share an equally passionate commitment to our Values and to running a business that does better by doing better, achieving financial results while addressing environmental and social needs.

It's a legacy we both intend to leave. And we believe there's no better, more honorable, or more strategic way to grow your company.

Steve Reinemund
Executive Chairman and
Chairman of the Board

Indra Nooyi
Chairman Elect and
Chief Executive Officer

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Questions & Answers

Our Chairman and President & Chief Executive Officer Perspective

The questions below reflect key questions shareholders often ask about our businesses, and are followed by joint responses from our Chairman, Steve Reinemund, and our President and Chief Executive Officer, Indra Nooyi.

Q: PepsiCo's product categories and their impact on health continues to capture media, consumer and regulatory focus. How is PepsiCo's portfolio faring in this environment?

A: As the transformation of PepsiCo's portfolio continues, we're able to add more choices for consumers to meet their needs for products that can contribute to healthier lifestyles, and we're proud of each and every choice we offer.

Our efforts are galvanized by three imperatives: continue making our fun-for-you products more nutritious, develop new products that address the needs of the entire food pyramid, and try to ensure consumers never have to trade off nutrition and taste.

The range of product choices we offer grows each year, as we develop or acquire new products or platforms that range from indulgent to good-for-you. At the same time, we're improving the nutritional profiles of our larger, core brands. For example, changing cooking oils to sunflower oil for both Lay's and Ruffles potato chips at FLNA and Walkers crisps in the United Kingdom reduces the saturated fat in these products without sacrificing taste. And we're working on developing new sweeteners and adding more nutritious ingredients to our products — such as fiber to foods and beverages and omega-3 fatty acids to juices.

Our portfolio of more nutritious choices is working well in this environment, evidenced by over two-thirds of our North America top line growth in 2006 being driven by products that are PepsiCo Smart Spot eligible — meaning they meet authoritative nutritional statements developed by the National Academy of Sciences or the U.S. Food and Drug Administration.

Q: What, specifically, is PepsiCo doing to address regulatory pressures relating to health concerns across the globe?

A: On the regulatory and policy side, we're firm believers in engaging a range of public and private experts to come to workable solutions on such things as how and where our products are sold and marketed. We're actively engaged with policy and thought leaders, as well as food and beverage industry leaders, to reach decisions on steps we can take to support consumers in their quest for healthier lifestyles. This includes insights from PepsiCo's Blue Ribbon Advisory Board, a group of leading health and wellness experts and third-party advisors from across the globe, as well as our Ethnic Advisory Boards who have provided insights relating to multicultural consumers.

Most recently, PepsiCo's work in the United States with the Clinton Foundation, the American Heart Association and the beverage industry, are examples of working proactively to set policies that put the right kinds of products in the right locations — in this case, schools. We're working in our international markets in much the same way.

An advantaged portfolio of good- and better-for-you products — products that are Smart Spot eligible — has provided, and will continue to provide, growth opportunities at what we call the intersection of business and public interests.

Q: How are you approaching innovation as a means to growth?

A: Innovation demands that we constantly look around the next corner to ensure we're providing products that our consumers and retail customers want. We have a relentless focus on innovation, as new products consistently deliver 15% to 20% of our total growth. In 2006 alone, our North American businesses introduced new products that totaled greater than $1 billion in retail sales.

More strategically said, we're focused on game-changing innovation. Clearly, we need to keep our existing big brands fresh while developing products and venturing into new categories.

Through a disciplined approach to innovation, we've developed a very strong pipeline for 2007 and beyond, including new products like Flat Earth vegetable and fruit crisps from Frito-Lay, and new beverage entries such as Izze, a sparkling beverage made with 70% fruit juice, and Naked Juice, a line of all natural juices and juice smoothies, acquired in January 2007. And we'll expand on our successes, such as introducing Baked Walkers crisps in the United Kingdom.

As the lifeblood of any successful consumer products company, we expect innovation will continue to be a key tool for growth at PepsiCo going forward.

U.S. Category Leaders

#2 Carbonated Soft Drinks

#1 Sports Drink

#1 PET Water Brand (non-jug)

#1 Chilled Juices & Juice Drinks

#1 Enhanced Water Brand

#1 Ready-to-Drink Coffee

#1 Ready-to-Drink Tea

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Q: **How are you addressing rising input costs in your businesses?**

A: Structural inflation is a reality we believe will persist over the next few years. Agricultural commodities, energy and certain metals are in a period of protracted inflation that's unlikely to moderate until supply catches up.

Fortunately, over the years we've demonstrated the resilience of the PepsiCo portfolio to navigate through these headwinds successfully. And we are confident we will find innovative solutions to cover rising input costs. It will mean pulling all available levers to address inflation, as we've always done, such as finding new productivity, strategically hedging our input costs, and executing prudent and judicious pricing.

Q: **How are you addressing the carbonated soft drink (CSD) category decline in North America?**

A: Rejuvenating the CSD category requires us to deliver new products, new packaging and new benefits to re-engage consumers. 2007 has one of the strongest line-ups of CSD innovation we've had in many years. In essence, we plan to build a new category for us of "sparkling" beverages.

Whether it's through Izze sparkling beverages, our new Jazz line, increased distribution of Pepsi Max throughout our system, new "choreography" packaging for Pepsi, or other new product and packaging news for Diet Pepsi, Mountain Dew and Sierra Mist, we believe we've got an impressive lineup ready for the marketplace. And we're supporting our new products as we continue to support our established core brands.

Looking ahead, we have increased our investment in truly breakthrough innovations to come, like new sweeteners that we believe hold the power to restoring CSD category growth.

Q: **You have had good success promoting senior executives from within the company. What are you doing to ensure you maintain a strong bench and good succession planning?**

A: We announced a number of senior executive changes this year, ranging from CEO to senior executive talent of our operating divisions. Because of the deep bench strength, we were able to provide opportunities to current PepsiCo executives — ensuring smooth transitions and tapping into literally hundreds of years' worth of experience within the company.

If anything, this series of moves underscores the importance of continuously building bench strength in our management group. We continue to place a high priority on sustaining our pool of executive talent, and we clearly understand that in the global competition for talent our people planning processes must be world class.

Q: **How will Indra Nooyi's appointment to CEO change PepsiCo's strategic focus or priorities?**

A: Our transition of the CEO role is as seamless a transition as any PepsiCo has ever done, largely reflecting the fact that we have co-authored the strategies the company is pursuing.

There are no major new strategies that have been put into place since the transition took effect in October of 2006, and we continue to aggressively pursue those strategies that have been driving the company's growth.

Q: **How will PepsiCo's work with diversity and inclusion, and its work with corporate social responsibility and corporate governance evolve under new leadership?**

A: Our commitment to diversity and inclusion as a means to drive our growth remains steadfast. We continue to see the impact of our efforts in our business results, as consumer product offerings, promotions and customer programming benefit from the diverse and inclusive workforce and environment we're building.

Our focus on corporate responsibility has always been strong and will even be stronger as we contribute to societal growth and help address societal problems. Some would say we have a moral and social obligation. Others would say it's simply good business. Either way, we have a major role to play.

Similarly for corporate governance, we continue to find ways to strengthen our approach, our tools and our reporting in the name of transparency for our shareholders and the range of constituents who track our business. For example, in 2006, PepsiCo participated in a pilot program at the SEC to test a new electronic filing system.

These kinds of priorities, which tie directly to our commitment to responsible corporate citizenship, will remain front and center.

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Q: **Where is PepsiCo in its investment in business process transformation, and specifically its SAP implementation?**

A: Business Process Transformation (BPT) is a multi-year transformation effort to simplify and synchronize our business processes and tools into one common platform.

In 2006, we began implementing SAP. We streamlined our indirect procurement system across our U.S. divisions, and for Quaker, Tropicana and Gatorade, we also streamlined customer orders, implemented a more efficient system for assessing and tracking capital expenditures and advertising and marketing spending, and provided common demand forecasting capability.

The project has an attractive business case including both IT cost savings and operating productivity. Additionally, we expect benefits from increased business information.

Q: **International has been a big contributor to PepsiCo's growth over the past few years. How do you plan to sustain this growth?**

A: PepsiCo International continues to be the growth engine for the company — delivering on our expectations to grow at about twice the rate of our North American businesses. Growth internationally across a wide range of markets is strong.

We believe the strong growth achieved by our PepsiCo International business in 2006 reflects the work of a world-class management team, years of investment, and the implementation of a deliberate strategy to create scale in key international markets that will deliver profitable growth.

The portfolio of international markets continues to broaden and strengthen as we deliver exciting new products, tailored to local tastes, to consumers in approximately 200 countries. And in developing and emerging markets in particular, growth in per capita GDP levels continues to generate increased demand for our products.

Q: **PepsiCo made a number of acquisitions in 2006 – both in North America and internationally. How is the integration of these businesses going? And what kinds of mergers and acquisitions activity can we expect to see going forward?**

A: Our North American acquisitions within the last year included Stacy's bagel and pita chips, Izze carbonated beverages and Naked Juice fruit beverages (acquired January 2, 2007). Each acquisition gives us a new opportunity for growth, whether through new product categories or greater reach into emerging retail channels.

Internationally, we completed the acquisitions of Duyvis nuts in the Netherlands and Star Foods snacks in Poland, as well as Bluebird snacks in New Zealand in early 2007. Here again, each provides opportunity for growth through new geographies and new product lines internationally.

Before any acquisition is made, we apply a disciplined approach to evaluating returns on the investment within a reasonable period and focus on ensuring these businesses add profitable growth to PepsiCo. We feel very good about these acquisitions, and their integration is proceeding well.

Going forward, you can expect us to continue acting on our stated strategy of smaller, tuck-in acquisitions as a means to help us grow.

Q: **What's the next big Power of One frontier?**

A: Our Power of One initiatives — those directed at accelerating growth for PepsiCo and our retailers through the power of the entire PepsiCo portfolio — are most definitely moving to a new level.

In 2006, we conducted "Innovation Summits" with our customers to share a holistic view of how shopping and eating habits are fragmenting. Using the insights from these summits, we've worked with our retail partners and tailored our product offerings — by account — to maximize the potential of our categories and boost performance and results.

But our partnerships with customers go beyond top-line driving initiatives. We've expanded it to include end-to-end supply chain efficiencies. We are refreshing our selling and merchandising activities and critically reviewing all touch points with our customers to eliminate inefficiencies like out-of-stocks and reduce "pain points," if any. This initiative extends beyond PepsiCo to include our bottling partners — members of the extended PepsiCo family who work hand in hand with us on all of our initiatives.

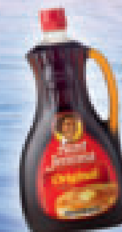
U.S. Category Leaders

#1 Hot Cereal

#1 Grits

#1 Rice Side Dish

#1 Brand Pancake Syrup



#2 Pancake Mix

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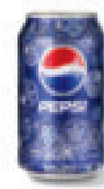
Superior performance starts with a wide selection of powerful brands and the capability to build more of them.

Performance



PepsiCo has a history of delivering strong financial performance. We strive to increase revenues, market share, volume, profits and earnings per share, while reducing costs and improving productivity. This, in turn, leads to strong returns for our shareholders. Our success in 2006 made PepsiCo the second-largest food and beverage company in the world. We believe our performance is the result of our unique competitive strengths: our structural and capability advantages, supported by a culture that is uniquely our own.

PepsiCo estimated worldwide retail sales: $92 billion.*

Our Structural Advantages

Our structural advantages reflect a presence in convenience categories that is both wide and deep — with global operations that reach approximately 200 snack and beverage markets and an unmatched portfolio of leading brands. Combined with our flexible, multiple go-to-market systems, these structural advantages provide us with a solid base for growth.

Convenience

As consumers' lives become more time-starved, demand for products that offer convenience continues to grow. This "sweet spot" of convenience features categories that have been outgrowing the overall food and beverage sector over the past several years.

Our innovation pipeline is being stoked to leverage our growing presence in these categories. Products such as Quaker Oatmeal-to-Go bars mean more people can enjoy a heart-healthy breakfast. With Tropicana FruitWise, a line of fruit strips and bars made from real fruit and juice, we offer consumers a delicious and portable way to eat one to two servings of fruit per item. Starting in 2007, consumers can choose our breakthrough line of Flat Earth fruit and vegetable crisps as a convenient snack option that provides a half serving of fruits or vegetables per ounce.

Our growing beverage portfolio offers consumers choices from regular and diet carbonated soft drinks to ready-to-drink teas and coffee, waters, sports drinks, energy drinks, and juices and juice drinks — all in a variety of sizes for home or on-the-go enjoyment.

Global Operations

We are the largest savory snack food business and the largest sports drink producer in the world. Our size gives us distinct advantages. No matter where consumers live or travel in the world, we're working hard to ensure our brands are available. Our reach provides a competitive edge when introducing new products and distributing our brands. Retailers are eager to stock our products because they know our brands provide quality, variety, great taste and move quickly off the shelves.

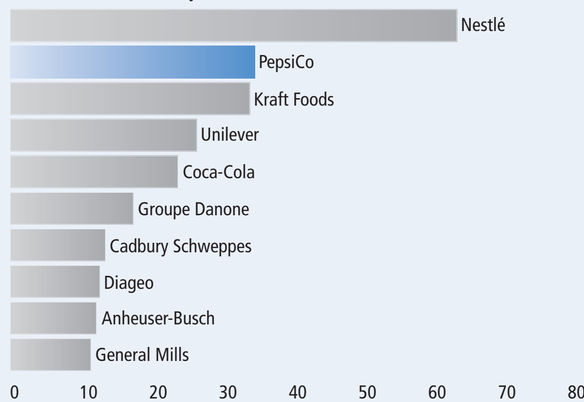
We have U.S. category leadership positions — either first or second position — in 18 categories of snacks, beverages and foods. In beverages — including carbonated plus non-carbonated — we have the leading market share in the United States.

PepsiCo International has delivered consistent growth over the last three years, with 18 businesses now generating revenues of at least $200 million. We have a solid share of snacks in major markets such as Mexico, the United Kingdom, Brazil, Australia, India and Russia. In developing markets, such as China, Pepsi

*Includes estimated retail sales of all PepsiCo products, including those sold by our partners and franchised bottlers.

Top Branded Food and Beverage Manufacturers

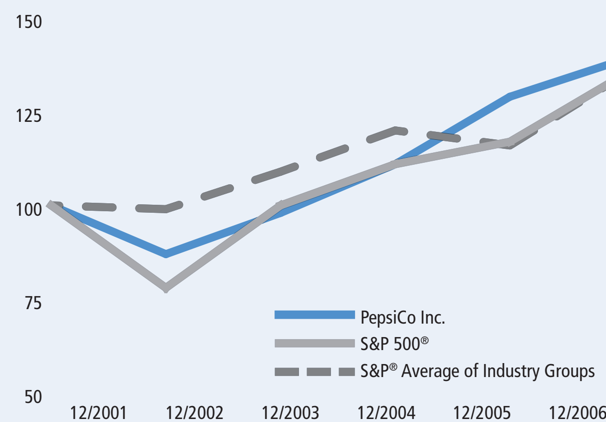
$ Net Sales in Billions
Food and beverage sales, excludes food ingredients, pet and agricultural products. Includes fruit and dairy.



PepsiCo is the world's second largest food and beverage company.

Cumulative Total Shareholder Return

% Return on PepsiCo stock investment, the S&P 500 and the S&P Average of Industry Groups.



Shareholders purchasing PepsiCo stock at the end of 2001 and holding it to the end of 2006 received a higher cumulative return than the returns of the S&P 500 and our industry group.

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is the leading soft drink, and we have also introduced many of our popular snacks such as Lay's potato chips.

And we're just getting started. We're establishing our big, muscular brands in new markets every year. We now offer Gatorade sports drinks in 42 markets, and we are expanding into more. We sell Tropicana juice and juice drinks in 27 markets, and we see near-term opportunity to introduce these products into many other markets. We also offer Lipton tea brands in many markets, with great potential to further expand.

As we achieve scale in global markets, we are introducing our Power of One initiatives — which integrate business planning, merchandising and promotions and focused customer teams across all our brands. For example, in Asia, Brazil, Russia and Mexico, we are working with our retail customers to create promotions and improve productivity across our portfolio.

Big Brands

We have 17 mega-brands, each of which delivers retail sales of at least $1 billion. Five of them generate retail sales of more than $5 billion each. These brands are big — and we continually foster their growth. Importantly, we have another 16 brands that generate retail sales between $250 million and $1 billion — and another 14 brands that generate sales between $100 and $250 million. Our brands' size and popularity give us the confidence to introduce new flavors and launch entirely new varieties with trusted brand names that deliver consistently great taste.

Distribution Systems

Our delivery — or "go-to-market" — systems provide a strong competitive advantage. With optimum efficiency, we can deliver to retailers and other customers who sell our products, virtually wherever they are and however they want.

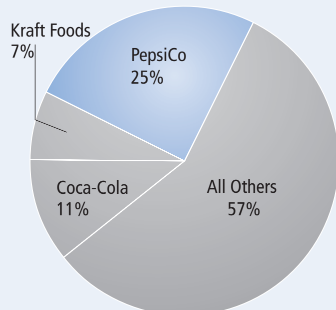
We offer consumers an increasingly wide choice of products for every occasion.

Our most powerful distribution system is direct-store-delivery (DSD), where PepsiCo associates deliver our products to stores and place them on the shelves. Direct-store-delivery allows us to create maximum appeal and visibility for our brands and support in-store promotions. DSD works well for popular products we restock often, because it allows us to distribute new products quickly.

Our DSD system reaches hundreds of thousands of retail outlets this way, from neighborhood convenience

U.S. Convenient Food and Beverage Sales

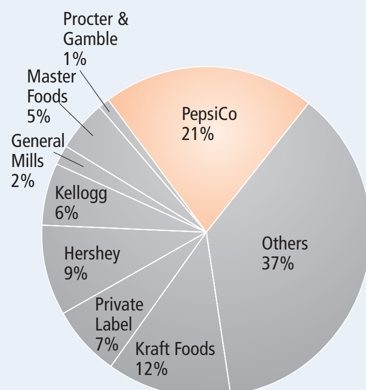
% Total Dollar Sales Snacks and Beverages



PepsiCo is the leading convenient food and beverage company in the United States.

U.S. Convenient Foods

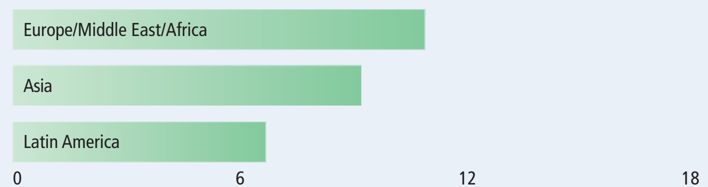
% Retail Sales in Measured Channels. Includes chips, pretzels, ready-to-eat popcorn, crackers, dips, snack nuts/seeds, meat snacks, bars, cookies, candy, sweet and other snacks.



Frito-Lay is the leading convenient snack food business in measured channels in the United States.

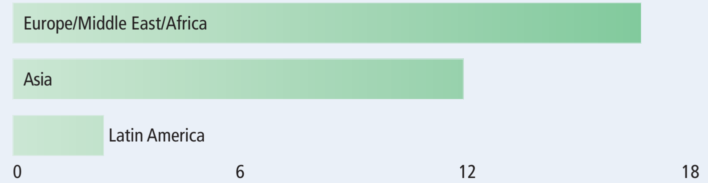
PepsiCo International Beverage Volume Growth by Region

% System Volume by Region

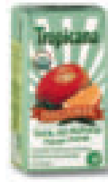


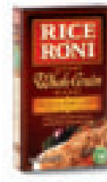
PepsiCo International Snack Volume Growth by Region

% System Volume by Region



PepsiCo International beverages and snacks generated volume growth across all regions.





stores to large-format supermarkets. The Frito-Lay North America team services nearly 440,000 retail outlets weekly.

We handle less perishable products — including Gatorade sports drinks, shelf-stable Tropicana juices and Quaker products — through our warehouse distribution system. We deliver Tropicana Pure Premium juices using either a refrigerated warehouse system or chilled direct-store-delivery system.

The success of these systems can be measured in many ways. For example, seven of the 15 largest brands sold in U.S. supermarkets are PepsiCo brands. No other company can make this claim.

Our distribution systems are part of one of the world's most powerful supply chains. Worldwide, we own or lease nearly 300 factories, operate more than 3,000 distribution centers, and employ nearly 70,000 salespeople working to ensure our products are available, merchandised and sold in engaging ways every hour of every day.

Our Capability Advantages

Our capability advantages include the strategic acuity necessary to anticipate consumer needs and innovate to fulfill them. Early on, we anticipated consumers moving from carbonated soft drinks to non-carbonated beverages, and we broadened our beverage portfolio to capture new growth in the non-carbonated segment. Similarly, we were among the first food and beverage companies to anticipate increased consumer interest in health and wellness and to recognize that we could help consumers live healthier lifestyles. Along with knowing our customers, we know our brands and how to build and market them. Add to this our demonstrated ability to pinpoint, acquire and integrate businesses — both big and small — and we believe our capability advantages will continue contributing to our strong performance.

Strategic Acuity — Move to Non-Carbonated Beverages

Carbonated beverages remain the most popular beverage category, with some 95% of U.S. households purchasing them. However, non-carbonated beverages represent a fast-growing category — a place where consumers are migrating. Today, in the United States and Canada, non-carbonated beverages, which are 38% of our volume, generate 69% of our revenue.

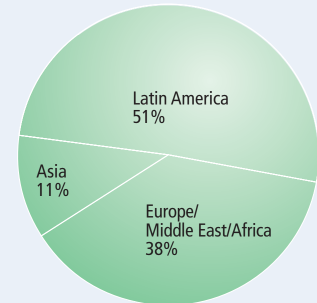
Gatorade Thirst Quencher is among our biggest brands and is being introduced in markets around the globe.

We recognized the need to broaden our portfolio early on and moved to extend our presence in non-carbonated beverages in 1992, when we formed a partnership with Thomas J. Lipton Co. to sell ready-to-drink tea brands. In 1994, we introduced Aquafina bottled water, and we also began a strategic partnership with Starbucks to market ready-to-drink coffee. We acquired Tropicana in 1998 and we expanded the Dole brand. We added SoBe, the producer of several varieties of tea and energy drinks, in 2001. Active thirst leaders, Gatorade Thirst Quencher sports drinks and Propel Fitness Water, became a part of our beverage business when we merged with Quaker in 2001. In 2006, we announced our alliance with Ocean Spray to market, bottle and distribute single-serve cranberry juice products and other product innovations.

Now we've defined a new category within our beverage portfolio — sparkling

PepsiCo International Snack Volume

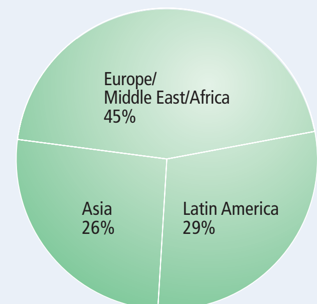
% System Volume by Region



PepsiCo has the largest snack business in the world.

PepsiCo International Beverage Volume

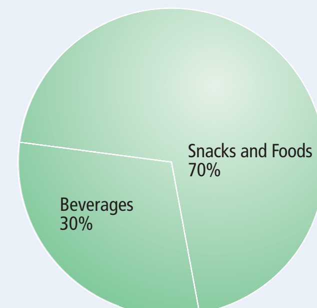
% System Volume by Region
Includes Pepsi-Cola, 7UP, Gatorade, Tropicana and other beverages.



Our beverage portfolio is well-positioned to take advantage of rising consumption in developing markets.

PepsiCo International Net Revenues

% Net Revenues



The major share of PepsiCo International revenues are generated by snacks and foods.

beverages — and we added a premium brand to help us capture the growth: Izze Beverage Co. Acquired in 2006, Izze is a maker of all-natural sparkling fruit juices.

To extend our lead in non-carbonated beverages, we recently completed the acquisition of Naked Juice, a premium juice producer in the United States whose portfolio includes fruit juices and smoothies made without added sugars or preservatives.

Internationally, we have a variety of non-carbonated products including Tropicana, Gatorade and Lipton products, plus local juices such as Copella fruit juices and PJ Smoothies in the United Kingdom, and Punica, a leading German maker of fruit juices and juice drinks, acquired in 2005. A huge opportunity awaits us in the world of non-carbonated beverages, as we currently account for less than 2% of an international non-carbonated beverage industry that we estimate to be about $70 billion and growing.

Strategic Acuity — Health and Wellness

Providing consumers with choices has long been a part of our mindset. We introduced Diet Pepsi in 1964 and Reduced Fat Ruffles in the mid 80s. We have historically supported active lifestyles as well. Throughout the world, PepsiCo is a frequent sponsor of sports and active lifestyles through our marketing and our charitable donations.

Our increasing commitment to health and wellness is reflected in the transformation of our portfolio, such as through our acquisitions of Tropicana and Quaker. That commitment is behind our creation of a Blue Ribbon Health and Wellness Advisory Board, a group that provides expert advice on a variety of initiatives including new products, nutrition news and exercise programs. And it has driven our work to improve the nutritional profile of our existing product lines. In 2003, long before concerns about trans fats became the subject of mainstream media, PepsiCo removed trans fats from Doritos, Cheetos and Tostitos in the United States and Canada, by converting to corn oil — a vegetable oil high in good fats, mono- and polyunsaturated fatty acids. In 2006, we changed the oils in our Lay's and Ruffles brand potato chips in the United States and internationally in Walkers crisps, moving to sunflower oil, which is lower in saturated fat.

We are pioneers in offering consumers smart choices. In 2004, we introduced the Smart Spot symbol in the United States, a first-of-its-kind designation that helps consumers identify PepsiCo products that can contribute to healthier lifestyles. Products with the Smart Spot symbol meet nutrition criteria based on authoritative statements from the U.S. Food and Drug Administration and the National Academy of Sciences or provide other functional benefits. More than 40% of our revenues in the United States and Canada come from products that are Smart Spot eligible.

PepsiCo offers a variety of products that are delicious and nutritious.

Our goal is to make our products available wherever there are hungry or thirsty people.

We have a growing portfolio of brands marketed internationally that provide a clear nutrition or health benefit — what we call "Good for You." In Mexico, for example, we are pioneering new technology to help preserve healthy nutrients in our products. A current example is a baked potato stick called Nutritas, which includes vegetables and is produced by microwave cooking, steaming and slow baking. We've introduced baked snacks in Mexico and the United Kingdom and will continue to offer more choices across the world.

