

Growth & Trust



PepsiCo 2003

Financial Highlights

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

	2003	2002	% Chg ^(a)
Summary of Operations			
Division net revenue	\$26,969	\$24,978	8
Total net revenue	\$26,971	\$25,112	7
Division operating profit	\$5,813	\$5,308	10
Total operating profit	\$4,781	\$4,295	11
Net income	\$3,568	\$3,000	19
Net income per common share	\$2.05	\$1.68	22
Other Data			
Management operating cash flow ^(b)	\$3,032	\$3,279	(7)
Net cash provided by operating activities	\$4,328	\$4,627	(6)
Capital spending	\$1,345	\$1,437	(6)
Common share repurchases	\$1,929	\$2,158	(11)
Dividends paid	\$1,070	\$1,041	3
Long-term debt	\$1,702	\$2,187	(22)

(a) Percentage changes above and in text are based on unrounded amounts.

(b) Excludes net capital spending. For additional information see "Our Liquidity and Capital Resources" in Management's Discussion and Analysis.



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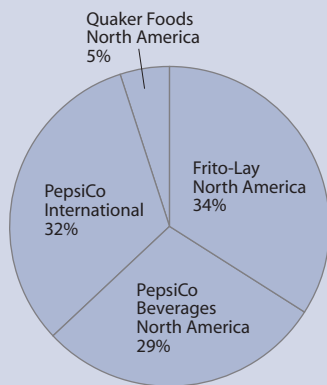
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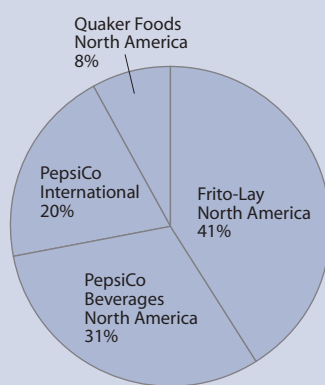
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Division Net Revenue Total: \$26,969



Division Operating Profit Total: \$5,813



On the cover:

Growth and trust go hand in hand.

PepsiCo grows because we work hard to earn consumer trust. People bring our brands into their homes and consume them throughout the day. This report explains some of the reasons why consumer trust — and the trust of other constituents — is a high priority for PepsiCo.

When markets 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 volume as Wal-Mart does not report volume to these services.

Dear Fellow Shareholders:

Growth and trust at PepsiCo are integrally connected, and we are proud of that.

They are at the core of our heritage, and together form the cornerstone for our future success. We are so confident of this connection that we chose to highlight it on our cover, and to share our 2003 performance in the context of our culture. We're



Steve Reinemund
Chairman and Chief Executive Officer

focused squarely on a commitment to deliver *sustained growth* through *empowered people*, acting with *responsibility* and building *trust*. Put simply, this commitment represents our priorities in the pursuit of creating value.

This isn't just corporate speak. It's how our 143,000 associates do business. It enables us to deliver our annual results, to plan for our future and to address challenges opportunistically.

To help show how, we've included in this publication a Corporate Social Responsibility Report for the first time in our company's history. I encourage you to read this special report, as it provides a clear line of sight into how we're operating responsibly, and building trust along the way.

Through growth and trust, your company consistently delivers industry leading performance. Over the past four years, we've grown faster than both the S&P 500 and our industry group. We improved on that strong record in 2003:

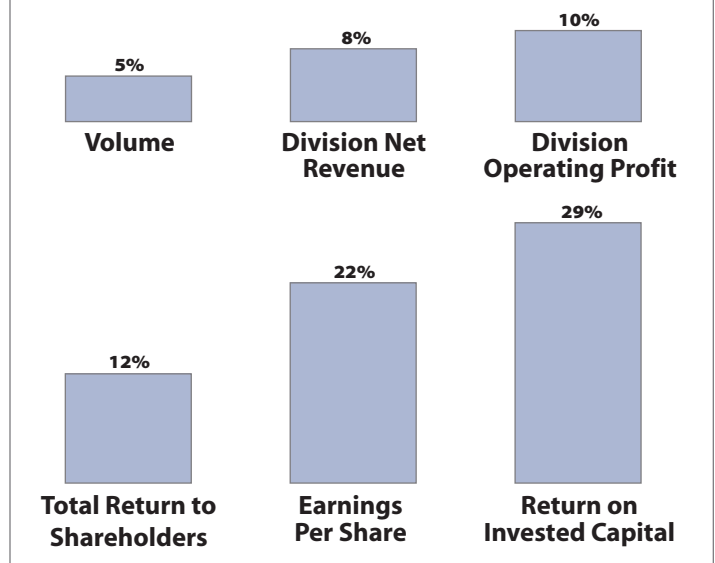
- Volume grew 5%.
- Division net revenue grew 8%.
- Division operating profit grew 10%.
- Total return to shareholders was 12%.
- Earnings per share grew 22%.
- Cash flow from operations was \$4.3 billion and management operating cash flow was more than \$3 billion.

Our leading brands, unparalleled distribution systems, and vibrant pipeline of innovation continued to drive that performance, and serve as strong platforms for future growth. We're proud of all these tools, and continue to invest in them. But at the heart of our capabilities is a culture committed to growth.

A commitment to sustained growth

It's not just any kind of growth. Just about any way you look at our businesses, we're producing solid, balanced growth. Our health and wellness brands are growing, as are our fun-for-you businesses. We've achieved solid growth rates in snacks as well as beverages, within our North American as well as international

2003 Scorecard



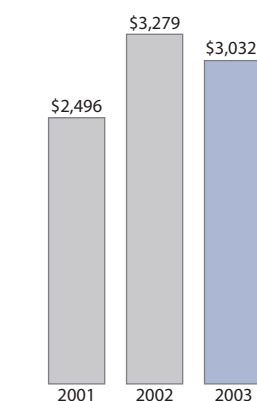
operations. Our top-line and bottom-line growth rates are in step, as are our short-term and long-term growth prospects.

Our businesses are strong. We rank fourth among the largest food and beverages companies in the world. We have 6 of the 15 largest-selling brands in U.S. supermarkets. And, around the world, 16 of our brands sell more than one billion dollars each at retail. Our products are enjoyed by people of all ages, at all times of day.

There's no better time to invest for future growth than when things are going well, and that's exactly what we did in 2003. Specifically, we streamlined our North American beverage operations, retired old snack assets, and restructured our international businesses. And we're investing in new business processes that will yield funds to reinvest back into our businesses. Those dollars will enhance our capabilities and

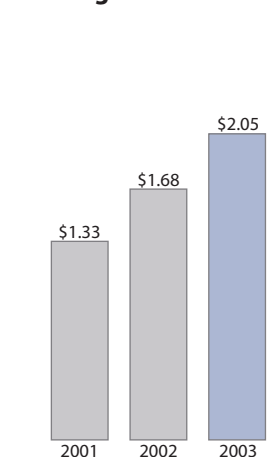
Management Operating Cash Flow *

\$ In Millions



* See pages 56-57

Earnings Per Share



advantages; for example, driving product innovation and exercising marketing muscle across the globe.

People make the difference

Just as growth is part of PepsiCo's DNA, so is the idea of personal ownership. Our people have a long history of thinking and acting like they own their businesses, which is a reflection of their passion and ability to make a difference in their work. The associates who make, move and sell our products, and their colleagues who support them, understand that even the greatest brands and plans in the world won't succeed without empowered people to steer those capabilities and resources in meaningful ways.

That has never been more true or necessary than today. The need for personal ownership is more compelling than ever as we face three inescapable realities:

- A rapidly consolidating customer base that expects us to operate efficiently and effectively to meet their needs.
- A changing consumer with increasingly different needs, and a desire and expectation for choices.
- Increasingly sophisticated competitors who understand that convenient foods and beverages, our "sweet spot," also represent an opportunity for growth.

To successfully address these challenges and meet our growth goals, the importance of ownership is clear. It's a long-standing strength we will continue to build upon, as we change and adapt to these market conditions. And we are changing ourselves.

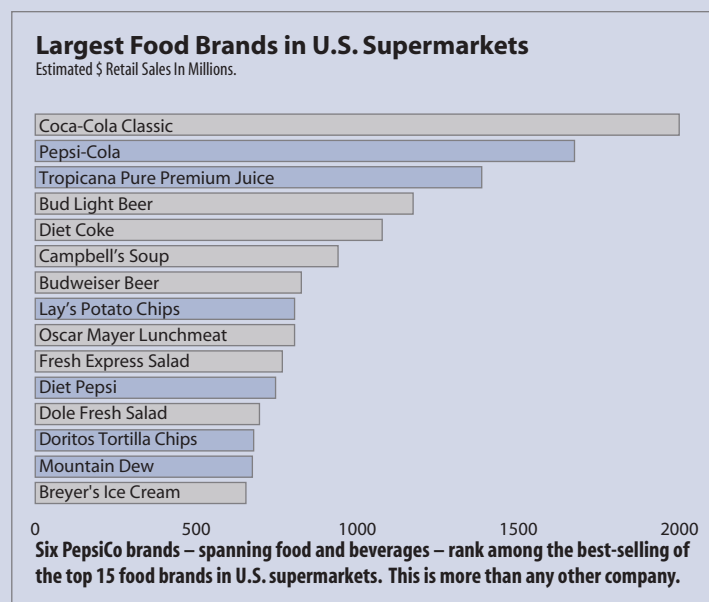
First and foremost, we've taken the best of what we've done historically — managing each independent and successful business vertically — and added a new dimension: managing across all our businesses horizontally to maximize PepsiCo's muscle. Whether that means purchasing boxes for everything from cereals to juices, or manufacturing and selling across a broader array of product lines, we're pushing ourselves to

operate faster and smarter than ever before. And we're doing it from a position of strength and success. In essence, we're building on how we've managed best.

In this new environment of vertical and horizontal management, PepsiCo associates are empowered to innovate not only across our brands, but through virtually any business process they touch. They're using their diverse experiences to develop new product platforms, to power up our existing big brands with big ideas, and to find new ways to enhance our effectiveness through deeper collaboration. For example, in Mexico our Sabritas and Gamesa businesses have joined together to share services such as accounting, audit, legal, fleet operations and warehousing to take advantage of their combined scale and create major efficiencies. Strong and successful businesses in their own right, Sabritas and Gamesa have discovered they can be even greater together.

Working together has also created success in the marketplace. Under our continuing "Power of One" initiative, we've adopted a horizontal management perspective with our customers — with great results. In 2003, we created dedicated sales teams to represent and sell our entire portfolio of brands to our major retail customers. Today, we have 20 teams that market our products to more than 35 of our largest partners: mass merchandisers, club, supermarket and convenience stores, drug and dollar stores, and foodservice accounts. We've learned that we can do much more together than any one of our divisions or business units can do alone. This approach increases our in-store presence — and boosts sales and profits for our customers. In fact, our brands drive nearly as much sales and profit growth and cash flow for major U.S. retailers as all five of our next largest competitors combined.

Empowerment helps drive success, and with success comes rewards. Last year, we redesigned our compensation system for executives, and our SharePower stock option program for PepsiCo associates. Our new compensation designs provide



industry leading pay for industry leading performance, and provide strong incentives for superior performance. Related to these compensation changes, we began expensing stock options at the end of 2003, ahead of the expected requirement to do so — something that will make financial performance comparisons easier in years to come.

No discussion of empowered people would be complete without mentioning two important PepsiCo leadership milestones. Rogelio Robledo, president and CEO of our Frito-Lay International business, and Peter Thompson, president and CEO of our PepsiCo Beverages International business, have chosen to retire. With more than 40 years of PepsiCo leadership experience between them, they have left an inspiring legacy for our company, for which we are extremely grateful. While these seasoned leaders are leaving PepsiCo, I'm particularly pleased that Rogelio Robledo has taken a new leadership role with The Pepsi Bottling Group as president and CEO of PBG Mexico. His track record for driving growth will serve PBG and PepsiCo well.

Doing it the right way

From product quality to environmental stewardship, regulatory compliance to corporate governance, we have a broad range of constituents who need to understand, support and trust our businesses and the way we operate them. Consumers need to trust that our products are high quality and that they are safe. Our shareholders and government agencies need to fully understand how our businesses are performing. Our communities need to know that we are actively involved in the issues and challenges of the times. We need to demonstrate what we are doing to be responsible stewards of the environment we all share. For these reasons, and many more, we have a responsibility to do things the right way, and we take it seriously.

We take pride in providing transparency in reporting financial and operating performance, in running our businesses responsibly, and in building trust with our constituents. Those

efforts are being recognized. Institutional Shareholder Services in 2003 reviewed and rated our corporate governance programs. PepsiCo outscored 100% of all other food, beverage and tobacco companies and 96% of the S&P 500 companies.

The enclosed Corporate Social Responsibility report begins to share more insight into just how we're accomplishing our work along these lines. You'll find details on our approach to managing our economic, environmental and social responsibilities.

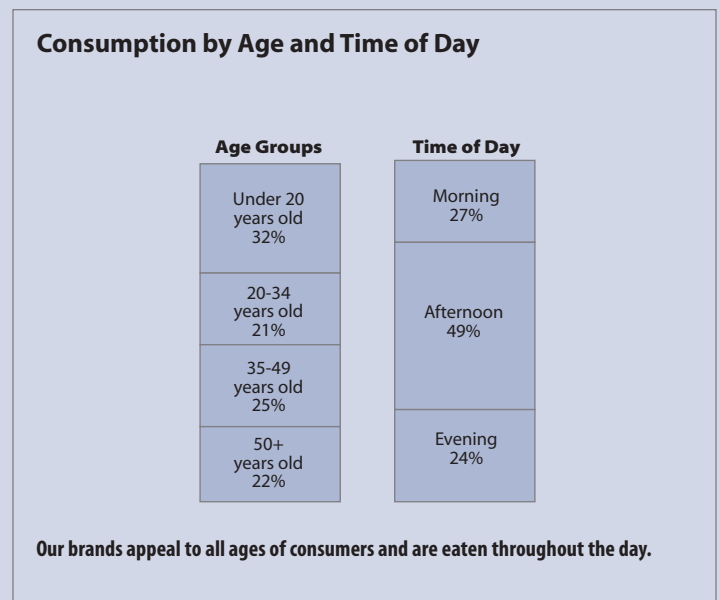
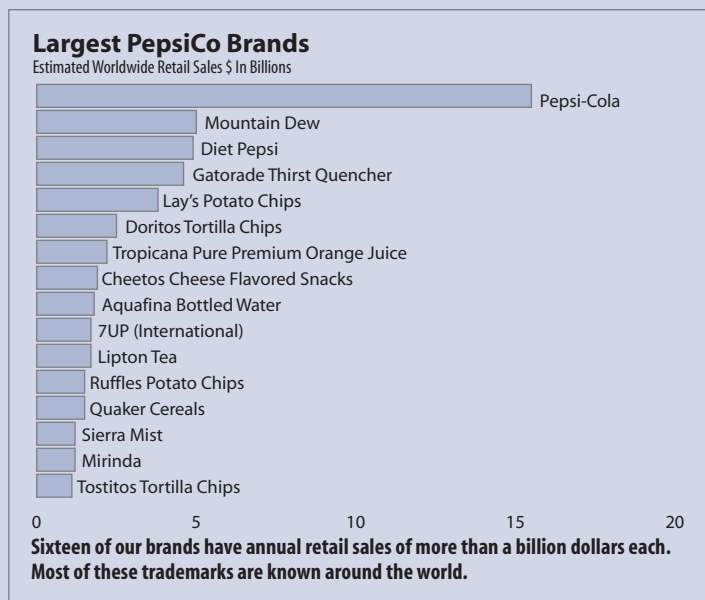
It works

To see how growth and trust work together to create value for you, consider how PepsiCo is taking action to address the issue of health and wellness.

You can't read a newspaper without finding a story on obesity in the United States and other countries, and its related health consequences. As a result, consumers want more choices of convenient foods and beverages that are healthier.

We started balancing PepsiCo's portfolio in the 1990s by adding some of the world's most recognizable better-for-you brands to our lineup of successful base brands — literally re-tooling our company for future growth. Bringing the Tropicana, Quaker Oats and Gatorade brands to PepsiCo dramatically increased our ability to provide more choices for consumers. We led the U.S. food and beverage industry as the first major company to eliminate trans fats from its salty snack brands, and we committed to driving 50% of innovation to better-for-you and good-for-you products. We exceeded that goal in 2003.

And that's just the beginning. We've engaged leading health and nutrition experts and formed a Blue Ribbon Health and Wellness Advisory Board to help us identify consumer nutrition needs. Our Advisory Board is made up of medical, nutrition, fitness and public policy professionals. Its role is not to endorse our actions or speak on our behalf — only to advise us objectively and candidly on how we can improve the healthfulness of existing products, develop new better-for-you products and



encourage more active lifestyles. It has been invaluable in helping us create a strong health and wellness agenda.

We are adopting scientifically accepted standards for nutritious foods and beverages — those based on guidelines from the National Academy of Sciences and the U.S. Food and Drug Administration — to better assess our product portfolio. We've expanded product choices through trusted brands like Quaker, Tropicana, Gatorade, Diet Pepsi, Lay's and Aquafina. We've identified many opportunities for other product improvements, and we're aggressively pursuing new product platforms like low-carbohydrate chips and reduced-calorie orange juice.

Importantly, we're looking at health and wellness globally, and working hard to understand unique nutritional needs in different parts of the world. For example, whereas calcium consumption is a concern in developed markets, iron deficiency is a problem in developing countries. A global business must be sensitive to local needs, and that's just what we intend to be.

Another example of turning challenge into opportunity is in the area of diversity. PepsiCo is addressing rapidly changing consumer product needs with an aggressive focus on diversity and inclusion, both inside and outside the company. And we've been doing it for years. We understand that consumers — particularly those in urban markets — have diverse product needs. The first company to "crack the code" for those needs will win in the marketplace.

That's why we have goals for recruiting a diverse workforce to help us better serve our changing, more diverse consumer base. It's also why we've set aggressive plans in action to nurture an inclusive work environment — one that assures all employees feel welcome and captures the best of diverse thinking. That focus is paying off with an array of new products and promotions for urban markets. Whether it's Gatorade Xtremo!, Quaker Oatmeal Breakfast Squares or guacamole-flavored Lay's potato chips, new products are reaching and connecting with urban and ethnic consumers in meaningful ways.

Two additional critical resources we're tapping to stay connected with our consumers are our Ethnic Advisory Boards. Our African American and Latino/Hispanic Advisory Boards comprise leading influencers and thought leaders in these rapidly growing ethnic segments of the population. They further enable us to keep pace with — if not lead — the trends that our consumers are following.

Our approach to health and wellness — and to diversity — is about acting responsibly, and delivering products consumers trust in a range of convenient food and beverage choices.

Riding the wave

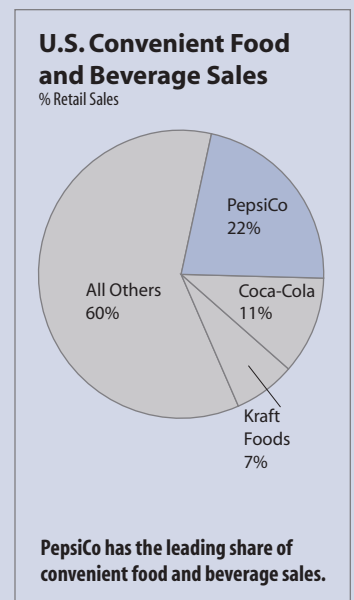
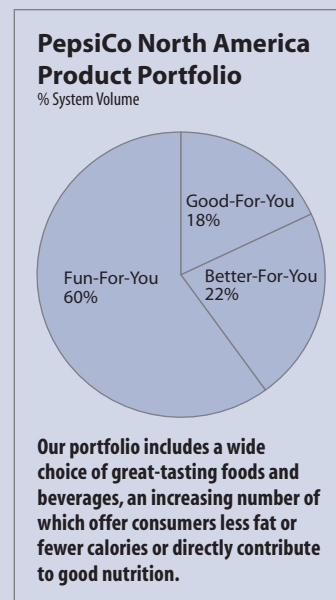
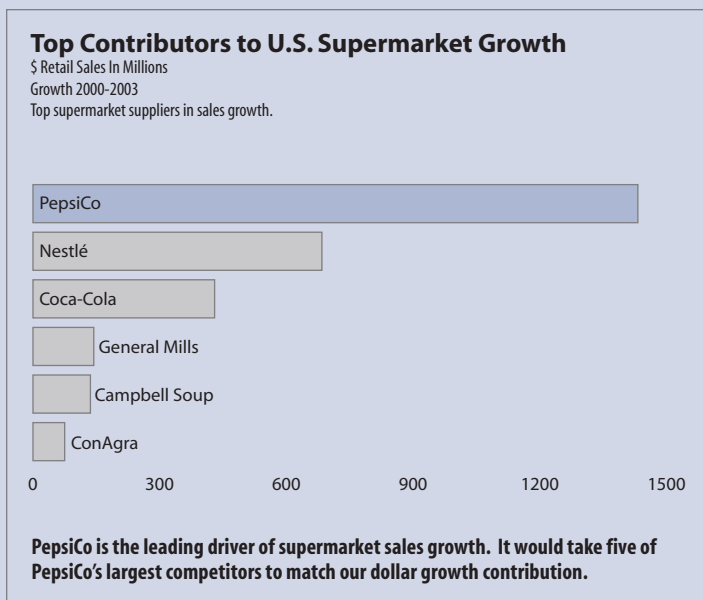
Our good news is that PepsiCo finished 2003 with industry leading results, strong momentum, a highly complementary stable of growing businesses, and a pipeline full of innovation.