Throughout 2006, we continued adding products that fit into healthier lifestyles. At the start of the year, we acquired Stacy's Pita Chip Company, a U.S.-based premium natural-snacks company. In the water category, we introduced SoBe Life Water, a line of vitamin-enhanced water beverages. At Frito-Lay, we launched Tostitos Multigrain to bring wholesome grains to one of America's favorite tortilla chip brands, and we introduced Baked! Cheetos and Doritos snacks in our line of 100-Calorie Mini Bites, to take the guesswork out of portion control. We introduced whole grain side dishes as part of our Rice-A-Roni brand. We are addressing the needs of serious athletes as well, with research-proven performance beverages like Gatorade Endurance Formula. And this momentum has continued into 2007, with the introduction of Gatorade AM Thirst Quencher, with flavors that appeal to morning exercisers.

Brand Building

Brand building is about extending a brand's image. And we are adept at connecting local preferences to our global brands, resulting in overall growth.

Take Lay's as an example: we've expanded it worldwide, tailoring it to local palates. We start with the well-known "banner sun" brand, and we cultivate the brand across our international markets — capitalizing on iconic names in their own right like Walkers in the United Kingdom, Sabritas in Mexico, and Matutano in Spain, among others.

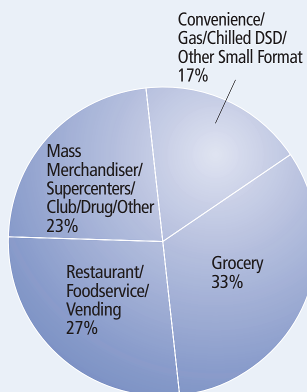
Then we extend the brand with flavors and seasonings geared to local tastes — chilies in Latin America, beef and ketchup in Europe, and prawn in Asia, for example. Next, we branch into entirely new variations, such as Lay's Artesanas and Lay's Mediterraneas made with olive oil. We offer different kinds of chips, like hard-bite kettle style chips and, more recently, natural and organic varieties.

We apply the same process to our other snack and beverage brands. The room for growth is huge.

Recent examples of our brand building prowess from our beverage portfolio include our 2006 U.S. introduction of Jazz from Diet Pepsi, a low-calorie, indulgent cola available in two flavors: Black Cherry French Vanilla and Strawberries & Cream. We launched Pepsi Limón in Peru, and in Argentina we introduce 7UP H2OH!, a drink that bridges carbonated water drinks with flavored water. In the United States,

U.S. PepsiCo Beverage Distribution Channels

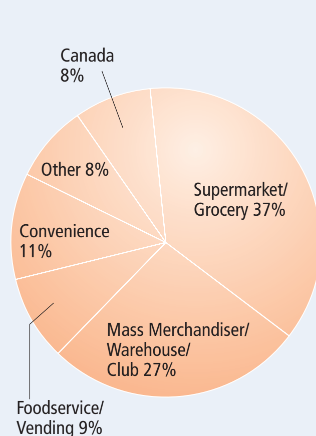
% Volume



PepsiCo beverages are distributed by a powerful go-to-market system that includes company-owned operations, independently-owned franchised bottlers and warehouse delivery systems.

Frito-Lay North America Distribution Channels

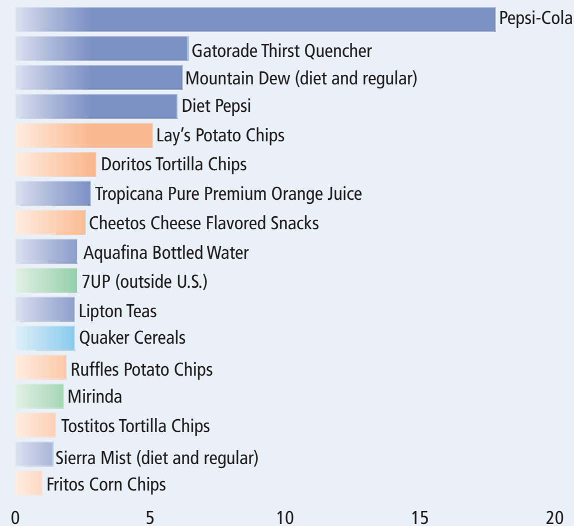
% Volume



Frito-Lay North America distributes to nearly 440,000 retail outlets each week.

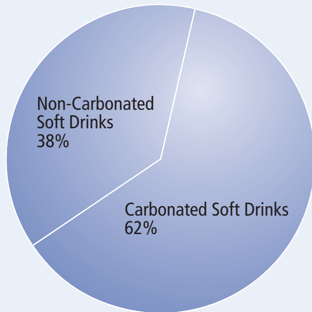
Largest PepsiCo Brands

Estimated Worldwide Retail Sales $ in Billions



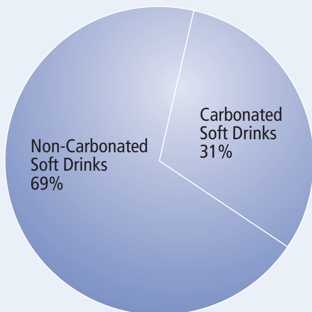
PepsiCo has 17 mega-brands that generate $1 billion or more each in annual retail sales.

PepsiCo Beverages North America Carbonated Soft Drink Volume vs. Non-Carbonated Soft Drink Volume



Carbonated soft drinks generate the largest volumes.

PepsiCo Beverages North America Carbonated Soft Drink Revenue vs. Non-Carbonated Soft Drink Revenue



Non-carbonated beverages generate the largest revenue.

we've recently extended Aquafina with vitamin-fortified Aquafina Alive, and we're now offering Tropicana Organics and Tropicana Essentials, juices with omega-3's, the fatty acids known for helping to promote heart health. Our Propel enhanced water brand, which was among the first entries into the enhanced water category, continues to meet consumer desires for more healthful options through brand extensions like Propel Calcium. Through our North American Coffee Partnership with Starbucks, we introduced Starbucks Iced Coffee as well as Strawberries and Crème Frappuccino and Starbucks DoubleShot Light.

Creating new products is not the only way we build brands. We are experts at capturing consumer attention with our brands. In 2006, we solidified Pepsi's popularity among music fans when Grammy award-winning artist Mariah Carey wrote and recorded original ringtones for the Pepsi Cool Tones and Motorola Phones promotion. In international markets, a Pepsi advertising campaign included an engaging theme song called "DaDaDa" that caught on by connecting soccer fans around the world.

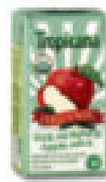
We give our brands special attention. For example, in 2006 we unveiled new packaging and a new logo for Doritos tortilla chips to communicate the brand's powerful crunch and bold flavor. We reformulated Diet Mountain Dew and gave consumers a taste during the largest single-day sampling event in Pepsi history. Similarly, we kicked off the biggest marketing campaign for Cheetos in the brand's history. And keep your eyes on Fritos corn chips as we celebrate the brand's 75th anniversary in 2007 with special retro packaging.

Mergers and Acquisitions

Our people have the skills to pinpoint, acquire and seamlessly integrate businesses — big and small. This has enabled us to successfully add large companies, like Quaker and Tropicana, and regularly add smaller "tuck-in" deals that enhance and expand our existing operations. These include our recent acquisitions of Izze Beverage Co., Naked Juice, and Stacy's Pita Chip Company in the United States, as well as Star Foods in Poland, Bluebird Foods in New Zealand and Duyvis nuts in the Netherlands and Belgium.

We are disciplined buyers, with a rigorous process for due diligence to ensure that any potential acquisition makes complete sense from both a business and culture standpoint. As diligent integrators, we have a special understanding of the entrepreneurial nature of smaller "tuck-in" acquisitions and exercise a thoughtful approach to helping these new businesses preserve and build upon their unique capabilities, such as the high level of involvement Stacy's has with its consumers. We not only sign the deals, but we are committed to making them work.

Quaker Oatmeal and Tropicana Pure Premium are important brands in our health and wellness portfolio of products.



Our products are known by trusted brand names in each region of the world, such as Sabritas in Mexico.

Our Unique Culture

PepsiCo's most important advantage resides in our people and the way we operate. We work hard to recruit, train, develop and — most of all — retain a diverse team of the best and brightest. We emphasize results, personal ownership and operational excellence.

Our People

Our people represent PepsiCo's ultimate competitive advantage. Diversity and inclusion are fundamental to our success. We recognize that a diverse workforce and a diverse supplier base help us understand and meet the needs of our diverse consumer base. An inclusive atmosphere allows everyone to contribute fully, generating new ideas and driving innovation.

Our "ownership culture" empowers our associates. We are a big company that thinks like a small enterprise. Our associates fundamentally see their jobs as finding solutions for customers and consumers and doing what it takes to exceed their expectations.

Most of all, we share a set of PepsiCo Values — represented in a commitment to deliver sustained growth through empowered people, operating with responsibility and building trust.

The Way We Operate

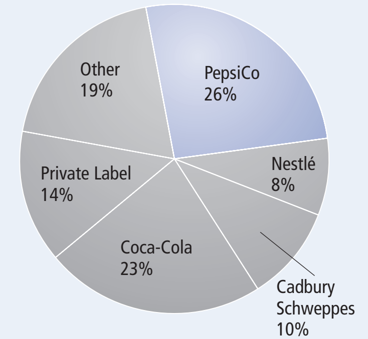
We make, move and sell millions of products every day, which is why day-to-day operational excellence is so critical.

Our Business Process Transformation (BPT) is simplifying and accelerating the speed of our information technology processes. Our goal is to make it easier for our retail and other customers to do business with us. For example, the BPT efforts will help us provide one invoice to our customers, rather than multiple invoices from our various businesses.

PepsiCo's Power of One initiatives continue to bring new efficiencies to our relationships with customers. For example, through "Innovation Summits" with our customers, we deepen our understanding of their needs and can build on the benefits we bring, with both our products and delivery systems across the entire supply chain.

U.S. Liquid Refreshment Beverage Market Share

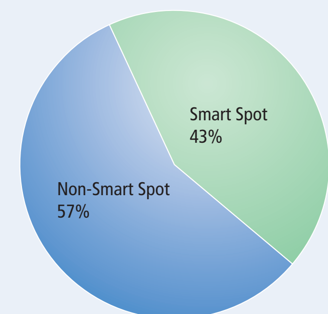
% Volume in Measured Channels



PepsiCo has the leading share of the liquid refreshment beverage market.

PepsiCo Net Revenues from Smart Spot Eligible Products U.S. and Canada

% Net Revenue



A wide variety of PepsiCo products carry the Smart Spot symbol to identify choices that can contribute to healthier lifestyles.

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In 2006, PepsiCo associate volunteers and KABOOM, a not-for-profit organization, built 12 playgrounds in inner cities to encourage children to be more physically active.

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Purpose

Today's consumers increasingly view their spending decisions as a way to make a difference in the world. They want to see their values reflected in the products they buy and their communities strengthened by the businesses they support. At PepsiCo, we believe we are in a perfect position to meet these needs. *We strive to do better by doing better.* In delivering on this commitment, we've identified three areas where we believe we can have the most impact: human sustainability, environmental sustainability and talent sustainability.

Human Sustainability

People need to be nourished in many ways, ranging from what they eat to how they live. We call this human sustainability, and the areas where we can make the greatest difference are through the products we offer consumers and through our efforts to encourage consumers to adopt more active lifestyles. As we pursue these priorities, we tap into the deep expertise and counsel of our Blue Ribbon Health and Wellness Advisory Board, established to help us address health and wellness opportunities.

Products

In the United States, our Smart Spot symbol makes it easier for consumers to identify our products that are nutritious, can contribute fiber, vitamins or other important nutrients, or are reduced in fat, sugar or sodium. Products with the Smart Spot symbol meet nutrition criteria based on authoritative statements from the U.S. Food and Drug Administration and the National Academy of Sciences or provide other functional benefits. Today, more than 250 of our products carry the Smart Spot symbol. On the front panel of the product packaging consumers see the green Smart Spot symbol that says "Smart Choices Made Easy." And on the back of the packaging we describe what makes each product a better choice.

As new technologies and ingredients become available, we're committed to making our core products better choices. For example, Frito-Lay North America's Ruffles and Lay's potato chips and Walkers United Kingdom's snacks reduced the saturated fat in their leading potato crisp and chip brands by switching to sunflower oil, which delivers improved nutrition without sacrificing taste.

The PepsiCo Smart Spot symbol helps consumers select products such as Baked! Cheetos, which are lower in calories.

Active Lifestyles

We're committed to helping consumers fight obesity and live healthier lives by supporting programs that help them engage in more active lifestyles. Among the programs we're proud to sponsor is America On the Move (AOM), a national effort in the United States dedicated to helping individuals, families and communities make positive changes in their health and quality of life. AOM recommends making small changes, such as walking 2,000 more steps and consuming 100 fewer calories per day, as a way for consumers to incorporate healthy habits into their everyday lives and avoid weight gain. The African American and Latino communities face some of the greatest health risks. That's why in partnership with the National Urban League and the National Council of La Raza, we're using the messages and methods of AOM to promote healthier living among these constituencies.

We believe it is important to develop the habit of exercising early in life so we have many programs for young people. In the United States, our alliance with the YMCA, the largest provider of fitness programs, is expected to reach more than nine million youths. We have programs on the local level as well. For example, in Chicago through the Chicago Communities in Schools and the Consortium to Lower Obesity in Chicago Children (CLOCC) we are collaborating on an effort to pilot, test and deliver a health promotion program in six Chicago communities and schools.

Outside the United States, we support initiatives such as the Gatorade Schools program in Brazil, which encourages good nutrition and physical activity. In Mexico, we support a program to construct recreational areas in indigenous shelters in order to promote sports in these communities.

Our Mission

We aspire to make PepsiCo the world's premier consumer products company, focused on convenient foods and beverages. We seek to produce healthy financial rewards for investors as we provide opportunities for growth and enrichment to our employees, our business partners and the communities in which we operate. And in everything we do, we strive to act with honesty, openness, fairness and integrity.

School Programs

We recognize the critical importance of helping children learn to make healthy food choices. In 2006, PepsiCo was the only company to be part of two historic agreements — one for beverages and one for snacks — to provide schools in the United States with products that can contribute to healthier lifestyles.

Through our partnership with the Alliance for a Healthier Generation — a joint initiative of the William J. Clinton Foundation and the American Heart Association — we will offer U.S. schools products that meet specific nutritional guidelines. Under the beverage guidelines, we no longer will offer full-calorie soft drinks, juice drinks or teas in any K-12 schools, and we'll limit the calories and portion sizes of beverages, including sports drinks and juices. On the snacks side, we helped set the first-ever voluntary guidelines for what will be offered in U.S. schools. Both agreements represent a breakthrough step to adopt a practical policy for snack, food and beverage offerings in U.S. schools.

Marketing

We have begun to enlist our products in promoting key issues. Through the North American Coffee Partnership, our joint venture with Starbucks Coffee Company, we entered into an agreement to increase distribution of Ethos Water to retail stores in the United States. For each bottle of Ethos Water that is sold, a $0.05 donation is made to help children and their communities around the world get access to clean drinking water.

Frito-Lay's SunChips brand sponsored the Komen Race for the Cure National Volunteer Recognition Program in the United States. The partnership included SunChips' "Crunch for the Cure" pink bags, with part of the proceeds going to the Susan G. Komen Breast Cancer Foundation to support the fight against breast cancer.

Through our North American Coffee Partnership, our joint venture with Starbucks, PepsiCo is working to increase distribution of Ethos Water, which will donate $0.05 for every bottle sold to help children around the world get clean drinking water.

Our Sustainability Vision

PepsiCo's responsibility is to continually improve all aspects of the world in which we operate — environment, social, economic — creating a better tomorrow than today.

Tomorrow > Today

Environmental Sustainability

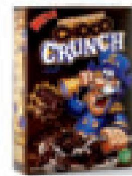
Environmental sustainability means replenishing resources we use — on our planet and in the communities we serve. We have defined our focus areas to be water, packaging and energy. In our communities we are supporting the fight against HIV/AIDS as well as other philanthropic and volunteer activities.

Water

Our water program goals begin with making sure our practices are responsible. We work closely with governments, municipalities and technical experts when locating our facilities to ensure adequate quantity and quality of water supply. We have programs to reduce our use of water and reuse water whenever possible. Gatorade, for example, is reducing its water use by installing waterless rinsing systems to clean its bottles. We are focused on finding new opportunities to save water. For example, across Frito-Lay North America our water conservation initiatives have reduced the quantity of water used in processing snack chips by more than one-third since 1999.

Where water shortages are an issue, we recognize our responsibility to help make sure the communities in which we operate have access to sufficient water. For example, in India, PepsiCo is supporting The Energy and Resources Institute (TERI) to help improve water processes and management. These projects include an evaluation of water resources and preparation of area-wide management plans, including the rejuvenation of traditional water systems.

The PepsiCo Foundation is working with the China Women's Development Foundation on a research initiative to expand availability of safe drinking water for the people of Western and Central China. PepsiCo China's work with the Mothers' Water Cellar Project has already brought water to thousands of families in remote locations by building water storage wells and the capability to harvest rainwater.



Programs with the National Council of La Raza and the National Urban League encourage physical activity and healthier eating and address health concerns of African American and Latino consumers.

Our Ethos Water distribution agreement has a goal of contributing at least $10 million by the end of 2010 to help children and their communities around the world get clean drinking water. Our support of The Safe Water Network, a not-for-profit organization we helped establish, is focused on developing and deploying new affordable water purification technology to provide safe water to communities in need.

We also share our water expertise. In India, for example, we've shown farmers techniques that save water by directly seeding rice paddies, rather than growing the rice through highly water-intensive conventional seeding.

Packaging

We are committed to reducing, reusing and recycling our packaging and waste. To help us achieve our goals, we have established a Sustainable Packaging Team. Its objectives include developing alternative packaging material technologies and supporting responsible disposal practices.

We begin with our operations. For example, in the United States today a 20-ounce Gatorade Thirst Quencher bottle weighs 10% less and uses 70% less packaging to deliver the product than the same size bottle sold in 1998. Tropicana re-engineered the way it delivers apple juice concentrate in the United States. Its move to recyclable "flexi" bags eliminated nearly 43,000 steel drums annually.

A Pepsi-Cola North America program with Keep America Beautiful and Sam's Club encouraged recycling by providing grants to schools that recycled the most beverage containers and donating fleece jackets made with recycled plastic to needy children in the community.

For decades, our snack food operations have recovered starch released in the potato chip making process. In 2006, our United Kingdom snack food operation received government approval for a process that creates food-grade level starch, much of which can be used in our own products.

Recycling is a way of life at PepsiCo. The Frito-Lay direct-store-delivery system enables our associates to recover delivery cartons after use. A typical carton makes about six trips, eliminating some 60 billion pounds of solid waste a year. We helped found the National Recycling Partnership, an initiative to increase recycling across the United States. And we have supported Keep America Beautiful's (KAB) Great American Cleanup, the nation's largest voluntary clean-up program, since its inception.

In 2006, Pepsi-Cola North America partnered with Sam's Club and KAB in an innovative program called "Return the Warmth." KAB helped communities recycle more than 36 million beverage bottles. Sam's Clubs provided school grants, as well as fleece jackets made with recycled plastic, for needy children in the area.

Helping to reduce waste is just as important in our markets outside the United States. In India, for example, we convert packaging film waste to boards, building and furniture material.

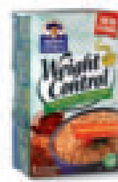
Energy

In 2006, Frito-Lay was recognized by the United States Environmental Protection Agency (EPA) and the U.S. Department of Energy (DOE) for energy conservation. The EPA and DOE conferred Partner-of-The-Year in Energy Management to Frito-Lay North America for its voluntary efforts to reduce greenhouse gas emissions through energy efficiency.

At Tropicana we reduced our electricity demand by eliminating some refrigeration

Selected 2006 Environmental Honors

- ★ **PepsiCo China: four awards for Mothers' Water Cellar Project.**
- ★ **PepsiCo: Vision for America Award from Keep America Beautiful.**
- ★ **Frito-Lay North America: Energy Star Partner of the Year from the Environmental Protection Agency (EPA) and the Department of Energy (DOE).**
- ★ **Frito-Lay San Antonio, Texas: WaterSaver Award.**
- ★ **Frito-Lay California: Bakersfield and Modesto facilities won the state WRAP award for outstanding performance in reducing solid waste.**



and instead storing juice blends in aseptic tanks at above freezing temperatures. The operation also co-generates power and heat to meet most of our on-site electricity needs. Three of our Gatorade plants capture and reuse biogas, a by-product of water treatment operations, as boiler fuel.

One way we are reducing greenhouse gas emissions is by using alternative power more and more. For example, in Cupar, Scotland, our Quaker oat mill is using electricity from 100% renewable sources. And at our Frito-Lay plant in Modesto, California, we're building a production line in which nearly three-quarters of the heat needed to produce SunChips brand multigrain snacks will come from solar thermal energy.

Our focus extends to the pages you are reading. This annual report was made with recycled paper and "Green Power," which means that the power used in the creation of some of the paper was not from fossil fuel.

PepsiCo water programs reach into communities to help address water shortages. In India, programs are bringing water to drought stricken areas and developing water management programs in areas where monsoons are common.

HIV/AIDS

HIV/AIDS poses a major threat in many places where we operate, especially in high risk countries such as South Africa, India, Russia, China and Thailand. Our global HIV/AIDS policy provides a template to help fight the pandemic, and our associates have joined in the fight. For example, in South Africa our Simba associates serve as Peer Educators in the community.

Contributions and Community Service

Through the PepsiCo Foundation, and our corporate and divisional contributions, we provide financial support for not-for-profit organizations across the globe. Focus areas include health and wellness, diversity and inclusion, the environment, employee community engagement and humanitarian aid in the event of disaster. Groups looking for support can apply on-line at www.pepsico.com.

In-kind donations include food and beverages donated to food banks. Our community outreach programs include community service weeks. During our 2006 Global Week of Community Service, more than 1,000 associates provided volunteer work in their communities in the United States, Mexico and South Africa. In Mexico City, for example, Sabritas associates repaired the "Casa de los Niños de Palo Solo," a health development center serving approximately 260 children.

Our associates are active in their communities in innovative ways. In Brazil, an Elma Chips truck has been turned into a roving library for children. In Vietnam, through the Poor Patient's Association, our associates help economically disadvantaged people receive medical care. In Egypt and Lebanon, our businesses support scholarships to help young people continue their education.

In India, we're promoting seaweed farming as a local employment opportunity for women in remote coastal communities, who would otherwise have to travel great distances to find work.

Sustainability Time Line

1999 Frito-Lay North America begins formal resource conservation program.

2001 PepsiCo Environmental Task Force formed.

2002 Carbonated beverage packaging goal of 10% recycled content in Pepsi-Cola North America adopted.

2003 Global Reporting Initiative Guidelines adopted.

2004 Sustainability Task Force formed.

2005 Environmental Management System developed.

2006 Dow Jones Sustainability Index North America names PepsiCo to list.

Selected 2006 Community and Sustainability Honors

- ★ International Corporate Courage Award: AIDS Responsibility Project (ARP).
- ★ Gamesa — Quaker, Mexico: Empresa Socialmente Responsible.
- ★ 100 Best Corporate Citizens from Business Ethics magazine.
- ★ America's Most-Admired Companies from FORTUNE magazine.
- ★ Dow Jones Sustainability Index North America.

2006 Contribution Summary

PepsiCo Foundation	$21.9 Million
Corporate Contributions	5.2 Million
Divisions	4.2 Million
Estimated In-Kind Donations	27.2 Million
Total	$58.5 Million

Talent Sustainability

Our approximately 168,000 PepsiCo associates around the world are the reason for our success. Recruiting, training and retaining our associates and building a culture of equality, diversity and inclusion allow us to achieve Talent Sustainability and demonstrate to our associates that we cherish them.

Associates

Our commitment to our associates is formalized in our Human Rights Policy which was introduced in 2006. Our goal is to make PepsiCo the company that hires, develops and retains the best people — irrespective of race, color, creed, gender or lifestyle orientation.

There are many ways we are making this a reality — ranging from how we train, reward and compensate our associates to our robust and historic diversity and inclusion programs. Company programs help associates manage their careers, train for advancement, increase their knowledge and skills, and participate in lifestyle and personal development opportunities. HealthRoads, offered in North America, is a health benefits program that promotes healthier lifestyles for our associates and their families through information, online tools and personalized wellness coaching. Our SharePower program provides stock options to associates around the world and encourages them to act like owners of the company.

Diversity and Inclusion

To attract and retain the best people, we seek to create a diverse and inclusive culture where everyone has equal opportunity to contribute and to succeed. We have several initiatives to help us in this area. Our Diversity and Inclusion Governance Council, formed in 2005, is a cross-divisional, cross-functional group composed of internal and external thought leaders. Its mission is to raise the bar on diversity and inclusion. Our Ethnic Advisory Boards provide counsel and advice on business issues ranging from marketing our brands to supporting our employees.

Outside North America we have a growing number of programs to promote diversity and inclusion and support employees. In the *United Kingdom and Ireland Times*, for example, we were rated as one of the "Top 50 Places Where Women Want to Work."

Associates like Israel Perez, a Frito-Lay route sales representative in the New York City area, are the reason for PepsiCo's success.

Spending with U.S. minority-owned and women-owned suppliers surpassed $1 billion for the first time.

Our focus on diversity is equally strong in our procurement processes. We have teams dedicated to increasing the diversity of our supplier base. In 2006, for the first time, we surpassed $1 billion in purchases from U.S. minority-owned and women-owned suppliers.

For more information, read our sustainability report, visit the Corporate Citizenship section and see our environmental programs in action at www.pepsico.com.

Selected 2006 Diversity and Inclusion Honors

- ★ **America's Top Corporations for Women's Business Enterprises: Women's Business Enterprise National Council (WBENC).**
- ★ **Top 50 Companies for Diversity: Diversity, Inc.**
- ★ **40 Best Companies for Diversity: Black Enterprise.**
- ★ **National Association of Asian American Professionals Convention: NAAAP Convention Excellence award.**
- ★ **Latina Style magazine: The 50 Best Companies for Latinas to Work for in the U.S.**
- ★ **Hispanic Business magazine: Top 50 Companies for Hispanics.**
- ★ **United Kingdom and Ireland Times: Top 50 Places Where Women Want to Work.**
- ★ **PepsiCo scores 100% on the Corporate Equality Index.**

U.S. Diversity and Inclusion Statistics

	Total	Women	%	Minority	%
Board of Directors	14	3	21	4	29
Senior Executives	23	4	17	6	26
Executives	2,165	696	32	422	19
All Managers	12,903	3,919	30	2,903	22
All Employees	62,251	15,169	24	18,573	30

At year-end we had approximately 168,000 associates worldwide.

Our Board of Directors is pictured on page 23. Our Senior Executives include Corporate and Division Officers based in the United States. The list appears on page 22. Beginning this year, we are including Professionals in the All Managers category to better capture our executive talent pool.

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PEPSICO

Corporate Officers and Principal Divisions

Executive Offices PepsiCo, Inc.

700 Anderson Hill Road
Purchase, NY 10577
914-253-2000

Co-founder of PepsiCo

Donald M. Kendall
Over 55 years of PepsiCo experience.

Corporate Officers

Steven S Reinemund
Executive Chairman and Chairman of the Board of Directors
58. 22 years.

Indra K. Nooyi
Chairman Elect and Chief Executive Officer
51. 13 years.

Mitch Adamek
Senior Vice President and Chief Procurement Officer
45. 17 years.

Peter A. Bridgman
Senior Vice President and Controller
54. 21 years.

Richard Goodman
Chief Financial Officer
58. 13 years.

Wahid Hamid
Senior Vice President, Corporate Strategy and Development
48. Less than one year.

Hugh F. Johnston
Executive Vice President, Operations
45. 19 years.

Antonio Lucio
Chief Health and Wellness Innovation Officer
47. 11 years.

Tod J. MacKenzie
Senior Vice President, Corporate Communications
49. 19 years.

Matthew M. McKenna
Senior Vice President, Finance
56. 13 years.

Margaret D. Moore
Senior Vice President, Human Resources
59. 33 years.

Lionel L. Nowell III
Senior Vice President and Treasurer
52. 15 years.

Ronald C. Parker
Senior Vice President, Human Resources, PepsiCo North America and Senior Vice President, Global Diversity, PepsiCo
53. 24 years.

Clay G. Small
Senior Vice President, Managing Attorney
57. 25 years.

Larry D. Thompson
Senior Vice President, Government Affairs General Counsel and Secretary
61. 2 years.

Cynthia M. Trudell
Senior Vice President and Chief Personnel Officer
53. Less than one year.

Michael D. White
Chief Executive Officer, PepsiCo International and Vice Chairman, PepsiCo
55. 17 years.

PepsiCo North America

700 Anderson Hill Road
Purchase, NY 10577
914-253-2000

John C. Compton
Chief Executive Officer
45. 23 years.

Division Officers

Frito-Lay North America
7701 Legacy Drive
Plano, TX 75024
972-334-7000

Albert P. Carey
President and Chief Executive Officer
55. 25 years.

Pepsi-Cola North America
700 Anderson Hill Road
Purchase, NY 10577
914-253-2000

Dawn Hudson
President and Chief Executive Officer
49. 10 years.

QTG (Quaker Foods/ Tropicana/Gatorade)
QTG Plaza
555 West Monroe Street
Chicago, IL 60661
312-821-1000

Charles I. Maniscalco
President and Chief Executive Officer
53. 26 years.

PepsiCo Sales
700 Anderson Hill Road
Purchase, NY 10577
914-253-2000

Tom Greco
President, Sales
48. 20 years.

PepsiCo International

700 Anderson Hill Road
Purchase, NY 10577
914-253-2000

Michael D. White
Chief Executive Officer, PepsiCo International and Vice Chairman, PepsiCo

Division Officers

PepsiCo Asia
20th Floor
Caroline Center
28 Yun Ping Road
Causeway Bay
Hong Kong
852-2839-0288

Ron McEachern
President
54. 22 years.

PepsiCo Europe
50, rue du Rhône
CH – 124 Geneva
Switzerland
41-22-818-6900

Zein Abdalla
President
47. 11 years.

PepsiCo Latin America Region Foods & Beverages
Av. Lázaro Cárdenas 2404 Pte.
Col. Residencial San Agustín
Garza García, NL
66270
Mexico
52-81-8399-5151

Salvador Alva
President
56. 23 years.

PepsiCo Middle East & Africa
Khalid Ibn Al Waleed Road
Bank of Fujairah Building,
3rd Floor
PO Box 11330
Dubai
United Arab Emirates
971-4-397-1666

Saad Abdul-Latif
President
53. 25 years.

Sabritas & Gatorade
Bosques de Duraznos No. 67
Col. Bosques de las Lomas
11700 Mexico D.F.
Mexico
52-55-2582-3000

Pedro Padierna
President
56. 19 years.

PepsiCo United Kingdom
1600 Arlington Business Park
Theale, Reading
Berkshire
RG7 4SA UK
44-118-930-6666

Salman Amin
President
47. 11 years.

PepsiCo International Commercial
700 Anderson Hill Road
Purchase, NY 10577
914-253-2000

Massimo d'Amore
Executive Vice President
51. 12 years.

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PepsiCo Board of Directors

Back row, left to right: Robert E. Allen, John F. Akers, Victor J. Dzau, M. D., Sharon Percy Rockefeller, Daniel Vasella.
Second row, left to right: Franklin A. Thomas, Alberto Ibargüen, Michael D. White, Ray L. Hunt, Arthur C. Martinez.
Front row, left to right: Steven S Reinemund, Dina Dublon, James J. Schiro, Indra K. Nooyi.

PepsiCo Board of Directors

John F. Akers
Former Chairman of the Board and Chief Executive Officer, International Business Machines Corporation
72. Elected 1991.

Robert E. Allen
Former Chairman of the Board and Chief Executive Officer, AT&T Corp.
72. Elected 1990.

Dina Dublon
Consultant, Former Executive Vice President and Chief Financial Officer, JPMorgan Chase & Co.
53. Elected 2005.

Victor J. Dzau, M.D.
Chancellor for Health Affairs, Duke University and President & CEO, Duke University Health Systems
61. Elected 2005.

Ray L. Hunt
Chief Executive Officer, Hunt Oil Company, and Chairman, Chief Executive Officer and President Hunt Consolidated, Inc.
63. Elected 1996.

Alberto Ibargüen
President and Chief Executive Officer, John S. and James L. Knight Foundation
63. Elected 2005.

Arthur C. Martinez
Former Chairman of the Board, President and Chief Executive Officer, Sears, Roebuck and Co.
67. Elected 1999.

Indra K. Nooyi
Chairman Elect and Chief Executive Officer, PepsiCo
51. Elected 2001.

Steven S Reinemund
Executive Chairman, and Chairman of the Board of Directors, PepsiCo
58. Elected 1996.

Sharon Percy Rockefeller
President and Chief Executive Officer, WETA Public Stations
62. Elected 1986.

James J. Schiro
Chief Executive Officer, Zurich Financial Services
61. Elected 2003.

Franklin A. Thomas
Consultant, The Study Group
72. Elected 1994.

Daniel Vasella
Chairman of the Board and Chief Executive Officer, Novartis AG
53. Elected 2002.

Michael D. White
Chief Executive Officer, PepsiCo International and Vice Chairman of PepsiCo
55. Elected 2006.

PepsiCo announced on Feb. 5, 2007, the election of Indra K. Nooyi as Chairman of the Board, effective when current Chairman Steven S Reinemund retires on May 2, 2007. Listings include age and year elected a PepsiCo director.

Ethnic Advisory Boards

Our Ethnic Advisory Boards provide management with external viewpoints on issues related to diversity and inclusion, especially in the marketplace.

Board membership is established for external individuals based on their diverse backgrounds, experiences and points of view. These boards provide counsel and advice on a range of business areas including:

- Marketing to targeted communities.
- Building alliances with retailers.
- Creating products for a more diverse consumer base.
- Developing a more diverse supplier base and other business relationships.

Back row, left to right: Kweisi Mfume, Keith Clinkscales, Roderick D. Gillum, Reverend Al Sharpton, Earl G. Graves, Jr., Robert Holland, Jerri DeVard, Warren M. Thompson.
Front row, left to right: Darlene Williamson, Ph.D., Ray M. Robinson, Reverend Dr. W. Franklyn Richardson, Glenda McNeal, Amy Hilliard, Earl G. Graves, Sr., Dawn Hudson, Benaree Pratt Wiley, Johnny F. Johnson, Clarence Avant.

African American Advisory Board

Clarence Avant
Chairman,
Interior Music
Joined 1999.

Keith Clinkscales
Senior Vice President and
General Manager,
ESPN Publishing
Joined 1999.

Jerri DeVard
Former Senior Vice President, Brand
Management and Marketing
Communications,
Verizon Communications
Joined 2002.

Roderick D. Gillum
Vice President, Corporate
Responsibility and Diversity,
General Motors
Joined 2005.

Earl G. Graves, Sr.
Chairman and Publisher,
Earl G. Graves Ltd.
Black Enterprise Magazine
Joined 1999.
Chairman of the Advisory Board

Earl G. Graves, Jr.
President and
Chief Executive Officer,
Black Enterprise Magazine
Joined 2006.

Amy Hilliard
President and Chief
Executive Officer,
The Hilliard Group &
The ComfortCake Co.
Joined 1999.

Robert Holland
Partner,
Williams Capital
Joined 1999.

Dawn Hudson
President and
Chief Executive Officer,
Pepsi-Cola North America
Joined 1999.

Johnny F. Johnson
Chief Executive Officer,
KA Management
Joined 1999.

Glenda McNeal
Senior Vice President Global
Partnerships, American Express
Joined 1999.

Kweisi Mfume
Former President and
Chief Executive Officer,
National Association for the
Advancement of Colored
People (NAACP)
Joined 2005.

Reverend Dr. W. Franklyn Richardson
Senior Minister,
Grace Baptist Church
Joined 1999.

Ray M. Robinson
President,
East Lake Golf
Joined 1999.

Reverend Al Sharpton
President,
National Action Network
Joined 1999.

Warren M. Thompson
Chairman and
Chief Executive Officer,
Thompson Hospitality
Corporation, Inc.
Joined 2002.

Benaree Pratt Wiley
Retired President and
Chief Executive Officer,
The Partnership
Joined 2002.

Darlene Williamson, Ph.D.
Former President and
Chief Executive Officer,
Performax Consulting Services
Joined 1999.

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- Promoting PepsiCo's diversity and inclusion efforts.
- Recommending diverse talent for open positions.
- Encouraging the expansion of diversity representation among PepsiCo employees.
- Providing a perspective on diversity and inclusion issues or questions.

Our African American Advisory Board was formed in 1999. The Latino/Hispanic Advisory Board was established in 2000. Our Canada business convened an Asian Advisory Council in 2006.

We welcome Earl Graves, Jr. to the African American Advisory Board. We regret the passing of our esteemed member, Darwin Davis, Sr., who served the board since 1999.

To our Latino/Hispanic Advisory Board, we welcome Cid Wilson.

Left to right: Isabel Valdés, Cid Wilson, Carlos H. Arce, Ph.D., Deborah Rosado Shaw, Raúl Yzaguirre, Albert P. Carey, Raquel Malo, Douglas X. Patiño, Ph.D., Maria Contreras-Sweet, Carlos A. Saladrigas, Victor Arias, Jr., Ricardo R. Fernández, Ph.D., Gilbert Aranza

Latino/Hispanic Advisory Board

Gilbert Aranza
President,
Star Concessions
The MultiRestaurant Group
Joined 2000.

Carlos H. Arce, Ph.D.
President and Founder,
NuStats
Joined 2000.

Victor Arias, Jr.
Partner,
Heidrick & Struggles
Joined 2000.

Albert P. Carey
President and Chief Executive Officer,
Frito-Lay North America
Joined 2006.

Ricardo R. Fernández, Ph.D.
President,
Lehman College,
The City University of New York
Joined 2003.

Raquel Malo
Senior Vice President,
High Performance Nutrition,
Human Performance Institute
Joined 2004.

Douglas X. Patiño, Ph.D.
Vice Chancellor Emeritus and
Professor,
California State University
Joined 2000.

Carlos A. Saladrigas
Chairman,
Premier American Bank
Joined 2003.

Deborah Rosado Shaw
Partner,
Multi-ethnic Success Ventures, LLC
Joined 2000.

Maria Contreras-Sweet
Chairwoman,
Proamerica Bank
Joined 2005.

Isabel Valdés
Consultant, Author, Public Speaker
Joined 2001.

Cid Wilson
Director of Equity Research,
Kevin Dann and Partners, LLC
Joined 2006.

Raúl Yzaguirre
Presidential Professor,
Center for Community Development
and Civil Rights
Arizona State University
Joined 2000.
Chairman of the Advisory Board

Blue Ribbon Health and Wellness Advisory Board

PepsiCo's Blue Ribbon Health and Wellness Advisory Board provides advice and expertise on a variety of health and wellness initiatives.

The initiatives include:
- Improving the healthfulness of our existing products.
- Evaluating our efforts to develop new better-for-you and good-for-you products.
- Providing access to resources that promote health and encourage active lifestyles.
- Identifying emerging opportunities in the area of health and wellness.
- Connecting us to thought leaders and policy makers in the area of health and wellness.

Some of our international businesses are seeking advice in a similar manner. For example, our Brazilian business has created the PepsiCo Panel of Experts. We welcome Dr. William Sears to our Board this year.

Front row, left to right: Brock H. Leach, Kristy F. Woods, M.D., M.P.H., James O. Hill, Ph.D., Gro Harlem Brundtland, M.D., Susan Love, M.D.
Second row, left to right: David Heber, M.D., Ph.D., Pamela Peeke, M.D., M.P. H., Antonio Lucio (PepsiCo), Antonia Demas, Ph.D., Mario Maranhão, M.D., Janet Taylor, M.D.
Back row, left to right: Kenneth Cooper, M.D., M.P.H., Fernando M. Treviño, Ph.D., M.P.H., James B. Hunt, Jr., Dean Ornish, M.D. Ambassador Thomas Foley, David A. Kessler, M.D., J.D., Samuel Ward Casscells, M.D., William Sears, M.D.

Gro Harlem Brundtland, M.D.
Former Director-General
World Health Organization,
United Nations
Former Prime Minister, Norway
Joined 2004.

Samuel Ward Casscells, M.D.
John Edward Tyson Distinguished Professor of Medicine & Public Health and Vice President for Biotechnology
The University of Texas Health & Science Center at Houston
Joined 2003.

Kenneth H. Cooper, M.D., M.P.H.
President & Founder
The Cooper Aerobics Center
Joined 2003.

Antonia Demas, Ph.D.
Director
Food Studies Institute
Joined 2003.

Ambassador Thomas Foley
Akin Gump Strauss Hauer & Feld, LLP
Former Speaker of the U.S. House of Representatives and Former U.S. Ambassador to Japan
Joined 2003.

David Heber, M.D., Ph.D.
Professor of Medicine & Public Health
Director, UCLA Center for Human Nutrition
Joined 2003.

James O. Hill, Ph.D.
Professor of Pediatrics & Medicine
University of Colorado Health Sciences Center
Founder, America On the Move
Joined 2003.

Governor James B. Hunt, Jr.
Former Governor of North Carolina
Joined 2003.

David A. Kessler, M.D., J.D.
Dean, School of Medicine
Vice Chancellor for Medical Affairs
University of California, San Francisco
Joined 2003.

Brock H. Leach
Seminary Student &
Community Volunteer
PepsiCo Chief Innovation and Health & Wellness Officer, Retired
Joined 2003.

Susan Love, M.D.
President and Medical Director
Dr. Susan Love Research Foundation
Joined 2003.

Mario Maranhão, M.D.
Former President
World Heart Federation
Joined 2004.

Dean Ornish, M.D.
Founder & Director
Preventive Medicine Research Institute (PMRI)
Joined 2003.
Chairman of the Advisory Board

Pamela Peeke, M.D., M.P.H.
Assistant Professor of Medicine
University of Maryland School of Medicine
Joined 2003.

William Sears, M.D.
Associate Clinical Professor of Pediatrics
University of California, Irvine, School of Medicine
Joined 2006.

Janet E. Taylor, M.D.
Clinical Instructor of Psychiatry
Columbia University
Joined 2004.

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Our Business

Our discussion and analysis is an integral part of understanding our financial results. Definitions of key terms can be found in the glossary on page 82. Tabular dollars are presented in millions, except per share amounts. All per share amounts reflect common per share amounts, assume dilution unless noted, and are based on unrounded amounts. Percentage changes are based on unrounded amounts.

Our Operations

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

Our Divisions
- Frito-Lay North America (FLNA)
- PepsiCo Beverages North America (PBNA)
- PepsiCo International (PI)
- Quaker Foods North America (QFNA)

Our North American divisions operate in the United States and Canada. Our international division operates in approximately 200 countries, with our largest operations in Mexico and the United Kingdom. Additional information concerning our divisions and geographic areas is presented in Note 1.

Frito-Lay North America

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

PepsiCo Beverages North America

PepsiCo Beverages North America (PBNA) manufactures or uses contract manufacturers, markets and sells beverage concentrates, fountain syrups and finished goods, under various beverage brands including Pepsi, Mountain Dew, Gatorade, Tropicana Pure Premium, Lipton, Sierra Mist, Tropicana juice drinks, Propel, Dole and SoBe. PBNA also manufactures or uses contract manufacturers, markets and sells ready-to-drink tea, coffee and water products through joint ventures with Unilever (under the Lipton brand name) and Starbucks. In addition, PBNA licenses the Aquafina water brand to its bottlers and markets this brand. PBNA sells concentrate and finished goods for some of these brands to authorized bottlers, and some of these branded products are sold directly by us to independent distributors and retailers. The bottlers sell our brands as finished goods to independent distributors and retailers. PBNA's volume reflects sales to its independent distributors and retailers, as well as the sales of beverages bearing our trademarks that bottlers have reported as sold to independent distributors and retailers.

PepsiCo International

PepsiCo International (PI) manufactures through consolidated businesses as well as through noncontrolled affiliates, a number of leading salty and sweet snack brands including Lay's, Walkers, Cheetos, Doritos, Ruffles, Gamesa and Sabritas. Further, PI manufactures or uses contract manufacturers, markets and sells many Quaker brand snacks. PI also manufactures, markets and sells beverage concentrates, fountain syrups and finished goods under the brands Pepsi, 7UP, Mirinda, Gatorade, Tropicana and Mountain Dew. These brands are sold to authorized bottlers, independent distributors and retailers. However, in certain markets, PI operates its own bottling plants and distribution facilities. PI also licenses the Aquafina water brand to certain of its authorized bottlers. PI reports two measures of volume. Snack volume is reported on a system-wide basis, which includes our own volume and the volume sold by our noncontrolled affiliates. Beverage volume reflects Company-owned and authorized bottler sales of beverages bearing our trademarks to independent distributors and retailers.

Quaker Foods North America

Quaker Foods North America (QFNA) manufactures or uses contract manufacturers, markets and sells cereals, rice, pasta and other branded products. QFNA's products include Quaker oatmeal, Aunt Jemima mixes and syrups, 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.

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 specify the amount to be paid by our bottlers for concentrate, finished goods and Aquafina royalties, as well as the manufacturing process required for product quality.

Since we do not sell directly to the consumer, we rely on and provide financial incentives to our customers to assist in the distribution and promotion of our products. For our independent distributors and retailers, these incentives include volume-based rebates, product placement fees, promotions and displays. For our bottlers, these incentives are referred to as bottler funding and are negotiated annually with each bottler to support a variety of trade and consumer programs, such as consumer incentives, advertising support, new product support, and vending and cooler equipment placement. Consumer incentives include coupons, pricing discounts and promotions, such as sweepstakes 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. The level of bottler funding is at our discretion because these incentives are not required by the terms of our bottling contracts.

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.

Retail consolidation continues to increase the importance of major customers. In 2006, sales to Wal-Mart represented approximately 9% of our total net revenue; and our top five retail customers represented approximately 26% of our 2006 North American net revenue, with Wal-Mart representing approximately 13%. These percentages include concentrate sales to our bottlers which are used in finished goods sold by them to these retailers. In addition, sales to The Pepsi Bottling Group (PBG) represented approximately 10% of our total net revenue. See "Our Related Party Bottlers" and Note 8 for more information on our anchor bottlers.

Our Related Party Bottlers

We have ownership interests in certain of our bottlers. Our ownership is less than 50%, and since we do not control these bottlers, we do not consolidate their results. We include our share of their net income based on our percentage of economic ownership in our income statement as bottling equity income. We have designated three related party bottlers, PBG, PepsiAmericas, Inc. (PAS) and Pepsi Bottling Ventures LLC (PBV), as our anchor bottlers. Our anchor bottlers distribute approximately 60% of our North American beverage volume and approximately 18% of our international beverage volume. Our anchor bottlers participate in the bottler funding programs described above. Approximately 8% of our total 2006 sales incentives are related to these bottlers. See Note 8 for additional information on these related parties and related party commitments and guarantees.

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Our Distribution Network

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

Direct-Store-Delivery

We, our bottlers and our distributors operate direct-store-delivery systems that deliver snacks and beverages directly to retail stores where the products are merchandised by our employees or our bottlers. Direct-store-delivery enables us to merchandise with maximum visibility and appeal. Direct-store-delivery is especially well-suited to products that are restocked often and respond to in-store promotion and merchandising.

Broker-Warehouse

Some of our products are delivered from our manufacturing plants and warehouses to customer warehouses and retail stores. These less costly systems generally work best for products that are less fragile and perishable, have lower turnover, and are less likely to be impulse purchases.

Foodservice and Vending

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

Our Competition

Our businesses operate in highly competitive markets. We compete against global, regional, local and private label manufacturers on the basis of price, quality, product variety and distribution. In measured channels, our chief beverage competitor, The Coca-Cola Company, has a slightly larger share of carbonated soft drink (CSD) consumption in the U.S., while we have a larger share of chilled juices and isotonics. In addition, The Coca-Cola Company maintains a significant CSD share advantage in many markets outside North America. Further, our snack brands hold significant leadership positions in the snack industry worldwide. Our snack brands face local and regional competitors, as well as national and global snack competitors, and compete on issues related to price, quality, product variety and distribution. Success in this competitive environment is dependent on effective promotion of existing products and the introduction of new products. We believe that the strength of our brands, innovation and marketing, coupled with the quality of our products and flexibility of our distribution network, allow us to compete effectively.

We believe that the strength of our brands, innovation and marketing, coupled with the quality of our products and flexibility of our distribution network, allow us to compete effectively.

Other Relationships

Certain members of our Board of Directors also serve on the boards of certain vendors and customers. Those Board members do not participate in our vendor selection and negotiations nor in our customer negotiations. Our transactions with these vendors and customers are in the normal course of business and are consistent with terms negotiated with other vendors and customers. In addition, certain of our employees serve on the boards of our anchor bottlers and other affiliated companies and do not receive incremental compensation for their Board services.

Our Business Risks

We are subject to risks in the normal course of business due to adverse developments with respect to:

- product demand,
- our reputation,
- information technology,
- supply chain,
- retail consolidation, the loss of major customers and failure to maintain good relationships with our bottling partners,
- global, economic, environmental and political conditions,
- the regulatory environment,
- workforce retention and outsourcing,
- raw materials and other supplies,
- competition, and
- market risks.

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

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

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

Our continued success is dependent on our product innovation, including maintaining a robust pipeline of new products, and the effectiveness of our advertising campaigns and marketing programs.

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

Maintaining a good reputation globally is critical to selling our branded products. If we fail to maintain high standards for product quality, safety and integrity, our reputation could be jeopardized. Adverse publicity about these types of concerns or the incidence of product contamination or tampering, whether or not valid, may reduce demand for our products or cause production and delivery disruptions. If any of our products becomes unfit for consumption, misbranded or causes injury, we may have to engage in a product recall and/or be subject to liability. A widespread product recall or a significant product liability judgment could cause our products to be unavailable for a period of time, which could further reduce consumer demand and brand equity. Failure to maintain high ethical, social and environmental standards for all of our operations and activities or adverse publicity regarding our responses to health concerns, our environmental impacts, including agricultural materials, packaging, energy and water use and waste management, or other sustainability

Maintaining a good reputation globally is critical to selling our branded products.

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issues, could also jeopardize our reputation. Failure to comply with local laws and regulations, to maintain an effective system of internal controls or to provide accurate and timely financial statement information could also hurt our reputation. Damage to our reputation or loss of consumer confidence in our products for any of these reasons could have a material adverse effect on our business, financial condition and results of operations, as well as require additional resources to rebuild our reputation.

If we are not able to build and sustain proper information technology infrastructure, 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 Process Transformation (BPT) 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.

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.

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

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

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

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

Retail consolidation continues to increase the importance of major customers. Sales to Wal-Mart represent approximately 9% of our total net revenue; and our top five retail customers currently represent approximately 26% of our 2006 North American net revenue, with Wal-Mart representing approximately 13%. These percentages include concentrate sales to our bottlers which are used in finished goods sold by them to these retailers. Loss of any of our key customers, including Wal-Mart, could have an adverse effect on our business, financial condition and results of operations.

Furthermore, if we are unable to provide an appropriate mix of incentives to our bottlers through a combination of advertising and marketing support, they may take actions that, while maximizing their own short-term profit, may be detrimental to us or our brands. Such actions could have an adverse effect on our profitability. See "Our Customers," "Our Related Party Bottlers" and Note 8 to our consolidated financial statements for more information on our customers, including our anchor bottlers.

We must maintain mutually beneficial relationships with our key customers, including our retailers and bottling partners, to effectively compete.

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

Unfavorable global economic or environmental changes, political conditions or other developments may result in business disruption, supply constraints, foreign currency devaluation, inflation, deflation or decreased demand. Unstable economic and political conditions or civil unrest in the countries in which we operate could have adverse impacts on our business results or financial condition. Our operations outside of the U.S. accounted for 41% and 36% of our net revenue and operating profit, respectively, for the year ended December 30, 2006. Our continued success depends on our ability to broaden and strengthen our presence in emerging markets, such as Brazil, Russia, India and China, and to create scale in key international markets.

Regulatory decisions and changes in the legal and regulatory environment could increase our costs and liabilities or limit our business activities.

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

In particular, governmental bodies in jurisdictions where we operate may impose new labeling, product or production requirements, or other restrictions. For example, Proposition 65 in California requires that a warning be given for any product that exposes consumers to a substance listed by the state as having been found to cause cancer or birth defects. If we were required to label any of our products or place warnings in locations where our products are sold in California under Proposition 65, sales of those products could suffer not only in California but elsewhere as a result of the adverse publicity.