We've opportunistically invested in ways designed to capture costs and reinvest them into our growing businesses. We've further strengthened a culture focused squarely on delivering sustained growth with empowered people, and new compensation programs that rewards industry leading performance.

We're also doing things the right way. Acting with responsibility and building trust are hallmarks of our commitment to corporate social responsibility, and we're more committed than ever to delivering results that we're proud to call our own, and proud to deliver to you. We welcome your thoughts and reactions, and look forward to updating you on our continued progress.



Steve Reinemund
Chairman of the Board and
Chief Executive Officer





Growth through customer focus.

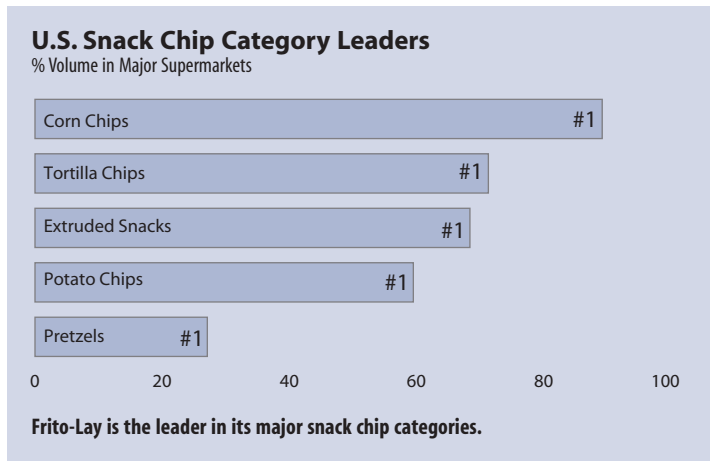
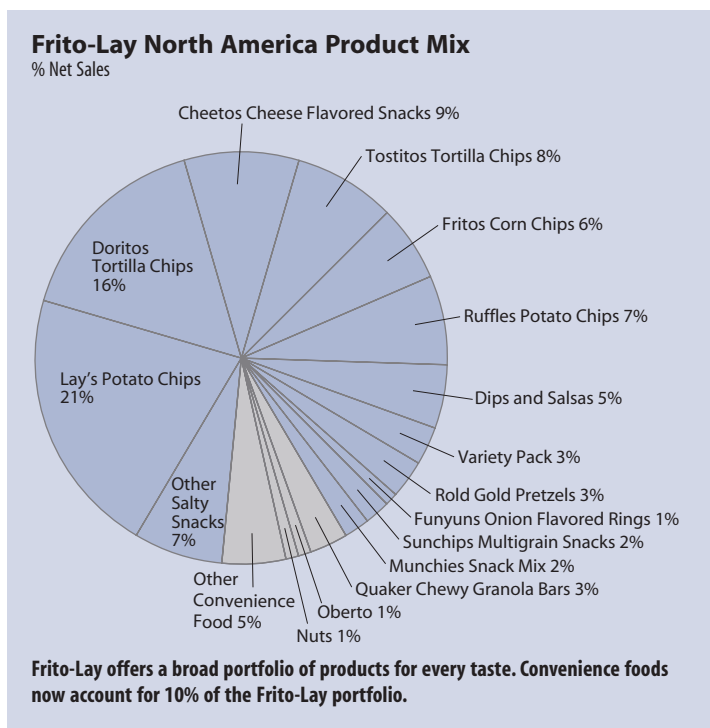
A focus on our retail partners — our customers — builds sales. We've created 20 dedicated customer sales teams that market PepsiCo products to more than 35 mass merchandiser, club, supermarket, convenience store, drug and dollar store, and foodservice accounts. Close attention to our customers' businesses yields increased sales for PepsiCo, and has made us the #1 source of sales growth, profit growth and cash flow for our retail partners. On Superbowl weekend, this display in a Houston Wal-Mart featured a variety of our products. Store Co-Manager Curtis Tipton (right) discusses the strong weekend sales with Mark Mohs (left) vice president, customer development, Frito-Lay North America and Tony Dunning (center) vice president, Pepsi Wal-Mart team, Pepsi-Cola North America.

Frito-Lay North America

Frito-Lay North America (FLNA) delivered a year of strong performance, further building on its position as the industry leader. Volume grew 4%, net revenue increased 6% and operating profit rose by 7%. This performance was generated by solid performance in both “core” salty snacks and “add more” convenience foods.

Driving this consistent performance was abundant and effective product and packaging innovation. From technical breakthroughs with products like Lay’s Stax potato crisps to the success of ethnic product launches like the Lay’s Cool Guacamole potato chips and Doritos Guacamole flavored tortilla chips, new products provided new choices for consumers. Chief among the new products in our core salty snack business was the line of Natural and Organic snacks, introduced early in 2003. By the end of the year, FLNA had achieved a leading share in this rapidly developing category. Our new Lay’s Stax brand potato crisps packaged in portable, resealable, crush-resistant containers, were introduced in the third quarter, and quickly attained a one-fifth share of their category.

Overall, salty brands performed well, led by Cheetos cheese-flavored snacks, Lay’s potato chips, Munchies snack mix and Doritos tortilla chips. Twisted Cheetos snacks, introduced early in 2003, and single-serve packages contributed strongly. Munchies snack mix, introduced in 2002, approached a 30% share of the snack mix category in 2003. FLNA gained almost a share point in the salty snack industry. Importantly, FLNA delivered on its landmark promise as the first U.S. company to

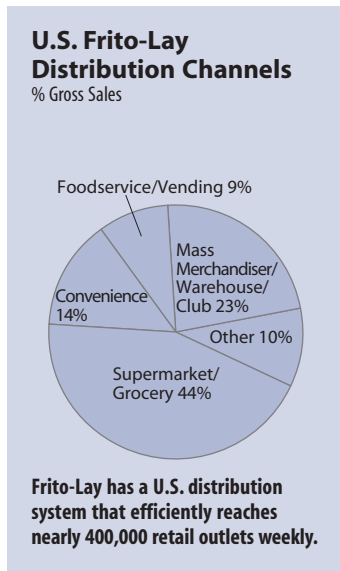
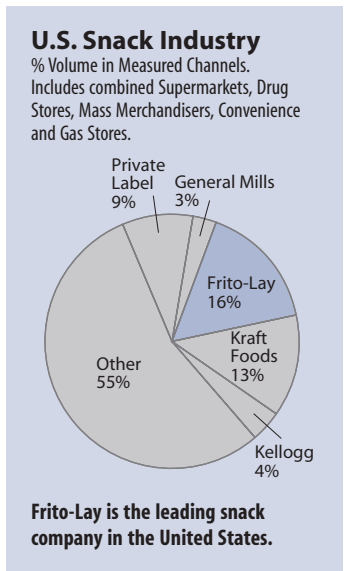
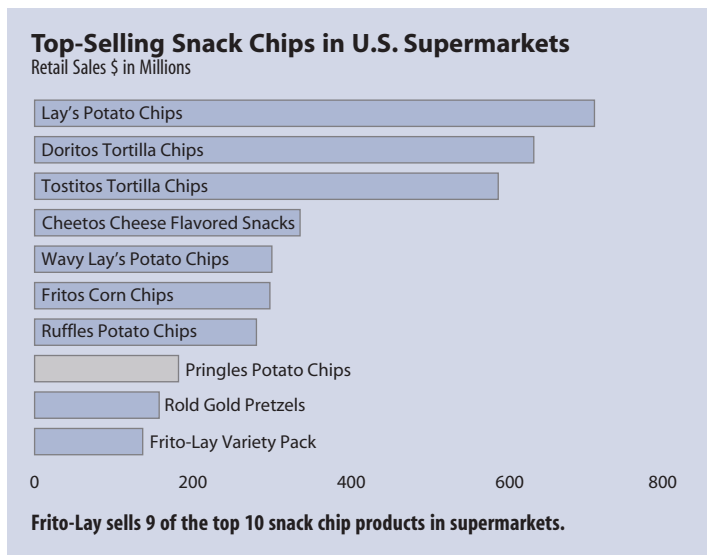


remove trans fats from its salty snack products. As the industry leader, this was the right decision, as consumer demand for more health conscious snacking choices is clear.

To capture more opportunities in the broader snack market, FLNA has created a team focused entirely on initiatives outside of salty snacks. By year-end, the strategic value of this reorganization was clear. The division’s convenience food business delivered a year of solid, double-digit volume growth, aided by the success of Quaker snack bars and with new product innovation like Quaker Chewy Wholesome Favorites granola bars and Oatmeal-On-The-Go cereal bars, both introduced in 2003. Quaker bars are the pound share leader in supermarkets, the largest distribution channel. Quaker Fruit &

Oatmeal Toastables, cholesterol-free, vitamin-fortified toaster pastries with real oatmeal crust and real fruit filling, were a big hit. They were another strong contributor to volume growth, as were nuts and Oberto meat snacks.

As FLNA enters 2004, the division's sights are set on growing the core salty snack business with even more choices for consumers. We'll expand our better-for-you snack portfolio and continue to focus on single-serve and convenience snacks. We see significant opportunities to expand in new channels, while continuing to grow volume in every channel.



New Products from Frito-Lay

Our innovation pipeline is full. Here are some of the new products, flavors and packages Frito-Lay introduced in North America in 2003:

In the United States

- Doritos Guacamole tortilla chips
- Grandma's Chocolate with Peanut Butter Crème mini sandwich cookies
- Lay's Cool Guacamole potato chips
- Lay's Dill Pickle potato chips
- Lay's Extra Hot! Flamin' Hot potato chips
- Lay's Honey BBQ potato chips
- Lay's Stax potato crisps
- Lay's Tangy Salsa potato chips
- Natural and Organic line
- Oberto Barbecue beef jerky
- Oberto meat sticks
- Oberto On the Go beef jerky bites
- Quaker Chewy Trail Mix granola bars
- Quaker Chewy Wholesome Favorites granola bars
- Quaker Fruit & Oatmeal Toastables toaster pastries

- Quaker Quick Bites cookies and crackers
- Quakes corn rings
- Rold Gold Braided Twists pretzels
- Rold Gold Pretzel & Cheese Dip kits
- Ruffles Hearty Chili & Cheese potato chips
- Tostitos Gold tortilla chips
- Trail Mix – Original and Honey flavored
- Twisted Cheetos cheese flavored snacks

In Canada

- Cheetos White Cheddar puffs
- Doritos Nacho Italiano tortilla chips
- Lay's Tastes of Canada – Cape Breton Sea Salt & Pepper potato chips
- Lay's Tastes of Canada – Toronto College Street Pizza potato chips
- Tostitos Restaurant Chips with Hint of Lime
- Miss Vickie's Sweet Chili & Sour Cream potato chips





Growth through health and wellness.

Growing consumer concerns about obesity and health and wellness offer PepsiCo new opportunities. As a company responsive to consumer needs, we want to be part of the solution. So we've committed to introducing more of what we call "better-for-you" products. These are lower in fat, sugar or sodium and products that contribute to a healthy diet. We were the first major company to remove trans fats from our salty snack products and label them as such. Our innovation pipeline has created a reduced-calorie orange juice beverage and lower-carbohydrate versions of our snacks, in addition to our existing portfolio of baked snacks, diet beverages, juices and waters. What won't change is our focus on great taste and convenience, so that our products can be enjoyed by all ages and consumed anywhere.

PepsiCo Beverages North America

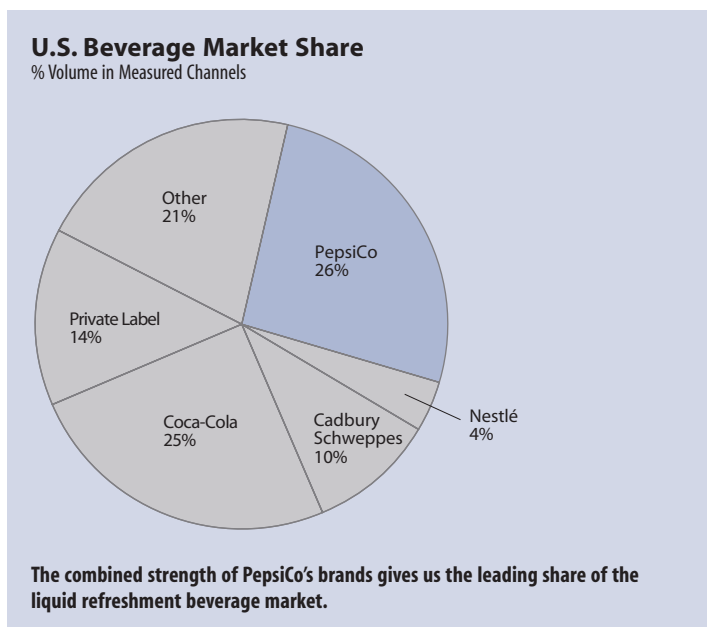
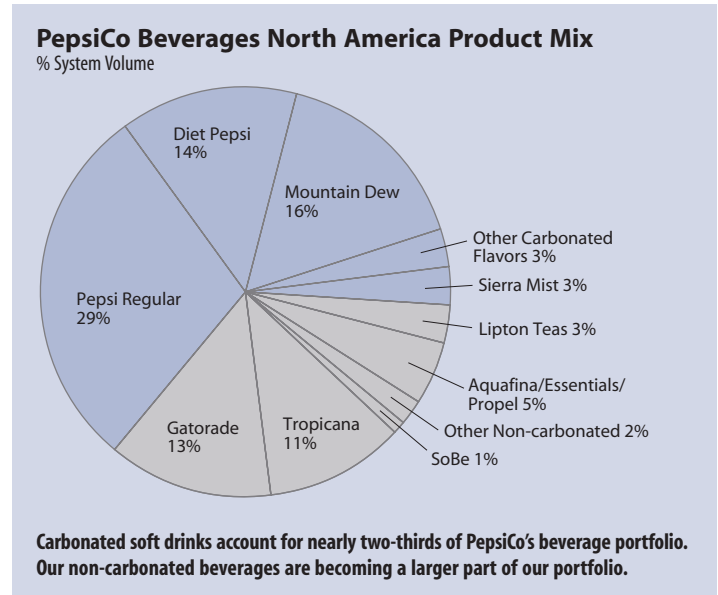
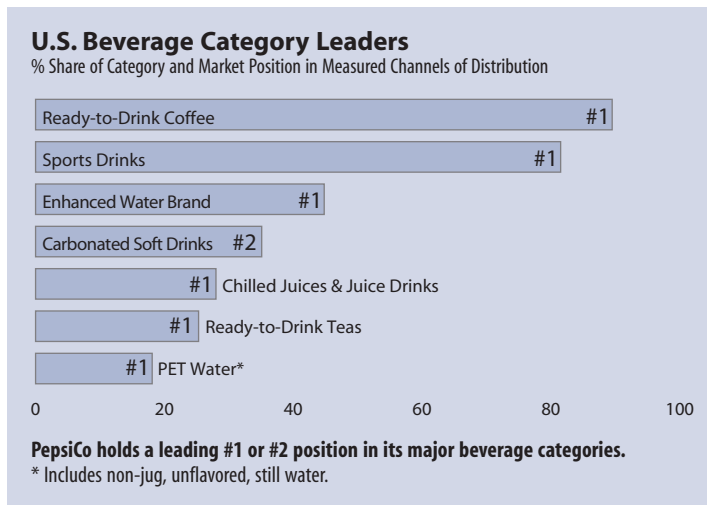
PepsiCo Beverages North America (PBNA) achieved a year of strong revenue and profit growth, and increased its U.S. leadership position in liquid refreshment beverages across all measured channels of distribution. PBNA volume growth was 3%, net revenue increased 7% and operating profit was up 13%. Both non-carbonated and carbonated beverages contributed to this performance.

PBNA saw healthy 8% volume growth in non-carbonated drinks, led by Gatorade sports drink, Propel fitness water and Aquafina bottled waters. Gatorade generated exceptional growth in major distribution channels such as mass merchandisers and club stores. As the world's preeminent authority on rehydration, Gatorade uses its scientific expertise and marketing prowess to extend consumer understanding of its efficacy, and increase the visibility of the brand. Gatorade's partnership with leading colleges and universities, and its sideline presence with leading professional and amateur sports organizations

are strategic growth levers for the business. Add in the brand's flavor and packaging innovation capabilities, and it's easy to see why this business has delivered double-digit compound growth for more than a decade.

In the bottled water category, Aquafina maintained its leading share. The business ran its first-ever national promotion, which kept it the #1 single-serve bottled water brand and registered another year of double-digit growth. Propel fitness water is a lightly flavored water with just 10 calories per eight-ounce serving and vitamins that contribute to an overall healthy lifestyle. Launched in 2002, Propel grew at a feverish pace, and led the enhanced water category with a share of more than 44%.

Our Tropicana juice business continued to outperform the chilled juice category, and expanded its category leadership in both the United States and Canada. Our flagship brand,



PepsiCo Beverages North America (continued)

Tropicana Pure Premium, gained share as we focused on the basics such as a better pricing architecture, improved advertising and new productivity enhancements. In late 2003, we combined the operations of Tropicana and Dole juices and juice drink brands — in both refrigerated and shelf-stable products — into one team, creating the single-largest juice and juice-drink organization in the world. In housing our combined juice business along with our Gatorade and Quaker Foods businesses, we'll be able to create further synergies across our portfolio.

Our carbonated soft drink volume grew 1.5% for the year, driven by the further roll out of Sierra Mist to more than 90% of the United States, and strong diet soft drink performance, led by Diet Pepsi. Across all channels in the United States, including foodservice and vending, Sierra Mist became the #2 lemon-lime and ninth best-selling carbonated soft drink brand of any kind. It is now our 16th PepsiCo brand to generate retail sales of more than \$1 billion. In the United States, Diet Pepsi, when measured across all channels, was the fastest growing established brand among the top-10. In Canada, Diet Pepsi surpassed our major competitor in share.

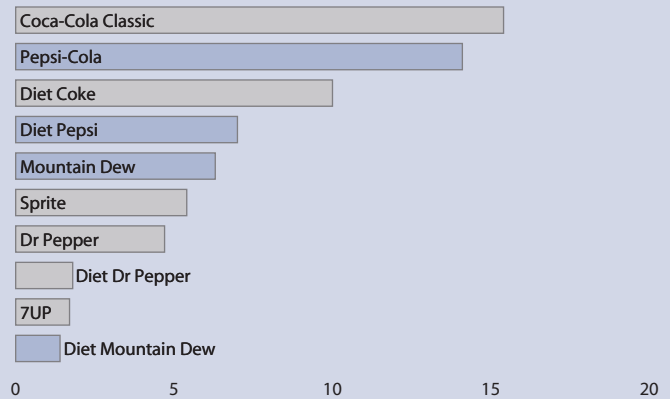
A strong pipeline of innovation for 2003 included Pepsi Vanilla, Diet Pepsi Vanilla, Mountain Dew LiveWire, SoBe No Fear and Diet Pepsi Slurpee. Each generated results that surpassed our plans. As consumers exercise the power of choice from carbonated to non-carbonated beverages, colas to waters, sports drinks to juices and everything in between, the breadth of our beverage portfolio offers the widest array of leading brands across beverage occasions.

Our recipe for continued growth in both non-carbonated and carbonated beverage products is tried and true: a pipeline filled with product and packaging innovation, a relentless focus on our bottling and retail partners, continuous cost management and world-class execution.



Top-Selling U.S. Carbonated Soft Drinks

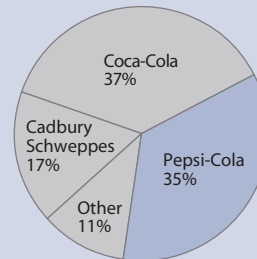
% Share of Volume in Measured Channels. Includes combined Supermarkets, Drug Stores, Mass Merchandisers, Convenience and Gas Stores. Includes caffeine-free versions.



PepsiCo sells 4 of the 10 top-selling soft drink brands.

Market Share of U.S. Carbonated Soft Drink Industry

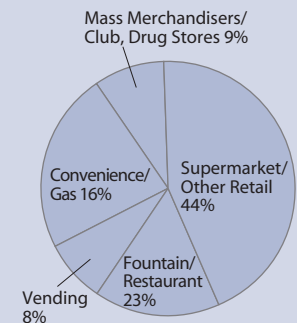
% Volume in Measured Channels. Includes combined Supermarkets, Drug Stores, Mass Merchandisers, Convenience and Gas Stores.



Pepsi-Cola brands account for more than one-third of the carbonated soft drink market.

Pepsi-Cola U.S. Soft Drink Distribution Channels

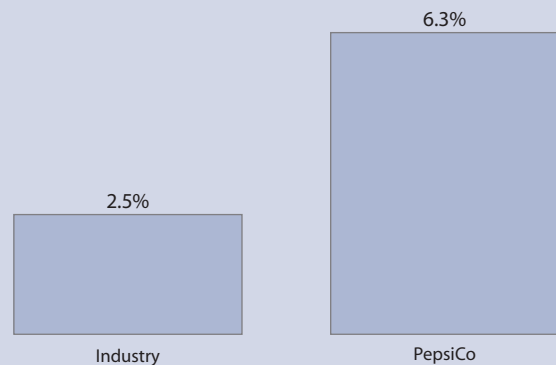
% System Volume



Pepsi-Cola products are broadly distributed by independent franchise bottlers focused on manufacturing and delivery.

Non-Carbonated U.S. Beverage Volume Growth

Estimated Measured Channel System Volume Growth



Pepsi-Cola non-carbonated beverage growth is more than double industry growth.

New Products from PepsiCo Beverages North America

These products and others are among 2003 innovations:

In the United States

- Diet Pepsi Slurpee
- Diet Pepsi Vanilla
- Dole 100% juice
Mango Lime Fiesta
(License)
- Frappuccino
Vanilla (Partnership)
- Gatorade Fierce
Strawberry flavor
- Gatorade Ice
Watermelon flavor

- Gatorade Thirst
Quencher Berry
Citrus flavor

- Mountain Dew
LiveWire
- Pepsi Vanilla
- Propel Kiwi-
Strawberry flavor
- Propel Peach flavor
- SoBe No Fear
- Tropicana 100% Juice
Blends Fruit Medley

- Tropicana 100% Juice
Blends Pineapple
Orange
- Tropicana Peach
Orchard Punch
- Tropicana Pure
Premium Lemonade
single serve
- Tropicana Pure
Premium Orange
Juice in Carafe

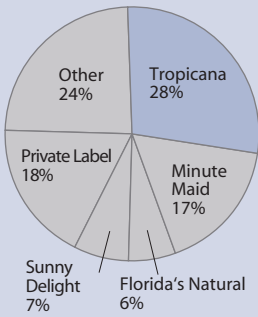
- Tropicana Smoothies
Piña Colada
- Tropicana Twister
Grape Wild
Strawberry Whirl
- Tropicana Twister
Orange Citrus Spark
- Tropicana Twister
Watermelon
Strawberry Whirl

In Canada

- Tropicana Pure
Premium Grape
Juice
- Tropicana Cranberry-
Raspberry juice
drink
- Tropicana Cranberry
Cocktail

Market Share of U.S. Chilled Juices and Drinks

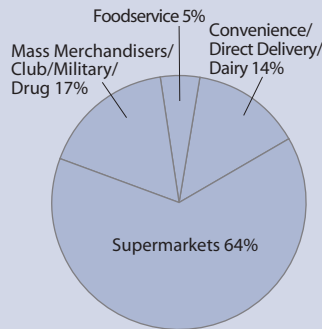
% Volume
Includes Supermarkets, Drug Stores, Mass Merchandisers.



Tropicana holds the leading share of the market.

Tropicana U.S. Distribution Channels

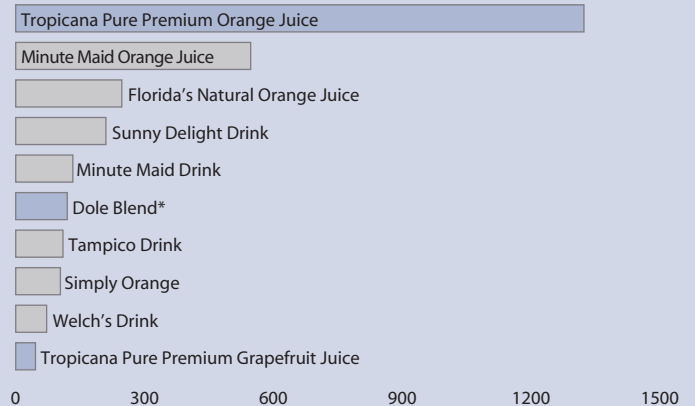
% Volume



Tropicana is distributing its juices through an increasing variety of channels. Volume in the Mass Merchandisers/Club/Military/Drug channel grew at nearly a double-digit rate.

Top-Selling Chilled Juice and Juice Drink Brands in U.S. Supermarkets

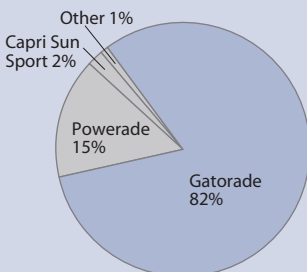
Retail Sales \$ in Millions



Tropicana sells three of the leading chilled juice brands.
* Under License

Market Share of U.S. Sports Drink Brands

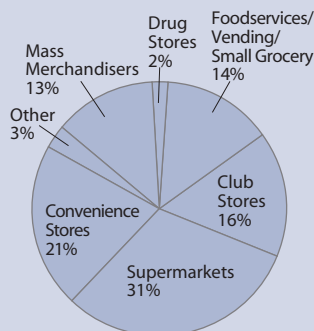
% Volume
Includes Supermarkets, Drug Stores, Mass Merchandisers.



Gatorade thirst quencher holds a very strong #1 share of its market.

Gatorade U.S. Distribution Channels

% Volume



Gatorade thirst quencher generated volume growth in all distribution channels.





Growth through innovation.

Innovation fuels growth. Members of Adelante, the Frito-Lay network for Hispanic employees, helped develop new Lay's Cool Guacamole potato chips and Doritos Guacamole tortilla chips, both introduced in 2003. The chips were a big hit with consumers of all backgrounds and generated nearly \$100 million in retail sales in the United States. PepsiCo introduced nearly 200 new products in 2003, and there are many more in the pipeline. Frito-Lay researchers Donna Diermeier (far right) and George Vindiola (second from right) worked with Adelante members Ximena Quintero (far left) and Agustin Sandoval (second from left) to check the quality of the new guacamole chips.

PepsiCo International

PepsiCo International (PI) comprises our beverages, snacks and foods businesses outside North America, which were integrated in 2003 to strengthen global capability and accelerate growth.

PI snack volume grew 6% and beverage volume increased 8%. Net revenue grew 12% and operating profit increased 14%. Acquisitions accounted for about two points of net revenue and operating profit growth.

Snack volume grew in all of our regions: Latin America, Europe, Middle East/Africa and Asia. In Mexico, Sabritas, our largest international salty snack business, delivered low single-digit volume growth while Gamesa, our cookie business, generated mid single-digit volume growth. At Walkers, our second largest business, products such as new Walkers Sensations premium snacks and the 2002 Wotsits acquisition contributed to double-digit volume growth. Also, our key growth markets such as China, India, and Russia generated strong double-digit volume increases.

We are the global leader in salty snacks, with the leading share in high-volume markets like Mexico, the United Kingdom and Brazil, as well as in key emerging markets like India and Turkey.

We're strengthening our leadership position by taking our global concepts and adapting them to local tastes, with varieties such as Lay's Mediterranean potato chips and Doritos Dippas tortilla chips. We're expanding our better-for-you portfolio, since there is a growing interest in nutrition and wellness in many of our markets.

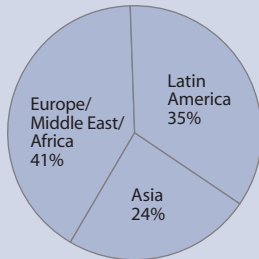
Our beverage business achieved strong volume growth, with contributions from virtually all of our major markets. China, Brazil, India, Russia, Middle East and Thailand were major contributors, generating double-digit growth.

Over the past five years, our international beverage business has gained market share against our primary competitor. PepsiCo-owned bottlers and independent franchise bottlers produce and distribute more than 500 products in markets outside the United States and Canada.

While Pepsi-Cola is our largest brand, we see many other opportunities for growth. These include Mirinda flavored carbonated soft drinks, sold in markets such as Mexico, China and India. The brand generates estimated retail sales of more than \$1 billion. Mirinda Orange is the most popular flavor, but we tailor the brand to other tastes, offering it in flavors that go from Mirinda Apple to Mirinda Tutti Frutti.

PepsiCo Beverage Volume Outside North America

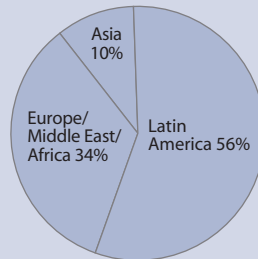
% System Volume by Region
Includes Pepsi-Cola, Gatorade, Tropicana, 7UP and other beverages sold outside North America.



PepsiCo brands are produced and distributed locally by company-owned bottlers or franchise bottlers and sold in about 160 countries.

PepsiCo Snack Volume Outside North America

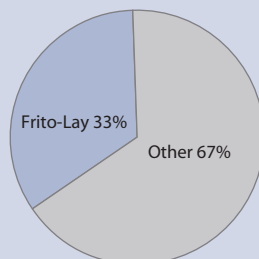
% System Volume by Region



PepsiCo snack brands are manufactured in about 100 plants outside of North America and distributed in about 160 countries.

Snack Industry Share Outside North America

% Retail Sales
Includes potato chips, tortilla chips and extruded snacks.



Frito-Lay is the largest salty snack company outside North America.



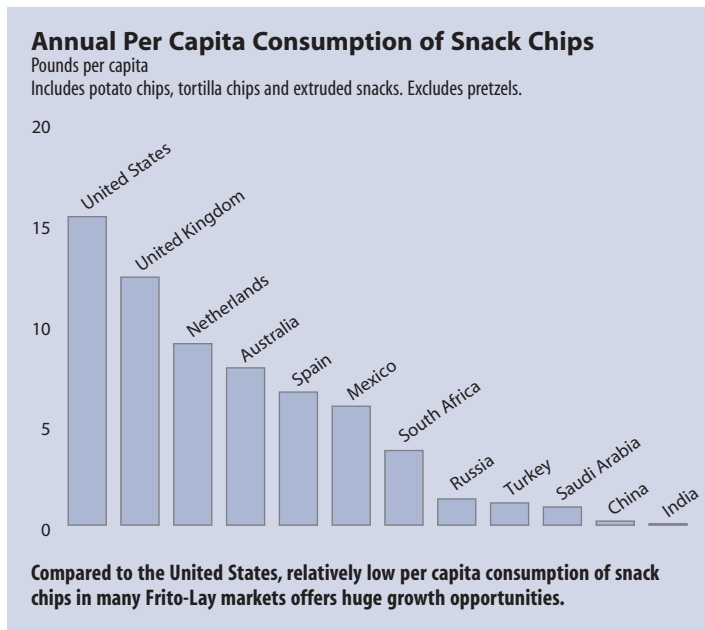
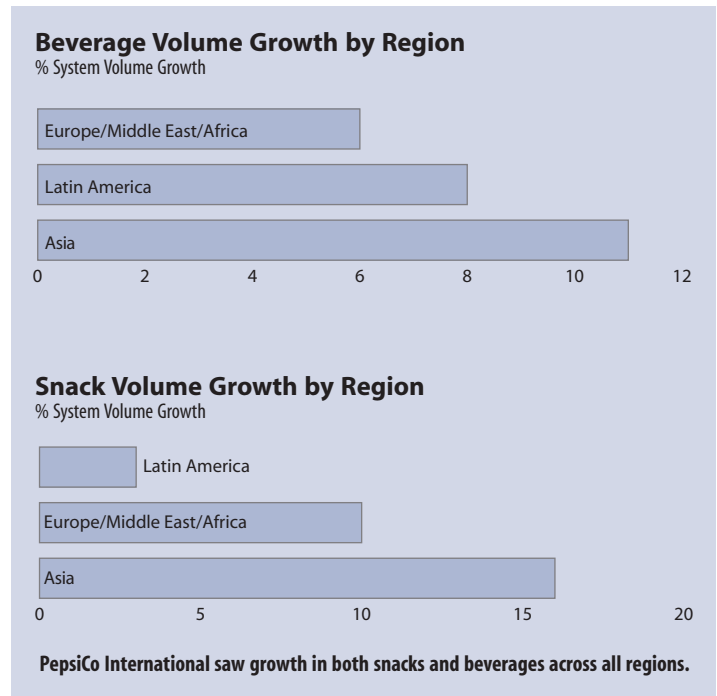
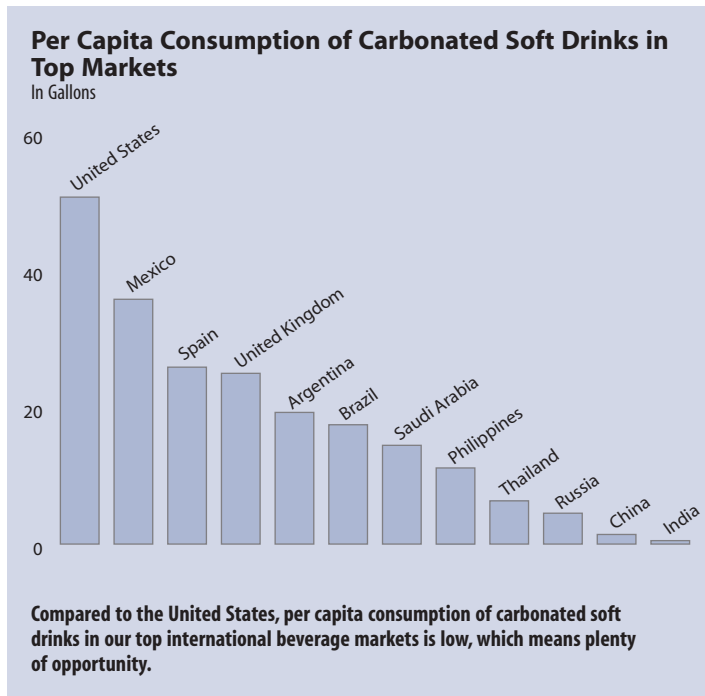
PepsiCo International (continued)

In markets outside the United States, we offer 7UP, one of the world's most popular lemon-lime brands and a billion-dollar brand in estimated retail sales. Diet soft drinks delivered accelerated growth, as consumers selected diet beverages more often.

In addition to carbonated beverages, we're introducing our non-carbonated beverages, including Gatorade, Aquafina

bottled water, Tropicana and Dole. With our broad beverage portfolio, we have the ability to meet many consumer tastes and needs, and we're well-positioned for continued growth.

As we've merged our snack and beverage businesses, we expect to see more initiatives bundling our products in the marketplace. Meanwhile, we will use the scale and purchasing power of this new organization to step up productivity.



New Products from PepsiCo International

Our international beverage and snack businesses introduced nearly 150 products and flavors in 2003 including:

Beverages

7UP Mint
Chiky Strawberry
Evervess Bitter Lemon
Fruko Orange
Fruvita Red Cocktail
Gatorade Fierce Orange Cherry
Ju-C Tropical Peach
Kas Lemon Light
Mirinda Naramango
Mirinda Exoticka
Pepsi Twist Light

Pepsi Light Lemon
Pepsi X
Slice Peach Exotica
SoBe Lizard Lava
Sting energy drink
Diet Ting
Tropicana Juicer - Grape and Peach
Tropicana Sweets
Tropicana Fruit Daizu Orange Soy
Tropicana Home Made Style Juices

Tropicana Mango
Tropicana Pineapple
Tropicana Sparkling Apple
Tropicana Twister Orange
Yedigun Tangerine

Snacks and Foods

Caribas Yuquitas Yuca chips
Cheetos Coconut Milk snacks

Cheetos Go Shots snacks
Doritos A La Turca tortilla chips
Kurkure Red Chili snacks
Lay's Artesanas potato chips
Lay's Cool Lemon potato chips
Lay's Mediterranean potato chips
Lay's Nori Seaweed potato chips
Lay's Siam Classic potato chips

Quaker Spudz snacks
Red Rock Deli potato chips
Sabritas Mexicanas potato chips
Smith's Great Australian Tastes potato chips
Tostilunch meal kits
Walkers Sensations Oriental crackers

Quaker Foods North America

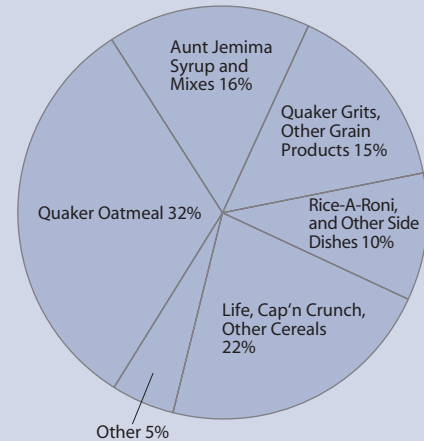
Quaker Foods North America (QFNA) volume and net revenue were flat, while operating profit grew 3%, reflecting cost savings and lower marketing spending.

QFNA is home to such valuable healthy trademarks as Quaker oatmeal and Life cereal, as well as other leading brands like Cap'n Crunch cereal, Aunt Jemima syrups and pancake mixes, Rice-A-Roni, Pasta Roni and Near East side dishes. Quaker Grits, Quaker Oatmeal and Aunt Jemima syrup are leaders in their categories. Quaker Oatmeal Breakfast Squares, the first hand-held breakfast with all the nutrition of a bowl of instant oatmeal, was introduced midyear. This successful new product appeals to today's on-the-go families that know the importance of eating a good breakfast.

Importantly, this foods business includes leading brands with high margins, strong cash flows and provides scale for our warehouse customer business. As we continue to focus on growing our leading share of the breakfast occasion, the Quaker and Tropicana combination gives us a powerful tool.

Quaker Foods North America Product Mix

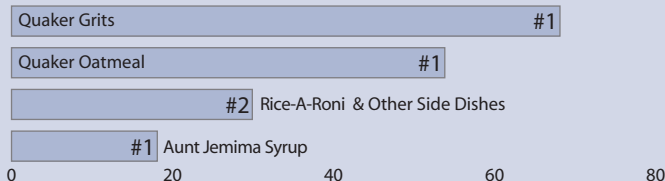
% Volume



Quaker's portfolio of brands puts us on the breakfast and dinner table.

Quaker Foods U.S. Category Leaders

% Share Supermarket Sales



Quaker's brands are leaders in their categories.



Principal Divisions and Corporate Officers

Executive Offices PepsiCo, Inc.

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

Co-Founder of PepsiCo, Inc.

Donald M. Kendall

Over 50 years of PepsiCo experience.

Corporate Officers

Steven S Reinemund

Chairman of the Board and
Chief Executive Officer
55
19 years.

Indra K. Nooyi

President and
Chief Financial Officer
48
10 years.

David R. Andrews

Senior Vice President,
Government Affairs,
General Counsel and Secretary
62
2 years.

Paula A. Banks

Senior Vice President
Global Diversity/Inclusion and
Organizational Partnerships
54
Under 1 year.

Peter A. Bridgman

Senior Vice President and Controller
51
18 years.

Albert P. Carey

President, PepsiCo Sales
52
22 years.

Tod J. MacKenzie

Senior Vice President,
Corporate Communications
46
16 years.

Matthew M. McKenna

Senior Vice President, Finance
53
10 years.

Margaret D. Moore

Senior Vice President,
Human Resources
56
30 years.

Lionel L. Nowell, III

Senior Vice President and Treasurer
49
4 years.

Principal Divisions and Officers

Frito-Lay North America

7701 Legacy Drive
Plano, TX 75024
972-334-7000

Abelardo E. Bru

Chairman and Chief Executive Officer
55
27 years.

PepsiCo Beverages & Foods North America

555 West Monroe Street
Chicago, IL 60661
312-821-1000

Gary M. Rodkin

Chairman and Chief Executive Officer
51
8 years.

PepsiCo International

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

Michael D. White

Chairman and Chief Executive Officer
52
14 years.

Listings include age and years of PepsiCo experience.



PepsiCo Board of Directors



Top row, left to right: Robert E. Allen, John F. Akers, Steven S Reinemund, Indra K. Nooyi, Franklin A. Thomas, James J. Schiro, Sharon Percy Rockefeller
Bottom row, left to right: Franklin D. Raines, Solomon D. Trujillo, Ray L. Hunt, Cynthia M. Trudell, Arthur C. Martinez, Daniel Vasella

John F. Akers

Former Chairman of the Board and Chief Executive Officer
International Business Machines
69. Elected 1991.

Robert E. Allen

Former Chairman of the Board and Chief Executive Officer, AT&T
69. Elected 1990.

Ray L. Hunt

Chairman and Chief Executive Officer
Hunt Oil Company and
Chairman, Chief Executive Officer and
President, Hunt Consolidated, Inc.
60. Elected 1996.

Arthur C. Martinez

Former Chairman of the Board,
President and Chief Executive Officer
Sears, Roebuck and Co.
64. Elected 1999.

Indra K. Nooyi

President and Chief Financial Officer
PepsiCo
48. Elected 2001.

Franklin D. Raines

Chairman of the Board and
Chief Executive Officer
Fannie Mae
55. Elected 1999.

Steven S Reinemund

Chairman of the Board and
Chief Executive Officer
PepsiCo
55. Elected 1996.

Sharon Percy Rockefeller

President and Chief Executive Officer
WETA Public Stations, Washington, D.C.
59. Elected 1986.

James J. Schiro

Chief Executive Officer
Zurich Financial Services
58. Elected 2003.

Franklin A. Thomas

Consultant
TFF Study Group
69. Elected 1994.

Cynthia M. Trudell

President
Sea Ray Group
50. Elected 2000.

Solomon D. Trujillo

Chief Executive Officer
Orange SA
52. Elected 2000.