Our operations outside of the U.S. accounted for 41% and 36% of our net revenue and operating profit, respectively, for the year ended December 30, 2006.

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

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

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

In addition, we have outsourced certain information technology support services and administrative functions, such as payroll processing and benefit plan administration, to third-party service providers and may outsource other functions in the future to achieve cost savings and efficiencies. If the service providers that we outsource these functions to do not perform effectively we may not be able to achieve the expected cost savings and may have to incur additional costs to correct errors made by such service providers. Depending on the function involved, such errors may also lead to business disruption, processing inefficiencies or the loss of or damage to intellectual property through security breach, or harm employee morale.

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

We and our business partners use various raw materials and other supplies in our business, including aspartame, cocoa, corn, corn sweeteners, flavorings, flour, grapefruits and other fruits, juice and juice concentrates, oats, oranges, potatoes, rice, seasonings, sucralose, sugar, vegetable and essential oils, and wheat. Our key packaging materials include aluminum used for cans, PET resin used for plastic bottles, film packaging used for snack foods, and cardboard. Fuel and natural gas are also important commodities due to their use in our plants and in the trucks delivering our products. Some of these raw materials and supplies are available from a limited number of suppliers. We are exposed to the market risks arising

from adverse changes in commodity prices, affecting the cost of our raw materials and energy. The raw materials and energy which we use for the production of our products are largely commodities that are subject to price volatility and fluctuations in availability caused by changes in global supply and demand, weather conditions, agricultural uncertainty or governmental controls. We purchase these materials and energy mainly in the open market. If commodity price changes result in unexpected increases in raw materials and energy costs, we may not be able to increase our prices to offset these increased costs without suffering reduced volume, revenue and operating income.

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

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

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

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 competitive, financial and economic data and our operating plans. They are inherently uncertain, and investors must recognize that events could turn out to be significantly different from our expectations. We undertake no obligation to update any forward-looking statement. The above discussion of risks is by no means all inclusive but is designed to highlight what we believe are important factors to consider when evaluating our trends and future results.

Market Risks

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

- commodity prices, affecting the cost of our raw materials and energy,
- foreign exchange rates,
- interest rates,
- stock prices, and
- discount rates affecting the measurement of our pension and retiree medical liabilities.

In the normal course of business, we manage these risks through a variety of strategies, including productivity initiatives, global purchasing programs and hedging strategies. Ongoing productivity initiatives involve the identification and effective implementation of meaningful cost saving opportunities or efficiencies. Our global purchasing programs include fixed-price purchase orders and pricing agreements. Our hedging strategies include the use of derivatives. Certain derivatives are designated as either cash flow or fair value hedges and qualify for hedge accounting treatment, while others do not qualify and are marked to market through earnings. We do not use derivative instruments for trading or speculative purposes, and we limit our exposure to individual counterparties to manage credit risk. The fair value of our derivatives fluctuates based on market rates and prices. The sensitivity of our derivatives to these market fluctuations is discussed below. See Note 10 for further discussion of these derivatives and our hedging policies. See "Our Critical Accounting Policies" for a discussion of the exposure of our pension plan assets and pension and retiree medical liabilities to risks related to stock prices and discount rates.

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

Commodity Prices

Our open commodity derivative contracts that qualify for hedge accounting had a face value of $55 million at December 30, 2006 and $89 million at December 31, 2005. The open derivative contracts that qualify for hedge accounting resulted in net unrealized gains of less than $1 million at December 30, 2006 and $39 million at December 31, 2005. We estimate that a 10% decline in commodity prices would have reduced our unrealized gains on open contracts to $2 million of unrealized losses in 2006 and $35 million of unrealized gains in 2005.

Our open commodity derivative contracts that do not qualify for hedge accounting had a face value of $196 million at December 30, 2006 and $129 million at December 31, 2005. The open derivative contracts that do not qualify for hedge accounting resulted in net losses of $28 million in 2006 and $3 million in 2005. We estimate that a 10% decline in commodity prices would have increased our net losses on open contracts to $31 million in 2006 and $4 million in 2005.

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

Foreign Exchange

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

Our operations outside of the U.S. generate approximately 40% of our net revenue, with Mexico, the United Kingdom and Canada comprising approximately 20% of our net revenue. As a result, we are exposed to foreign currency risks, including unforeseen economic changes and political unrest. During 2006, net favorable foreign currency, primarily due to appreciation in the Canadian dollar and Brazilian real, contributed almost 1 percentage point to net revenue growth. Currency declines which are not offset could adversely impact our future results.

We do not use derivative instruments for trading or speculative purposes.

Exchange rate gains or losses related to foreign currency transactions are recognized as transaction gains or losses in our income statement as incurred. We may enter into derivatives to manage our exposure to foreign currency transaction risk. Our foreign currency derivatives had a total face value of $1.0 billion at December 30, 2006 and $1.1 billion at December 31, 2005. The contracts that qualify for hedge accounting resulted in net unrealized losses of $6 million at December 30, 2006 and $9 million at December 31, 2005. We estimate that an unfavorable 10% change in the exchange rates would have resulted in unrealized losses of $86 million in 2006 and $81 million in 2005. The contracts not meeting the criteria for hedge accounting resulted in net losses of $10 million in 2006 and net gains of $14 million in 2005. All losses and gains were offset by changes in the underlying hedged items, resulting in no net impact on earnings.

Interest Rates

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

Assuming year-end 2006 and 2005 variable rate debt and investment levels, a 1-percentage-point increase in interest rates would have decreased net interest expense by $10 million in 2006 and $8 million in 2005.

Stock Prices

A portion of our deferred compensation liability is tied to certain market indices and our stock price. We manage these market risks with mutual fund investments and prepaid forward contracts for the purchase of our stock. The combined gains or losses on these investments are substantially offset by changes in our deferred compensation liability.

Our Approach to Managing Risks

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 Executive Risk Council (PERC), comprised of a cross-functional, geographically diverse, senior management group which identifies, assesses, prioritizes and addresses strategic and reputational risks;
- Division Risk Committees (DRCs), comprised of cross-functional senior management teams which meet regularly each year to identify, assess, prioritize and address division-specific operating risks;
- PepsiCo's Risk Management Office, which manages the overall risk management process, provides ongoing guidance, tools and analytical support to the PERC 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; and
- PepsiCo Corporate Audit, which confirms the ongoing effectiveness of the risk management framework through periodic audit and review procedures.

In 2006, we continued to focus our mitigation efforts where it was determined that actions were necessary and appropriate to further reduce PepsiCo's exposure to risks, integrating those efforts in our businesses' operating plans and budgets, where accountabil-

ity is assigned and performance measured. Some highlights include:

- To address certain risks related to the demand for our products, such as consumer health concerns about product attributes and ingredients, we continued to focus on the development of products that respond to consumer trends, including formulating products to lower sugar, fats, and sodium and adding ingredients and new products that can deliver nutritional benefits. For example, at FLNA we introduced a new portion control line of 100-calorie offerings, and we also switched to NuSun sunflower oil, an oil containing 90% mono- and polyunsaturated fats and less saturated fat than most other cooking oils, for our Lay's and Ruffles potato chips. Internationally, we reduced the amount of saturated fats in our Walkers crisps in the United Kingdom by 70% and the amount of salt by 25%. Beyond providing more nutritious product choices, and in an effort to help address the growing concerns regarding childhood obesity trends in the U.S., we joined with the Alliance for a Healthier Generation — a joint initiative of the William J. Clinton Foundation and the American Heart Association — to set voluntary beverage guidelines for U.S. schools that limit portion sizes and establish voluntary guidelines for snacks and side items in U.S. schools.
- To help ensure that we maintain our reputation for providing safe convenient foods and beverages, we enhanced the coordination of our division-led product integrity efforts through the PepsiCo Product Integrity Council (PPIC), a cross-functional forum to share leading practices and confer about areas of potential risk. Through the PPIC, we completed a third-party review of our food safety and food security programs which helped identify opportunities to better leverage internal best practices across all of our businesses. Furthermore, we enhanced our product sampling and testing protocols.
- We continued to enhance our information technology infrastructure and application systems by upgrading our networks and updating or retiring older infrastructure and systems. We signed a multi-year managed services contract to consolidate PI's technology infrastructure into three data centers and another multi-year services contract to provide and manage PI's data network. The data center services will provide full system and data protection and backup and recovery capabilities, and the data network services will enhance security and provide 24x7x365 monitoring and response capabilities. We expect to fully implement both of these service contracts over the next three years.

We continued to focus on leveraging diversity and inclusion, ensuring we have the talent base necessary to lead our growing businesses.

- With respect to our BPT initiative, we continue to build on our learnings and incorporate these into the metrics used to monitor the project. Specific actions taken this year include revising the overall project structure, project resources and timelines. We also continue to invest in process and control resources to build a more automated control environment that remains compliant with the Sarbanes-Oxley Act.
- To address supply chain risks, we continued to assess our capability to mitigate potential business disruptions and increased the coordination of our efforts across IT disaster recovery, crisis management and business continuity. Having recognized the potentially significant impact of a pandemic such as avian influenza on our employees and our business, we formed a cross-functional, cross-divisional Pandemic Planning Team that worked to develop strategies and tactics to mitigate that impact.
- Against a challenging trade environment, we continued to work to ensure consistent and equitable trade practices across our customers, to deliver value-added product innovation and differentiation, to achieve the most effective trade spend across customers and channels through productivity programs, and to more effectively communicate to our customers the economic advantages of our direct-store-delivery (DSD) system.
- To address risks relating to legal and regulatory issues, we have launched an enhanced PepsiCo Code of Conduct training program in multiple languages. We also improved the functionality of our employee hotline to better enable reporting of compliance and ethics concerns and enhanced our process for handling reported incidents and ensuring appropriate corrective action. Furthermore, we completed environmental and health & safety audits that will help focus our mitigation efforts in these areas going forward.
- As part of our ongoing efforts to maintain a talented workforce, we continued to focus on leveraging diversity and inclusion, designing the right organizational model to meet our business needs and ensuring we have the talent base necessary to lead our growing businesses. Tactically, we worked to expand the breadth and depth of our succession plans and reinforced our focus on managing our people through an increased emphasis on people development as part of our performance management process.
- To manage our risks related to raw materials, we continued to reduce our input cost volatility across our total portfolio by employing various hedging strategies where appropriate and as market opportunities arose. We also continued to utilize our scale to achieve maximum value across our commodity portfolio and to ensure adequate supply. In addition, we have developed strategic global supplier solutions to help minimize volatility.

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,**
- **stock-based compensation expense, and**
- **pension and retiree medical plans.**

In connection with our ongoing BPT initiative, we aligned certain accounting policies across our divisions in 2005. We conformed our methodology for calculating our bad debt reserves and modified our policy for recognizing revenue for products shipped to customers by third-party carriers. Additionally, we conformed our method of accounting for certain costs, primarily warehouse and freight. These changes reduced our net revenue by $36 million and our operating profit by $60 million in 2005.

Revenue Recognition

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

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

Our credit terms typically require payment within 30 days of delivery in the U.S., and generally within 30 to 90 days internationally.

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 $10.1 billion in 2006, $8.9 billion in 2005 and $7.8 billion in 2004. Sales incentives include payments to customers for performing merchandising activities on our behalf, such as payments for in-store displays, payments to gain distribution of new products, payments for shelf space and discounts to promote lower retail prices. A number of our sales incentives, such as bottler funding and customer volume rebates, are based on annual targets, and accruals are established during the year for the expected payout. These accruals are based on contract terms and our historical experience with similar programs and require management judgment with respect to estimating customer participation and performance levels. Differences between estimated expense and actual incentive costs are normally insignificant and are recognized in earnings in the period such differences are determined. The terms of most of our incentive arrangements do not exceed a year, and therefore do not require highly uncer-

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tain long-term estimates. For interim reporting, we estimate total annual sales incentives for most of our programs and record a pro rata share in proportion to revenue. Certain arrangements, such as fountain pouring rights, may extend beyond one year. The costs incurred to obtain incentive arrangements are recognized over no longer than the contract period as a reduction of revenue, and the remaining balances of $297 million at year-end 2006 and $321 million at year-end 2005 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. In 2005, our method of determining the reserves was conformed across our divisions in connection with our BPT initiative, as discussed above. 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 and goodwill 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.

We believe that a brand has an indefinite life if it has significant market share in a stable macroeconomic environment and a history of strong revenue and cash flow performance that we expect to continue 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 considerable management judgment and is based on an evaluation of a number of factors, including the competitive environment, market share, brand history and 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 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.

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

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.

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

We did not recognize any impairment charges for perpetual brands or goodwill in the years presented. As of December 30, 2006, we had $5.8 billion of perpetual brands and goodwill, of which approximately 65% related to Tropicana and Walkers.

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. See Note 5 for additional information regarding our tax reserves.

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 benefits from the resolution of prior year tax matters to be such items.

In 2006, we recognized non-cash tax benefits of $602 million (the "2006 Tax Adjustments"), substantially all of which related to the Internal Revenue Service's (IRS) examination of our consolidated income tax returns for the years 1998 through 2002. The IRS issued a Revenue Agent's Report (RAR), and we are in agreement with their conclusion, except for one matter which we continue to dispute. The agreed adjustments relate to transfer pricing and various other transactions, including certain acquisitions, the public offering of PBG, as well as the restructuring of our international snack foods operations during that audit period.

Tax law requires items to be included in our tax returns at different times than the items are reflected in our financial statements. As a result, our annual tax rate reflected in our financial statements is different than that reported in our tax returns (our cash tax rate). Some of these differences are permanent, such as expenses that are not deductible in our tax return, and some differences reverse over time, such as depreciation expense. These temporary differences create deferred tax assets and liabilities. Deferred tax assets generally represent items that can be used as a tax deduction or credit in our tax returns in future years for which we have already recorded the tax benefit in our income statement. We establish valuation allowances for our deferred tax assets when we believe expected future taxable income is not likely to support the use of a deduction or credit in that tax jurisdiction. 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.

The American Jobs Creation Act of 2004 (AJCA) created a one-time incentive for U.S. corporations to repatriate undistributed international earnings by providing an 85% dividends received deduction. In 2005, we repatriated approximately $7.5 billion in earnings previously considered indefinitely reinvested outside the U.S. and recorded income tax expense of $460 million related to this repatriation. Other than the earnings repatriated, 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. At December 30, 2006, we had approximately $10.8 billion of undistributed international earnings.

In 2006, our annual tax rate was 19.3% compared to 36.1% in 2005 as discussed in "Other Consolidated Results." The tax rate in 2006 decreased 16.8 percentage points primarily reflecting the 2006 Tax Adjustments, the absence of the 2005 AJCA tax charge and the resolution of certain state income tax audits in the current year. In 2007, our annual tax rate is expected to be 27.7%, primarily reflecting the absence of the 2006 Tax Adjustments.

Stock-Based Compensation Expense

We believe that we will achieve our best results if our employees act and are rewarded as business owners. Therefore, we believe stock ownership and stock-based incentive awards are the best way to align the interests of employees with those of our shareholders. A majority of our employees participate in our stock-based compensation programs. Stock option grants are made at the current stock price, meaning each employee's exercise price is equivalent to our stock price on the date of grant. Employees must generally provide three additional years of service to earn the grant, referred to as the vesting period. Our options generally have a 10-year term, which means our employees would have up to seven years after the vesting period to elect to pay the exercise price to purchase one share of our stock for each option exercised. Employees benefit from stock options to the extent our stock price appreciates above the exercise price after vesting and during the term of the grant. There have been no reductions to the exercise price of previously issued awards, and any repricing of awards would require approval of our shareholders.

Executives who are awarded long-term incentives based on their performance are offered the choice of stock options or restricted stock units (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% RSUs. 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. Vesting of RSU awards for senior officers is contingent upon the achievement of pre-established performance targets.

We also continued, as we have since 1989, to grant an annual award of stock options to all eligible employees, based on job level or classification, under our broad-based stock option program, SharePower. SharePower awards generally have a 10-year term and vest over three years.

Method of Accounting

We account for our employee stock options, which include grants under our executive program and 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 grants have an exercise price equal to the fair market value of our common stock on the date of grant. The fair value of stock option grants is amortized to expense over the vesting period.

On January 1, 2006, we adopted SFAS 123R, *Share-Based Payment*. Since we had previously accounted for our stock-based compensation under the fair value method, our adoption did not significantly impact our financial position or our results of operations.

On January 1, 2006, we adopted Statement of Financial Accounting Standards (SFAS) 123R, *Share-Based Payment*, under the modified prospective method. Since we had previously accounted for our stock-based compensation plans under the fair value provisions of SFAS 123, our adoption did not significantly impact our financial position or our results of operations. Under SFAS 123R, actual tax benefits recognized in excess of tax benefits previously established upon grant are reported as a financing cash inflow. Prior to adoption, such excess tax benefits were reported as an operating cash inflow.

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 2006 was approximately 28% to FLNA, 19% to PBNA, 32% to PI, 4% to QFNA and 17% to corporate unallocated expenses. The expense allocated to our divisions excludes any impact of changes in our Black-Scholes 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.

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Our Assumptions

Our Black-Scholes model estimates the expected value our employees will receive from the options based on a number of assumptions, such as interest rates, employee exercises, our stock price and dividend yield. Our weighted-average fair value assumptions include:

	Estimated 2007	2006	2005	2004
Expected life	6 yrs.	6 yrs.	6 yrs.	6 yrs.
Risk free interest rate	5.7%	4.5%	3.8%	3.3%
Expected volatility	18%	18%	23%	26%
Expected dividend yield	1.9%	1.9%	1.8%	1.8%

The expected life is a significant assumption as it determines the period for which the risk free interest rate, volatility and dividend yield must be applied. 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.

2007 Estimated Expense and Sensitivity of Assumptions

Our stock-based compensation expense, including RSUs, is as follows:

	Estimated 2007	2006	2005
Stock-based compensation expense	$271	$270	$311

If we assumed a 100-basis-point change in the following assumptions, our estimated 2007 stock-based compensation expense would increase/(decrease) as follows:

	100-Basis-Point Increase	100-Basis-Point Decrease
Risk free interest rate	$6	$(6)
Expected volatility	$1	$(1)
Expected dividend yield	$(9)	$10

If the expected life were assumed to be one year longer, our estimated 2007 stock-based compensation expense would increase by $7 million. If the expected life were assumed to be one year shorter, our estimated 2007 stock-based compensation expense would decrease by $8 million. As noted, changing the assumed expected life impacts all of the Black-Scholes valuation assumptions as the risk free interest rate, expected volatility and expected dividend yield are estimated over the expected life.

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Pension and Retiree Medical Plans

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

On December 30, 2006, we adopted SFAS 158, *Employers' Accounting for Defined Benefit Pension and Other Postretirement Plans — an amendment of FASB Statements No. 87, 88, 106, and 132(R)* (SFAS 158). SFAS 158 requires that we recognize the overfunded or underfunded status of our pension and retiree medical plans (our Plans) as an asset or liability on our December 30, 2006 balance sheet. Subsequent changes in the funded status will be recognized in comprehensive income in the year in which they occur. SFAS 158 also requires that, beginning in 2008, our assumptions used to measure our annual pension and retiree medical expenses be determined as of the balance sheet date, and all plan assets and liabilities be reported as of that date. Currently, the assumptions used to measure our annual pension and retiree medical expenses are determined as of September 30 (measurement date) and all plan assets and liabilities are generally reported as of that date. In accordance with SFAS 158, prior year amounts have not been adjusted. For further information regarding the impact of our adoption of SFAS 158, see Note 7.

SFAS 158 requires that we recognize the overfunded or underfunded status of our pension and retiree medical plans as an asset or liability on our December 30, 2006 balance sheet.

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 expenses include:

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

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

At each measurement date, the discount rate is based on interest rates for high-quality, long-term corporate debt securities with maturities comparable to those of our liabilities. In the U.S., we use the Moody's Aa Corporate Index yield and adjust for differences between the average duration of the bonds in this Index and the average duration of our benefit liabilities, based upon a published index.

The expected return on pension plan assets is based on our historical experience, our pension plan investment strategy and our expectations for long-term rates of return. Our pension plan investment strategy is reviewed annually and is established based upon plan liabilities, an evaluation of market conditions, tolerance for risk, and cash requirements for benefit payments. We use a third-party advisor to assist us in determining our investment allocation and modeling our long-term rate of return assumptions. Our current investment allocation target for our U.S. plans is 60% in equity securities, with the balance in fixed income securities. Our expected long-term rate of return on U.S. plan assets is 7.8%, reflecting estimated long-term rates of return of 9.3% from equity securities and 5.8% from fixed income securities. We use a market-related value method that recognizes each year's asset gain or loss over a five-year period. Therefore, it takes five years for the gain or loss from any one year to be fully included in the other gains and losses calculation described below.

Other gains and losses resulting from actual experience differing from our assumptions and from changes in our assumptions are also determined at each measurement date. If this net accumulated gain or loss exceeds 10% of the greater of plan assets or liabilities, a portion of the net gain or loss is included in expense for the following year. The cost or benefit of plan changes that increase or decrease benefits for prior employee service (prior service cost/(credit)) is included in earnings on a straight-line basis over the average remaining service period of those employees expected to benefit, which is approximately 11 years for pension expense and approximately 13 years for retiree medical.

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

	2007	2006	2005
Pension			
Expense discount rate	5.7%	5.6%	6.1%
Expected rate of return on plan assets	7.7%	7.7%	7.8%
Expected rate of salary increases	4.5%	4.4%	4.3%
Retiree medical			
Expense discount rate	5.8%	5.7%	6.1%
Current health care cost trend rate	9.0%	10.0%	11.0%

Future Expense

The estimated changes in pension and retiree medical expense are as follows:

	Pension	Retiree Medical
2006 expense	$417	$127
Increase in discount rate	(15)	(2)
(Decrease)/Increase in experience loss amortization	(1)	1
Impact of contributions	(2)	–
Other	(3)	4
2007 estimated expense	$396	$130

Pension and retiree medical service costs, measured at a fixed discount rate but including the effect of demographic assumption changes, as well as the effects of gains and losses due to demographics, 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, measured at a fixed discount rate, and the effect of changes in discount rates, gains and losses other than those due to demographics, pension asset returns and the impact of pension funding are all reflected in corporate unallocated expenses.

Based on our current assumptions, which reflect our prior experience, current plan provisions and expectations for future experience, we expect our pension expense to decrease slightly in 2008, declining to approximately $360 million by 2012 as unrealized losses are amortized. If our assumptions and our plan provisions for retiree medical costs remain unchanged and our experience mirrors these assumptions, we expect our annual retiree medical expense beyond 2007 to approximate $130 million.

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 2007 pension expense is an increase of approximately $37 million. The estimated impact on 2007 pension expense of a 25-basis-point decrease in the expected rate of return is an increase of approximately $16 million.

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

Future Funding

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

Our pension contributions for 2006 were $59 million, all of which were non-discretionary. In 2007, we expect to make contributions of up to $150 million with up to $75 million expected to be discretionary. Our cash payments for retiree medical are estimated to be approximately $85 million in 2007. As our retiree medical plans are not subject to regulatory funding requirements, we fund these plans on a pay-as-you-go basis. For estimated future benefit payments, including our pay-as-you-go payments as well as those from trusts, see Note 7.

Recent Accounting Pronouncements

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

In July 2006, the Financial Accounting Standards Board (FASB) issued FASB Interpretation No. 48, *Accounting for Uncertainty in Income Taxes—an interpretation of FASB Statement No. 109* (FIN 48), which clarifies the accounting for uncertainty in tax positions. FIN 48 requires that we recognize in our financial statements, the impact of a tax position, if that position is more likely than not of being sustained on audit, based on the technical merits of the position. The provisions of FIN 48 are effective as of the beginning of our 2007 fiscal year, with the cumulative effect of the change in accounting principle recorded as an adjustment to opening retained earnings. We do not expect our adoption of FIN 48 to materially impact our financial statements.

In September 2006, the FASB issued SFAS 157, *Fair Value Measurements* (SFAS 157), which defines fair value, establishes a framework for measuring fair value, and expands disclosures about fair value measurements. The provisions of SFAS 157 are effective as of the beginning of our 2008 fiscal year. We are currently evaluating the impact of adopting SFAS 157 on our financial statements.

Our Financial Results

Items Affecting Comparability

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

	2006	2005
Net revenue		
53rd week	–	$418
Operating profit		
2006 restructuring and impairment charges	$(67)	–
53rd week	–	$75
2005 restructuring charges	–	$(83)
Net income		
2006 restructuring and impairment charges	$(43)	–
2006 Tax Adjustments	$602	–
PepsiCo share of PBG tax settlement	$18	–
AJCA tax charge	–	$(460)
53rd week	–	$57
2005 restructuring charges	–	$(55)
Net income per common share — diluted		
2006 restructuring and impairment charges	$(0.03)	–
2006 Tax Adjustments	$0.36	–
PepsiCo share of PBG tax settlement	$0.01	–
AJCA tax charge	–	$(0.27)
53rd week	–	$0.03
2005 restructuring charges	–	$(0.03)

For the items affecting our 2004 results, see Notes 3 and 5, as well as our 2005 Annual Report.

53rd week

In 2005, we had an additional week of results (53rd week). Our fiscal year ends on the last Saturday of each December, resulting in an additional week of results every five or six years.

2006 Restructuring and Impairment Charges

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

2005 Restructuring Charges

In 2005, we incurred restructuring charges of $83 million to reduce costs in our operations, principally through headcount reductions.

2006 Tax Adjustments

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

PepsiCo Share of PBG Tax Settlement

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

AJCA Tax Charge

In 2005, we repatriated approximately $7.5 billion in earnings previously considered indefinitely reinvested outside the U.S. in connection with the AJCA and recorded income tax expense of $460 million related to this repatriation.

Results of Continuing Operations – Consolidated Review

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

Servings

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

In 2006, total servings increased 5.5% over the prior year, as servings for beverages worldwide grew over 6% and servings for snacks worldwide grew 5%. All of our divisions positively contributed to the total servings growth. In 2005, total servings increased 7% compared to 2004, as servings for beverages worldwide grew over 7% and servings for snacks worldwide grew 6%.

Net Revenue and Operating Profit

2006

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

Total operating profit increased 9% and margin increased 0.1 percentage points. The operating profit gains reflect the net revenue growth, partially offset by the impact of higher raw material and energy costs across all divisions. The absence of the prior year's additional week reduced operating profit growth by over 1 percentage point.