Daniel Vasella

Chairman of the Board and
Chief Executive Officer
Novartis AG
50. Elected 2002.

Listings include age and year elected PepsiCo director.

Seeking Outside Perspectives

To help build our competitive advantage, we continually seek the views of individuals who can provide unique perspective. We've created Advisory Boards to actively consult on various aspects of our business.

Ethnic Advisory Boards

Our Ethnic Advisory Boards were formed to provide management with an external perspective on diversity-related issues. Having had active diversity programs for many years, the company wanted to look at its diversity efforts far more strategically, particularly in the marketplace, and this advisory board approach has been extremely helpful. Our African American Advisory Board was established in 1999. The Latino/Hispanic Advisory Board was formed the following year in 2000.

African American Advisory Board



Back row, left to right:
Johnnie L. Cochran, Esq., Jerri DeVard,
Warren M. Thompson,
Ray M. Robinson,
Rev. Dr. Franklyn Richardson,
Keith Clinkscales, Robert Holland

Front row, left to right:
Rev. Al Sharpton, Gary Rodkin,
Darlene Williamson, Ph.D.,
Johnny F. Johnson,
Darwin N. Davis, Sr.,
Amy Hilliard, Benaree Pratt Wiley,
Clarence Avant, Glenda McNeal,
Dawn Hudson

Seated: Earl G. Graves, Sr.

Clarence Avant
Chairman
Interior Music
Joined 1999.

Keith Clinkscales
President
KTC Ventures
Joined 1999.

Johnnie L. Cochran, Esq.
Partner
Cochran, Cherry, Givens,
Smith & Ferrer
Joined 1999.

Darwin N. Davis, Sr.
Consultant
Retired Senior Vice President
AXA/Equitable
Joined 1999.

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

Earl G. Graves, Sr.
Chairman and
Chief Executive Officer
Earl G. Graves Ltd.
Joined 1999.
Chairman of the
Advisory Board

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

Robert Holland
Partner,
Williams Capital Partners
Joined 1999.

Dawn Hudson
President Pepsi-Cola
North America

Johnny F. Johnson
Chairman and
Chief Executive Officer
Market Place Holdings, Inc.
Joined 1999.

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

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

Ray M. Robinson
President
East Lake Golf
Joined 1999.

Gary Rodkin
Chairman and
Chief Executive Officer
PepsiCo Beverages & Foods

Reverend Al Sharpton
President National
Action Network
Joined 1999.

Warren M. Thompson
President/Chairman
Thompson Hospitality
Corporation, Inc.
Joined 2002.

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

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

Individuals are carefully chosen, based on their diverse backgrounds, experiences and points of view. Several of them serve on the board of directors of other companies.

These boards provide counsel and ideas on a wide range of initiatives including:

- Marketing to ethnic communities.
- Creating alliances with ethnic retailers.

- Developing products aimed at ethnic consumers.
- Hiring, retaining and motivating diverse employees.
- Expanding diversity representation among our employees, particularly in management.
- Addressing conflicts and misunderstandings that could jeopardize PepsiCo's standing in diverse communities.
- Developing diverse supplier and other business relationships.

Latino/Hispanic Advisory Board



Back row, left to right:
Dr. Ricardo R. Fernández,
Carlos A. Saladrigas, Victor Arias, Jr.,
Dr. Douglas X. Patiño,
Maria Elena Toraño

Front row, left to right:
Oscar A. Chacón, Isabel Valdés,
George Muñoz, Dr. Carlos H. Arce,
Gilbert Aranza,
Deborah Rosado Shaw

Seated, left to right:
Raúl Yzaguirre, Abelardo E. Bru

Gilbert Aranza
President
Star Concessions
The MultiRestaurant Group
Joined 2000.

Dr. Carlos H. Arce
President and Founder
NuStats
Joined 2000.

Victor Arias, Jr.
Executive Search Consultant
Spencer Stuart
Joined 2000.

Abelardo E. Bru
Chairman and
Chief Executive Officer
Frito-Lay North America

Oscar A. Chacón
Director
Enlaces America
Heartland Alliance for Human
Needs and Human Rights
Joined 2001.

Dr. Ricardo R. Fernández
President
Lehman College
The City University of
New York
Joined 2003.

George Muñoz
President
Muñoz Investment
Banking Group, LLC
Joined 2000.

Dr. Douglas X. Patiño
Vice Chancellor Emeritus
and Professor
California State University
Joined 2000.

Carlos A. Saladrigas
Chairman
Premier American Bank
Joined 2003.

Deborah Rosado Shaw
Chief Executive Officer
Umbrellas Plus, LLC
Joined 2000.

Maria Elena Toraño
Member
U.S. Commission on
Public Diplomacy
Joined 2000.

Isabel Valdés
Consultant, Author,
Public Speaker
Joined 2001.

Raúl Yzaguirre
President and Chief
Executive Officer
National Council of La Raza
Chairman of the
Advisory Board
Joined 2000.

Seeking Outside Perspectives (continued)

Health and Wellness Advisory Board

In recognition of the growing opportunity in health and wellness, we formed a Blue Ribbon Health and Wellness Advisory Board of distinguished medical, nutrition, fitness and public policy professionals in 2003. Its role is to provide advice on how PepsiCo can improve the healthfulness of existing products, develop new better-for-you and good-for-you products and provide access to resources that promote health and

encourage more active lifestyles. The Board is helping us identify emerging opportunities as well as connect us with key thought leaders and policy makers. We are particularly indebted to Dr. Ken Cooper and Dr. Dean Ornish, both leading experts in disease prevention, who have been advising us for almost two years, and have been instrumental in helping us form a strong health and wellness agenda.



Back row, left to right:
George Graham, Ph.D.,
David A. Kessler, M.D., J.D.,
Kenneth L. Gladish, Ph.D.,
Ambassador Thomas S. Foley,
Antonia Demas, Ph.D.,
James O. Hill, Ph.D.,
Samuel Ward Casscells, III, M.D.

Front row, left to right:
Governor James B. Hunt, Jr.,
Pamela Peeke, M.D., M.P.H.,
Kenneth H. Cooper, M.D., M.P.H.,
Dean Ornish, M.D.,
David Heber, M.D., Ph.D.,
Susan Love, M.D.

Samuel Ward Casscells, III, M.D.

John Edward Tyson
Distinguished Professor of
Medicine & Public Health and
Vice President for
Biotechnology
University of Texas Health &
Science Center at Houston

Kenneth H. Cooper, M.D., M.P.H.

President and Founder
The Cooper Aerobics Center

Antonia Demas, Ph.D.

Director
Food Studies Institute

Ambassador Thomas S. Foley

Partner
Akin, Gump, Strauss, Hauer &
Feld, LLP
Former Speaker of the U.S.
House of Representatives
and former U.S. Ambassador
to Japan

Kenneth L. Gladish, Ph.D.

National Executive Director,
YMCA of the U.S.A.

George Graham, Ph.D.

Chairman
Department of Kinesiology,
Pennsylvania State University

David Heber, M.D., Ph.D.

Professor of Medicine & Public
Health Director
UCLA Center for Human
Nutrition

James O. Hill, Ph.D.

Professor of Pediatrics &
Medicine
University of Colorado Health
Sciences Center
Founder of America on
the Move

Governor James B. Hunt, Jr.

Attorney, Womble Carlyle
Sandridge & Rice
Former Governor of
North Carolina

David A. Kessler, M.D., J.D.

Dean, School of Medicine
Vice Chancellor for
Medical Affairs
University of California, San
Francisco

Susan Love, M.D.

Professor of Surgery
The David Geffen School of
Medicine at UCLA and
Founder of Luminari,
multimedia women's health
company

Dean Ornish, M.D.

Founder and Director
Preventive Medicine Research
Institute
Chairman of the
Advisory Board

Pamela Peeke, M.D., M.P.H.

Assistant Professor
University of Maryland
School of Medicine
Expert and speaker in
nutrition, stress and
integrative medicine

A Look at Our Corporate Citizenship

Who we are.
What we do.
How we do it.

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Letter from the Chairman

Dear Friends,

What predicts the long-term success of an enterprise? High on the list, in my view, is the ability to build strong, enduring, mutually beneficial relationships based on trust.

For PepsiCo, those relationships extend around the globe to a wide array of parties: current and prospective employees, consumers who eat and drink our products, retail customers who sell our brands, communities where we operate, shareholders, partners and suppliers. They include governments, educational institutions and organizations that work to improve our communities, our environment and our way of life.

The best way I know for PepsiCo to preserve and build all of those varied, and sometimes disparate, relationships is to act responsibly — every day — in everything we do.

We strive to do exactly that.

Responsible corporate citizenship means operating in a manner that is ethical, respectful of others and sensitive to the world around us. It means adhering to high standards. It means helping to create a more positive, hopeful future for everyone by contributing to economic, environmental and social well-being in all we do. It includes engaging in open, honest dialogue with people who have a legitimate stake in our activities.

For several years, we've provided information about our values, community programs, corporate governance, employee programs, environmental policies and other areas of corporate responsibility. This year, we are taking our commitment a step further by publishing this corporate responsibility section in our annual report.

To improve our reporting, we have voluntarily adopted the Global Reporting Initiative (GRI) Guidelines. The GRI has been supported by many groups, including the United Nations. The Guidelines provide a template for reporting economic, environmental and social performance — the “triple bottom line” — and a measure of an organization's sustainability. At the end of this report we've provided an index that explains where to find information that corresponds to the GRI Guidelines.

Many challenges lie ahead of us in achieving sustainability and reporting using the Guidelines. Our first effort primarily covers the United States and is far from complete.

We're beginning by issuing this report and concentrating our efforts in five areas we believe are critical to our success:

- 1. Values** — We have defined and honed our corporate values and we will develop our vision of sustainability to guide our future actions.
- 2. Diversity and Inclusion** — We know that a diverse and inclusive culture is necessary for our success.
- 3. Health and Wellness** — As a food and beverage company, we have the responsibility — and an opportunity — to contribute to the well-being of our consumers.
- 4. Water** — We are committed to using this precious resource efficiently and responsibly.
- 5. Packaging** — We have a responsibility and an opportunity to make a difference for a cleaner environment.

Our focus on these key areas builds on what we already have accomplished. In the future, we will work to expand our areas of focus and the depth and breadth of our reporting.

I hope you find this report informative.



Steve Reinemund
Chairman of the Board and
Chief Executive Officer

Mission, Values and Guiding Principles

Our Mission

We aspire to make PepsiCo the world's premier consumer product company, focused on convenient foods and beverages. We seek to produce healthy financial rewards to 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.

To achieve our mission, we have articulated the behaviors that will help us get there in our Values Statement.

Our Values

We introduced a statement of our values in early 2004. This statement identifies what we stand for, and how we go about delivering on that commitment.

PepsiCo's Values:

Our commitment is to deliver sustained growth, through empowered people, acting with responsibility and building trust.



Here's what this means:

Sustained Growth is fundamental to motivating and measuring our success. Our quest for sustained growth stimulates innovation, places a value on results, and helps us understand whether

actions today will contribute to our future. It is about growth of people and company performance. It prioritizes making a difference and getting things done.

Empowered People means we have the freedom to act and think in ways that we feel will get the job done, while being consistent with the processes that ensure proper governance and being mindful of the rest of the company's needs.

Responsibility and Trust form the foundation for healthy growth. It's about earning the confidence that other people place in us as individuals and as a company. Our responsibility means we take personal and corporate ownership for all we do, to be good stewards of the resources entrusted to us. We build trust between ourselves and others by walking the talk and being committed to succeeding together.

Our Guiding Principles

This is how we carry out Our Commitment.

We must always strive to:

Care for customers, consumers and the world we live in. We are driven by an intense, competitive spirit in the marketplace, but we direct this spirit toward solutions that achieve a win for each of our constituents as well as a win for the corporation. Our success depends on a thorough understanding of our customers, consumers and communities. Caring also means going the extra mile for them. Essentially, this is a spirit of growing rather than taking.

Sell only products we can be proud of. The test of our standards is that we must be able to personally endorse our products without reservation and consume them ourselves. This principle extends to every part of the business, from the purchasing of ingredients to the point where our products reach the consumer's hands.

Speak with truth and candor. We speak up, telling the whole picture, not just what is convenient to achieving individual goals. In addition to being clear, honest and accurate, we take responsibility to ensure our communications are understood.

Balance short term and long term. We make decisions that hold both short-term and long-term risks and benefits in balance over time. Without this balance, we cannot achieve the goal of sustainable growth.

Win with diversity and inclusion. We leverage a work environment that embraces people with diverse traits and different ways of thinking. This leads to innovation, the ability to identify new market opportunities, all of which helps develop new products and drives our ability to sustain our commitments to growth through empowered people.

Respect others and succeed together. This company is built on individual excellence and personal accountability, but no one can achieve our goals by acting alone. We need great people who also have the capability of working together, whether in structured teams or informal collaboration. Mutual success is absolutely dependent on treating everyone who touches the business with respect, inside and outside the company. A spirit of fun, our respect for others and the value we put on teamwork make us a company people enjoy being a part of, and this enables us to deliver world-class performance.

Our Business

Profile

With roots that go back more than 100 years, PepsiCo is one of the world's leading consumer product companies. We offer great tasting, convenient foods and beverages to consumers in nearly 200 countries.

Through the dedication of more than 143,000 employees, we make, market and sell more than 500 products designed to serve the needs of consumers of all ages throughout the day. Across our product portfolio, we offer fun and refreshment and contribute directly to good health and nutrition.

PepsiCo's principal brand families are Frito-Lay, Pepsi-Cola, Tropicana, Gatorade and Quaker, a lineup including brands that generate an estimated \$69 billion in retail sales.

Corporate Governance

Since PepsiCo's founding in 1965, we have worked to ensure that every director, officer and associate acts responsibly and in the interest of our shareholders. Today, we pursue that goal as vigorously as ever with policies and programs, including:

Independent Directors — Strong, independent directors are the foundation of a healthy corporation. Our Board has 11 independent outside directors and 2 inside directors.

Independent Auditors — We have always limited the amount of non-audit services provided by our external auditors. In 2002, we adopted a formal policy that prohibits our external auditors from providing any tax or non-audit services that are not an extension or do not enhance the efficiency of the audit or audit-related services. We will not hire anyone who has worked on our audit in the past two years.

Code of Conduct — Since 1976, PepsiCo has had a Code of Conduct that applies to every employee. The Code, which covers many aspects of our business, was revised again in 2003 and is distributed globally in more than 30 languages.

Exercise and Hold Policy — Under a policy revised in 2002, insiders may trade PepsiCo stock only during specific, limited time periods. Furthermore, senior executives and directors exercising PepsiCo stock options may take only 20% of their pre-tax gains in cash upon exercise. They must hold the rest in PepsiCo shares for at least one year.

Stock Ownership Guidelines — Stock ownership guidelines clearly align the interests of management, directors and shareholders. Senior executives and directors are required to own PepsiCo stock worth between two and eight-times their compensation, depending on their position.

Certification of Financial Statements — PepsiCo was among the first corporations to comply when the Securities and Exchange Commission required written certification of financial statements by CEOs and CFOs. Since then, our CEO and CFO have issued certifications every quarter. The certifications for our 2003 financial statements are attached as Exhibits 31 and 32 to our 2003 Form 10-K.

Open Communication — To promote high ethical standards across a global organization, we ensure that employees have clear lines of communication to inform senior management of potential issues. We have a telephone hotline called "Speak Up" for this purpose. It is accessible from around the world at no charge to employees. To further ensure an open communication environment, employees may remain anonymous.

For details on our Corporate Governance principles, committee charters, policies and related efforts, please visit the Corporate Governance section of our web site.

Rating PepsiCo's Governance: Outside Perspectives

Our high standards of corporate governance are widely recognized. Several independent organizations rate companies on the quality of their corporate governance. According to Institutional Shareholder Services, for example, PepsiCo outscored 96% of all companies in the S&P 500, and 100% of all food, beverage or tobacco companies with respect to corporate governance in 2003. PepsiCo also received perfect 10 out of 10 corporate governance ratings from Governance Metrics International in early 2004.

Our Business (continued)

Our Constituencies

Our various relationships are shaped by certain basic principles:

Our Investors — We strive to provide investors a reasonable return on their investment, based on consistent growth in the marketplace and consistent financial results. We take a long-term view and make appropriate investments to strengthen our brands, develop our capabilities and pursue new opportunities. We seek healthy, year-over-year growth, and report our financial results honestly, transparently and on a timely basis.

Our Employees — Our employees are the greatest factor in our success. Their hard work, dedication and resourcefulness enable PepsiCo to compete effectively, serve the needs of customers and deliver the results our investors expect. We are committed to providing a work environment that is safe and welcoming and that allows our employees to achieve professional growth and personal fulfillment. We provide competitive compensation and benefit programs.

Our Customers, Partners and Suppliers — PepsiCo will only achieve long-term success if our business partners also succeed. Whether we work with retailers, franchise bottlers, joint-venture partners or suppliers, we try to ensure that our partnerships appropriately balance the interests of all parties.

- With our **bottlers and other business partners**, we conduct our business to allow both our partners and PepsiCo to earn a reasonable return on their investment. We grow together.
- With our **retail customers**, we provide products and services, such as marketing support, that contribute to growth, profit and positive cash flow.
- With our **suppliers**, we buy goods and services at competitive prices that allow them to make a reasonable profit. We seek efficient suppliers with whom we can work and grow as long-term partners. We seek out suppliers that are owned by minorities and women.

Our Consumers — We offer consumers great tasting products that provide outstanding quality, convenience and value. Each year, we invest millions of dollars in innovation to better serve consumer needs and wants through new products and packages. We continually expand our distribution network to make our products more widely available. And we work relentlessly to improve productivity so we can keep our products affordable to a broad range of consumers.

Our Communities — We support our communities with direct contribution to not-for-profit groups and by working with organizations dedicated to improving the lives of people. We seek to be a positive force in our communities and the world.

Our Stakeholders — We touch the lives of many people through our businesses. We welcome honest discussion with individuals, groups, and advocates who represent community, environmental or social interests.

We interact with:

- Investors
- Employees
- Bottlers and other business partners
- Retail customers
- Suppliers
- Consumers
- Communities
- Other Stakeholders



Trust through relationships.

PepsiCo is about relationships — with the people who consume our products, retail customers who sell our products, with shareholders, employees and suppliers. One of the best examples of how we're building trust is through our relationship with Integrated Packaging Corporation (IPC), our major supplier of corrugated boxes. In 1992, when IPC was just starting out, Pepsi-Cola signed a long-term contract to purchase boxes. This allowed IPC to secure necessary funding to grow and attract other major customers. Here, IPC owners Joe Wilson (left), and Al Fuller (right) meet with Scott Buchanan, vice president, global procurement, paperboard and corrugated, to discuss packaging. IPC is one of the many minority- and women-owned firms that supply PepsiCo with products and services. In 2003, we spent about \$722 million with minority-owned and women-owned firms.

Our Economic Contribution

PepsiCo makes an important economic contribution to thousands of communities in which we operate around the world.

Employment — We directly employ more than 143,000 people, including more than 60,000 in the United States, where PepsiCo is headquartered. Our customers and business partners, such as franchised bottlers and licensees, employ thousands of additional people as they manufacture and distribute our products.

Retail Sales — We create jobs and opportunities for our customers in millions of stores around the world. Our brands are among the most profitable that retailers carry.

Purchases — In 2003, we purchased more than \$10 billion in supplies, services and raw materials. These purchases help to support hundreds of thousands of additional jobs.

Goods and services from women- and minority-owned businesses accounted for \$722 million in purchases in 2003. We have a long-standing and active supplier diversity program. We have a dedicated team devoted to increasing supplier diversity. Our efforts have earned PepsiCo awards and recognition from a number of national, regional and local organizations of minority and women suppliers. Since we began tracking our spending in 1982, PepsiCo has purchased goods and services from minority and women suppliers worth more than \$6 billion.

Taxes — We paid income taxes of nearly \$1.6 billion in 2003. In addition, we paid hundreds of millions of dollars in other taxes like payroll, sales and property taxes.

Technology — We share expertise and technologies that provide important benefits to communities and countries. In emerging markets, such as India and China, our agricultural development programs have significantly improved crop yields for local farmers.

China — A Case Study

China is a good example of how we contribute to countries where we operate.

PepsiCo has been in China for more than two decades and our businesses include some 40 joint or wholly owned ventures. Over the years, PepsiCo and its partners have invested more than \$1 billion in the China beverage and snack food businesses — almost \$800 million of that was direct investment by PepsiCo. We employ more than 10,000 Chinese people directly and an estimated 150,000 indirectly. This includes the people who provide us with services and supplies and serve as distributors for our products.

One of the most exciting areas of cooperation between PepsiCo and China is a joint program with the Chinese Ministry of Agriculture to share knowledge about potato farming. PepsiCo funded a \$20 million, comprehensive agro-technology program that introduced state-of-the-art seed development techniques and farming practices to China. The company also established one of the world's most advanced potato research laboratories and created a model farm training center for farmers. Potato yields more than doubled in three years, benefiting 1,100 farming families. In addition, The PepsiCo Foundation made a

\$700,000 grant to fund the construction of the Agriculture Development Center in Beijing, where Frito-Lay participates in seminars and shares its advanced farming techniques.

PepsiCo has made major contributions in many other areas, including training, supplier development and community support.

Pepsi-Cola has offered training and development programs to more than 4,500 local joint venture employees, wholesalers and distributors. Frito-Lay has trained an additional 1,200 workers and distributors.

Our presence puts cash directly into the economy. Almost all of our ingredients — including raw materials, sugar, bottles, crates, caps and other packing materials, motor vehicles and vending equipment — are purchased from businesses that are Chinese-owned or based in China.

On the community front, Pepsi-Cola China launched the Pepsi-Cola fund in 2001 to help ease the water shortage and keep students from dropping out of school in the west of China. Frito-Lay community involvement has been focused on education and teacher training.



Trust through caring for the environment.

Part of being a responsible corporate citizen is caring for our environment. PepsiCo has many programs to conserve, reuse and recycle energy and natural resources and to protect our world. As a company focused on convenient food and beverages, one priority is our packaging. We encourage recycling, and by 2005, 10% of Pepsi-Cola packaging in the United States will include recycled content. There are many other uses for recycled plastic, including making T-shirts and fleece tops such as those pictured here.

Environmental

Our Environmental Principles

Environmental responsibility is an integral part of the way we do business. Our commitment is demonstrated by our adoption of the following fundamental core principles:

- We conduct our business in an environmentally responsible way. We comply with, or exceed, requirements of all applicable laws and regulations. In the absence of specific laws and regulations, our goal is to apply prudent environmental management practices, manage environmental risks and operate responsibly.
- We strive to minimize the impact of our businesses on the environment. We seek methods that are socially responsible, scientifically based and economically sound.
- Using scientific research, new technology and innovative approaches, we work continuously to improve our environmental performance through conservation, source reduction, recycling and improved packaging designs.
- We develop and apply programs that promote clean air and water, conserve energy and reduce landfill waste. PepsiCo divisions work together on programs that address environmental issues and develop their own operational approaches when appropriate.
- We support and implement programs that educate, train and motivate associates to conduct their activities on behalf of the company in an environmentally responsible manner. Our associates are expected to assume responsibility as environmental stewards.
- We hold management accountable for upholding our environmental standards.
- We cooperate with organizations and governments working to develop collaborative solutions to environmental problems, and we support policies and programs that improve the environment by setting reasonable standards for future conduct.
- We are committed to improving our environmental performance through cooperative efforts involving governmental organizations, our licensed and franchised partners, suppliers, customers and consumers.

Environmental Programs

Each of our operating units has ongoing programs to improve its environmental performance. In 2001, we created an Environmental Task Force representing all of our operating units to address environmental issues on a company-wide basis, and share best practices.

In 2002, the Task Force developed the framework for an internal Environmental Management System (EMS), now being used to improve performance. Frito-Lay North America, our largest operating unit, already fully meets or exceeds all requirements of the EMS. Other divisions are taking steps to develop the programs and policies to meet the requirements.

Our employees are directly involved in helping us meet our environmental commitments. Teams of Frito-Lay employees work to reduce waste, reuse resources and recycle, and promote environmental awareness within their facilities. These “Green Teams” also participate in community activities to improve the environment. Each year, Frito-Lay formally recognizes the best environmental programs and performance by presenting that team with an award.

Teams of Quaker Oats and Gatorade employees systematically review their plant operations to identify, evaluate and control spill and environmental release risks. Additionally, Quaker Foods North America recently began a program that helps both the company and the community. Our Cedar Rapids, Iowa, cereal plant generates more than 100,000 tons of oat hulls each year. We send much of that biomass to the University of Iowa, which burns the hulls as fuel in their boilers. The oat hulls save the University from burning about 30,000 tons of coal each year, reducing annual sulfur dioxide emissions by 60 tons and carbon dioxide by 72,000 tons. This also reduces the University’s annual fuel costs.

Other initiatives and programs are covered in PepsiCo’s Environmental Report, which can be found on our web site. The following discussions relate to packaging and water.

Packaging

Each of our divisions is charged with incorporating environmental considerations into its packaging decisions.

In 2001, we announced a goal of using 10% recycled material in Pepsi-Cola plastic beverage bottles in the United States by the end of 2005. We are working with our bottlers to include recycled material.

In 2003, more than 20 million pounds of recycled plastic was used in beverage bottles bearing our brand names.

In addition to using more recycled plastic, we are actively supporting recycling efforts to benefit the environment and

Environmental (continued)

our communities. We support efforts to recycle all plastic that is collected into such things as clothing, carpets and plastic lumber.

We've also supported reducing the weight of our containers. An aluminum can today contains about half the aluminum used in cans in 1972. Reducing the size of the lid on cans has also led to a lighter package and saves 37 million pounds of aluminum a year.

Soft drink containers are America's number one recycled consumer packaging. They are recycled at a rate of nearly 50% — much higher than America's overall recycling rate of 30%. However, we are concerned that overall recycling rates, including those for beverage containers, recently have been dropping.

To reverse the trend, we are working in tandem with our bottlers by investing in recycling through a variety of efforts, including:

- Providing our customers with highly visible recycling bins.
- Supporting a multi-million dollar industry effort to promote curbside recycling and away-from-home recycling.
- Working with the U.S. Environmental Protection Agency and other beverage companies on recycling issues.
- Continuing our major support to the nation's leading voluntary anti-litter campaign, Keep America Beautiful's Great American Clean-up.
- Providing school educational materials to teach young people about recycling.

At Quaker Foods North America, product packaging successes have included using high percentage post-consumer recycled paperboard in nearly all of our foods packaging material.

Tropicana also has reduced the use of its packaging materials by reducing the weight of its plastic bottles and plastic pour spouts.

Frito-Lay has a long-standing program to return cartons for reuse. Each delivery box is used an average of five times before being recycled. On an annual basis, this diverts about 60 million pounds of cardboard from landfills and saves more than a million trees.

Water

All our products use water, whether in growing the ingredients for our products, such as oranges, oats, potatoes and corn, or in the manufacturing of beverages bearing our brand names, such as carbonated soft drinks, non-carbonated beverages and Aquafina bottled water.

As a result, we have many programs to reduce our use of water and to reuse water wherever possible.

Frito-Lay North America maintains a continuous focus on water conservation. The program includes water conservation training, targets for water usage rates and weekly water usage

tracking. Processing water is reused in the manufacturing process, and processing wastewaters are collected, processed and reused, often to water other agricultural products such as alfalfa and Bermuda grass hay. In 2003, Frito-Lay reduced its water use by 10%. In addition, Frito-Lay is investigating water reclamation and reuse technologies that could allow further reduction of water use.

Our Dallas Gatorade plant and Danville, Illinois, Quaker foods plant have implemented projects that reduce water usage by several hundred thousand gallons daily. Tropicana recaptures and reuses more than half a million gallons of water a day at its Florida plants.

Pepsi-Cola plants are increasingly designed to avoid burdening municipal wastewater treatment systems and to reduce the use of water. For example, all Pepsi bottling plants in China, and many of our bottlers' beverage plants in other countries, operate their own wastewater treatment plants, thereby protecting the quality of our water resources.

As water is an increasingly scarce resource, usage issues pose significant challenges related to availability and access.

For example, questions were raised about whether a Pepsi-Cola bottling plant in Kerala, India, was reducing water resources available to the local population. In fact, our own conservation and recycling initiatives — augmented by a variety of rainwater harvesting and groundwater recharge systems employed by the local industrial estate authorities — have resulted in enough net recharge of the aquifer to maintain a good flow of water at the site. Pepsi has installed water conservation systems in all of our plants in India. We have established rainwater harvesting systems at four of our plants, with plans to repeat this at all of our plants in India in the near future. In addition, we rotate the bore wells, from which we draw water, which allows the aquifers time to recharge. The industrial park where the Kerala plant is located created a man-made lake to capture additional rainwater, which further recharges the supplies.

In short, we have taken what we believe are prudent and responsible steps. Nonetheless, we recognize that we need to take a more active role in the ongoing discussion on water, water usage and allocation, and to make sure we are doing everything we can to ensure fairness and efficiency in the use of this precious resource.

For more information on PepsiCo environmental programs, see our Environmental Report on our web site.



Trust through community.

PepsiCo's goal is to make a positive impact in the community. In 2003, The PepsiCo Foundation and PepsiCo divisions contributed \$23.6 million to nonprofit groups. For example, PepsiCo is a Mission Sponsor of the YMCA, the largest provider of fitness programs, serving nine million young people across the United States. At the YMCA of Greater New York, the PepsiCo Foundation funded a pilot program called Teen Health and Wellness 101, which teaches basic fitness principles and healthy eating habits. Pictured here, at the Prospect Park YMCA in Brooklyn, NY, is a program that introduces youngsters ages 6 through 9 to kid-sized exercise machines and uses equipment such as parachutes, large balls and Hula Hoops to instill good exercise habits at an early age.

Health and Wellness

As a food and beverage company, we want to make a positive contribution to the daily diets and lifestyles of our consumers. Our goal is to provide our consumers with products they want and enjoy. We are committed to actively promoting health and wellness in ways that serve the public interest and contribute to our growth. This is particularly important as populations age in some of our largest markets and obesity rates rise.

Good health is a result of a balanced diet and sufficient physical activity. So we focus on two broad areas:

- providing healthy product choices, and
- encouraging healthy lifestyle habits.

PepsiCo has offered product choices for many years. In fact, one-calorie Diet Pepsi was born in 1964 and reduced fat Ruffles were introduced in 1989.

As concern has grown around health and wellness — particularly obesity — we have increasingly balanced our product offerings. We offer dozens of healthy products. For example, U.S. consumers rated Quaker oatmeal and Tropicana Pure Premium orange juice the top two healthiest brands. We have many other brands that either contribute to good health, such as Aquafina bottled water, or contain less fat or sugar than regular varieties, for example, Baked Lay's potato chips and diet soft drinks.

Our Blue Ribbon Health and Wellness Advisory Board, pictured on page 20, has provided advice on improving existing products, developing new products and promoting healthy lifestyles. As a result, we were the first company to remove trans fats from our salty snack products. With their help, we are strengthening our nutritional guidelines for our products.

As part of our health and wellness commitment, we are taking specific actions:

- **Accelerating development of better-for-you and good-for-you products.** These products, which have fewer calories or less fat than their traditional counterparts or contribute directly to good health and nutrition, accounted for 40% of PepsiCo volume in North America in 2003. Our goal is to continue to introduce new good-for-you and better-for-you products at a rapid rate.
- **Improving the healthfulness of existing products.**

Frito-Lay North America announced its plans to remove trans fats from its major corn snack brands (its potato chip brands were already trans fat free) in September 2002. Today, all Frito-Lay core brands in the United States are "0% trans fat." Canada is following suit. We're also working to reduce or eliminate trans fat in other products.

- **Providing healthy food and beverage choices in schools.**

We are working closely with our bottlers to help schools offer a wide selection of healthy food and beverage choices. In 2003, 17,000 vending machines devoted exclusively to Aquafina bottled water and Gatorade were placed in schools. We've also introduced new Tropicana Pure Premium orange juice and Quaker oatmeal items and a range of baked and reduced fat Frito-Lay snacks. We're also introducing SoBe Synergy, a 50% juice drink that's nutritionally better than juice. And our partnership with the American School Food Service Association promotes good food choices and provides access to health promotion resources.

- **Promoting healthy lifestyles.** Since the 1970s, PepsiCo has sponsored programs that encourage kids and adults to be active. Today, we support programs that promote healthy eating as well as activity.

- *YMCA* — A commitment of \$16 million over 10 years to give financially disadvantaged teens scholarships to participate in YMCA programs.
- *Get Kids in Action* — A partnership between Gatorade and the University of North Carolina to get kids more active and reduce childhood obesity.
- *America on the Move* — A program to help people improve their health through simple changes in diet and exercise. We plan to create school-based versions of the program for elementary and middle schools.
- *Kidnetic* — The International Food Information Council's web-based program to promote healthy lifestyles in children 8-12 years olds (www.kidnetic.org).
- *Get Active, Stay Active* — A web-based journal, where teens can track their physical activity and eligibility for the President's Active Lifestyle Award (www.getactivestayactive.com).
- *Healthy Living Radio with Dr. Ken Cooper* — A syndicated weekly radio show.
- *The American Council on Fitness and Nutrition* — PepsiCo is a founding member.

For more information see the Health and Wellness section on our web site.

We focus on two broad areas:

- providing healthy product choices,
- encouraging healthy lifestyle habits.

Diversity and Inclusion

PepsiCo's heritage of promoting diversity goes back more than half a century. In the 1940s, Pepsi-Cola was a pioneer in multicultural marketing. In the 1960s, Pepsi-Cola became the first major U.S. company to appoint an African American corporate vice president.

We approach diversity and inclusion as a fundamental strategic priority. We believe our leadership in this area will give us an opportunity to drive our growth and gain a genuine competitive advantage.

The business rationale is clear: Minority populations are growing faster than the population overall and, in the United States, ethnically diverse groups are expected to make up about 40% of the total population by 2025, and more than 50% of people under age 20. Each year, racial and ethnic minorities constitute a greater share of our potential employees, consumers and retail customers.

Two years ago we launched major urban marketing programs aimed at African Americans and Latinos in 27 U.S. cities. We developed products tailored to the preferences of our African American and Latino consumers, and were rewarded with increased sales.

Progress on Diversity and Inclusion in the United States

In 2000, we had 25% minority employees; 15% of our executives and managers were members of minority groups, and 20% of our executives and managers were women. In 2003, our minority employee representation rose to more than 27%, as our percentage of minority executives and managers increased to nearly 19%. The percentage of women executives and managers increased to 23%.

YEAR	2000		2003	
All Employees	53,513		61,186	
Minority Employees	13,612	25%	16,711	27%
All Managers	5,551		7,042	
Minority Managers	807	15%	1,315	19%
Women Managers	1,123	20%	1,634	23%

For more information on diversity and inclusion, see the Diversity section on our web site.

To stay strong and competitive, we must attract and retain the brightest, most capable employees — including people who understand the changing needs of our customers and consumers. And we must demonstrate very clearly PepsiCo's commitment to these growing communities.

So we treat diversity and inclusion as a business imperative. We create strategic plans, set goals for recruiting a diverse workforce and link our executives' compensation to their efforts and progress toward those goals.

In 1999, we created our African American Advisory Board, the first of our Ethnic Advisory Boards, which are shown on pages 18-19 of this report. Both our African American Advisory Board and our Latino/Hispanic Advisory Board, created in 2000, have provided excellent counsel on cultural, social and business issues such as hiring, marketing, benefits and diversity.

Workplace Diversity and Inclusion

Our goal is to create a diverse, inclusive and welcoming workplace. One where *everyone* feels they have an equal opportunity to succeed and grow — regardless of gender, race, ethnicity, religion or sexual orientation.

In 2002, we launched the first phase of a multi-year employee education effort: a day-and-a-half inclusion training session for all our salaried employees in the United States. Additional programs have already been rolled out.

We have active networks for our female and diverse employees. Employees in these networks sponsor events, discuss relevant issues and provide business insights.

Our Harvey Russell Inclusion Award, initiated in 2003 as part of our Chairman's Award, recognizes outstanding achievement in support of PepsiCo's diversity and inclusion efforts. It honors employees and external partners who consistently demonstrate inclusive behaviors and go "above and beyond" to move our diversity and inclusion agenda forward.

Social (continued)

Community Support and Charitable Contributions

We give to the community through the PepsiCo Foundation, PepsiCo Community Affairs and our various operating divisions. In 2003, we contributed \$23.6 million to more than 1,000 not-for-profit organizations.

Additionally, we provide support through gifts in kind, including product, premiums, printing, meeting space, equipment donations, support of events, conventions, journals and meeting sponsorship.

We support employees who volunteer with not-for-profit organizations and encourage employee groups to do volunteer work as team-building events. Employee groups have provided such services as fixing up a youth home and restoring a park.

Giving Priorities

The PepsiCo Foundation focuses on programs in four principal areas:

Youth

Encouraging physical activity and promoting youth fitness.

For example, we contribute millions of dollars each year to support a wide range of programs and organizations that encourage young people to be physically active and educate them about the value of healthy eating and a balanced diet. These include pilot projects with the YMCA, Teen Health & Wellness 101 and FitKids: Learning for Life. Both of these programs teach kids and teens about leading an active and healthy lifestyle.

Developing skills, primarily among urban and low-income youth, in leadership, entrepreneurship and other areas to prepare young people to be successful in post-secondary education and the workforce.

Examples include the International Franchise Association Educational Foundation's Franchising Entrepreneurship Program — a project exposing minority and urban youth to careers in franchising; and the Minority Scholarship Awards Program — which encourages the study of franchising and entrepreneurship by minority students in college.

Education

Supporting colleges and universities that prepare young adults for careers in business.

We provide funding primarily for leadership development programs and scholarships. For example:

- *Howard University* — funding of an endowment for scholarships at the Business School.
- *California State University, Los Angeles* — funding of the Frito-Lay Leadership Center, a facility that will help develop tomorrow's leaders by providing real-world perspective for students and faculty through practicums, internships and scholarships.
- *Hampton University* — a grant to this historically black college is endowing scholarships for promising students and supporting their Leadership Institute.
- *University of Texas, Austin* — funding of a Student Leadership Center and the LeaderShape Institute, a leadership development experience at the Business School.
- *Michigan State University (MSU)* — a grant to further opportunities and careers in the field of food science among minority students. This is the largest gift targeted to minority recruitment at MSU.

Diversity

Supporting education and community organizations.

Our support for community groups and cultural programs promotes diversity and inclusion. For example:

- *National Council of La Raza* — a multi-year contribution supports Escalera — Taking Steps to Success, a college readiness program for Latino youth.
- *In the Spirit of Martin: The Living Legacy of Dr. Martin Luther King, Jr.* — PepsiCo sponsored a traveling art exhibition organized by the Smithsonian Institution and in partnership with the King Center. A curriculum guide accompanied the exhibition, and educated many young people on the importance of Dr. King's work and legacy.
- *U.S. Pan Asian American Chamber of Commerce* — The company supported the Women's Pioneer Symposium, which brought together emerging female leaders.

Employees

We support our associates where they contribute and volunteer, as well as by providing scholarships for their children.

- The PepsiCo Foundation has one of the longest running scholarship programs for children of employees. Since 1981, over \$27 million in college scholarships have been awarded to students all over the world.
- We donate to organizations through Matching Gifts, United Way and grants to nonprofit groups where employees are involved.

For more information on The PepsiCo Foundation and our community programs, visit our web site. Grant guidelines are available online.

Social (continued)

Employee Benefits and Safety

We offer competitive compensation and benefits to our employees. Benefits are available to eligible full-time and part-time employees, including domestic partners.

In the United States, we offer a full range of health care, savings and retirement benefits. Our health and welfare benefits include medical, dental, vision, prescription drug, mental health, life and accident insurance, disability and flexible spending accounts. Other benefits offered include commuter reimbursement, group legal insurance, tuition reimbursement, adoption assistance, Employee Assistance Program, child care and elder care referral and resources, smoking cessation programs, and family and medical leave.

Financial benefits include company-funded pension plans, a company-matched 401(k) Plan, the PepsiCo Stock Purchase

Program and SharePower, a broad-based stock option program. SharePower was introduced in 1989 and is a global program that offers eligible employees stock options that may be exercised after a vesting period. We believe SharePower clearly reflects a culture that places a high priority on ownership.

Our various headquarter locations offer on-site fitness centers and wellness classes. We also offer lifestyle benefits such as on-site banking through member-owned credit unions and other amenities.

PepsiCo is committed to providing safe and healthy work environments. It is our policy to comply with all applicable safety and health laws and regulations. We are dedicated to designing, constructing, maintaining and operating facilities that protect our people and physical resources. For example, almost two-thirds of Frito-Lay's manufacturing plants have earned "Star" certificates in OSHA's Voluntary Protection Program for facility workplace safety excellence.

External Memberships

PepsiCo is a member or has representation on countless organizations relating to our employees and our businesses. Those of special social interest include:

Family Friendly Programming Forum — A group of advertisers who have taken positive steps to increase family friendly programming choices on television. We are committed to high standards regarding our advertising and where it appears. It is our policy to avoid advertising on programs that are excessively violent, dependent on unnecessary sexual themes, distasteful as judged by contemporary society or otherwise offensive to large numbers of people on an ethical, moral or racial basis.

Global Business Coalition on HIV/AIDS — An alliance of international companies dedicated to combating the AIDS

epidemic. PepsiCo has established an internal task force on HIV/AIDS. Its purpose is to gather data on HIV/AIDS and related illnesses and to monitor and respond to issues related to the disease. These issues include employee policies, programs and encouragement of community outreach efforts. U.S. policies relating to HIV/AIDS may be found on our web site, along with a description of our programs in South Africa, which is the hardest hit area. PepsiCo will be stepping up its focus on HIV/AIDS and related diseases.

Sullivan Principles — PepsiCo is a signer of the Global Sullivan Principles. The goal of the Principles is to support economic, social and political justice by companies where they do business; to support human rights, and to encourage equal opportunity at all levels of employment.