2005

Net revenue increased 11% reflecting, across all divisions, increased volume, favorable effective net pricing and net favorable foreign currency movements. The volume gains contributed 6 percentage points, the effective net pricing contributed 3 percentage points and the net favorable foreign currency movements contributed over 1 percentage point. The 53rd week contributed over 1 percentage point to revenue growth and almost 1 percentage point to volume growth.

				Change	
	2006	2005	2004	**2006**	2005
Total net revenue	**$35,137**	$32,562	$29,261	**8%**	11%
Operating profit					
FLNA	**$2,615**	$2,529	$2,389	**3%**	6%
PBNA	**2,055**	2,037	1,911	**1%**	7%
PI	**1,948**	1,607	1,323	**21%**	21%
QFNA	**554**	537	475	**3%**	13%
Corporate unallocated	**(733)**	(788)	(689)	**(7)%**	14%
Restructuring and impairment charges	**–**	–	(150)		
Total operating profit	**$6,439**	$5,922	$5,259	**9%**	13%
Total operating profit margin	**18.3%**	18.2%	18.0%	**0.1**	0.2

Total operating profit increased 13% and margin increased 0.2 percentage points. The operating profit gains primarily reflect leverage from the revenue growth, partially offset by higher selling and distribution (S&D) expenses and increased cost of sales, largely due to higher raw materials, energy and S&D labor costs, as well as higher advertising and marketing expenses. Total operating profit margin also benefited from a favorable comparison to prior year restructuring and impairment charges. The additional week in 2005 contributed over 1 percentage point to total operating profit growth.

Corporate Unallocated Expenses

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

In 2006, corporate unallocated expenses decreased $55 million primarily reflecting the absence of a non-recurring charge of $55 million in the prior year to conform our method of accounting across all divisions, primarily for warehouse and freight costs. Higher costs associated with our BPT initiative of $35 million, as well as the unfavorable comparison to the prior year's $25 million gain in connection with the settlement of a class action

lawsuit related to our purchases of high fructose corn syrup from 1991 to 1995, were offset by the favorable impact of certain other corporate items.

In 2005, corporate unallocated expenses increased 14%. This increase primarily reflects higher costs associated with our BPT initiative which contributed 7 percentage points, increased support behind health and wellness and innovation initiatives which contributed 5 percentage points, and Corporate departmental expenses and restructuring charges which each contributed 2 percentage points to the increase. In 2005, items of a non-recurring nature included charges of $55 million to conform our method of accounting across all divisions, primarily for warehouse and freight costs, and a gain of $25 million in connection with the settlement of a class action lawsuit related to our purchases of high fructose corn syrup from 1991 to 1995. In 2004, we recorded a charge of $50 million for the settlement of a contractual dispute with a former business partner.

Other Consolidated Results

Bottling equity income includes our share of the net income or loss of our noncontrolled bottling affiliates 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. We continue to sell shares of PBG stock to reduce our ownership to the level at the time of PBG’s initial public offering, since our ownership has increased as a result of PBG’s share repurchase program. We sold 10.0 million and 7.5 million shares of PBG stock in 2006 and 2005, respectively. The resulting lower ownership percentage reduces the equity income from PBG that we recognize.

				Change	
	2006	2005	2004	**2006**	2005
Bottling equity income	**$616**	$557	$380	**11%**	46%
Interest expense, net	**$(66)**	$(97)	$(93)	**(33)%**	4%
Annual tax rate	**19.3%**	36.1%	24.7%		
Net income — continuing operations	**$5,642**	$4,078	$4,174	**38%**	(2)%
Net income per common share — continuing operations — diluted	**$3.34**	$2.39	$2.41	**40%**	(1)%

2006

Bottling equity income increased 11% primarily reflecting a $186 million pre-tax gain on our sale of PBG stock, which compared favorably to a $126 million pre-tax gain in the prior year. The non-cash gain of $21 million from our share of PBG’s Tax Settlement was fully offset by lower equity income from our anchor bottlers in the current year, primarily resulting from the impact of their respective adoptions of SFAS 123R in 2006.

Net interest expense decreased 33% primarily reflecting higher average rates on our investments and lower debt balances, partially offset by lower investment balances and the impact of higher average rates on our borrowings.

The tax rate decreased 16.8 percentage points compared to prior year primarily reflecting the 2006 Tax Adjustments, the absence of the 2005 AJCA tax charge and the resolution of certain state income tax audits in the current year.

Net income increased 38% and the related net income per share increased 40%. These increases primarily reflect the 2006 Tax Settlement, the absence of the AJCA tax charge and our solid operating profit growth.

2005

Bottling equity income increased 46% reflecting $126 million of pre-tax gains on our sales of PBG stock, as well as stronger bottler results.

Net interest expense increased 4% reflecting the impact of higher debt levels, substantially offset by higher investment rates and cash balances.

The tax rate increased 11.4 percentage points reflecting the $460 million AJCA tax charge, as well as the absence of income tax benefits of $266 million recorded in 2004 related to a reduction in foreign tax accruals following the resolution of certain open tax items with foreign tax authorities and a refund claim related to prior U.S. tax settlements. This increase was partially offset by increased international profit which is taxed at a lower rate.

Net income from continuing operations decreased 2% and the related net income per common share from continuing operations decreased 1%. These decreases reflect the impact of the tax items discussed above, partially offset by our operating profit growth, increased bottling equity income, which includes the gain on our PBG stock sale, the impact of the 53rd week, a favorable comparison to prior year restructuring and impairment charges, and for net income per share, the impact of our share repurchases.

Results of Continuing Operations – Division Review

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

	FLNA	PBNA	PI	QFNA	Total
Net Revenue, 2006	**$10,844**	**$9,565**	**$12,959**	**$1,769**	**$35,137**
Net Revenue, 2005	$10,322	$9,146	$11,376	$1,718	$32,562
% Impact of:					
Volume	1%	3%[a]	6%[a]	1%	3%
Effective net pricing	3	1	4	2	3
Foreign exchange	0.5	–	1	1	1
Acquisitions/divestitures	0.5	–	3	–	1
% Change[b]	*5%*	*5%*	*14%*	*3%*	*8%*

	FLNA	PBNA	PI	QFNA	Total
Net Revenue, 2005	$10,322	$9,146	$11,376	$1,718	$32,562
Net Revenue, 2004	$9,560	$8,313	$9,862	$1,526	$29,261
% Impact of:					
Volume	4.5%	4%[a]	8%[a]	9%	6%
Effective net pricing	3	5	2.5	3	3
Foreign exchange	0.5	–	3	1	1
Acquisitions/divestitures	–	–	2	–	0.5
% Change[b]	*8%*	*10%*	*15%*	*13%*	*11%*

(a) For beverages sold to our bottlers, volume growth is based on our concentrate shipments and equivalents.
(b) Amounts may not sum due to rounding.

Frito-Lay North America

	2006	2005	2004	% Change 2006	% Change 2005
Net revenue	**$10,844**	$10,322	$9,560	**5**	8
Operating profit	**$2,615**	$2,529	$2,389	**3**	6

2006

Net revenue grew 5% reflecting volume growth of 1% and positive effective net pricing due to salty snack pricing actions and favorable mix. Pound volume grew primarily due to double-digit growth in SunChips, Multipack and Quaker Rice Cakes. These volume gains were partially offset by low-single-digit declines in trademark Lay's and Doritos. Overall, salty snacks revenue grew 5% with volume growth of 1%, and other macro snacks revenue grew 9% with volume growth of 6%. The Stacy's Pita Chip Company acquisition contributed approximately 0.5 percentage points to both revenue and volume growth. The absence of the prior year's additional week reduced volume and net revenue growth by 2 percentage points.

In 2006, FLNA volume grew primarily due to double-digit growth in SunChips, Multipack and Quaker Rice Cakes.

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

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

2005

Net revenue grew 8% reflecting volume growth of 4.5% and positive effective net pricing driven by salty snack pricing actions and favorable mix on both salty and convenience foods products. Pound volume grew primarily due to mid-single-digit growth in trademark Lay's potato chips, high-single-digit growth in salty trademark Tostitos, double-digit growth in Santitas, mid-single-digit growth in trademark Cheetos, high-single-digit growth in Dips and Fritos, and double-digit growth in SunChips. These gains were partially offset by the discontinuance of Toastables and Doritos Rollitos. Overall, salty snacks revenue grew 8% with volume growth of 5%, and other macro snacks revenue grew 13% with volume growth of 1%. Other macro snacks products revenue benefited from favorable mix. The additional week contributed 2 percentage points to volume and net revenue growth.

FLNA's Smart Spot eligible products experienced double-digit revenue growth in both 2006 and 2005.

Operating profit grew 6% reflecting positive effective net pricing actions and volume growth. This growth was offset by higher S&D costs resulting from increased labor and benefit charges and fuel costs; higher cost of sales, driven by raw materials, natural gas and freight; and increased advertising and marketing costs. Operating profit was also negatively impacted by more than 1 percentage point as a result of fourth quarter charges to reduce costs in our operations, principally through headcount reductions. The additional week contributed 2 percentage points to operating profit growth.

Smart Spot eligible products represented approximately 13% of net revenue. These products experienced double-digit revenue growth, while the balance of the portfolio had high-single-digit revenue growth.

PepsiCo Beverages North America

				% Change	
	2006	2005	2004	**2006**	2005
Net revenue	**$9,565**	$9,146	$8,313	**5**	10
Operating profit	**$2,055**	$2,037	$1,911	**1**	7

2006

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

In 2006, Smart Spot eligible products grew to over 70% of PBNA's total net revenue.

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

Operating profit increased 1% primarily reflecting the net revenue growth and lower advertising and marketing expenses. Higher raw material costs, primarily oranges, increased supply chain costs in Gatorade and higher energy costs substantially offset the operating profit increase. Total marketplace spending for the year increased, reflecting a shift from advertising and marketing spending to trade spending. Additionally, the impact of more-favorable settlements of trade spending accruals in 2005 was mostly offset by a favorable insurance settlement of $29 million in 2006. The absence of the prior year's additional week, which reduced operating profit growth by 1 percentage point, was fully offset by the impact of charges taken in the fourth quarter of 2005 to reduce costs in our operations, principally through headcount reductions.

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

2005

Net revenue grew 10% and BCS volume grew 4%. The volume increase was driven by a 16% increase in non-carbonated beverages, partially offset by a 1% decline in CSDs. Within non-carbonated beverages, Gatorade, trademark Aquafina, Tropicana juice drinks, Propel and SoBe all experienced double-digit growth. Above average summer temperatures across the country, as well as the launch of new products such as Aquafina FlavorSplash and Gatorade Lemonade earlier in the year, drove Gatorade and trademark Aquafina growth. Tropicana Pure Premium experienced a low-single-digit decline resulting from price increases taken in the first quarter. The decline in CSDs reflects low-single-digit declines in trademark Pepsi and trademark Mountain Dew, slightly offset by low-single-digit growth in Sierra Mist. Across the brands, a low-single-digit decline in regular CSDs was partially offset by low-single-digit growth in diet CSDs. The additional week in 2005 had no significant impact on volume growth as bottler volume is reported based on a calendar month.

Net revenue also benefited from 5 percentage points of favorable effective net pricing, reflecting the continued migration from CSDs to non-carbonated beverages and price increases taken in the first quarter, primarily on concentrate and Tropicana Pure Premium, partially offset by increased trade spending in 2005. The additional week in 2005 contributed 1 percentage point to net revenue growth.

Operating profit increased nearly 7%, primarily reflecting net revenue growth. This increase was partially offset by higher raw material, energy and transportation costs, as well as increased advertising and marketing expenses. The additional week in 2005 contributed 1 percentage point to operating profit growth and was fully offset by a 1-percentage-point decline related to charges taken in 2005 to reduce costs in our operations, principally through headcount reductions.

Aquafina, Gatorade, Tropicana juice drinks and Propel all experienced double-digit volume growth in both 2006 and 2005.

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

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PepsiCo International

	2006	2005	2004	% Change 2006	% Change 2005
Net revenue	**$12,959**	$11,376	$9,862	**14**	15
Operating profit	**$1,948**	$1,607	$1,323	**21**	21

2006

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

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

International snack volume and beverage volume each grew 9% in 2006.

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

Operating profit grew 21%, driven primarily by the net revenue growth, partially offset by increased raw material and energy costs. The net impact of acquisitions and divestitures had no impact on the growth rate. Foreign currency contributed 1 percentage point of growth. The absence of the prior year's additional week, which reduced the operating profit growth rate by 1 percentage point, was fully offset by the impact of charges taken in 2005 to reduce costs in our operations and rationalize capacity.

2005

International snacks volume grew 7%, reflecting growth of 11% in the Europe, Middle East & Africa region, 5% in the Latin America region and 6% in the Asia Pacific region. Acquisition and divestiture activity, principally the divestiture in 2004 of our interest in a South Korea joint venture, reduced Asia Pacific region volume by 11 percentage points. The acquisition of a business in Romania late in 2004 increased the Europe, Middle East & Africa region volume growth by 3 percentage points. Cumulatively, our divestiture and acquisition activities did not impact the reported total PepsiCo International snack volume growth rate. The overall gains reflected mid-single-digit growth at Sabritas in Mexico, double-digit growth in India, Turkey, Russia, Australia and China, partially offset by a low-single-digit decline at Walkers in the United Kingdom. The decline at Walkers is due principally to marketplace pressures. The additional week contributed 1 percentage point to international snack volume growth.

Beverage volume grew 11%, reflecting growth of 14% in the Europe, Middle East & Africa region, 11% in the Asia Pacific region and 6% in the Latin America region. Acquisitions had no significant impact on the reported total PepsiCo International beverage volume growth rate. Broad-based increases were led by double-digit growth in the Middle East, China, Argentina, Venezuela and Russia. Carbonated soft drinks and non-carbonated beverages both grew at a double-digit rate. The additional week had no impact on beverage volume growth as volume is reported based on a calendar month.

Net revenue grew 15%, primarily as a result of the broad-based volume growth and favorable effective net pricing. Foreign currency contributed almost 3 percentage points of growth reflecting the favorable Mexican peso and Brazilian real, partially offset by the unfavorable British pound. Acquisitions and divestitures contributed almost 2 percentage points of growth. The additional week contributed 1 percentage point to revenue growth. Cumulatively, the impact of foreign currency, acquisitions and divestitures, and the additional week on net revenue was 5 percentage points.

Operating profit grew 21% driven largely by the broad-based volume growth and favorable effective net pricing, partially offset by increased energy and raw material costs. Foreign currency contributed 4 percentage points of growth based on the favorable Mexican peso and Brazilian real. The net favorable impact from acquisition and divestiture activity, primarily the acquisition of General Mills' minority interest in Snack Ventures Europe in the first quarter of 2005, contributed 2 percentage points of growth. The additional week contributed 1 percentage point to operating profit growth which was fully offset by a 1-percentage-point decline in operating profit growth related to fourth quarter charges to reduce costs in our operations and rationalize capacity.

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Quaker Foods North America

				% Change	
	2006	2005	2004	**2006**	2005
Net revenue	**$1,769**	$1,718	$1,526	**3**	13
Operating profit	**$554**	$537	$475	**3**	13

2006

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

Operating profit increased 3% primarily reflecting the net revenue growth. Increased cost of sales, primarily driven by higher raw material and energy costs, were largely offset by lower advertising and marketing expenses. The absence of the prior year's additional week reduced operating profit growth by approximately 2 points.

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

2005

Net revenue increased 13% and volume increased 9%. The volume increase reflects double-digit growth in Oatmeal, Aunt Jemima syrup and mix, Rice-A-Roni and Pasta Roni, as well as high-single-digit growth in Cap'n Crunch cereal and mid-single-digit growth in Life cereal. Higher effective net pricing contributed nearly 3 percentage points of growth reflecting favorable product mix, the settlement of prior year trade spending accruals and price increases on ready-to-eat cereals taken in the third quarter of 2004. Favorable Canadian exchange rates contributed nearly 1 percentage point to net revenue growth. The additional week in 2005 contributed approximately 2 percentage points to both net revenue and volume growth.

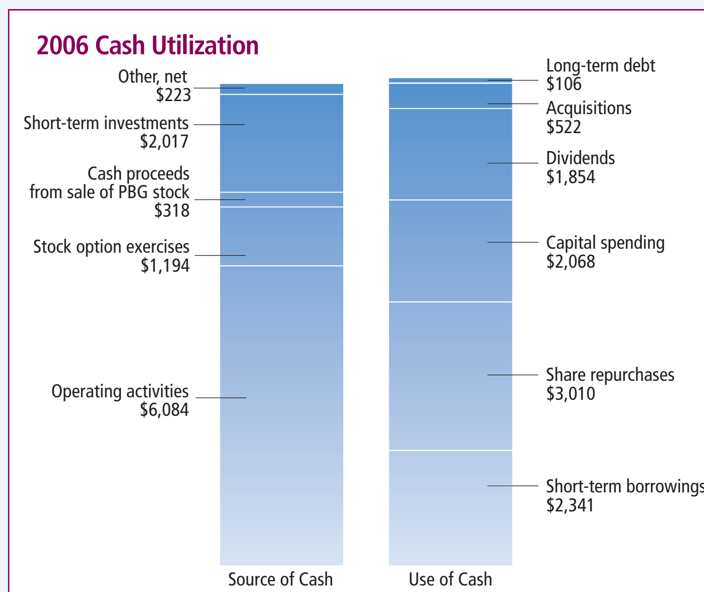
Operating profit increased 13% reflecting the net revenue growth. This growth was partially offset by higher advertising and marketing costs behind programs for core brands and innovation, as well as an unfavorable cost of sales comparison primarily due to higher energy and raw material costs in the latter part of 2005. The additional week in 2005 contributed approximately 2 percentage points to operating profit growth.

Smart Spot eligible products reprsented approximately half of net revenue and had double-digit revenue growth. The balance of the portfolio also experienced double-digit revenue growth.

In 2006 and 2005, Smart Spot eligible products represented over half of QFNA's total net revenue.

Our Liquidity and Capital Resources

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



Operating Activities

In 2006, our operations provided $6.1 billion of cash compared to $5.9 billion in the prior year. The increase primarily reflects our solid business results. Our operating cash flow in 2006 also reflects increased net tax payments over the prior year of $897 million, which included $420 million related to our repatriation of international cash in 2005 in connection with the AJCA, substantially offset by reductions in pension plan contributions over the prior year of $744 million.

Investing Activities

In 2006, we used $194 million for our investing activities. Capital spending of $2.1 billion and acquisitions of $522 million were mostly offset by net sales of short-term investments of $2.0 billion and proceeds from our sale of PBG stock of $318 million. The increase in capital spending over the prior year primarily reflects increased investments at PI and in our North American Gatorade business, as well as increased support behind our ongoing BPT initiative. In 2005, we used $3.5 billion, primarily reflecting capital spending of $1.7 billion, acquisitions of $1.1 billion, primarily the $750 million acquisition of General Mills' minority interest in Snack Ventures Europe, and net purchases of short-term investments of $1.0 billion. These amounts were partially offset by the proceeds from our sale of PBG stock of $214 million.

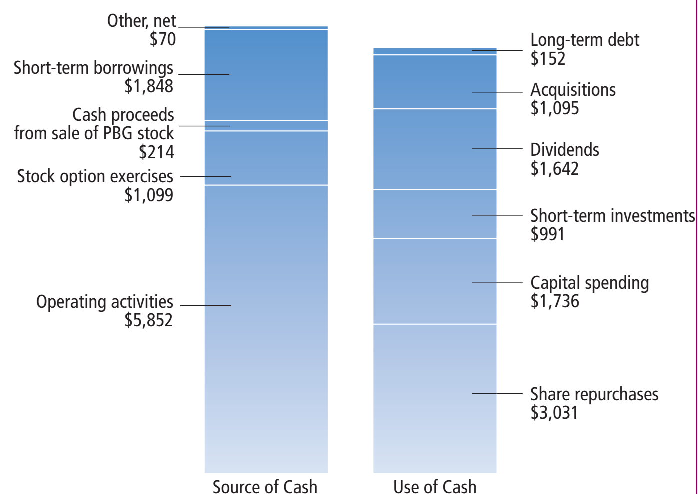
In the first quarter of 2007, we completed our acquisition of Naked Juice Company which was funded with existing domestic cash. This acquisition will be included in the first quarter of 2007 as an investing activity in our Condensed Consolidated Statement of Cash Flows.

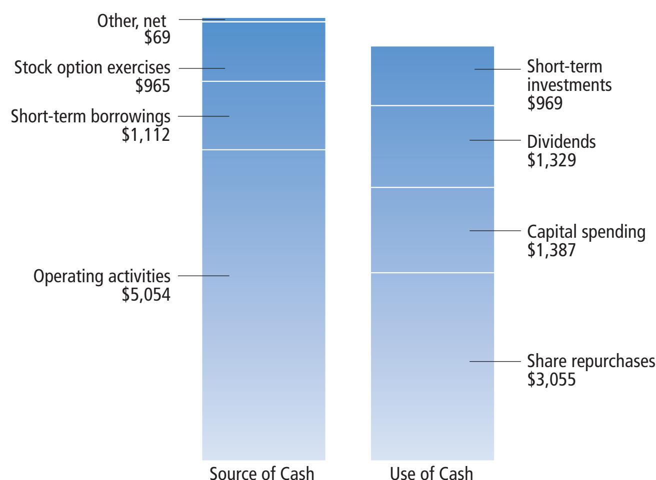
We anticipate net capital spending of approximately $2.6 billion in 2007, which is expected to be within our net capital spending target of approximately 5% to 7% of net revenue in each of the next few years. Planned capital spending in 2007 includes increased investments at PI, particularly in the developing and emerging markets, and additional investments in manufacturing capacity to support our North American Gatorade business as well as other non-carbonated beverage businesses. New capital projects are evaluated on a case-by-case basis and must meet certain payback and internal rate of return targets.

Financing Activities

In 2006, we used $6.0 billion for our financing activities, primarily reflecting the return of operating cash flow to our shareholders through common share repurchases of $3.0 billion and dividend payments of $1.9 billion. Net repayments of short-term borrowings of $2.3 billion were partially offset by stock option proceeds of $1.2 billion. In 2005, we used $1.9 billion for our financing activities, primarily reflecting share repurchases of $3.0 billion and dividend payments of $1.6 billion, partially offset by net proceeds from short-term borrowings of $1.8 billion and stock option proceeds of $1.1 billion.

On May 3, 2006, our Board of Directors authorized and publicly announced our new $8.5 billion repurchase program, which expires on June 30, 2009. Since inception of the new program, we have repurchased $1.1 billion of shares, leaving $7.4 billion of remaining authorization. We have historically repurchased significantly more shares each year than we have issued under our stock-based compensation plans, with average net annual repurchases of 1.4% of outstanding shares for the last five years. We target an annual dividend payout of approximately 45% of prior year's net income from continuing operations. Annually, we review our capital structure with our Board, including our dividend policy and share repurchase activity.





	2006	2005	2004
Net cash provided by operating activities	**$ 6,084**	$ 5,852	$ 5,054
Capital spending	**(2,068)**	(1,736)	(1,387)
Sales of property, plant and equipment	**49**	88	38
Management operating cash flow	**$ 4,065**	$ 4,204	$ 3,705

Management Operating Cash Flow

We focus on management operating cash flow as a key element in achieving maximum shareholder value, and it is the primary measure we use to monitor cash flow performance. However, it is not a measure provided by accounting principles generally accepted in the U.S. Since net capital spending is essential to our product innovation initiatives and maintaining our operational capabilities, we believe that it is a recurring and necessary use of cash. As such, we believe investors should also consider net capital spending when evaluating our cash from operating activities. The table above reconciles the net cash provided by operating activities as reflected in our Consolidated Statement of Cash Flows to our management operating cash flow. Management operating cash flow was used primarily to repurchase shares and pay dividends. We expect to continue to return approximately all of our management operating cash flow to our shareholders through dividends and share repurchases. However, see "Our Business Risks" for certain factors that may impact our operating cash flows.

Credit Ratings

Our debt ratings of Aa3 from Moody's and A+ from Standard & Poor's contribute to our ability to access global capital markets. We have maintained strong investment grade ratings for over a decade. Each rating is considered strong investment grade and is in the first quartile of their respective ranking systems. These ratings also reflect the impact of our anchor bottlers' cash flows and debt.

Credit Facilities and Long-Term Contractual Commitments

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

Off-Balance-Sheet Arrangements

It is not our business practice to enter into off-balance-sheet arrangements, other than in the normal course of business, nor is it our policy to issue guarantees to our bottlers, noncontrolled affiliates or third parties. However, certain guarantees were necessary to facilitate the separation of our bottling and restaurant operations from us. At year-end 2006, we believe it is remote that these guarantees would require any cash payment. We do not enter into off-balance-sheet transactions specifically structured to provide income or tax benefits or to avoid recognizing or disclosing assets or liabilities. See Note 9 for a description of our off-balance-sheet arrangements.

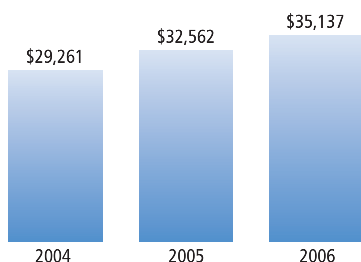
Consolidated Statement of Income

PepsiCo, Inc. and Subsidiaries
Fiscal years ended December 30, 2006, December 31, 2005 and December 25, 2004

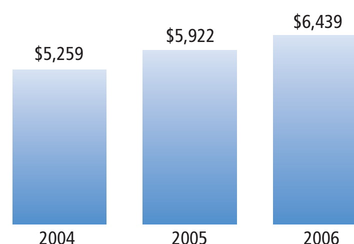
(in millions except per share amounts)	2006	2005	2004
Net Revenue	**$35,137**	$32,562	$29,261
Cost of sales	**15,762**	14,176	12,674
Selling, general and administrative expenses	**12,774**	12,314	11,031
Amortization of intangible assets	**162**	150	147
Restructuring and impairment charges	**–**	–	150
Operating Profit	**6,439**	5,922	5,259
Bottling equity income	**616**	557	380
Interest expense	**(239)**	(256)	(167)
Interest income	**173**	159	74
Income from Continuing Operations before Income Taxes	**6,989**	6,382	5,546
Provision for Income Taxes	**1,347**	2,304	1,372
Income from Continuing Operations	**5,642**	4,078	4,174
Tax Benefit from Discontinued Operations	**–**	–	38
Net Income	**$ 5,642**	$ 4,078	$ 4,212
Net Income per Common Share — Basic			
Continuing operations	**$3.42**	$2.43	$2.45
Discontinued operations	**–**	–	0.02
Total	**$3.42**	$2.43	$2.47
Net Income per Common Share — Diluted			
Continuing operations	**$3.34**	$2.39	$2.41
Discontinued operations	**–**	–	0.02
Total	**$3.34**	$2.39	$2.44*

* Based on unrounded amounts.
See accompanying notes to consolidated financial statements.