Recognition and Awards

Awards tell us when we are making progress and achieving valuable goals. They also help us benchmark our progress. In 2003, PepsiCo and our people were honored in many areas. Here are just a few:

- *Fortune* magazine named PepsiCo **the most admired company in the beverage industry**.
- Frito-Lay received a **Star of Energy Efficiency Award** from the Alliance to Save Energy for its achievement of energy saving goals: water usage down 10%, and electricity usage down 11%.

- Women's Business Enterprise National Council named PepsiCo to its **"Elite Eleven"** list.
- PepsiCo was named to *DiversityInc's* **"Top 50 Companies for Diversity."**
- *Latina Style* magazine named PepsiCo to its list of **"Top 50 Best Companies for Latinas to work for in the U.S."**
- *Saludos Hispanos* magazine named PepsiCo a **Leader of Distinction** in supplier diversity.
- *Fortune* magazine ranked PepsiCo #9 in its **"50 Best Companies for Minorities"** survey.

For a more complete listing, visit the Honors section on our web site.

GRI Index and Contact Information

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*Reference to the Global Reporting Initiative (GRI) indicators. See <http://www.globalreporting.org/guidelines/2002.asp> for more information.

Note: Some indicators are fully reported, others partially. For a more comprehensive listing, please visit <http://www.pepsico.com>.

Key:

EC – economic
EN – environmental
LA – labor practices
HR – human rights
SO – society
PR – product responsibility

Contact Information:

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Manager, Corporate Information
914-253-3122

Additional information on these and other PepsiCo initiatives can be found at <http://www.pepsico.com>.

Management's Discussion and Analysis and Consolidated Financial Statements

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Our Chairman and CEO Perspective

The questions below reflect those commonly asked by our shareholders, and are followed by answers from our Chairman and CEO, Steve Reinemund. Commonly asked questions regarding current financial issues have been included in "Our Financial Results," along with responses from our President and CFO, Indra Nooyi.

(1) This year, obesity and health and wellness have been making headlines in almost every newspaper and magazine. What are you doing to address these concerns?

We are actively addressing health and wellness and see this as an opportunity for us to provide a diversified portfolio for consumers. We see this as a win for ourselves and for our customers. You are right in that you can't read a newspaper without finding a story on obesity and its related health consequences. For us, it signals that consumers want more choices of convenient foods and beverages that are healthier.

Rather than looking at this consumer need as a threat to our business, we began in the late 1990s to focus on further building a portfolio of better-for-you and good-for-you brands — literally re-tooling our company for future growth. Adding Tropicana, Quaker Oats and Gatorade brands over the last several years has dramatically increased our ability to provide more choices for consumers. We committed to driving 50% of our North American product innovation to better-for-you and good-for-you products. We exceeded that goal in 2003, and led the food and beverage industry as the first major company to eliminate trans fats from our corn snacks.

And that's just the beginning. We've engaged leading health and nutrition experts to help us identify consumer

Our Business

Our discussion and analysis is an integral part of understanding our financial results. 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. Percentage changes are based on unrounded amounts.

Our Operations

We are a leading, global snack and beverage company. We manufacture, market

snacks, Tostitos tortilla chips, Fritos corn chips, Ruffles potato chips, branded dips, Quaker Chewy granola bars, Rold Gold pretzels, SunChips multigrain snacks, Munchies snack mix, Grandma's cookies, Quaker Quakes corn and rice snacks, Quaker Fruit & Oatmeal bars,

Our Divisions

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

and sell a variety of salty, convenient, sweet and grain-based snacks, carbonated and non-carbonated beverages and foods. We are organized in four divisions. Our North American divisions operate in the United States and Canada. Our international divisions operate in nearly 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 to our consolidated financial statements.

Frito-Lay North America

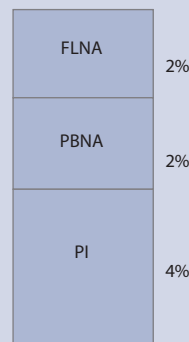
Frito-Lay North America (FLNA) manufactures, markets, sells and distributes branded snacks. These snacks include Lay's potato chips, Doritos flavored tortilla chips, Cheetos cheese flavored

Cracker Jack candy coated popcorn, Lay's Stax and Go Snacks. FLNA branded products are sold to independent distributors and retailers.

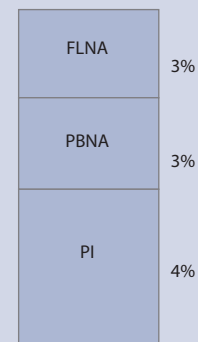
PepsiCo Beverages North America

PepsiCo Beverages North America (PBNA) manufactures or uses contract manufacturers, markets and sells beverage concentrates, fountain syrups and finished goods, under the brands Pepsi, Mountain Dew, Sierra Mist, Mug, SoBe, Gatorade, Tropicana Pure Premium, Dole, Tropicana Season's Best, Tropicana Twister and Propel. PBNA also manufactures, markets and sells ready-to-drink tea and coffee products through joint ventures with Lipton and Starbucks. In addition, PBNA licenses the Aquafina water brand to its bottlers and markets this brand. PBNA

Division Net Revenue Growth 8%



Division Operating Profit Growth 10%



sells concentrate and finished goods for some of these brands to bottlers licensed by us, and some of these branded products are sold directly by us to independent distributors and retailers. The franchise bottlers sell our brands as finished goods to independent distributors and retailers. PBNA's volume reflects sales to its independent distributors and retailers, and the sales of beverages bearing our trademarks that franchise 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 Sabritas, Gamesa and Alegro in Mexico, Walkers in the United Kingdom, and Smith's in Australia. 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, Mountain Dew, Gatorade and Tropicana outside North America. These

brands are sold to franchise 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 franchise 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 franchise 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, Cap'n Crunch and Life ready-to-eat cereals, Rice-A-Roni, Pasta Roni and Near East side dishes, Aunt Jemima mixes and syrups and Quaker grits. These branded products are sold to independent distributors and retailers.

nutrition needs. We are adopting scientifically accepted standards for nutritious foods and beverages — those based on guidance from the National Academy of Sciences and the U.S. Food and Drug Administration — to better assess our product portfolio. We've expanded product choices with trusted brands like Quaker, Tropicana, Gatorade, Diet Pepsi, Baked Lay's and Aquafina. We've identified many opportunities for other product improvements, and we're aggressively pursuing new product platforms. So you can see, health and wellness means opportunity for us.

(2) Retail consolidation and the power of companies like Wal-Mart seems ever-growing. What does this mean for PepsiCo?

We can only achieve long-term success if we help our business partners with their success. So when we work with retailers, franchise bottlers, joint-venture partners and suppliers, we try to ensure that our partnerships appropriately balance the interests of both parties. With our retail customers, we strive to provide products and services that contribute to growth in their sales, profit and cash flow.

Based on our research, we are a significant source of sales, profit, and cash flow growth for our retail customers. Our 16 billion-dollar brands create significant consumer pull for our retailers. This pull translates into pricing leverage for our retailers. In addition, our products are restocked often and frequently purchased on impulse. Add these factors together with our portfolio of choice for consumers and you can see why we have been, and continue to be, so important to the profit equation of our retail customers.

I also believe that our powerful Direct-Store-Delivery (DSD) system offers a unique benefit. We have almost daily contact with our retailers and consumers. We can quickly react to the marketplace and can tailor our marketing and merchandising.

Our Customers

Our customers include franchise bottlers and independent distributors and retailers. We 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 and full goods and for Aquafina

Customers are franchise bottlers and independent distributors and retailers.

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

Certainly, the consolidation of retailers can increase financial risk. Here, we believe that we are in a relatively good position. With our DSD system, we have better control over inventory levels. In addition, our 30-day or less sales terms and the high turnover of our products limit our financial risk.

(3) We've heard a lot from your soft drink competitor and its bottlers over the last six months — about better and greater sharing of the profits. Are PepsiCo and its bottlers aligned?

Here again, our long-term success is dependent on the success of our business partners and this requires alignment with our bottlers. With our bottlers, we strive to conduct business in a way that allows both the bottlers and PepsiCo to earn a reasonable return. We cannot grow at the expense of our bottlers.

(4) 2003 seemed to be jam-packed with innovation, from new products like Lay's Stax, Pepsi Vanilla, and Frito-Lay Natural line, to expanded distribution for Sierra Mist and Propel fitness water. How does 2004 product innovation measure up?

I feel very confident that our 2004 innovation lineup can stand up to the success of 2003. We know that targeting our innovation to the changing consumer is key to our future success. Our 2004 innovation reflects a broad range of consumer choices, including those focused on health and wellness. It starts with new beverage products at Tropicana, including new Light 'n Healthy, with 1/3 fewer calories and Healthy Heart, with vitamins, potassium and folate. Our fun-for-you innovation continues with the many products introduced late in 2003 like Lay's Stax and Pepsi Vanilla. New snack innovation for 2004 also includes our low-carb Doritos and Tostitos offerings, Doritos Rollitos, a better-for-you Munchies kid mix, new multi-serve options and Frito-Lay Natural line-extensions. These are just some of the exciting new products for 2004.

are not required by the terms of our bottling contracts.

Sales to Wal-Mart Stores, Inc. represent approximately 10% of our global net revenue. Retail consolidation has increased the importance of major

Consumers are the people who eat and drink our products.

customers and further consolidation is expected. Our top five retail customers currently represent approximately 26% of our 2003 North American gross revenue, with Wal-Mart representing approximately 12%. In addition, sales to The Pepsi Bottling Group (PBG) represent approximately 10% of our net revenue. See Note 8 to our consolidated financial statements for more information on our anchor bottlers.

Our Related Party Bottlers

We have ownership interests in certain of our bottlers. Our ownership is generally less than fifty percent 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 ownership in our income statement as bottling equity income. We have designated three related party bottlers, PBG, PepsiAmericas, Inc. (PAS) and Pepsi Bottling Ventures (PBV), as our anchor bottlers. Our anchor bottlers distribute approximately 65% of our North American beverage volume and approximately 20% of our international beverage volume. These bottlers participate in the bottler funding programs described above. Approximately 12% of our total sales incentives for 2003 related to these bottlers. See Note 8 to our consolidated financial statements for additional information on these related parties and related party commitments and guarantees.

Our Distribution Network

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

Direct-Store-Delivery

We and our bottlers 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 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, and for certain beverages, distributes 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 and private label manufacturers on the basis of price, quality, product variety and effective distribution. Success in this competitive environment is primarily achieved through

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

Other Relationships

Certain members of our Board of Directors also serve on the boards of certain vendors and customers. Those Board members do not participate in our vendor selection and negotiations nor in our customer negotiations. Our transactions with these vendors and customers are in the normal course of business and are

consistent with terms negotiated with other vendors and customers. In addition, certain of our employees serve on the boards of our anchor bottlers and other affiliated companies and do not receive incremental compensation for their Board services.

Our Market Risks

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

- commodity prices, affecting the cost of our raw materials and fuel;
- foreign exchange 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 designated as cash flow and fair value hedges. The fair value of our hedges fluctuates based on market rates and prices. The sensitivity of our hedges to these market fluctuations is discussed below. See Note 10 to our consolidated financial statements for further discussion of these hedges 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. See "Cautionary Statements" for further discussion.

Commodity Prices

Our open commodity derivative contracts designated as hedges had a face value of \$43 million at December 27, 2003 and \$70 million at December 28, 2002. These derivatives resulted in a net unrealized gain of \$4 million at December 27, 2003 and \$6 million at December 28, 2002. We estimate that a 10% decline in commodity prices would have resulted in an unrealized loss of \$1 million in 2003 and \$2 million in 2002.

At the end of 2002, we made the strategic decision to switch from oil containing trans fats, such as hydrogenated soybean oil, to healthier corn oil for our salty snacks. As a result of our decision and that of others to follow, corn oil costs were more difficult to completely manage in 2003 with hedges or purchase commitments due to the limited availability of corn oil. We expect to be able to mitigate the risk of fluctuating corn oil prices with hedges or purchase commitments in 2004.

Keep in mind that growth is not simply the number of new products in one year versus another. We also get a lift from targeting certain distribution channels or consumers. Consider our Frito-Lay Natural line which is high margin and very incremental, as it places our products in a completely new aisle for us and targets a different consumer.

(5) Carbonated soft drink (CSD) growth has been slowing overall, and brand Pepsi has been declining. Are you concerned about this?

We saw declines in brand Pepsi in 2003, but I think in part, we are losing some cola volume to our non-carbonated products, such as water, tea and isotonic, as well as diet. As the leading liquid refreshment beverage company, this is a trade-off issue for us. Change in consumer choice has translated into explosive growth in water and isotonic, where we have leading brands. Aquafina and Gatorade had double-digit volume growth in 2003. On the carbonated soft drink front, we have seen very good diet CSD performance for both the industry and for Pepsi specifically. In 2003, Diet Pepsi had solid volume growth. This diet growth reflects a consumer focused on less calories. That being said, we also have tremendous focus on strengthening our namesake brand, and have committed significant resources in new advertising and promotions to support brand Pepsi in 2004 and beyond.

So you can see, we are addressing consumer desires with expanded product choices, and with committed resources to strengthen Pepsi-Cola.

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 revenue and expenses. Adjustments resulting from translating net assets are reported as a separate component of accumulated other comprehensive loss within shareholders' equity called currency translation adjustment.

political unrest. During 2003, the impact of the unfavorable Mexican peso was more than offset by the favorable euro, British pound and the Canadian dollar resulting in a contribution of nearly 1 percentage point to revenue growth. For operating profit, this unfavorability was not offset and unfavorable foreign currency reduced operating profit growth by 1 percentage point. If declines in the Mexican peso continue and are not offset, our

transaction risk. Our foreign currency derivatives had a total face value of \$484 million at December 27, 2003 and \$329 million at December 28, 2002. These contracts had a net unrealized loss of \$30 million at December 27, 2003 and less than \$1 million at December 28, 2002. We estimate that an unfavorable 10% change in the exchange rates would have resulted in an unrealized loss of \$50 million in 2003 and \$34 million in 2002.

Translation adjustments — conversion of foreign subsidiary financial statements to U.S. dollars.

Transaction gains and losses — result from exchange rate changes arising from specific transactions.

Our operations outside of the United States generate about 35% of our net revenue of which Mexico, the United Kingdom and Canada comprise nearly 20%. As a result, we are exposed to foreign currency risks, including from unforeseen economic changes and

future results will be adversely impacted.

Exchange rate gains or losses related to foreign currency transactions are recognized as transaction gains or losses in the income statement as incurred. We may enter into derivatives to manage our exposure to foreign currency

Stock Prices

We manage the market risk related to our deferred compensation liability, which is indexed to certain market indices and our stock price, with mutual fund investments and prepaid forward contracts for the purchase of our stock. The combined gains or losses on these investments are offset by changes in our deferred compensation liability, which are included in corporate selling, general and administrative expenses.

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. The following discussion of risks and uncertainties 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.

Product Demand and Retail Consolidation

We are a consumer products company 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. Our continued success is dependent on our product innovation, effective sales incen-

tives, advertising campaigns and marketing programs, and our responses to consumer health concerns, including obesity, and changes in product category consumption. Seasonal weather conditions, particularly for sports drinks and hot cereals, can also impact demand. Our top five retail customers now represent approximately 26% of our North American gross revenue reflecting the continuing consolidation of the retail trade. In this environment, there continues to be competitive product and pricing pressures, as well as challenges in maintaining profit margins. We must maintain mutually beneficial relationships with our key customers, including our retailers and anchor bottlers, to effectively compete.

Cost Pressures

Our costs are not fixed but fluctuate, particularly due to the availability of labor and raw materials. Therefore, our success is dependent in part on our continued ability to manage these costs through productivity initiatives,

purchasing commitments and hedges. Ongoing productivity initiatives require the identification of meaningful cost saving opportunities or efficiencies and effective implementation.

Global Economic Conditions

Unforeseen economic changes and political unrest may result in business interruption, foreign currency devaluation, inflation, deflation or decreased demand, particularly in Latin America, Europe and the Middle East. Economic conditions in North America could also adversely impact growth, particularly in convenience stores where our products are generally sold in higher margin single serve packages.

Regulatory Environment

Changes in laws, regulations and the related interpretations, including changes in food and drug laws, accounting standards, taxation requirements, competition laws and environmental laws may alter the environment in which we do business and, therefore, impact our results or increase our liabilities.

Our Critical Accounting Policies

An appreciation of our critical accounting policies is necessary to understand our financial results. These policies 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 stock compensation, 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 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 compensation expense, and
- pension and retiree medical plans.

Revenue Recognition

Our products are sold for cash or on credit terms. Our credit terms, which are established in accordance with local and industry practices, typically require payment within 30 days of delivery and may allow discounts for early payment. We recognize revenue upon delivery to our customers in accordance with written sales terms that do not allow for a right of return. However, our policy for direct-store-delivery and chilled products is to

We recognize revenue upon delivery to our customers.

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 product. Our bottlers have a similar replacement policy and are responsible for the products they distribute.

As discussed in "Our Customers," we offer sales incentives through various programs to customers and consumers. Sales incentives are accounted for as a reduction of sales and totaled \$6.0 billion in 2003, \$5.5 billion in 2002 and \$4.7 billion in 2001. A number of these programs, such as bottler funding and customer volume rebates, are based on annual targets, and accruals are established during the year for the expected payout. The accruals are based on our historical experience with similar programs. The terms of most of our incentive arrangements do not exceed a year. However, certain arrangements,

including fountain pouring rights, may extend up to 15 years. Costs incurred to obtain these arrangements are recognized over the life of the contract as a reduction of sales, and the outstanding balance of \$359 million at year-end 2003 and \$349 million at year-end 2002 is included in other assets in our Consolidated Balance Sheet.

We estimate and reserve for our bad debt exposure from credit sales based on our experience. Our method of determining the reserves has been consistent during the years presented in the consolidated financial statements. Bad debt expense is classified within selling, general and administrative expenses in our Consolidated Statement of Income.

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 twenty 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 country in which the brand is sold.

Nearly 75% of our perpetual brands and goodwill relate to Tropicana and Walkers.

Goodwill and perpetual brands are not amortized. Perpetual brands and goodwill are assessed for impairment at least annually to ensure that estimated future cash flows continue to exceed the related book value. A perpetual brand is impaired if its book value exceeds its fair value. Goodwill is evaluated for impairment if the book value of its reporting unit exceeds its fair value. A reporting unit can be a division or business within a division. If the fair value of an evaluated asset is less than its book value, the asset is written down to fair value based on its discounted future cash flows.

Amortizable brands are only evaluated for impairment upon a significant change in the operating or macroeconomic environment. If an evaluation of the undiscounted 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 consistent with our internal projections and operating plans.

We did not recognize any impairment charges for perpetual brands or goodwill during the years presented. As of December 27, 2003, we had \$4.7 billion of perpetual brands and goodwill, of which nearly 75% related to Tropicana and Walkers. In our most recent impairment evaluations for Tropicana and Walkers, no impairment charges would have resulted even if operating profit growth were assumed to be 5% lower.

Income Tax Expense and Accruals

In 2003, our annual tax rate was 28.5% compared to 32.3% in 2002 as discussed in "Other Consolidated Results." For 2004, our annual tax rate is expected to be 29.5% reflecting the absence of a \$109

Our annual tax rate was 28.5% in 2003.

million benefit from the United States Internal Revenue Service (IRS) agreements discussed below, and lower taxes on foreign results, which includes the increasing benefit from our new concentrate operations, and certain ongoing benefits resulting from agreements reached with the IRS.

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 likely to be challenged and that we may not succeed. We adjust these reserves, as well as the related interest, in light of changing facts and circumstances, such as the progress of a tax audit. An estimated effective tax rate for a year is applied to our quarterly operating results. In the event there is a significant or unusual item recognized in our quarterly operating results, the tax attributable to that item is separately calculated and recorded at the same time as that item. We consider the tax benefits from the Quaker merger-related costs and the taxes related to divestitures of businesses to be such items.

Tax law requires items to be included in the tax return at different times than the items are reflected in the financial

statements. As a result, our annual tax rate reflected in our financial statements is different than that reported in our tax return (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 timing differences create deferred tax assets and liabilities. Deferred tax assets generally represent items that can be used as a tax deduction or credit in

For 2004, our annual tax rate is expected to be 29.5%.

our tax return 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 we have not yet recognized as expense in our financial statements. We have not recognized any United States tax expense on undistributed international earnings since we intend to reinvest the earnings outside the United States for the foreseeable future. These undistributed earnings are approximately \$8.8 billion at December 27, 2003 and \$7.5 billion at December 28, 2002.

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. At the end of 2003, we entered into agreements with the IRS for open years through 1997. As part of these agreements, we also resolved the treatment of certain other issues related to future tax years. These agreements resulted in a tax benefit of \$109 million in the fourth quarter of 2003 and resolved issues that will lower our future tax rate. Our tax returns subsequent to 1997 have not yet been examined. 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 most

probable outcome of known tax contingencies. 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 are presented in the balance sheet within other liabilities, except for amounts relating to items we expect to pay in the coming year which are classified as current income taxes payable. For more information on the impact of our tax agreements, see "Other Consolidated Results" and "Our Liquidity and Capital Resources."