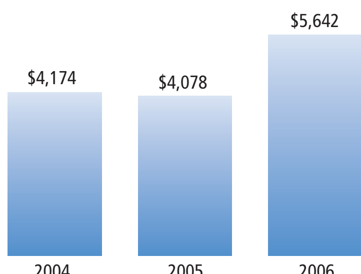
Net Revenue



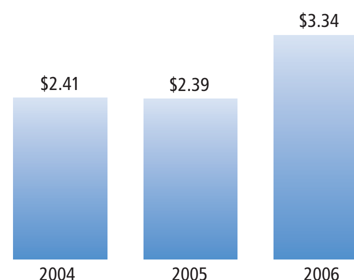
Operating Profit



Income from Continuing Operations



Net Income per Common Share — Continuing Operations



Consolidated Statement of Cash Flows

PepsiCo, Inc. and Subsidiaries
Fiscal years ended December 30, 2006, December 31, 2005 and December 25, 2004

(in millions)	2006	2005	2004
Operating Activities			
Net income	**$ 5,642**	$ 4,078	$ 4,212
Depreciation and amortization	**1,406**	1,308	1,264
Stock-based compensation expense	**270**	311	368
Excess tax benefits from share-based payment arrangements	**(134)**	–	–
Restructuring and impairment charges	**–**	–	150
Cash payments for merger-related costs and restructuring charges	**–**	(22)	(92)
Tax benefit from discontinued operations	**–**	–	(38)
Pension and retiree medical plan contributions	**(131)**	(877)	(534)
Pension and retiree medical plan expenses	**544**	464	395
Bottling equity income, net of dividends	**(479)**	(411)	(297)
Deferred income taxes and other tax charges and credits	**(510)**	440	(203)
Other non-cash charges and credits, net	**32**	145	166
Change in accounts and notes receivable	**(330)**	(272)	(130)
Change in inventories	**(186)**	(132)	(100)
Change in prepaid expenses and other current assets	**(37)**	(56)	(31)
Change in accounts payable and other current liabilities	**223**	188	216
Change in income taxes payable	**(295)**	609	(268)
Other, net	**69**	79	(24)
Net Cash Provided by Operating Activities	**6,084**	5,852	5,054
Investing Activities			
Snack Ventures Europe (SVE) minority interest acquisition	**–**	(750)	–
Capital spending	**(2,068)**	(1,736)	(1,387)
Sales of property, plant and equipment	**49**	88	38
Investment in finance assets	**(25)**	–	–
Other acquisitions and investments in noncontrolled affiliates	**(522)**	(345)	(64)
Cash proceeds from sale of PBG stock	**318**	214	–
Divestitures	**37**	3	52
Short-term investments, by original maturity			
More than three months — purchases	**(29)**	(83)	(44)
More than three months — maturities	**25**	84	38
Three months or less, net	**2,021**	(992)	(963)
Net Cash Used for Investing Activities	**(194)**	(3,517)	(2,330)
Financing Activities			
Proceeds from issuances of long-term debt	**51**	25	504
Payments of long-term debt	**(157)**	(177)	(512)
Short-term borrowings, by original maturity			
More than three months — proceeds	**185**	332	153
More than three months — payments	**(358)**	(85)	(160)
Three months or less, net	**(2,168)**	1,601	1,119
Cash dividends paid	**(1,854)**	(1,642)	(1,329)
Share repurchases — common	**(3,000)**	(3,012)	(3,028)
Share repurchases — preferred	**(10)**	(19)	(27)
Proceeds from exercises of stock options	**1,194**	1,099	965
Excess tax benefits from share-based payment arrangements	**134**	–	–
Net Cash Used for Financing Activities	**(5,983)**	(1,878)	(2,315)
Effect of exchange rate changes on cash and cash equivalents	**28**	(21)	51
Net (Decrease)/Increase in Cash and Cash Equivalents	**(65)**	436	460
Cash and Cash Equivalents, Beginning of Year	**1,716**	1,280	820
Cash and Cash Equivalents, End of Year	**$ 1,651**	$ 1,716	$ 1,280

See accompanying notes to consolidated financial statements.

Consolidated Balance Sheet

PepsiCo, Inc. and Subsidiaries
December 30, 2006 and December 31, 2005

(in millions except per share amounts)	2006	2005
ASSETS		
Current Assets		
Cash and cash equivalents	$ 1,651	$ 1,716
Short-term investments	1,171	3,166
Accounts and notes receivable, net	3,725	3,261
Inventories	1,926	1,693
Prepaid expenses and other current assets	657	618
Total Current Assets	9,130	10,454
Property, Plant and Equipment, net	9,687	8,681
Amortizable Intangible Assets, net	637	530
Goodwill	4,594	4,088
Other nonamortizable intangible assets	1,212	1,086
Nonamortizable Intangible Assets	5,806	5,174
Investments in Noncontrolled Affiliates	3,690	3,485
Other Assets	980	3,403
Total Assets	$29,930	$31,727
LIABILITIES AND SHAREHOLDERS' EQUITY		
Current Liabilities		
Short-term obligations	$ 274	$ 2,889
Accounts payable and other current liabilities	6,496	5,971
Income taxes payable	90	546
Total Current Liabilities	6,860	9,406
Long-Term Debt Obligations	2,550	2,313
Other Liabilities	4,624	4,323
Deferred Income Taxes	528	1,434
Total Liabilities	14,562	17,476
Commitments and Contingencies		
Preferred Stock, no par value	41	41
Repurchased Preferred Stock	(120)	(110)
Common Shareholders' Equity		
Common stock, par value 1 2/3¢ per share (issued 1,782 shares)	30	30
Capital in excess of par value	584	614
Retained earnings	24,837	21,116
Accumulated other comprehensive loss	(2,246)	(1,053)
	23,205	20,707
Less: repurchased common stock, at cost (144 and 126 shares, respectively)	(7,758)	(6,387)
Total Common Shareholders' Equity	15,447	14,320
Total Liabilities and Shareholders' Equity	$29,930	$31,727

See accompanying notes to consolidated financial statements.

Consolidated Statement of Common Shareholders' Equity

PepsiCo, Inc. and Subsidiaries
Fiscal years ended December 30, 2006, December 31, 2005 and December 25, 2004

	2006		2005		2004	
(in millions)	**Shares**	**Amount**	Shares	Amount	Shares	Amount
Common Stock	**1,782**	**$ 30**	1,782	$ 30	1,782	$ 30
Capital in Excess of Par Value						
Balance, beginning of year		**614**		618		548
Stock-based compensation expense		**270**		311		368
Stock option exercises[(a)]		**(300)**		(315)		(298)
Balance, end of year		**584**		614		618
Retained Earnings						
Balance, beginning of year		**21,116**		18,730		15,961
Net income		**5,642**		4,078		4,212
Cash dividends declared — common		**(1,912)**		(1,684)		(1,438)
Cash dividends declared — preferred		**(1)**		(3)		(3)
Cash dividends declared — RSUs		**(8)**		(5)		(2)
Balance, end of year		**24,837**		21,116		18,730
Accumulated Other Comprehensive Loss						
Balance, beginning of year		**(1,053)**		(886)		(1,267)
Currency translation adjustment		**465**		(251)		401
Cash flow hedges, net of tax:						
Net derivative (losses)/gains		**(18)**		54		(16)
Reclassification of (gains)/losses to net income		**(5)**		(8)		9
Unamortized pension and retiree medical, net of tax		**(1,782)**		–		–
Minimum pension liability adjustment, net of tax		**138**		16		(19)
Unrealized gain on securities, net of tax		**9**		24		6
Other		**–**		(2)		–
Balance, end of year		**(2,246)**		(1,053)		(886)
Repurchased Common Stock						
Balance, beginning of year	**(126)**	**(6,387)**	(103)	(4,920)	(77)	(3,376)
Share repurchases	**(49)**	**(3,000)**	(54)	(2,995)	(58)	(2,994)
Stock option exercises	**31**	**1,619**	31	1,523	32	1,434
Other	**–**	**10**	–	5	–	16
Balance, end of year	**(144)**	**(7,758)**	(126)	(6,387)	(103)	(4,920)
Total Common Shareholders' Equity		**$15,447**		$14,320		$13,572

	2006	2005	2004
Comprehensive Income			
Net income	**$5,642**	$4,078	$4,212
Currency translation adjustment	**465**	(251)	401
Cash flow hedges, net of tax	**(23)**	46	(7)
Minimum pension liability adjustment, net of tax	**5**	16	(19)
Unrealized gain on securities, net of tax	**9**	24	6
Other	**–**	(2)	–
Total Comprehensive Income	**$6,098**	$3,911	$4,593

(a) Includes total tax benefits of $130 million in 2006, $125 million in 2005 and $183 million in 2004.
See accompanying notes to consolidated financial statements.

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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%. Our share of the net income of noncontrolled bottling affiliates is reported in our income statement as bottling equity income. Bottling equity income also includes any changes in our ownership interests of these affiliates. Bottling equity income includes $186 million and $126 million of pre-tax gains on our sales of PBG stock in 2006 and 2005, respectively. See Note 8 for additional information on our significant noncontrolled bottling affiliates. Intercompany balances and transactions are eliminated. In 2005, we had an additional week of results (53rd week). Our fiscal year ends on the last Saturday of each December, resulting in an additional week of results every five or six years.

In connection with our ongoing BPT initiative, we aligned certain accounting policies across our divisions in 2005. We conformed our methodology for calculating our bad debt reserves and modified our policy for recognizing revenue for products shipped to customers by third-party carriers. Additionally, we conformed our method of accounting for certain costs, primarily warehouse and freight. These changes reduced our net revenue by $36 million and our operating profit by $60 million in 2005.

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. Actual results could differ from these estimates.

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.

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 2006 presentation.

Our Divisions

We manufacture or use contract manufacturers, market and sell a variety of salty, sweet and grain-based snacks, carbonated and non-carbonated beverages, and foods through our North American and international business divisions. Our North American divisions include the United States and Canada. The accounting policies for the divisions are the same as those described in Note 2, except for certain allocation methodologies for stock-based compensation expense and pension and retiree medical expenses, as described in the unaudited information in "Our Critical Accounting Policies." Additionally, beginning in the fourth quarter of 2005, we began centrally managing commodity derivatives on behalf of our divisions. Certain of the commodity derivatives, primarily those related to the purchase of energy for use by our divisions, do not qualify for hedge accounting treatment. These derivatives hedge underlying commodity price risk and were not entered into for speculative purposes. Such derivatives 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, division results reflect the contract purchase price of the energy or other commodities.

Division results are based on how our President and Chief Executive Officer assesses the performance of and reallocates resources to our divisions. Division results exclude certain Corporate-initiated restructuring and impairment charges. For additional unaudited information on our divisions, see "Our Operations" in Management's Discussion and Analysis.

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Frito-Lay North America (FLNA)

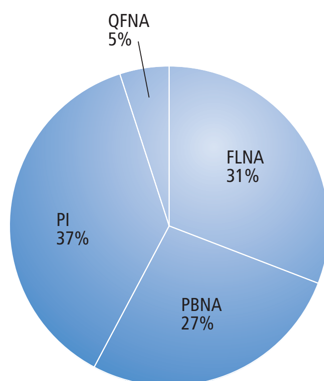
PepsiCo Beverages North America (PBNA)

PepsiCo International (PI)

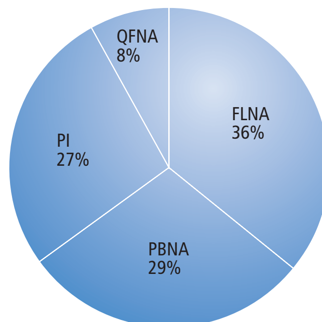
Quaker Foods North America (QFNA)

	Net Revenue			Operating Profit		
	2006	2005	2004	**2006**	2005	2004
FLNA	**$10,844**	$10,322	$ 9,560	**$2,615**	$2,529	$2,389
PBNA	**9,565**	9,146	8,313	**2,055**	2,037	1,911
PI	**12,959**	11,376	9,862	**1,948**	1,607	1,323
QFNA	**1,769**	1,718	1,526	**554**	537	475
Total division	**35,137**	32,562	29,261	**7,172**	6,710	6,098
Corporate	**–**	–	–	**(733)**	(788)	(689)
	35,137	32,562	29,261	**6,439**	5,922	5,409
Restructuring and impairment charges	**–**	–	–	**–**	–	(150)
Total	**$35,137**	$32,562	$29,261	**$6,439**	$5,922	$5,259

Net Revenue



Division Operating Profit



Corporate
Corporate includes costs of our corporate headquarters, centrally-managed initiatives, such as our BPT initiative in North America, unallocated insurance and benefit programs, foreign exchange transaction gains and losses, and certain commodity derivative gains and losses, as well as profit-in-inventory elimination adjustments for our non-controlled bottling affiliates and certain other items.

Restructuring and Impairment Charges — See Note 3.

Other Division Information

	Total Assets			Capital Spending		
	2006	2005	2004	**2006**	2005	2004
FLNA	**$ 5,969**	$ 5,948	$ 5,476	**$ 499**	$ 512	$ 469
PBNA	**6,567**	6,316	6,048	**492**	320	265
PI	**11,274**	9,983	8,921	**835**	667	537
QFNA	**1,003**	989	978	**31**	31	33
Total division	**24,813**	23,236	21,423	**1,857**	1,530	1,304
Corporate [(a)]	**1,739**	5,331	3,569	**211**	206	83
Investments in bottling affiliates	**3,378**	3,160	2,995	**–**	–	–
	$29,930	$31,727	$27,987	**$2,068**	$1,736	$1,387

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

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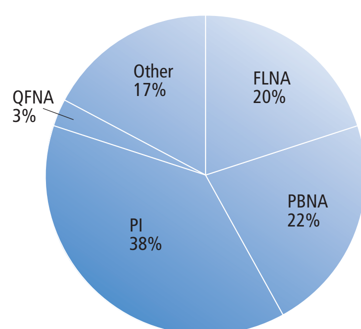
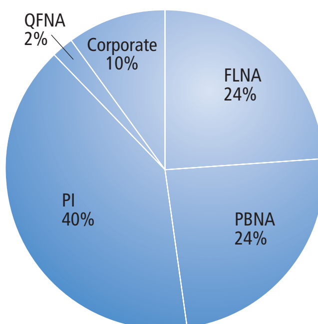
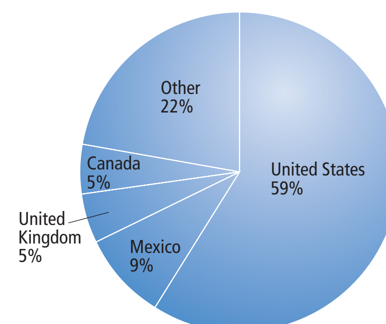
Total Assets



Capital Spending



Net Revenue



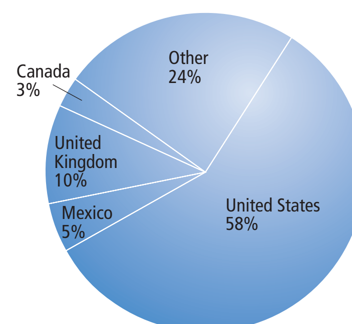
	Amortization of Intangible Assets			Depreciation and Other Amortization		
	2006	2005	2004	**2006**	2005	2004
FLNA	**$ 9**	$ 3	$ 3	**$ 432**	$ 419	$ 420
PBNA	**77**	76	75	**282**	264	258
PI	**76**	71	68	**478**	420	382
QFNA	**–**	–	1	**33**	34	36
Total division	**162**	150	147	**1,225**	1,137	1,096
Corporate	**–**	–	–	**19**	21	21
	$162	$150	$147	**$1,244**	$1,158	$1,117

	Net Revenue[a]			Long-Lived Assets[b]		
	2006	2005	2004	**2006**	2005	2004
U.S.	**$20,788**	$19,937	$18,329	**$11,515**	$10,723	$10,212
Mexico	**3,228**	3,095	2,724	**996**	902	878
United Kingdom	**1,839**	1,821	1,692	**1,995**	1,715	1,896
Canada	**1,702**	1,509	1,309	**589**	582	548
All other countries	**7,580**	6,200	5,207	**4,725**	3,948	3,339
	$35,137	$32,562	$29,261	**$19,820**	$17,870	$16,873

(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.

Long-Lived Assets



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 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 warehouse-distributed products is to replace damaged and out-of-date products. Based on our historical experience with this practice, we have reserved for anticipated damaged and out-of-date products. 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. We are exposed to concentration of credit risk by our customers, Wal-Mart and PBG. In 2006, Wal-Mart represented approximately 9% 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 10%. 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 $10.1 billion in 2006, $8.9 billion in 2005 and $7.8 billion in 2004. While most of these incentive arrangements have terms of no more than one year, certain arrangements, such as fountain pouring rights, extend beyond one year. Costs incurred to obtain these arrangements are recognized over no longer than the contract period and the remaining balances of $297 million at December 30, 2006 and $321 million at December 31, 2005 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.

Other marketplace spending includes the costs of advertising and other marketing activities and is reported as selling, general and administrative expenses. Advertising expenses were $1.7 billion in 2006, $1.8 billion in 2005 and $1.7 billion in 2004. 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 $171 million and $202 million at year-end 2006 and 2005, respectively, are classified as prepaid expenses on our balance sheet.

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 $4.6 billion in 2006, $4.1 billion in 2005 and $3.9 billion in 2004.

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. 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 seven years. Net capitalized software and development costs were $537 million at December 30, 2006 and $327 million at December 31, 2005.

Commitments and Contingencies

We are subject to various claims and contingencies related to lawsuits, 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. Research and development costs were $344 million in 2006 and $340 million in 2005 and are reported as selling, general and administrative expenses.

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.
- Income Taxes — Note 5 and, for additional unaudited information, see "Our Critical Accounting Policies" in Management's Discussion and Analysis.
- Stock-Based Compensation Expense — Note 6 and, for additional unaudited information, see "Our Critical Accounting Policies" in Management's Discussion and Analysis.
- Pension, Retiree Medical and Savings Plans — Note 7 and, for additional unaudited information, see "Our Critical Accounting Policies" in Management's Discussion and Analysis.
- Risk Management — Note 10 and, for additional unaudited information, see "Our Business Risks" in Management's Discussion and Analysis.

Recent Accounting Pronouncements

As further discussed in Note 6, we adopted SFAS 123R on January 1, 2006.

As further discussed in Note 7, we adopted SFAS 158 on December 30, 2006.

In September 2006, the SEC issued SAB 108 to address diversity in practice in quantifying financial statement misstatements. SAB 108 requires that we quantify misstatements based on their impact on each of our financial statements and related disclosures. On December 30, 2006, we adopted SAB 108. Our adoption of SAB 108 did not impact our financial statements.

In July 2006, the FASB issued FIN 48 which clarifies the accounting for uncertainty in tax positions. FIN 48 requires that we recognize in our financial statements, the impact of a tax position, if that position is more likely than not of being sustained on audit, based on the technical merits of the position. The provisions of FIN 48 are effective as of the beginning of our 2007 fiscal year, with the cumulative effect of the change in accounting principle recorded as an adjustment to opening retained earnings. We do not expect our adoption of FIN 48 to materially impact our financial statements.

In September 2006, the FASB issued SFAS 157 which defines fair value, establishes a framework for measuring fair value, and expands disclosures about fair value measurements. The provisions of SFAS 157 are effective as of the beginning of our 2008 fiscal year. We are currently evaluating the impact of adopting SFAS 157 on our financial statements.

Note 3 – Restructuring and Impairment Charges

2006 Restructuring and Impairment Charges

In 2006, we incurred a charge of $67 million ($43 million after-tax or $0.03 per share) in conjunction with consolidating the manufacturing network at FLNA by closing two plants in the U.S., and rationalizing other assets, to increase manufacturing productivity and supply chain efficiencies. The charge was comprised of $43 million of asset impairments, $14 million of severance and other employee costs and $10 million of other costs. Employee-related costs primarily reflect the termination costs for approximately 380 employees. We expect all of the cash payments related to this charge to be paid by the end of 2007.

2005 Restructuring Charges

In 2005, we incurred a charge of $83 million ($55 million after-tax or $0.03 per share) in conjunction with actions taken to reduce costs in our operations, principally through headcount reductions. Of this charge, $34 million related to FLNA, $21 million to PBNA, $16 million to PI and $12 million to Corporate. Most of this charge related to the termination of approximately 700 employees. As of December 30, 2006, all terminations had occurred and substantially no accrual remains.

2004 Restructuring and Impairment Charges

In 2004, we incurred a charge of $150 million ($96 million after-tax or $0.06 per share) in conjunction with the consolidation of FLNA's manufacturing network as part of its ongoing productivity program. Of this charge, $93 million related to asset impairments, primarily reflecting the closure of four U.S. plants. Production from these plants was redeployed to other FLNA facilities in the U.S. The remaining $57 million included employee-related costs of $29 million, contract termination costs of $8 million and other exit costs of $20 million. Employee-related costs primarily reflect the termination costs for approximately 700 employees. As of December 30, 2006, all terminations had occurred and substantially no accrual remains.

Note 4 – Property, Plant and Equipment and Intangible Assets

	Average Useful Life	2006	2005	2004
Property, plant and equipment, net				
Land and improvements	10 – 30 yrs.	**$ 756**	$ 685	
Buildings and improvements	20 – 44	**4,095**	3,736	
Machinery and equipment, including fleet and software	5 – 15	**12,768**	11,658	
Construction in progress		**1,439**	1,066	
		19,058	17,145	
Accumulated depreciation		**(9,371)**	(8,464)	
		$ 9,687	$ 8,681	
Depreciation expense		**$1,182**	$1,103	$1,062
Amortizable intangible assets, net				
Brands	5 – 40	**$1,288**	$1,054	
Other identifiable intangibles	3 – 15	**290**	257	
		1,578	1,311	
Accumulated amortization		**(941)**	(781)	
		$ 637	$ 530	
Amortization expense		**$162**	$150	$147

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 average 2006 foreign exchange rates, is expected to be $49 million in 2007, $49 million in 2008, $47 million in 2009, $46 million in 2010 and $44 million in 2011.

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.

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. Goodwill is evaluated using a two-step impairment test at the reporting unit level. A reporting unit can be a division or business within a division. The first step compares the book value of a reporting unit, including goodwill, with its fair value, as determined by its discounted cash flows. If the book value of a reporting unit exceeds its fair value, we complete the second step to determine the amount of goodwill impairment loss that we should record. In the second step, we determine an implied fair value of the reporting unit's goodwill by allocating the fair value of the reporting unit to all of the assets and liabilities other than goodwill (including any unrecognized intangible assets). The amount of impairment loss is equal to the excess of the book value of the goodwill over the implied fair value of that goodwill. No impairment charges resulted from the required impairment evaluations. The change in the book value of nonamortizable intangible assets is as follows:

	Balance, Beginning 2005	Acquisitions	Translation and Other	Balance, End of 2005	Acquisitions	Translation and Other	**Balance, End of 2006**
Frito-Lay North America							
Goodwill	$ 138	$ –	$ 7	$ 145	$139	$ –	**$ 284**
PepsiCo Beverages North America							
Goodwill	2,161	–	3	2,164	39	–	**2,203**
Brands	59	–	–	59	–	–	**59**
	2,220	–	3	2,223	39	–	**2,262**
PepsiCo International							
Goodwill	1,435	278	(109)	1,604	183	145	**1,932**
Brands	869	263	(106)	1,026	–	127	**1,153**
	2,304	541	(215)	2,630	183	272	**3,085**
Quaker Foods North America							
Goodwill	175	–	–	175	–	–	**175**
Corporate							
Pension intangible	5	–	(4)	1	–	(1)	**–**
Total goodwill	3,909	278	(99)	4,088	361	145	**4,594**
Total brands	928	263	(106)	1,085	–	127	**1,212**
Total pension intangible	5	–	(4)	1	–	(1)	**–**
	$4,842	$541	$(209)	$5,174	$361	$271	**$5,806**

Note 5 – Income Taxes

		2006	2005	2004
Income before income taxes — continuing operations				
U.S.		**$3,844**	$3,175	$2,946
Foreign		**3,145**	3,207	2,600
		$6,989	$6,382	$5,546
Provision for income taxes — continuing operations				
Current:	U.S. Federal	**$ 776**	$1,638	$1,030
	Foreign	**569**	426	256
	State	**56**	118	69
		1,401	2,182	1,355
Deferred:	U.S. Federal	**(31)**	137	11
	Foreign	**(16)**	(26)	5
	State	**(7)**	11	1
		(54)	122	17
		$1,347	$2,304	$1,372
Tax rate reconciliation — continuing operations				
U.S. Federal statutory tax rate		**35.0%**	35.0%	35.0%
State income tax, net of U.S. Federal tax benefit		**0.5**	1.4	0.8
Taxes on AJCA repatriation		**–**	7.0	–
Lower taxes on foreign results		**(6.5)**	(6.5)	(5.4)
Settlement of prior years' audit		**–**	–	(4.8)
2006 Tax Adjustments		**(8.6)**	–	–
Other, net		**(1.1)**	(0.8)	(0.9)
Annual tax rate		**19.3%**	36.1%	24.7%
Deferred tax liabilities				
Investments in noncontrolled affiliates		**$1,103**	$ 993	
Property, plant and equipment		**784**	772	
Pension benefits		**–**	863	
Intangible assets other than nondeductible goodwill		**169**	135	
Zero coupon notes		**27**	35	
Other		**221**	169	
Gross deferred tax liabilities		**2,304**	2,967	
Deferred tax assets				
Net carryforwards		**667**	608	
Stock-based compensation		**443**	426	
Retiree medical benefits		**541**	400	
Other employee-related benefits		**342**	342	
Pension benefits		**38**	–	
Other		**592**	520	
Gross deferred tax assets		**2,623**	2,296	
Valuation allowances		**(624)**	(532)	
Deferred tax assets, net		**1,999**	1,764	
Net deferred tax liabilities		**$ 305**	$1,203	
Deferred taxes included within:				
Assets:				
Prepaid expenses and other current assets		**$223**	$231	
Liabilities:				
Deferred income taxes		**$528**	$1,434	
Analysis of valuation allowances				
Balance, beginning of year		**$532**	$564	$438
Provision/(benefit)		**71**	(28)	118
Other additions/(deductions)		**21**	(4)	8
Balance, end of year		**$624**	$532	$564

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.

Carryforwards, Credits and Allowances

Operating loss carryforwards totaling $6.1 billion at year-end 2006 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 2007, $5.0 billion between 2008 and 2026 and $0.9 billion may be carried forward indefinitely. In addition, certain tax credits generated in prior periods of approximately $33.9 million are available to reduce certain foreign tax liabilities through 2011. We establish valuation allowances for our deferred tax assets when the amount of expected future taxable income is not likely to support the use of the deduction or credit.

Undistributed International Earnings

The AJCA created a one-time incentive for U.S. corporations to repatriate undistributed international earnings by providing an 85% dividends received deduction. In 2005, we repatriated approximately $7.5 billion in earnings previously considered indefinitely reinvested outside the U.S. and recorded income tax expense of $460 million related to this repatriation. Other than the earnings repatriated, 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. At December 30, 2006, we had approximately $10.8 billion of undistributed international earnings.

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. In 2006, we recognized non-cash tax benefits of $602 million, substantially all of which related to the IRS's examination of our consolidated income tax returns for the years 1998 through 2002. The IRS issued a Revenue Agent's Report (RAR), and we are in agreement with their conclusion, except for one matter which we continue to dispute. The agreed adjustments relate to transfer pricing and various other transactions, including certain acquisitions, the public offering of PBG, as well as the restructuring of our international snack foods operations during that audit period. During 2004, we recognized $266 million of tax benefits related to the favorable resolution of certain previously open tax issues. In addition, in 2004, we recognized a tax benefit of $38 million upon agreement with the IRS on a previously open issue related to our discontinued restaurant operations.

The IRS has initiated their audits of our tax returns for the years 2003 through 2005. 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. Our tax reserves, covering all federal, state and foreign jurisdictions, are presented on our balance sheet within other liabilities (see Note 14), except for any amounts relating to items we expect to pay in the coming year which are included in current income taxes payable. For further unaudited information on the impact of the resolution of open tax issues, see "Other Consolidated Results."

As further discussed in Note 2, we will adopt FIN 48 as of the beginning of our 2007 fiscal year.

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 programs. In addition, members of our Board of Directors participate in our stock-based compensation program in connection with their service on our Board. Stock options and RSUs are granted to employees under the shareholder-approved 2003 Long-Term Incentive Plan (LTIP), our only active stock-based plan. Stock-based compensation expense was $270 million in 2006, $311 million in 2005 and $368 million in 2004. Related income tax benefits recognized in earnings were $80 million in 2006, $87 million in 2005 and $103 million in 2004. Stock-based compensation cost capitalized in connection with our BPT initiative was $3 million in 2006, $4 million in 2005 and none in 2004. At year-end 2006, 36 million shares were available for future stock-based compensation grants. For additional unaudited information on our stock-based compensation program, see "Our Critical Accounting Policies" in Management's Discussion and Analysis.

Method of Accounting and Our Assumptions

We account for our employee stock options, which include grants under our executive program and 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. 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% RSUs. 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. Vesting of RSU awards for senior officers is contingent upon the achievement of pre-established performance targets. There have been no reductions to the exercise price of previously issued awards, and any repricing of awards would require approval of our shareholders.

On January 1, 2006, we adopted SFAS 123R under the modified prospective method. Since we had previously accounted for our stock-based compensation plans under the fair value provisions of SFAS 123, our adoption did not significantly impact our financial position or our results of operations. Under SFAS 123R, actual tax benefits recognized in excess of tax benefits previously established upon grant are reported as a financing cash inflow. Prior to adoption, such excess tax benefits were reported as an operating cash inflow.

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

	2006	2005	2004
Expected life	**6 yrs.**	6 yrs.	6 yrs.
Risk free interest rate	**4.5%**	3.8%	3.3%
Expected volatility	**18%**	23%	26%
Expected dividend yield	**1.9%**	1.8%	1.8%

A summary of our stock-based compensation activity for the year ended December 30, 2006 is presented below:

Our Stock Option Activity	Options (a)	Average Price (b)	Average Life (years) (c)	Aggregate Intrinsic Value (d)
Outstanding at January 1, 2006	150,149	$42.03		
Granted	12,519	57.72		
Exercised	(31,056)	38.61		
Forfeited/expired	(3,863)	49.06		
Outstanding at December 30, 2006	127,749	$44.24	5.46	$2,339,562
Exercisable at December 30, 2006	91,381	$41.02	4.42	$1,967,843

(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 (a)	Average Intrinsic Value (b)	Average Life (years) (c)	Aggregate Intrinsic Value (d)
Outstanding at January 1, 2006	5,669	$50.70		
Granted	2,992	58.22		
Converted	(183)	50.00		
Forfeited/expired	(593)	53.17		
Outstanding at December 30, 2006	7,885	$53.38	1.38	$493,201

(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	2006	2005	2004
Stock Options			
Weighted-average fair value of options granted	**$12.81**	$13.45	$12.04
Total intrinsic value of options exercised[(a)]	**$686,242**	$632,603	$667,001
RSUs			
Total number of RSUs granted[(a)]	**2,992**	3,097	3,077
Weighted-average intrinsic value of RSUs granted	**$58.22**	$53.83	$47.28
Total intrinsic value of RSUs converted[(a)]	**$10,934**	$4,974	$914

(a) In thousands.

At December 30, 2006, there was $301 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 1.5 years.

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. We use a September 30 measurement date and all plan assets and liabilities are generally reported as of that date.

Other gains and losses resulting from actual experience differing from our assumptions and from changes in our assumptions are also determined at each measurement date. If this net accumulated gain or loss exceeds 10% of the greater of plan assets or liabilities, a portion of the net gain or loss is included in expense for the following year. The cost or benefit of plan changes that increase or decrease benefits for prior employee service (prior service cost/(credit)) is included in earnings on a straight-line basis over the average remaining service period of those expected to benefit, which is approximately 11 years for pension expense and approximately 13 years for retiree medical.

On December 30, 2006, we adopted SFAS 158 which requires that we recognize the overfunded or underfunded status of our Plans as an asset or liability on our December 30, 2006 balance sheet. Subsequent changes in the funded status will be recognized through comprehensive income in the year in which they occur. SFAS 158 also requires that, beginning in 2008, our assumptions used to measure our annual pension and retiree medical expenses be determined as of the balance sheet date, and all plan assets and liabilities be reported as of that date. In accordance with SFAS 158, prior year amounts have not been adjusted.

The following illustrates the incremental effect of applying SFAS 158 on individual line items on our balance sheet as of December 30, 2006:

	Before Application of SFAS 158	Adjustments	After Application of SFAS 158
Other nonamortizable intangible assets	$1,229	$(17)	$1,212
Other assets	$2,979	$(1,999)	$980
Total assets	$31,946	$(2,016)	$29,930
Accounts payable and other current liabilities	$6,475	$21	$6,496
Other liabilities	$4,127	$497	$4,624
Deferred income taxes	$1,419	$(891)	$528
Total liabilities	$14,935	$(373)	$14,562
Accumulated other comprehensive loss	$603	$1,643	$2,246
Total common shareholders’ equity	$17,090	$(1,643)	$15,447

	Pension				Retiree Medical	
	U.S.		International			
	2006	2005	**2006**	2005	**2006**	2005
Change in projected benefit liability						
Liability at beginning of year	**$5,771**	$4,968	**$1,263**	$ 952	**$1,312**	$1,319
Service cost	**245**	213	**52**	32	**46**	40
Interest cost	**319**	296	**68**	55	**72**	78
Plan amendments	**11**	–	**8**	3	**–**	(8)
Participant contributions	**–**	–	**12**	10	**–**	–
Experience (gain)/loss	**(163)**	517	**20**	203	**(34)**	(45)
Benefit payments	**(233)**	(241)	**(38)**	(28)	**(75)**	(74)
Settlement/curtailment loss	**(7)**	–	**(6)**	–	**–**	–
Special termination benefits	**4**	21	**–**	–	**1**	2
Foreign currency adjustment	**–**	–	**126**	(68)	**–**	–
Other	**–**	(3)	**6**	104	**48**	–
Liability at end of year	**$5,947**	$5,771	**$1,511**	$1,263	**$1,370**	$1,312
Change in fair value of plan assets						
Fair value at beginning of year	**$5,086**	$4,152	**$1,099**	$ 838	**$ –**	$ –
Actual return on plan assets	**513**	477	**112**	142	**–**	–
Employer contributions/funding	**19**	699	**30**	104	**75**	74
Participant contributions	**–**	–	**12**	10	**–**	–
Benefit payments	**(233)**	(241)	**(38)**	(28)	**(75)**	(74)
Settlement/curtailment loss	**(7)**	–	**–**	–	**–**	–
Foreign currency adjustment	**–**	–	**116**	(61)	**–**	–
Other	**–**	(1)	**(1)**	94	**–**	–
Fair value at end of year	**$5,378**	$5,086	**$1,330**	$1,099	**$ –**	$ –
Reconciliation of funded status						
Funded status	**$(569)**	$ (685)	**$(181)**	$(164)	**$(1,370)**	$(1,312)
Adjustment for fourth quarter contributions	**6**	5	**13**	4	**16**	19
Unrecognized prior service cost/(credit)	**–**	5	**–**	17	**–**	(113)
Unrecognized experience loss	**–**	2,288	**–**	474	**–**	402
Net amount recognized	**$(563)**	$1,613	**$(168)**	$ 331	**$(1,354)**	$(1,004)
Amounts recognized						
Other assets	**$ 185**	$2,068	**$ 6**	$367	**$ –**	$ –
Intangible assets	**–**	–	**–**	1	**–**	–
Other current liabilities	**(19)**	–	**(2)**	–	**(84)**	–
Other liabilities	**(729)**	(479)	**(172)**	(41)	**(1,270)**	(1,004)
Minimum pension liability	**–**	24	**–**	4	**–**	–
Net amount recognized	**$(563)**	$1,613	**$(168)**	$331	**$(1,354)**	$(1,004)
Amounts included in accumulated other comprehensive loss (pre-tax)						
Net loss	**$1,836**	$ –	**$475**	$ –	**$ 364**	$ –
Prior service cost/(credit)	**13**	–	**24**	–	**(101)**	–
Minimum pension liability	**–**	24	**–**	4	**–**	–
Total	**$1,849**	$24	**$499**	$4	**$ 263**	$ –
Components of the (decrease)/increase in net loss						
Change in discount rate	**$(123)**	$ 365	**$ 2**	$194	**$(30)**	$ 61
Employee-related assumption changes	**(45)**	57	**6**	2	**–**	–
Liability-related experience different from assumptions	**5**	95	**6**	7	**(4)**	(54)
Actual asset return different from expected return	**(122)**	(133)	**(30)**	(73)	**–**	–
Amortization of losses	**(164)**	(106)	**(29)**	(15)	**(21)**	(26)
Other, including foreign currency adjustments and 2003 Medicare Act	**(3)**	(3)	**46**	(22)	**17**	(52)
Total	**$(452)**	$(275)	**$ 1**	$ 93	**$(38)**	$(71)
Liability at end of year for service to date	**$4,998**	$4,783	**$1,239**	$1,047		

Components of benefit expense are as follows:

	Pension						Retiree Medical		
	2006	2005	2004	**2006**	2005	2004	**2006**	2005	2004
	U.S.			International					
Components of benefit expense									
Service cost	**$ 245**	$ 213	$ 193	**$ 52**	$ 32	$ 27	**$ 46**	$ 40	$ 38
Interest cost	**319**	296	271	**68**	55	47	**72**	78	72
Expected return on plan assets	**(391)**	(344)	(325)	**(81)**	(69)	(65)	**–**	–	–
Amortization of prior service cost/(credit)	**3**	3	6	**2**	1	1	**(13)**	(11)	(8)
Amortization of net loss	**164**	106	81	**29**	15	9	**21**	26	19
	340	274	226	**70**	34	19	**126**	133	121
Settlement/curtailment loss	**3**	–	4	**–**	–	1	**–**	–	–
Special termination benefits	**4**	21	19	**–**	–	1	**1**	2	4
Total	**$ 347**	$ 295	$ 249	**$ 70**	$ 34	$ 21	**$127**	$135	$125

The estimated amounts to be amortized from accumulated other comprehensive loss into benefit expense in 2007 for our pension and retiree medical plans are as follows:

	Pension		Retiree Medical
	U.S.	International	
Net loss	$136	$29	$ 18
Prior service cost/(credit)	5	3	(13)
Total	$141	$32	$ 5

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		
	2006	2005	2004	**2006**	2005	2004	**2006**	2005	2004
	U.S.			International					
Weighted average assumptions									
Liability discount rate	**5.8%**	5.7%	6.1%	**5.2%**	5.1%	6.1%	**5.8%**	5.7%	6.1%
Expense discount rate	**5.7%**	6.1%	6.1%	**5.1%**	6.1%	6.1%	**5.7%**	6.1%	6.1%
Expected return on plan assets	**7.8%**	7.8%	7.8%	**7.3%**	8.0%	8.0%	**–**	–	–
Rate of salary increases	**4.5%**	4.4%	4.5%	**3.9%**	4.1%	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:

	Pension				Retiree Medical	
	2006	2005	**2006**	2005	**2006**	2005
	U.S.		International			
Selected information for plans with liability for service to date in excess of plan assets						
Liability for service to date	**$(387)**	$(374)	**$(286)**	$(65)		
Fair value of plan assets	**$1**	$8	**$237**	$33		
Selected information for plans with benefit liability in excess of plan assets						
Benefit liability	**$(754)**	$(2,690)	**$(1,387)**	$(1,158)	**$(1,370)**	$(1,312)
Fair value of plan assets	**$1**	$1,758	**$1,200**	$985	**–**	–

Of the total projected pension benefit liability at year-end 2006, $701 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:

	2007	2008	2009	2010	2011	2012-16
Pension	$265	$285	$310	$345	$375	$2,490
Retiree medical*	$90	$95	$100	$100	$105	$595

*Expected future benefit payments for our retiree medical plans do not reflect any estimated subsidies expected to be received under the Medicare Act. Subsidies are expected to be approximately $5 million for each of the years from 2007 through 2011 and approximately $40 million for 2012 through 2016.

These future benefits to beneficiaries include payments from both funded and unfunded pension plans.

In 2007, we expect to make pension contributions of up to $150 million with up to $75 million expected to be discretionary. Our cash payments for retiree medical are estimated to be approximately $85 million in 2007.

Pension Assets

The expected return on pension plan assets is based on our historical experience, our pension plan investment strategy and our expectations for long-term rates of return. We use a market-related value method that recognizes each year's asset gain or loss over a five-year period. Therefore, it takes five years for the gain or loss from any one year to be fully included in the value of pension plan assets that is used to calculate the expected return. Our pension plan investment strategy is reviewed annually and is established based upon plan liabilities, an evaluation of market conditions, tolerance for risk, and cash requirements for benefit payments. Our investment objective is to ensure that funds are available to meet the plans' benefit obligations when they are due. Our investment strategy is to prudently invest plan assets in high-quality and diversified equity and debt securities to achieve our long-term return expectation. Our investment policy also permits the use of derivative instruments to enhance the overall return of the portfolio. We use a third-party advisor to assist us in determining our investment allocation and modeling our long-term rate of return assumptions. Our expected long-term rate of return on U.S. plan assets is 7.8%, reflecting estimated long-term rates of return of 9.3% from equity securities and 5.8% from fixed income securities. Our target allocation and actual pension plan asset allocations for the plan years 2006 and 2005 are as follows:

		Actual Allocation	
Asset Category	Target Allocation	**2006**	2005
Equity securities	60%	**61%**	60%
Debt securities	40%	**39%**	39%
Other, primarily cash	–	**–**	1%
Total	100%	**100%**	100%

Pension assets include 5.5 million shares of PepsiCo common stock with a market value of $358 million in 2006, and 5.5 million shares with a market value of $311 million in 2005. Our investment policy limits the investment in PepsiCo stock at the time of investment to 10% of the fair value of plan assets.

Retiree Medical Cost Trend Rates

An average increase of 9% in the cost of covered retiree medical benefits is assumed for 2007. This average increase is then projected to decline gradually to 5% in 2011 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% Increase	1% Decrease
2006 service and interest cost components	$4	$(3)
2006 benefit liability	$42	$(36)

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 2006 and 2005, our matching contributions were $56 million and $52 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.

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Note 8 – Noncontrolled Bottling Affiliates

Our most significant noncontrolled bottling affiliates are PBG and PAS. Approximately 10% of our total net revenue in 2006, 2005 and 2004 reflects sales to PBG.

The Pepsi Bottling Group

In addition to approximately 38% and 41% of PBG's outstanding common stock that we own at year-end 2006 and 2005, respectively, we own 100% of PBG's class B common stock and approximately 7% of the equity of Bottling Group, LLC, PBG's principal operating subsidiary. This gives us economic ownership of approximately 43% and 45% of PBG's combined operations at year-end 2006 and 2005, respectively. Bottling equity income includes $186 million and $126 million of pre-tax gains on our sales of PBG stock in 2006 and 2005, respectively.

PBG's summarized financial information is as follows:

	2006	2005	2004
Current assets	**$ 2,749**	$ 2,412	
Noncurrent assets	**9,178**	9,112	
Total assets	**$11,927**	$11,524	
Current liabilities	**$2,051**	$2,598	
Noncurrent liabilities	**7,252**	6,387	
Minority interest	**540**	496	
Total liabilities	**$9,843**	$9,481	
Our investment	**$1,842**	$1,738	
Net revenue	**$12,730**	$11,885	$10,906
Gross profit	**$5,920**	$5,632	$5,250
Operating profit	**$1,017**	$1,023	$976
Net income	**$522**	$466	$457

Our investment in PBG, which includes the related goodwill, was $500 million and $400 million higher than our ownership interest in their net assets at year-end 2006 and 2005, respectively. Based upon the quoted closing price of PBG shares at year-end 2006 and 2005, the calculated market value of our shares in PBG, excluding our investment in Bottling Group, LLC, exceeded our investment balance by approximately $1.4 billion and $1.5 billion, respectively.

PepsiAmericas

At year-end 2006 and 2005, we owned approximately 44% and 43% of PepsiAmericas, respectively, and their summarized financial information is as follows:

	2006	2005	2004
Current assets	**$ 675**	$ 598	
Noncurrent assets	**3,532**	3,456	
Total assets	**$4,207**	$4,054	
Current liabilities	**$ 694**	$ 722	
Noncurrent liabilities	**1,909**	1,763	
Total liabilities	**$2,603**	$2,485	
Our investment	**$1,028**	$968	
Net revenue	**$3,972**	$3,726	$3,345
Gross profit	**$1,608**	$1,562	$1,423
Operating profit	**$356**	$393	$340
Net income	**$158**	$195	$182

Our investment in PAS, which includes the related goodwill, was $316 million and $292 million higher than our ownership interest in their net assets at year-end 2006 and 2005, respectively. Based upon the quoted closing price of PAS shares at year-end 2006 and 2005, the calculated market value of our shares in PepsiAmericas exceeded our investment balance by approximately $173 million and $364 million, respectively.

In January 2005, PAS acquired a regional bottler, Central Investment Corporation. The table includes the results of Central Investment Corporation from the transaction date forward.

Related Party Transactions

Our significant related party transactions involve our noncontrolled bottling affiliates. We sell concentrate to these affiliates, which they use in the production of CSDs and non-carbonated beverages. We also sell certain finished goods to these affiliates and we receive royalties for the use of our trademarks for certain products. 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.

These transactions with our bottling affiliates are reflected in our consolidated financial statements as follows:

	2006	2005	2004
Net revenue	**$4,837**	$4,633	$4,170
Selling, general and administrative expenses	**$87**	$143	$114
Accounts and notes receivable	**$175**	$178	
Accounts payable and other current liabilities	**$62**	$117	

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

In addition, we coordinate, on an aggregate basis, the negotiation and purchase of sweeteners and other raw materials requirements for certain of our bottlers with suppliers. 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.

Note 9 – Debt Obligations and Commitments

	2006	2005
Short-term debt obligations		
Current maturities of long-term debt	**$ 605**	$ 143
Commercial paper (5.3% and 3.3%)	**792**	3,140
Other borrowings (7.3% and 7.4%)	**377**	356
Amounts reclassified to long-term debt	**(1,500)**	(750)
	$ 274	$2,889
Long-term debt obligations		
Short-term borrowings, reclassified	**$1,500**	$ 750
Notes due 2007-2026 (6.0% and 5.4%)	**1,148**	1,161
Zero coupon notes, $425 million due 2007-2012 (13.4%)	**299**	312
Other, due 2007-2016 (6.1% and 6.3%)	**208**	233
	$3,155	2,456
Less: current maturities of long-term debt obligations	**(605)**	(143)
	$2,550	$2,313

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

In the second quarter of 2006, we entered into a new unsecured revolving credit agreement which enables us to borrow up to $1.5 billion subject to customary terms and conditions. Funds borrowed under this agreement may be used for general corporate purposes, including supporting our outstanding commercial paper issuances. The agreement terminates in May 2011 and replaces our previous $2.1 billion of credit facilities. As of December 30, 2006, we have reclassified $1.5 billion of short-term debt to long-term based on our intent and ability to refinance on a long-term basis.

In addition, $394 million of our debt related to borrowings from various lines of credit 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.

In the third quarter of 2006, we entered into a U.S. $2.5 billion euro medium term note program. Under the program, we may issue unsecured notes under mutually agreed upon terms with the purchasers of the notes. Proceeds from any issuance of notes may be used for general corporate purposes, except as otherwise specified in the related prospectus. As of December 30, 2006, we have no outstanding notes under the program.

Interest Rate Swaps

We entered into interest rate swaps in 2004 to effectively convert the interest rate of a specific debt issuance from a fixed rate of 3.2% to a variable rate. The variable weighted-average interest rate that we pay is linked to LIBOR and is subject to change. The notional amount of the interest rate swaps outstanding at December 30, 2006 and December 31, 2005 was $500 million. The terms of the interest rate swaps match the terms of the debt they modify. The swaps mature in May 2007.

At December 30, 2006, approximately 63% of total debt, after the impact of the related interest rate swaps, was exposed to variable interest rates, compared to 78% at December 31, 2005. 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.

Cross Currency Interest Rate Swaps

In 2004, we entered into a cross currency interest rate swap to hedge the currency exposure on U.S. dollar denominated debt of $50 million held by a foreign affiliate. The terms of this swap match the terms of the debt it modifies. The swap matures in 2008. The unrealized gain related to this swap was less than $1 million at December 30, 2006 and December 31, 2005, resulting in a U.S. dollar liability of $50 million. We have also entered into cross currency interest rate swaps to hedge the currency exposure on U.S. dollar denominated intercompany debt of $95 million at December 30, 2006 and $125 million at December 31, 2005. The terms of the swaps match the terms of the debt they modify. The swaps mature in 2007. The net unrealized loss related to these swaps was less than $1 million at December 30, 2006 and the net unrealized gain related to these swaps was $5 million at December 31, 2005.

Long-Term Contractual Commitments

Payments Due by Period	Total	2007	2008-2009	2010-2011	2012 and beyond
Long-term debt obligations[a]	$1,050	$ –	$ 583	$ 125	$ 342
Interest on debt obligations[b]	295	50	57	43	145
Operating leases	922	231	302	176	213
Purchasing commitments	5,205	1,357	2,216	871	761
Marketing commitments	1,199	287	453	332	127
Other commitments	279	229	43	5	2
	$8,950	$2,154	$3,654	$1,552	$1,590

(a) Excludes current maturities of long-term debt of $605 million which are classified within current liabilities, as well as short-term borrowings reclassified as long-term debt of $1,500 million.

(b) Interest payments on floating-rate debt are estimated using interest rates effective as of December 30, 2006.

The above table reflects non-cancelable commitments as of December 30, 2006 based on year-end foreign exchange rates.

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, cooking oil and packaging materials. Non-cancelable marketing commitments primarily are 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 and former restaurant operations.

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, nor is it our policy to issue guarantees to our bottlers, noncontrolled affiliates or third parties. However, certain guarantees were necessary to facilitate the separation of our bottling and restaurant operations from us. In connection with these transactions, we have guaranteed $2.3 billion of Bottling Group, LLC's long-term debt through 2012 and $23 million of YUM! Brands, Inc.'s (YUM) outstanding obligations, primarily property leases, through 2020. 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. Our guarantees of certain obligations ensured YUM's continued use of certain properties. These guarantees would require our cash payment if YUM failed to perform under these lease obligations.

See "Our Liquidity and Capital Resources" in Management's Discussion and Analysis for further unaudited information on our borrowings.

Note 10 – Risk Management

We are exposed to the risk of loss arising from adverse changes in:

- commodity prices, affecting the cost of our raw materials and energy,
- foreign exchange risks,
- interest rates,
- stock prices, and
- discount rates affecting the measurement of our pension and retiree medical liabilities.

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. See "Our Business Risks" in Management's Discussion and Analysis for further unaudited information on our business risks.

For cash flow hedges, changes in fair value are deferred in accumulated other comprehensive loss within 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 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. If the derivative instrument is terminated, we continue to defer the related gain or loss and 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 in that period.

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, and we

limit our exposure to individual counterparties to manage credit risk.

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 two 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. However, such commodity cash flow hedges have not had any significant ineffectiveness for all periods presented. 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 gains of $1 million related to cash flow hedges from accumulated other comprehensive loss into net income. Derivatives used to hedge commodity price risks that do not qualify for hedge accounting are marked to market each period and reflected in our income statement.

Foreign Exchange

Our operations outside of the U.S. generate approximately 40% of our net revenue, with Mexico, the United Kingdom and Canada comprising approximately 20% of our net revenue. As a result, we are exposed to foreign currency risks from unforeseen economic changes and political unrest. On occasion, we enter into hedges, primarily forward contracts with terms of no more than two years, to reduce the effect of foreign exchange rates. Ineffectiveness of these hedges has not been material.

Interest Rates

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

Stock Prices

The portion of our deferred compensation liability that is based on certain market indices and on our stock price is subject to market risk. We hold mutual fund investments and prepaid forward contracts to manage this risk. Changes in the fair value of these investments and contracts are recognized immediately in earnings and are offset by changes in the related compensation liability.