Stock 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. Historically, we have used stock options as our primary form of long-term incentive compensation. These 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; this is referred to as vesting. Our options generally have a ten-year term which means our employees would have seven years after the vesting date 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.

At the end of 2003, our Board approved a new compensation program which strengthens the link between pay and individual performance by differing the amount of long-term compensation for each employee based on responsibility and, for executive grants, based on individual performance. Our new program will provide our executives with

We adopted the fair value method of accounting for stock options and restated prior year amounts.

the choice of being granted stock options or restricted stock units (RSUs). RSUs do not require the executive to pay an exercise price to receive a share of our stock. Executives who elect RSUs will receive one RSU for every four stock options that would have otherwise been granted. In addition, the size of the annual executive grant will be reduced

to provide for a long-term cash bonus to executives. Three years of service after the grant date will continue to be required to earn the stock compensation, as well as to earn the entire long-term cash bonus. As part of the new 2003 Long-Term Incentive Plan (LTIP) program, our broad-based SharePower program will be reduced by approximately 50% for employees in the U.S. and replaced with 401(k) matching contributions of PepsiCo stock. For additional information on the 401(k) savings plans, see Note 7 to our consolidated financial statements.

Fair Value Method of Accounting

Historically, we accounted for our employee stock options using the intrinsic value method. This method measures stock compensation expense as the amount by which the market price of the stock on the date of grant exceeds the exercise price. We did not recognize any stock compensation expense under this method because we granted our stock options at the current stock price.

At the end of 2003, we voluntarily adopted the fair value method of accounting for stock options. We selected the retroactive restatement method as described in SFAS 148, *Accounting for Stock-Based Compensation — Transition and Disclosure*, to adopt this accounting. Under this method, we have restated our results for the years presented to recognize stock compensation expense as if we had applied the fair value method to account for our unvested stock options. We recognize stock compensation expense from the date of grant to the vesting date.

The restatement reduced our results as follows:

	2003	2002	2001
Operating profit	\$407	\$435	\$385
Net income	\$293	\$313	\$262
Net income per common share — diluted	\$0.16	\$0.17	\$0.14

The impact of the restatement has been recorded in corporate unallocated expenses in each of the years presented. Stock compensation expense was not included in division results as the divisions were not held responsible for this expense. Commencing in 2004, our divisions will be held accountable for stock

compensation expense and will be allocated an incremental employee compensation cost. Prior year division results will then be adjusted for comparability. The expected allocation of compensation expense will be approximately 30% FLNA, 21% PBNA, 31% PI, 4% QFNA and 14% PepsiCo Corporate.

Our Assumptions

Under the fair value method of accounting, we measure stock option expense at the date of grant using a Black-Scholes valuation model. This 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 Black-Scholes fair value assumptions include:

	2004	2003	2002	2001
Expected life	6 yrs.	6 yrs.	6 yrs.	5 yrs.
Risk free interest rate	3.4%	3.1%	4.4%	4.8%
Expected volatility	26%	27%	27%	29%
Expected dividend yield	1.15%	1.15%	1.14%	0.98%

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 average length of time we expect our employee groups will exercise 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.

Sensitivity of Assumptions

If we assumed a 100 basis point change in the following assumptions, our estimated 2004 stock compensation expense would increase/(decrease) as follows:

	100 Basis Point Increase	100 Basis Point Decrease
Risk free interest rate	\$4	\$(4)
Expected volatility	\$1	\$(1)
Expected dividend yield	\$(6)	\$7

If we assumed the expected life was one year longer, our estimated 2004 stock compensation expense would increase by \$6 million. If we assumed the expected life was one year shorter, our estimated 2004 stock compensation expense would decrease by \$8 million.

Changing the assumed expected life changes 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.

2004 Estimated Expense

Our 2004 stock compensation expense, including RSUs, is estimated to be approximately \$360 million compared to \$407 million in 2003. The reduction in our estimated 2004 expense is due to the changes in our new compensation plan. However, total executive compensation expense, including the new long-term cash bonus award, is not expected to significantly change in 2004.

- **Pension plans cover full-time U.S. and certain international employees.**
- **Our 2004 pension expense is estimated to be approximately \$245 million.**
- **Our 2004 retiree medical expense is estimated to be approximately \$120 million.**

Our pension plans cover full-time employees in the United States and certain international employees. Benefits are determined based on either years of service or a combination of years of service and earnings. U.S. retirees are also eligible for medical and life insurance benefits (retiree medical) if they meet age and service requirements. Generally, our retiree medical costs are capped at a specified dollar amount, with retirees contributing the remainder, therefore, changes in assumptions will not materially affect retiree medical expense.

Our Assumptions

The pension or retiree medical benefits expected to be paid are expensed over the employees' expected service. We must make many assumptions to measure our annual pension and retiree medical expense, including:

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

Our assumptions reflect our historical experience and management's best

judgment regarding future expectations. The assumptions, assets and liabilities used to measure our annual pension and retiree medical expense are determined as of September 30 (measurement date). Since pension and retiree medical liabilities are measured on a discounted basis, the discount rate is a significant assump-

- **Our pension contributions for 2003 were \$535 million of which \$500 million was discretionary.**
- **In 2004, we expect pension contributions to be approximately \$450 million of which approximately \$400 million is expected to be discretionary.**
- **Our 2004 cash funding for retiree medical is estimated to be \$75 million.**

tion. It is based on interest rates for high-quality, long-term corporate debt at each measurement date. The expected return on pension plan assets is based on our historical experience, our pension plan investment guidelines, and our expectations for long-term rates of return. Our pension plan investment guidelines are established based upon an evaluation of market conditions, tolerance for risk and cash requirements for benefit payments. We updated the pension investment strategy for our U.S. plans during 2003, revising our investment allocation to a target of 60% equities (from a 65% target), with the balance in fixed income securities. As a result, our estimated

pension expense for 2004 incorporates a reduction in the expected weighted average rate of return on plan assets to 7.8%, reflecting an estimated 9.3% return from equity securities and an estimated 5.5% return from debt securities. As permitted by U.S. generally accepted accounting principles, plan assets used in determining the expected return component of annual pension expense reflect the difference between the actual and the expected return in any one year over five years. Therefore, it takes five years for the gain or loss from any one year to be fully included in the measurement of plan assets.

Other gains and losses resulting from

actual experience differing from 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, such as increasing or decreasing benefits for prior employee service, is included in expense on a straight-line basis over the average remaining service period of the employees expected to receive benefits.

Weighted-average assumptions for pension and retiree medical expense:

	2004	2003	2002
Pension			
Expense discount rate	6.1%	6.7%	7.4%
Expected rate of return on plan assets	7.8%	8.2%	9.1%
Expected rate of salary increases	4.4%	4.4%	4.4%
Retiree medical			
Expense discount rate	6.1%	6.7%	7.5%
Current health care cost trend rate	12.0%	10.0%	7.5%

Sensitivity of Assumptions

A decrease in the discount rate or a decrease in the rate of return on assets would increase pension expense. The estimated impact of a 25 basis point change in the discount rate on 2004 pension expense is a change of approximately \$27 million. The estimated impact on 2004 pension expense of a 25 basis point change in the expected rate of return on assets is a change of approximately \$12 million. See Note 7 to our consolidated financial statements regarding the sensitivity of our retiree medical cost assumptions.

Future Expense

Our 2004 pension expense is estimated to be approximately \$245 million and retiree medical expense is estimated to be approximately \$120 million. These estimates incorporate the 2004 assumptions, as well as the impact of the increased pension plan assets resulting from our discretionary contributions of \$500 million in 2003 and the impact of the 2003 Medicare Act as discussed in Note 7 to our consolidated financial statements. An analysis of the estimated change in pension and retiree medical expense follows:

Pension service costs and the impact of demographic changes are reflected in division results, while the impact of changes in discount and asset return rates, asset gains and losses, and the impact of funding are reflected in corporate unallocated. Under this policy, approximately \$75 million of the increased expense in 2004 will be reflected in corporate unallocated expense.

Based on our current assumptions, experience mirroring these assumptions and assuming we make annual discretionary contributions of approximately \$400 million, we expect our pension expense to increase by approximately \$15 million in 2005 and by another \$15 million in 2006. In 2007, our pension expense would begin to decrease, with the expense dropping to approximately \$200 million by 2009 as the unrecognized losses are amortized. If our assumptions for retiree medical remain unchanged and our experience mirrors these assumptions, we expect our retiree medical expense beyond 2004 to approximate \$130 million.

Future Funding

We make contributions to 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 or when the employee would be taxed prior to receipt of benefit.

Our pension contributions for 2003 were \$535 million of which \$500 million was discretionary. In 2004, we expect contributions to be \$450 million of which approximately \$400 million is expected to be discretionary with the remainder satisfying minimum requirements, including the pay-as-you-go requirements related to our unfunded plans. Our cash funding for retiree medical in 2004 is estimated to be \$75 million. Since our retiree medical plans are not subject to regulatory funding requirements, we fund 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 to our consolidated financial statements.

	Pension	Retiree Medical
2003 expense	\$ 157	\$116
Decrease in discount rate	54	7
Decrease in expected rate of return	18	–
Increase in health care cost trend rate	–	13
Increase in experience loss amortization	54	6
Impact of funding	(39)	–
Increase in prior service benefit amortization	–	(16)
Other, including impact of 2003 Medicare Act	1	(6)
2004 estimated expense	\$ 245	\$120

Our Financial Results

Items Affecting Comparability

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

	2003	2002
Operating profit		
Impairment and restructuring charges	\$(147)	–
Merger-related costs	\$(59)	\$(224)
Net income		
Impairment and restructuring charges	\$(100)	–
Merger-related costs	\$(42)	\$(190)
Net tax benefit	\$109	–
Net income per common share — diluted		
Impairment and restructuring charges	\$(0.06)	–
Merger-related costs	\$(0.02)	\$(0.11)
Net tax benefit	\$0.06	–

For the items and accounting changes affecting our 2001 results, see Note 1 to our consolidated financial statements and our 2002 Annual Report.

Impairment and Restructuring Charges and Merger-Related Costs

In the fourth quarter of 2003, we incurred a restructuring charge of \$147 million in conjunction with the streamlining of our North American divisions and PepsiCo International. Also, during 2003 and 2002, we incurred costs associated with our merger with The Quaker Oats Company (Quaker). For additional information, see Note 3 to our consolidated financial statements.

Net Tax Benefit

At the end of 2003, we entered into agreements with the IRS for open tax years through 1997. As part of these agreements, we also resolved the treatment of certain other issues related to future tax years. These agreements resulted in a tax benefit of \$109 million. For additional information, see “Our Critical Accounting Policies” and “Our Liquidity and Capital Resources.”

Accounting Changes

See “Our Critical Accounting Policies” on the adoption of fair value accounting for stock options. There are no recently issued accounting standards that we have not yet adopted that are expected to have a material impact on our consolidated financial statements.

Our President and CFO Perspective

The questions below reflect those commonly asked by our shareholders about financial issues and are followed by answers from our President and CFO, Indra Nooyi.

(1) PepsiCo has strong cash flow and relatively little debt. Shouldn't PepsiCo increase its dividend?

Our strong cash generation is one of our greatest strengths. In 2003, PepsiCo generated \$4.3 billion in cash from operating activities. We invested \$1.3 billion back into our businesses through capital spending, and returned \$3.0 billion to our shareholders through a combination of share repurchases and dividend payments. Over the past three years, we've returned over \$8.9 billion to our shareholders through dividends and share repurchases.

Our policy has been to return one-third of our prior year earnings to shareholders through dividend payments, and we are nearing completion of a \$5 billion multi-year share repurchase program. As we do each spring, we will soon be meeting with our Board of Directors to discuss our capital structure, and this discussion will include consideration of our dividend rate and authorization for our share repurchase program. Any decisions regarding dividend rates and our share repurchase program will be communicated following the meeting.

(2) Why are your pension costs increasing, and what are you doing to control them?

Our pension cost increases have been largely influenced by a reduction in the interest rate used to calculate the current value of our pension obligations and by the relatively low market returns on the pension trust assets. Neither of these financial market conditions was unique to our plans.

Results of Operations – Consolidated Review

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

Servings

Since our divisions each use different measures of physical unit volume (i.e., kilos, 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.

Total servings increased 5% in 2003 compared to 2002 as servings for snacks worldwide and beverages worldwide each grew 5%. PI, PBNA and FLNA contributed to the total servings growth. Total servings increased 4% in 2002 compared to 2001 primarily due to contributions across our divisions, led by beverage growth.

Net Revenue and Operating Profit

	2003	2002	2001	Change	
				2003	2002
Division net revenue	\$26,969	\$24,978	\$24,045	8%	4%
Divested businesses	2	134	173		
SVE consolidation	–	–	(706)		
Total net revenue	\$26,971	\$25,112	\$23,512	7%	7%
Division operating profit	\$5,813	\$5,308	\$4,774	10%	11%
Corporate unallocated	(852)	(812)	(756)	5%	7%
Merger-related costs	(59)	(224)	(356)		
Impairment and restructuring charges	(147)	–	(31)		
Divested businesses	26	23	39		
Other reconciling items	–	–	(34)		
Total operating profit	\$4,781	\$4,295	\$3,636	11%	18%
Division operating profit margin	21.6%	21.2%	19.9%	0.4	1.3
Total operating profit margin	17.7%	17.1%	15.5%	0.6	1.6

Interest rates are at a 40-year low, and the pension trust asset returns from 2000 to 2002 reflected the generally poor equity market performance in those years. We have adjusted our key pension expense assumptions to reflect the current market expectations of lower interest rates and lower investment returns, which contributed to the increase in our pension expense.

Over the past two years, we have contributed approximately \$1.3 billion to our pension plans to ensure the plans remain financially sound. I am pleased to say that, at the end of 2003, our pension assets exceeded the liability for benefits earned to date for all our qualified pension plans.

(3) We have heard a lot from you about productivity/restructuring initiatives, such as Quaker merger synergies, Business Process Transformation and the reorganization of PBNA and PI. When will the savings get to the bottom line?

We have two kinds of productivity. The first is productivity that results within an operating division from volume leverage and through implementing multiple ideas for cost savings in all parts of the value chain. Every year, our operating divisions use some of those savings to fund business initiatives and offset cost inflation and the rest of those savings flow to the bottom line. This is what results in sustained margin improvements.

The second kind of productivity results from efficiencies that span our divisions where savings are generated when we combine resources. Items here include the procurement of goods and services on a combined basis and information technology platforms that can reduce back-office redundancies. The successful integration of Quaker delivered significant savings in these areas. Currently, I'm heading up our Business Process Transformation initiative that spans all divisions. With this initiative, we are driving toward an enterprise-wide information technology system based on common business processes to lower costs and serve

2003

Net revenue increased 7%. Division net revenue increased 8%, primarily due to the strong volume which contributed 4 percentage points of growth. Favorable product and country mix, as well as North American snack and concentrate price increases, contributed over 2 percentage points to the growth. Favorable foreign currency movements contributed nearly 1 percentage point to the net revenue growth.

Total operating profit increased 11% and margin increased 0.6 percentage points. Division operating profit increased 10% and division margin increased 0.4 percentage points. These gains were driven by the strong volume and higher effective net pricing. Cost of sales increased 8% reflecting increased commodity costs, particularly corn oil and natural gas. Selling, general and administrative expenses increased 6% driven by higher selling costs primarily reflecting the increased volume and increased fuel costs. Unfavorable foreign currency reduced operating profit growth by nearly 1 percentage point. In addition, total operating profit reflects the benefit from lower merger-related costs, offset by the 2003 impairment and restructuring charges of \$147 million.

2002

Net revenue increased 7%. Division net revenue increased 4% driven by volume gains across all divisions, higher concentrate pricing and favorable mix. These gains were partially offset by increased promotional spending at PepsiCo Beverages North America and Frito-Lay North America, and net unfavorable foreign currency movement. The consolidation of SVE increased total net revenue growth by 3 percentage points, and net unfavorable foreign currency reduced the growth by 1 percentage point.

Total operating profit increased 18% and margin increased 1.6 percentage points. Division operating profit increased 11% and margin increased

1.3 percentage points. These gains were driven by the net revenue growth. In addition, total operating profit benefited from Quaker merger-related synergies of approximately \$250 million, lower merger-related costs and productivity. Total operating profit growth improved 6 percentage points from the impact of lower merger-related costs, the absence of other impairment and restructuring costs and the adoption of SFAS 142. Operating profit growth was not materially affected by foreign currency movements.

Corporate Unallocated Expenses

Corporate unallocated expenses include the costs of our corporate headquarters, centrally managed initiatives, unallocated insurance and benefit programs, foreign exchange transactions gains and losses and certain other items. In the fourth quarter, we voluntarily elected to expense stock options. As a result, corporate unallocated expenses also include stock compensation expense of \$407 million in 2003, \$435 million in 2002 and \$385 million in 2001.

For 2003, corporate unallocated expenses increased 5% primarily reflecting our 2003 investment in the Business Process Transformation initiative as discussed in "Our President and CFO Perspective." Higher employee-related costs, including deferred compensation, and corporate departmental costs also contributed to the increase. The increase in the deferred compensation costs is partially offset in net interest expense as described below. Corporate departmental expenses increased 5% reflecting staffing and other costs related to our health and wellness initiatives.

For 2002, corporate unallocated expenses increased 7% due to higher employee-related expenses partially offset by lower net foreign exchange transaction losses. Corporate departmental expenses declined 2%.

Our President and CFO Perspective (*continued*)

our customers better. Our focus so far is North America and we are in the process of evaluating the enterprise-wide alternatives along with a timetable for implementation. This is a multi-year effort and savings from this initiative will help us sustain the margin improvement trend in our businesses.

(4) Do you expect to make any acquisitions in the near future?

We are constantly evaluating potential "tuck-in" acquisitions, which can be a brand, technology or distribution capability that leverages our existing infrastructure, and that can be easily integrated into our business. A great example of a recent tuck-in acquisition is our purchase of the Wotsits brand in the U.K.

However, we have very stringent financial and strategic criteria for making acquisitions, so we pursue only a small fraction of the potential acquisitions we evaluate, and we are not dependent on acquisitions to achieve our long-term financial and strategic objectives.

(5) Today, corporate excesses and fraudulent financial reporting seem all too common place. What are you doing to make sure this could never happen at PepsiCo?

We take the governance of your company very seriously. We were among the first to certify our financial statements under the new Sarbanes-Oxley rules because we wanted to demonstrate that we are absolutely committed to the highest standards of financial governance and integrity. Our corporate governance includes the following:

- *A Code of Conduct since 1976 which applies and is distributed to all our employees. Our code mandates that we conduct our business with only the highest ethical standards.*

- Our Disclosure Committee which meets to review and discuss our financial statements and earnings releases to ensure that we are providing timely, transparent public disclosures.
- Strong oversight by our Board of Directors which includes 11 outside Directors and 2 inside Directors. Each Committee of our Board has a clear public charter and includes only outside directors. The Audit Committee of our Board includes 3 financial experts, and reviews our financial statements, critical accounting policies, earnings releases and our internal controls.
- An internal control environment which is regularly monitored by an extensive program of internal audits. Our General Auditor assesses business and control risks, develops ongoing programs to mitigate identified risks and regularly reports on progress. This risk control process is monitored by our Risk Committee and Audit Committee of our Board.
- A culture which encourages integrity and open communication. We provide continuous training to reinforce our focus on integrity. Last year, I personally encouraged finance associates all around the world to call me directly to discuss anything that makes them uncomfortable and we have telephone "Speak Up" lines accessible from around the world to ensure open lines of communication.

Other Consolidated Results

	2003	2002	2001	% Change	
				2003	2002
Bottling equity income	\$323	\$280	\$160	16	75
Interest expense, net	\$(112)	\$(142)	\$(152)	(21)	(6)
Annual tax rate	28.5%	32.3%	34.1%		
Net income	\$3,568	\$3,000	\$2,400	19	25
Net income per common share — diluted	\$2.05	\$1.68	\$1.33	22	27

Bottling equity income includes our share of the net income or loss of our non-controlled 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.

2003

Bottling equity income increased 16%. This increase primarily reflects a favorable comparison to the impairment charge taken in 2002 on a Latin American bottling investment, and increased earnings from PBG and PAS in 2003.

Net interest expense declined 21% primarily due to a gain of \$22 million on investments used to economically hedge a portion of our deferred compensation liability versus losses of \$18 million in the prior year. The offsetting increase in deferred compensation costs is reported in corporate unallocated expenses within selling, general and administrative expenses. This net gain was partially offset by lower investment rates.

The annual tax rate decreased 3.8 percentage points compared to the prior year. At the end of 2003, we entered into agreements with the IRS. These agreements resulted in a tax benefit of \$109 million, reducing our tax rate by over 2 percentage points. The resolution of certain issues is also expected to lower our future tax rate. Lower taxes on foreign results, including the impact of our new concentrate operations, also reduced our tax rate by nearly 2 percentage points. The impact of lower nondeductible merger-related costs contributed 0.9 percentage points to the decrease.

Net income increased 19% and the related net income per common share increased 22%. These increases primarily reflect the solid operating profit growth,

our lower annual tax rate and increased bottling equity income. The benefit of lower merger-related costs was largely offset by the impairment and restructuring charges. Net income per common share also reflects the benefit of a reduction in average shares outstanding primarily as a result of share buyback activity.