Fair Value

All derivative instruments are recognized on our balance sheet at fair value. The fair value of our derivative instruments is generally based on quoted market prices. Book and fair values of our derivative and financial instruments are as follows:

	2006		2005	
	Book Value	**Fair Value**	Book Value	Fair Value
Assets				
Cash and cash equivalents[a]	**$1,651**	**$1,651**	$1,716	$1,716
Short-term investments[b]	**$1,171**	**$1,171**	$3,166	$3,166
Forward exchange contracts[c]	**$8**	**$8**	$19	$19
Commodity contracts[d]	**$2**	**$2**	$41	$41
Prepaid forward contracts[e]	**$73**	**$73**	$107	$107
Cross currency interest rate swaps[f]	**$1**	**$1**	$6	$6
Liabilities				
Forward exchange contracts[c]	**$24**	**$24**	$15	$15
Commodity contracts[d]	**$29**	**$29**	$3	$3
Debt obligations	**$2,824**	**$2,955**	$5,202	$5,378
Interest rate swaps[g]	**$4**	**$4**	$9	$9

The above items are included on our balance sheet under the captions noted or as indicated below. In addition, derivatives qualify for hedge accounting unless otherwise noted below.

(a) Book value approximates fair value due to the short maturity.

(b) Principally short-term time deposits and includes $145 million at December 30, 2006 and $124 million at December 31, 2005 of mutual fund investments used to manage a portion of market risk arising from our deferred compensation liability.

(c) The 2006 liability includes $10 million related to derivatives that do not qualify for hedge accounting and the 2005 asset includes $14 million related to derivatives that do not qualify for hedge accounting. Assets are reported within current assets and other assets and liabilities are reported within current liabilities and other liabilities.

(d) The 2006 liability includes $28 million related to derivatives that do not qualify for hedge accounting. The 2005 asset includes $2 million related to derivatives that do not qualify for hedge accounting and the liability relates entirely to derivatives that do not qualify for hedge accounting. Assets are reported within current assets and other assets and liabilities are reported within current liabilities and other liabilities.

(e) Included in current assets and other assets.

(f) Asset included within other assets.

(g) Reported in other liabilities.

This table excludes guarantees, including our guarantee of $2.3 billion of Bottling Group, LLC's long-term debt. The guarantee had a fair value of $35 million at December 30, 2006 and $47 million at December 31, 2005 based on a third-party estimate of the cost to us of transferring the liability to an independent financial institution. See Note 9 for additional information on our guarantees.

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Note 11 – Net Income per Common Share from Continuing Operations

Basic net income per common share is net income available to common shareholders divided by the weighted average of common shares outstanding during the period. Diluted net income 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 0.1 million shares in 2006, 3.0 million shares in 2005 and 7.0 million shares in 2004 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 $65.24 in 2006, $53.77 in 2005 and $52.88 in 2004.

The computations of basic and diluted net income per common share from continuing operations are as follows:

	2006		2005		2004	
	Income	**Shares[a]**	Income	Shares[a]	Income	Shares[a]
Net income	**$5,642**		$4,078		$4,174	
Preferred shares:						
Dividends	**(2)**		(2)		(3)	
Redemption premium	**(9)**		(16)		(22)	
Net income available for common shareholders	**$5,631**	**1,649**	$4,060	1,669	$4,149	1,696
Basic net income per common share	**$3.42**		$2.43		$2.45	
Net income available for common shareholders	**$5,631**	**1,649**	$4,060	1,669	$4,149	1,696
Dilutive securities:						
Stock options and RSUs	**–**	**36**	–	35	–	31
ESOP convertible preferred stock	**11**	**2**	18	2	24	2
Diluted	**$5,642**	**1,687**	$4,078	1,706	$4,173	1,729
Diluted net income per common share	**$3.34**		$2.39		$2.41	

(a) Weighted-average common shares outstanding.

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Note 12 – Preferred and Common Stock

As of December 30, 2006 and December 31, 2005, there were 3.6 billion shares of common stock and 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 2006 and 2005, there were 803,953 preferred shares issued and 320,853 and 354,853 shares outstanding, respectively. The outstanding preferred shares had a fair value of $100 million as of December 30, 2006 and $104 million as of December 31, 2005. 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. There were 17 million shares of common stock held in the accounts of ESOP participants as of December 30, 2006 and December 31, 2005. Quaker made the final award to its ESOP plan in June 2001.

	2006		2005		2004	
	Shares	**Amount**	Shares	Amount	Shares	Amount
Preferred stock	**0.8**	**$41**	0.8	$41	0.8	$41
Repurchased preferred stock						
Balance, beginning of year	**0.5**	**$110**	0.4	$ 90	0.3	$63
Redemptions	**–**	**10**	0.1	19	0.1	27
Balance, end of year	**0.5**	**$120**	0.5	$110*	0.4	$90

*Does not sum due to rounding.

Note 13 – Accumulated Other Comprehensive Loss

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) was $456 million in 2006, $(167) million in 2005 and $381 million in 2004. The accumulated balances for each component of other comprehensive loss were as follows:

	2006	2005	2004
Currency translation adjustment	**$ (506)**	$ (971)	$(720)
Cash flow hedges, net of tax(a)	**4**	27	(19)
Unamortized pension and retiree medical, net of tax(b)	**(1,782)**	–	–
Minimum pension liability adjustment(c)	**–**	(138)	(154)
Unrealized gain on securities, net of tax	**40**	31	7
Other	**(2)**	(2)	–
Accumulated other comprehensive loss	**$(2,246)**	$(1,053)	$(886)

(a) Includes $3 million gain in 2006, no impact in 2005 and $6 million gain in 2004 for our share of our equity investees' accumulated derivative activity.
(b) Net of taxes of $964 million in 2006.
(c) Net of taxes of $72 million in 2005 and $77 million in 2004. Also includes $120 million in 2005 and $121 million in 2004 for our share of our equity investees' minimum pension liability adjustments.

Note 14 – Supplemental Financial Information

	2006	2005	2004
Accounts receivable			
Trade receivables	**$3,147**	$2,718	
Other receivables	**642**	618	
	3,789	3,336	
Allowance, beginning of year	**75**	97	$105
Net amounts charged/(credited) to expense	**10**	(1)	18
Deductions[a]	**(27)**	(22)	(25)
Other[b]	**6**	1	(1)
Allowance, end of year	**64**	75	$ 97
Net receivables	**$3,725**	$3,261	
Inventories[c]			
Raw materials	**$ 860**	$ 738	
Work-in-process	**140**	112	
Finished goods	**926**	843	
	$1,926	$1,693	

(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 19% in 2006 and 17% in 2005 of the inventory cost was computed using the LIFO method. The differences between LIFO and FIFO methods of valuing these inventories were not material.

	2006	2005	2004
Other assets			
Non-current notes and accounts receivable	**$149**	$ 186	
Deferred marketplace spending	**232**	281	
Unallocated purchase price for recent acquisitions	**196**	256	
Pension plans	**197**	2,440	
Other	**206**	240	
	$980	$3,403	
Accounts payable and other current liabilities			
Accounts payable	**$2,102**	$1,799	
Accrued marketplace spending	**1,444**	1,383	
Accrued compensation and benefits	**1,143**	1,062	
Dividends payable	**492**	431	
Other current liabilities	**1,315**	1,296	
	$6,496	$5,971	
Other liabilities			
Reserves for income taxes	**$1,435**	$1,884	
Other	**3,189**	2,439	
	$4,624	$4,323	
Other supplemental information			
Rent expense	**$291**	$228	$245
Interest paid	**$215**	$213	$137
Income taxes paid, net of refunds	**$2,155**	$1,258	$1,833
Acquisitions[a]			
Fair value of assets acquired	**$ 678**	$ 1,089	$ 78
Cash paid and debt issued	**(522)**	(1,096)	(64)
SVE minority interest eliminated	**–**	216	–
Liabilities assumed	**$ 156**	$ 209	$ 14

(a) In 2005, these amounts include the impact of our acquisition of General Mills, Inc.'s 40.5% ownership interest in SVE for $750 million. The excess of our purchase price over the fair value of net assets acquired is $250 million and is included in goodwill. We also reacquired rights to distribute global brands for $263 million which is included in other nonamortizable intangible assets.

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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 senior compliance officer to lead and coordinate our compliance policies and practices.

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.

Peter A. Bridgman
Senior Vice President and Controller

Richard Goodman
Chief Financial Officer

Indra K. Nooyi
President and Chief Executive Officer

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Management's Report on Internal Control over Financial Reporting

To Our Shareholders:

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 30, 2006.

KPMG LLP, an independent registered public accounting firm, has audited the consolidated financial statements included in this Annual Report and, as part of their audit, has issued their attestation report, included herein, (1) on our management's assessment of the effectiveness of our internal controls over financial reporting and (2) on the effectiveness of our internal control over financial reporting.

During our fourth fiscal quarter of 2006, we began migrating certain of our financial processing systems to SAP software. This software implementation is part of our ongoing Business Process 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, we are modifying the design and documentation of our internal control processes and procedures relating to the new software.

Except as described above, there were no changes in our internal control over financial reporting that have materially affected, or are reasonably likely to materially affect, our internal control over financial reporting during our fourth fiscal quarter of 2006.

Peter A. Bridgman
Senior Vice President and Controller

Richard Goodman
Chief Financial Officer

Indra K. Nooyi
President and Chief Executive Officer

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Report of Independent Registered Public Accounting Firm

Board of Directors and Shareholders PepsiCo, Inc.:

We have audited the accompanying Consolidated Balance Sheet of PepsiCo, Inc. and Subsidiaries as of December 30, 2006 and December 31, 2005 and the related Consolidated Statements of Income, Cash Flows and Common Shareholders' Equity for each of the years in the three-year period ended December 30, 2006. We have also audited management's assessment, included in Management's Report on Internal Control over Financial Reporting that PepsiCo, Inc. and Subsidiaries maintained effective internal control over financial reporting as of December 30, 2006, 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. Our responsibility is to express an opinion on these consolidated financial statements, an opinion on management's assessment, and an opinion on the effectiveness of PepsiCo, Inc.'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 consolidated financial statements are free of material misstatement and whether effective internal control over financial reporting was maintained in all material respects. Our audit of the consolidated financial statements included examining, on a test basis, evidence supporting the amounts and disclosures in the consolidated 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, evaluating management's assessment, testing and evaluating the design and operating effectiveness of internal control, and 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. and Subsidiaries as of December 30, 2006 and December 31, 2005, and the results of their operations and their cash flows for each of the years in the three-year period ended December 30, 2006, in conformity with United States generally accepted accounting principles. Also, in our opinion, management's assessment that PepsiCo, Inc. maintained effective internal control over financial reporting as of December 30, 2006, is fairly stated, in all material respects, based on criteria established in Internal Control — Integrated Framework issued by COSO. Furthermore, in our opinion, PepsiCo, Inc. maintained, in all material respects, effective internal control over financial reporting as of December 30, 2006, based on criteria established in Internal Control — Integrated Framework issued by COSO.

As discussed in Note 7 to the consolidated financial statements, PepsiCo, Inc. and Subsidiaries adopted the provisions of FASB Statement No. 158, "Employers' Accounting for Defined Benefit Pension and Other Postretirement Plans — an amendment to FASB Statements No. 87, 88, 106 and 132(R)," as of December 30, 2006.

KPMG LLP

KPMG LLP
New York, New York
February 16, 2007

Selected Financial Data (in millions except per share amounts, unaudited)

Quarterly	First Quarter	Second Quarter	Third Quarter	Fourth Quarter
Net revenue				
2006	$7,205	$8,599	$8,950	$10,383
2005	$6,585	$7,697	$8,184	$10,096
Gross profit				
2006	$4,026	$4,790	$4,920	$5,639
2005	$3,715	$4,383	$4,669	$5,619
2006 restructuring and impairment charges[(a)]				
2006	–	–	–	$67
2005 restructuring charges[(a)]				
2005	–	–	–	$83
2006 Tax Adjustments[(b)]				
2006	–	–	–	$(602)
AJCA tax charge[(c)]				
2005	–	–	$468	$(8)
Net income				
2006	$1,019	$1,358	$1,481	$1,784
2005	$912	$1,194	$864	$1,108
Net income per common share — basic				
2006	$0.61	$0.82	$0.90	$1.09
2005	$0.54	$0.71	$0.52	$0.66
Net income per common share — diluted				
2006	$0.60	$0.80	$0.88	$1.06
2005	$0.53	$0.70	$0.51	$0.65
Cash dividends declared per common share				
2006	$0.26	$0.30	$0.30	$0.30
2005	$0.23	$0.26	$0.26	$0.26
2006 stock price per share[(d)]				
High	$60.55	$61.19	$65.99	$65.99
Low	$56.00	$56.51	$58.65	$61.15
Close	$59.34	$59.70	$64.73	$62.55
2005 stock price per share[(d)]				
High	$55.71	$57.20	$56.73	$60.34
Low	$51.34	$51.78	$52.07	$53.55
Close	$52.62	$55.52	$54.65	$59.08

The first, second, and third quarters consist of 12 weeks and the fourth quarter consists of 16 weeks in 2006 and 17 weeks in 2005.

(a) The 2006 restructuring and impairment charges were $67 million ($43 million or $0.03 per share after-tax). The 2005 restructuring charges were $83 million ($55 million or $0.03 per share after-tax). See Note 3.

(b) Represents non-cash tax benefits in connection with the 2006 Tax Adjustments. See Note 5.

(c) Represents income tax expense associated with our repatriation of earnings in connection with the AJCA. See Note 5.

(d) Represents the composite high and low sales price and quarterly closing prices for one share of PepsiCo common stock.

Five-Year Summary	**2006**	2005	2004
Net revenue	**$35,137**	$32,562	$29,261
Income from continuing operations	**$5,642**	$4,078	$4,174
Net income	**$5,642**	$4,078	$4,212
Income per common share — basic, continuing operations	**$3.42**	$2.43	$2.45
Income per common share — diluted, continuing operations	**$3.34**	$2.39	$2.41
Cash dividends declared per common share	**$1.16**	$1.01	$0.85
Total assets	**$29,930**	$31,727	$27,987
Long-term debt	**$2,550**	$2,313	$2,397
Return on invested capital[(a)]	**30.4%**	22.7%	27.4%

Five-Year Summary (Cont.)	2003	2002
Net revenue	$26,971	$25,112
Net income	$3,568	$3,000
Income per common share — basic	$2.07	$1.69
Income per common share — diluted	$2.05	$1.68
Cash dividends declared per common share	$0.63	$0.595
Total assets	$25,327	$23,474
Long-term debt	$1,702	$2,187
Return on invested capital[(a)]	27.5%	25.7%

(a) Return on invested capital is defined as adjusted net income divided by the sum of average shareholders' equity and average total debt. Adjusted net income is defined as net income plus net interest expense after-tax. Net interest expense after-tax was $72 million in 2006, $62 million in 2005, $60 million in 2004, $72 million in 2003 and $93 million in 2002.

- Includes restructuring and impairment charges of:

	2006	2005	2004	2003
Pre-tax	**$67**	$83	$150	$147
After-tax	**$43**	$55	$96	$100
Per share	**$0.03**	$0.03	$0.06	$0.06

- Includes Quaker merger-related costs of:

	2003	2002
Pre-tax	$59	$224
After-tax	$42	$190
Per share	$0.02	$0.11

- In 2006, we recognized non-cash tax benefits of $602 million ($0.36 per share) in connection with the 2006 Tax Adjustments. In 2005, we recorded income tax expense of $460 million ($0.27 per share) related to our repatriation of earnings in connection with the AJCA. In 2004, we reached agreement with the IRS for an open issue related to our discontinued restaurant operations which resulted in a tax benefit of $38 million ($0.02 per share).
- On December 30, 2006, we adopted SFAS 158 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 fifty-three weeks compared to fifty-two weeks in our normal fiscal year. The 53rd week increased 2005 net revenue by an estimated $418 million and net income by an estimated $57 million ($0.03 per share).

Reconciliation of GAAP and Non-GAAP Information

The financial measures listed below are not measures defined by generally accepted accounting principles. However, we believe investors should consider these measures as they are more indicative of our ongoing performance. Specifically, investors should consider the following:

- Our 2006 and 2005 division operating profit and our 2006 division operating profit growth;
- Our 2006 net income without the impact of the 2006 Tax Adjustments, our share of PBG's tax settlement and restructuring and impairment charges; our 2005 net income without the impact of the AJCA tax charge, restructuring charges and the extra week in 2005; and our 2006 net income growth without the impact of the aforementioned items;
- Our 2006 diluted EPS without the impact of the 2006 Tax Adjustments, our share of PBG's tax settlement and restructuring and impairment charges; our 2005 diluted EPS without the impact of the AJCA tax charge, restructuring charges and the extra week in 2005; our 2006 diluted EPS growth without the impact of the aforementioned items; and our 2004 diluted EPS without the impact of restructuring and impairment charges and certain tax benefits; and
- Our 2006 return on invested capital (ROIC) without the impact of the 2006 Tax Adjustments, our adoption of SFAS 158, the AJCA tax charge, restructuring and impairment charges and the extra week in 2005.

Operating Profit Reconciliation	2006	2005	Growth
Total PepsiCo Reported Operating Profit	$6,439	$5,922	9%
Corporate Unallocated	733	788	
PepsiCo Total Division Operating Profit	$7,172	$6,710	7%

Net Income Reconciliation	2006	2005	Growth
Reported Net Income	$5,642	$4,078	38%
2006 Tax Adjustments	(602)	–	
PepsiCo Share of PBG Tax Settlement	(18)	–	
AJCA Tax Charge	–	460	
Extra Week	–	(57)	
Restructuring and Impairment Charges	43	55	
Net Income Excluding above Items	$5,065	$4,536	12%

Diluted EPS Reconciliation	2006	2005	2006 Growth	2004
Reported Diluted EPS	$3.34	$2.39	40%	$2.44
2006 Tax Adjustments	(0.36)	–		–
PepsiCo Share of PBG Tax Settlement	(0.01)	–		–
AJCA Tax Charge	–	0.27		–
Extra Week	–	(0.03)		–
Restructuring and Impairment Charges	0.03	0.03		0.06
2004 Tax Benefits	–	–		(0.18)
Diluted EPS Excluding above Items	$3.00	$2.66	13%	$2.32

ROIC Reconciliation	2006
Reported ROIC	30%
2006 Tax Adjustments	(3)
SFAS 158 Adoption	(1)
AJCA Tax Charge	(1)
ROIC Excluding above Items	26%*

* Does not sum due to rounding. Additionally, the impact on ROIC of the 2006 and 2005 restructuring and impairment charges and the extra week in 2005 rounds to zero.

Glossary

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

Bottler: 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 sold from our bottlers to independent distributors and retailers.

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

Business Process Transformation (BPT): our comprehensive multi-year effort to drive efficiencies. It includes efforts to consolidate, or integrate, key business functions to take advantage of our scale. It also includes moving to a common set of processes that underlie our key activities, and supporting them with a common technology application. And finally, it includes our SAP installation, the computer system that will link all of our systems and processes.

Concentrate Shipments and Equivalents (CSE): measure of our physical beverage volume sold to our customers. This measure is reported on our fiscal year basis.

Consumers: people who eat and drink our products.

Customers: authorized bottlers and independent distributors and retailers.

CSD: carbonated soft drinks.

Derivatives: financial instruments 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.

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.

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.

Smart Spot: our initiative that helps consumers find our products that can contribute to healthier lifestyles.

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

Translation adjustments: the impact of the conversion of our foreign affiliates' financial statements to U.S. dollars for the purpose of consolidating our financial statements.

Common Stock Information

Stock Trading Symbol — PEP
Stock Exchange Listings

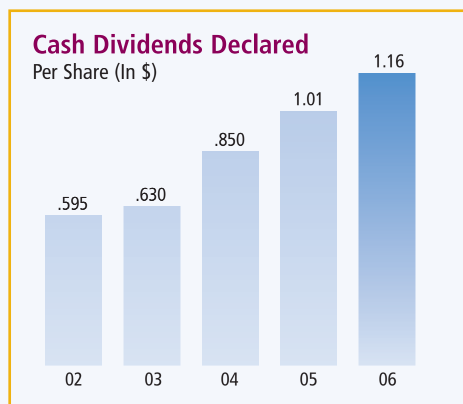
The New York Stock Exchange is the principal market for PepsiCo common stock, which is also listed on the Amsterdam, Chicago and Swiss Stock Exchanges.

Shareholders

At year-end 2006, there were approximately 190,000 shareholders of record.

Dividend Policy

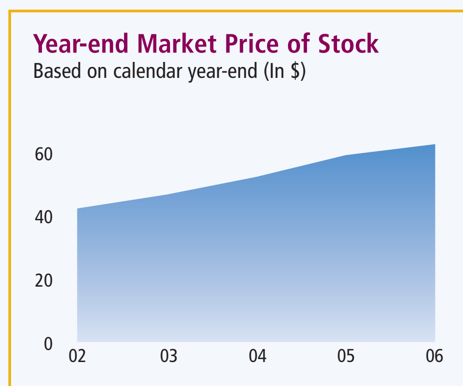
We target an annual dividend payout of approximately 45% of prior year's net income from continuing operations. Dividends are usually declared in January, May, July and November and paid at the end of March, June and September and the beginning of January. The dividend record dates for these payments are March 9, and, subject to approval of the Board of Directors, expected to be June 8, September 7 and December 7, 2007. We have paid quarterly cash dividends since 1965.



Stock Performance

PepsiCo was formed through the 1965 merger of Pepsi-Cola Company and Frito-Lay, Inc. A $1,000 investment in our stock made on December 31, 2001 was worth about $1,393 on December 31, 2006, assuming the reinvestment of dividends into PepsiCo stock. This performance represents a compounded annual growth rate of 7%.

The closing price for a share of PepsiCo common stock on the New York Stock Exchange was the price as reported by Bloomberg for the years ending 2002-2006. Past performance is not necessarily indicative of future returns on investments in PepsiCo common stock.



Shareholder Information

Annual Meeting

The Annual Meeting of Shareholders will be held at Frito-Lay Corporate Headquarters, 7701 Legacy Drive, Plano, Texas, on Wednesday, May 2, 2007, at 9 a.m. local time. Proxies for the meeting will be solicited by an independent proxy solicitor. This Annual Report is not part of the proxy solicitation.

Inquiries Regarding Your Stock Holdings

Registered Shareholders (shares held by you in your name) should address communications concerning transfers, statements, dividend payments, address changes, lost certificates and other administrative matters to:

The Bank of New York
Shareholder Services Department
P.O. Box 11258
Church Street Station
New York, NY 10286-1258
Telephone: 800-226-0083
212-815-3700 (Outside the U.S.)
E-mail: shareowners@bankofny.com
Website: www.stockbny.com
or
Manager Shareholder Relations
PepsiCo, Inc.
700 Anderson Hill Road
Purchase, NY 10577
Telephone: 914-253-3055

In all correspondence or telephone inquiries, please mention PepsiCo, your name as printed on your stock certificate, your Social Security number, your address and telephone number.

SharePower Participants (employees with SharePower options) should address all questions regarding your account, outstanding options or shares received through option exercises to:

Merrill Lynch/SharePower
Stock Option Unit
1600 Merrill Lynch Drive
Mail Stop 06-02-SOP
Pennington, NJ 08534
Telephone: 800-637-6713 (U.S., Puerto Rico and Canada)
609-818-8800 (all other locations)

In all correspondence, please provide your account number (for U.S. citizens, this is your Social Security number), your address, your telephone number and mention PepsiCo SharePower. For telephone inquiries, please have a copy of your most recent statement available.

Employee Benefit Plan Participants

PepsiCo 401(k) Plan & PepsiCo Stock Purchase Program

The PepsiCo Savings & Retirement Center at Fidelity
P.O. Box 770003
Cincinnati, OH 45277-0065
Telephone: 800-632-2014
(Overseas: Dial your country's AT&T Access Number +800-632-2014. In the U.S., access numbers are available by calling 800-331-1140. From anywhere in the world, access numbers are available online at www.att.com/traveler.)
Website: www.netbenefits.fidelity.com

PepsiCo Stock Purchase Program – for Canadian employees:
Fidelity Stock Plan Services
P.O. Box 5000
Cincinnati, OH 45273-8398
Telephone: 800-544-0275
Website: www.iStockPlan.com/ESPP
Please have a copy of your most recent statement available when calling with inquiries.

If using overnight or certified mail send to:
Fidelity Investments
100 Crosby Parkway
Mail Zone KC1F-L
Covington, KY 41015

Shareholder Services

BuyDIRECT Plan

Interested investors can make their initial purchase directly through The Bank of New York, transfer agent for PepsiCo, and Administrator for the Plan. A brochure detailing the Plan is available on our website www.pepsico.com or from our transfer agent:

The Bank of New York
PepsiCo Plan
Church Street Station
P.O. Box 1958
Newark, NJ 07101-9774
Telephone: 800-226-0083
212-815-3700 (Outside the U.S.)
Website: www.stockbny.com
E-mail: shareowners@bankofny.com

Other services include dividend reinvestment, optional cash investments by electronic funds transfer or check drawn on a U.S. bank, sale of shares, online account access, and electronic delivery of shareholder materials.

Financial and Other Information

PepsiCo's 2007 quarterly earnings releases are expected to be issued the weeks of April 23, July 23, October 8, 2007, and February 4, 2008.

Copies of PepsiCo's SEC reports, earnings and other financial releases, corporate news and additional company information are available on our website www.pepsico.com.

Our CEO and CFO Certifications required under Sarbanes-Oxley Section 302 were filed as an exhibit to our Form 10-K filed on February 20, 2007. Our 2006 Domestic Company Section 303A CEO Certification was filed with the New York Stock Exchange (NYSE).

If you have questions regarding PepsiCo's financial performance contact:

Jamie Caulfield
Vice President, Investor Relations
PepsiCo, Inc.
Purchase, NY 10577
Telephone: 914-253-3035

Independent Auditors

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New York, NY 10154-0102
Telephone: 212-758-9700

Corporate Headquarters

PepsiCo, Inc.
700 Anderson Hill Road
Purchase, NY 10577
Telephone: 914-253-2000

PepsiCo Website: www.pepsico.com

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Tropicana
PURE PREMIUM
CALCIUM

Gatorade

Lay's
Classic

PEPSI

OATMEAL
HELPS REMOVE
CHOLESTEROL
OLD FASHIONED
QUAKER
OATS