2002

Bottling equity income increased 75%. This increase primarily reflects the adoption of SFAS 142, improved performance of our international bottling investments, and contributions from our North American anchor bottlers. The impact of impairment charges of \$35 million relating to a Latin American bottling investment was more than offset by the settlement of issues upon the sale of our investment in Pepsi-Gemex, our Mexican bottling affiliate, and the absence of 2001 unusual items.

Net interest expense declined 6% primarily due to lower average debt levels, partially offset by increased losses of \$10 million on investments used to economically hedge a portion of our deferred compensation liability. Decreases in borrowing rates were offset by decreases in investment rates.

The annual tax rate decreased 1.8 percentage points compared to prior year. The adoption of SFAS 142 reduced the rate by 0.9 percentage points. The impact of nondeductible merger-related costs decreased from 2.5 percentage points in 2001 to 1.0 percentage point in 2002.

Net income increased 25% and the related net income per common share increased 27%. These increases primarily reflect the solid operating profit growth, lower merger-related costs and the adoption of SFAS 142. Net income per common share also reflects the benefit of a reduction in average shares outstanding primarily as a result of increased share buyback activity.

Results of Operations – Division Review

The results and discussions below are based on how our Chief Executive Officer monitors the performance of our divisions. Prior year amounts exclude the results of divested businesses and 2001 reflects the adoption of SFAS 142 and consolidation of SVE. For additional information on these items and our divisions, see Note 1 to our consolidated financial statements.

Frito-Lay North America

	2003	2002	2001	% Change	
				2003	2002
Net revenue	\$9,091	\$8,565	\$8,216	6	4
Operating profit	\$2,366	\$2,216	\$2,056	7	8

2003

Net revenue growth of 6% reflects volume growth of 4% and positive effective net pricing. Pound volume grew primarily due to new products, double-digit growth in Cheetos, Munchies snack mix and Quaker Chewy Granola bars, and single-digit growth in branded dips and Doritos. Quaker Toastables, Lay's Stax and the Natural snack line led the new product growth. These gains were partially offset by double-digit declines in Rold Gold, Lay's Bistro, and Go Snacks. Collectively, the higher priced better-for-you products, with less fat, fewer calories or lower sodium, generated over 10% of the 2003 and 2002 volume. Modest pricing actions on certain salty snacks and favorable mix led the positive effective

net pricing. These gains were partially offset by higher trade spending on product innovation.

Operating profit growth of 7% reflects the volume growth and positive effective net pricing. These gains were partially offset by increased commodity costs, particularly corn oil and natural gas. Increased commodity costs reduced operating profit growth by 3 percentage points, more than offsetting the cost leverage generated from productivity initiatives.

2002

Net revenue growth of 4% reflects the increased volume of 4%. Pound volume grew primarily due to new products, strong growth in branded snack mix, single-digit growth in Cheetos cheese

flavored snacks, Doritos tortilla chips, branded dips and Quaker Chewy Granola bars, and double-digit growth in Rold Gold pretzels. Go Snacks significantly contributed to the new product growth and Munchies drove the branded snack mix growth. These gains were partially offset by a single-digit decline in Ruffles potato chips. Approximately half of the net revenue growth came from new products. Increased promotional spending more than offset favorable mix and other pricing.

Operating profit growth of 8% reflects the increased volume, as well as reduced costs. Lower performance-based compensation and lower commodity prices for vegetable oils and natural gas contributed 4 percentage points of the operating profit growth.

Volume grew 4% in 2003 and 2002.

PepsiCo Beverages North America

	2003	2002	2001	% Change	
				2003	2002
Net revenue	\$7,733	\$7,200	\$6,888	7	5
Operating profit	\$1,775	\$1,577	\$1,466	13	8

2003

Net revenue increased 7% on volume growth of 3%. The volume growth reflects non-carbonated growth of 8% and carbonated beverage growth of 1.5%. Double-digit growth in Gatorade, Aquafina and Propel drove the non-carbonated portfolio. Tropicana chilled products growth was low single-digit. The carbonated beverage performance reflects the national launch of Sierra Mist and high single-digit growth in diet car-

bonated beverages, primarily Diet Pepsi. Declines in trademark Pepsi, excluding diet, partially offset this carbonated beverage growth. Higher effective net pricing contributed 4 percentage points to the net revenue growth. The higher effective net pricing reflects a favorable product mix shift to the higher priced non-carbonated beverages, and fountain and concentrate price increases, partially offset by increased promotional spending. The price increases contributed 1 per-

centage point to the net revenue growth.

Operating profit increased 13 percentage points reflecting the higher effective net pricing, volume gains and purchasing efficiencies. These gains were partially offset by increased advertising and marketing expenses. The higher effective net pricing contributed 8 percentage points to the operating profit growth with product mix contributing 6 percentage points.

Volume grew 3% in 2003 with:

- non-carbonated beverages growing 8%, and
- carbonated beverages growing 1.5%.

2002

Net revenue increased 5% on volume growth of 3%. The volume growth reflects non-carbonated growth of 10% and flat carbonated beverage performance. Double-digit growth in Gatorade and Aquafina, the national launch of Propel fitness water and the introduction of Lipton Brisk Lemonade, drove the non-carbonated portfolio. Tropicana chilled products declined compared to prior year as a result of the loss of the single serve pure premium business at Burger King. The carbonated beverage performance reflects continued growth in Pepsi Twist, Code Red and

Sierra Mist, and the introduction of Pepsi Blue. Declines in base Pepsi and base Mountain Dew partially offset this carbonated beverage growth. Higher effective net pricing contributed 2 percentage points to the net revenue growth. The higher effective net pricing reflects a favorable product mix shift to the higher priced non-carbonated beverages, and fountain and concentrate price increases, partially offset by increased promotional spending.

Operating profit increased 8% reflecting the volume gains, higher concentrate pricing and favorable product mix. These gains were partially offset by increased

promotional spending, costs associated with litigation, increased inventory costs and increased advertising and marketing expenses related to our new products.

Volume increased 3% in 2002 with:

- non-carbonated beverages growing 10%, and
- carbonated beverage performance flat.

PepsiCo International

	2003	2002	2001	% Change	
				2003	2002
Net revenue	\$8,678	\$7,749	\$7,504	12	3
Operating profit	\$1,186	\$1,042	\$863	14	21

2003

International snacks volume grew 6%, comprised of 3% in our Latin America region, 10% in our Europe, Middle East and Africa region and 16% in our Asia region. These gains were driven by double-digit growth from Walkers in the United Kingdom, India, Turkey and Russia, and low single-digit growth at Sabritas in Mexico. Mid single-digit sweet growth was led by Gamesa in Mexico.

Beverage volume grew 8%, comprised of 8% in our Latin America region, 6% in our Europe, Middle East and Africa region and 11% in our Asia region. Broad-based increases were led by double-digit growth in the Middle East, China, Brazil, India, Russia and Thailand, and mid single-digit growth in Mexico. Volume gains in India driven by competitive pricing actions were offset by

double-digit declines in Germany due to the new one-way bottle deposit requirement imposed by the government.

Net revenue grew 12% driven by higher volume across most markets. Acquisitions contributed nearly 2 percentage points of growth and favorable foreign currency contributed 1 percentage point as the favorable euro and British pound substantially offset the unfavorable Mexican peso. These gains were partially offset by the impact of the German one-way beverage deposits and competitive beverage pricing actions in India.

Operating profit grew 14% largely due to the drivers of net revenue growth. Acquisitions contributed almost 2 percentage points of growth. Unfavorable foreign currency reduced operating profit by nearly 6 percentage points due to the impact of the peso on our Mexican snack businesses. In addition, operating profits were reduced by over 2 percentage points due to reserve actions taken on potentially unrecoverable beverage assets.

International snack volume grew 6% in 2003 and 5% in 2002.

International beverage volume grew 8% in 2003 and 5% in 2002.

2002

International snacks volume grew 5%, comprised of 5% in our Latin America region, 7% in our Europe, Middle East and Africa region and 6% in our Asia region, led by low single-digit salty growth and strong single-digit sweet growth. Single-digit growth at Walkers and Sabritas contributed over 70% of the salty volume growth. Strong single-digit growth at Gamesa contributed nearly 80% of the sweet growth and the introduction of Chipita croissants in Russia contributed the remainder.

Beverage volume grew 5%, comprised of 2% in our Latin America region, 5% in our Europe, Middle East and Africa region

and 11% in our Asia region. Broad-based increases were led by strong double-digit growth in China, India, Turkey and Russia. These advances were partially offset by declines in Argentina driven by macroeconomic conditions.

Net revenue grew 3% driven by volume and higher effective net pricing in Brazil and Argentina. Walkers and Gamesa together contributed over half of the net revenue growth. Unfavorable foreign currency reduced net revenue growth by 3 percentage points as unfavorable Latin American and Egyptian currencies more than offset the favorable euro and British pound.

Operating profit grew 21% driven by

volume growth, with Walkers and Gamesa together contributing nearly one-third of the growth. These gains were partially offset by the impact of unfavorable foreign currencies. The franchising of the Gatorade business in certain countries increased operating profit growth by 3 percentage points. Unfavorable foreign currency reduced operating profit growth by 2 percentage points as unfavorable Latin American and Egyptian currencies more than offset the favorable euro and British pound.

Quaker Foods North America

	2003	2002	2001	% Change	
				2003	2002
Net revenue	\$1,467	\$1,464	\$1,437	-	2
Operating profit	\$486	\$473	\$389	3	22

2003

Net revenue and volume were flat compared to prior year as the national launch of Breakfast Squares and Canadian Oatmeal to Go growth were offset by declines in Rice and Pasta Roni side dishes and in our hot cereal business. A favorable Canadian exchange rate, which contributed 1 percentage point to net revenue growth, and ready-to-eat price increases, were offset by unfavorable product mix and increased promotional spending related to the Breakfast Squares launch.

Operating profit grew 3% compared to prior year. Lower advertising and marketing spending and favorable cost of

sales comparisons each contributed 4 percentage points to operating profit growth. These gains were partially offset by an unfavorable product mix, which reduced operating profit growth by 6 percentage points. The unfavorable product mix reflects declines in higher margin products.

Volume was flat in 2003.

Volume grew 2% in 2002.

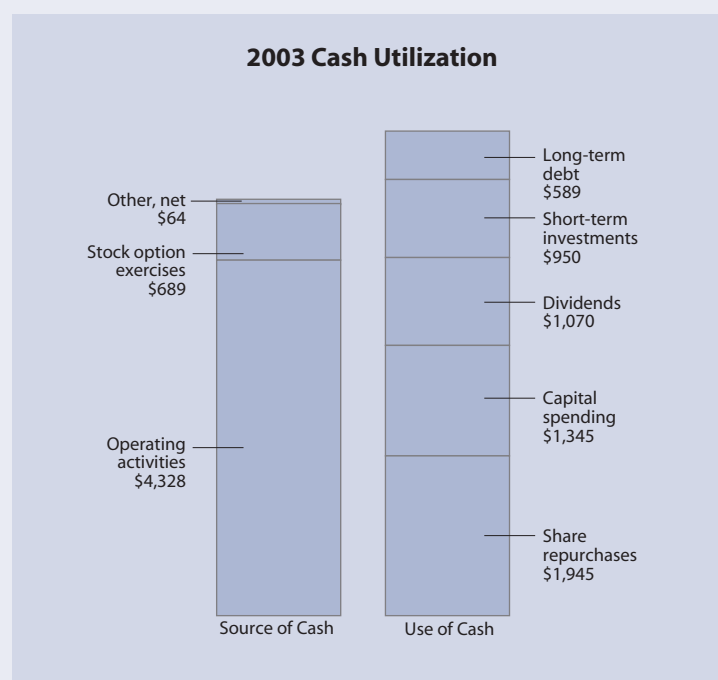
2002

Net revenue and volume increased 2%. Hot cereals and ready-to-eat cereals each contributed 1 percentage point of volume growth driven by new product introductions and product news.

Operating profit increased 22% reflecting the increased volume. In addition, the benefit of productivity, merger-related synergies and lower advertising and marketing expense, partially offset by higher oat prices, contributed more than 15 percentage points of the operating profit growth.

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 operating cash flows, which are derived from net income. 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 to our consolidated financial statements.



Operating Activities

In 2003, our operations provided \$4.3 billion of cash reflecting our solid business results, net of pension plan contributions of \$535 million of which \$500 million was discretionary, and a \$250 million tax payment related to our IRS agreements. In 2002, net cash provided by operating activities of \$4.6 billion reflected our business results, pension plan contributions of \$820 million of which \$750 million was discretionary, and a net tax refund of approximately \$250 million related to prior years. The year-over-year decline in cash flows from operations is primarily attributable to the higher net tax payments, partially offset by lower pension contributions in 2003.

In the first half of 2004, we will make an additional tax payment of approximately \$750 million as a result of the IRS agreements. A portion of this payment represents deductible interest, which will lower our estimated tax payments during the second half of 2004 by a total of approximately \$150 million. Due to the tax payment and the current market environment, we expect to issue medium-term debt of up to \$500 million in the first half of 2004. We estimate our 2004 discretionary pension contributions will be approximately \$400 million.

Investing Activities

In 2003, we used \$2.3 billion for investing, primarily reflecting capital spending of \$1.3 billion and short-term investments of \$1.0 billion. In 2002, we used \$0.5 billion for investing, primarily reflecting capital spending of \$1.4 billion and the acquisition of the Wotsits brand in the United Kingdom, partially offset by short-term investment maturities and proceeds from the Pepsi-Gemex transaction.

We expect capital spending to continue at a rate of approximately 5% to 5.5% of net revenue in 2004.

Financing Activities

In 2003, we used \$2.9 billion for financing, primarily reflecting share repurchases at a cost of \$1.9 billion and dividend payments of \$1.1 billion. This compares to \$3.2 billion used for financing in 2002 for share repurchases of \$2.2 billion and dividend payments of \$1.0 billion.

In 2002, our Board of Directors authorized a share repurchase program of up to \$5 billion over a three-year period. Since inception of the program, we have repurchased \$4.1 billion of shares, leaving \$0.9 billion of remaining authorization. Our current dividend policy is to pay approximately one-third of our previous year's net income in dividends.

Each spring we review our capital structure with our Board. Our discussion covers our dividend policy and share repurchase activity.

Management Operating Cash Flow

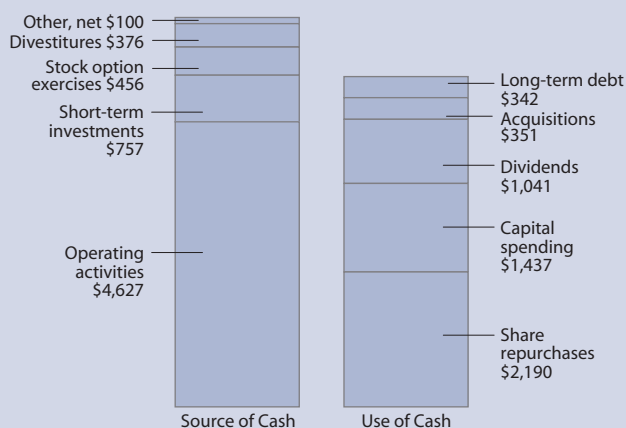
We focus on management operating cash flow as a key element in achieving maximum shareholder value and it is the primary measure we use to monitor cash flow performance. However, it is not a measure provided by accounting principles generally accepted in the United States. Since net capital spending is essential to our product innovation

Management operating cash flow was \$3.0 billion in 2003.

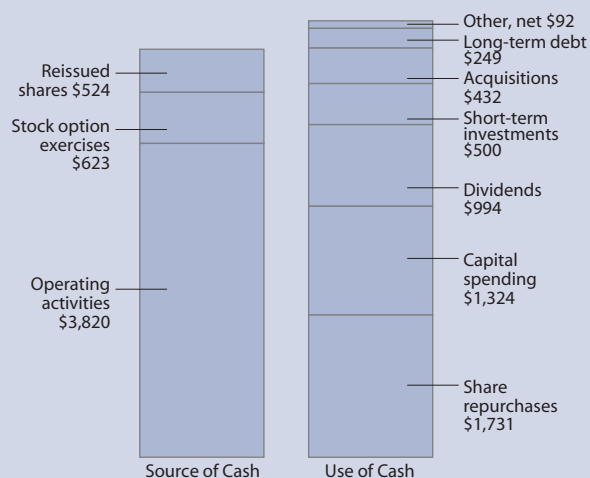
Net cash provided by operating activities was \$4.3 billion in 2003.

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 eval-

2002 Cash Utilization



2001 Cash Utilization



uating our cash from operating activities. The table below reconciles the net cash provided by operating activities as reflected in our Consolidated Statement of Cash Flows to our management operating cash flow.

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 healthy investment grade ratings for

over a decade. Standard & Poor's rating reflects an upgrade from A to A+ during 2003 and Moody's rating reflects an upgrade from A1 to Aa3 in

Credit Facilities and Long-Term Contractual Commitments

See Note 9 to our consolidated financial statements 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 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. As of year-end 2003, we believe it is remote that these guarantees would require any cash payment. See Note 9 to our consolidated financial statements for a description of our off-balance sheet arrangements.

	2003	2002	2001
Net cash provided by operating activities	\$4,328	\$4,627	\$3,820
Capital spending	(1,345)	(1,437)	(1,324)
Sales of property, plant and equipment	49	89	–
Management operating cash flow	\$3,032	\$3,279	\$2,496

Management operating cash flow was used primarily to repurchase shares and pay dividends. We expect management operating cash flow in 2004 to grow by 10% or more reflecting our underlying business growth. We currently expect to continue to return approximately all our management operating cash flows to our shareholders through dividends and share repurchases. However, see "Cautionary Statements" for certain factors that may impact our operating cash flows.

2004 due to the strength of our balance sheet and cash flows. 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.

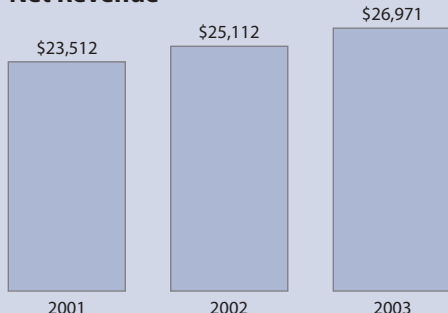
Consolidated Statement of Income

PepsiCo, Inc. and Subsidiaries
Fiscal years ended December 27, 2003, December 28, 2002 and December 29, 2001

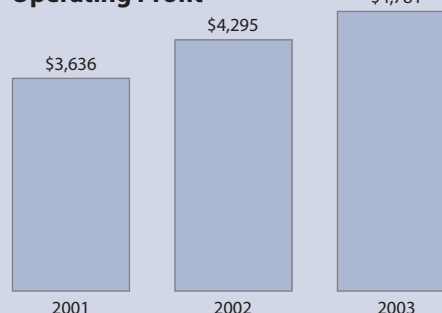
(in millions except per share amounts)	2003	2002	2001
Net Revenue	\$26,971	\$25,112	\$23,512
Cost of sales	12,379	11,497	10,750
Selling, general and administrative expenses	9,460	8,958	8,574
Amortization of intangible assets	145	138	165
Merger-related costs	59	224	356
Impairment and restructuring charges	147	-	31
Operating Profit	4,781	4,295	3,636
Bottling equity income	323	280	160
Interest expense	(163)	(178)	(219)
Interest income	51	36	67
Income Before Income Taxes	4,992	4,433	3,644
Provision for Income Taxes	1,424	1,433	1,244
Net Income	\$ 3,568	\$ 3,000	\$ 2,400
Net Income per Common Share			
Basic	\$2.07	\$1.71	\$1.36
Diluted	\$2.05	\$1.68	\$1.33

See accompanying notes to consolidated financial statements.

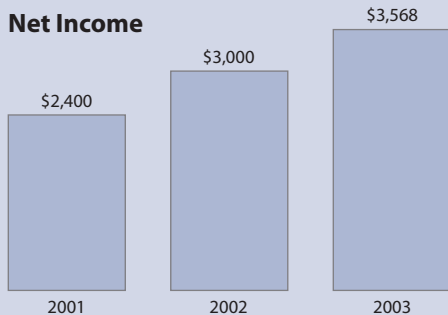
Net Revenue



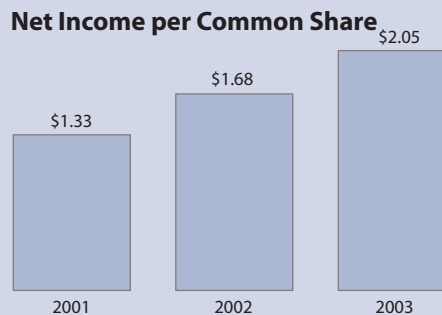
Operating Profit



Net Income



Net Income per Common Share



Consolidated Statement of Cash Flows

PepsiCo, Inc. and Subsidiaries
Fiscal years ended December 27, 2003, December 28, 2002 and December 29, 2001

(in millions)	2003	2002	2001
Operating Activities			
Net income	\$ 3,568	\$ 3,000	\$ 2,400
Adjustments to reconcile net income to net cash provided by operating activities			
Depreciation and amortization	1,221	1,112	1,082
Stock compensation expense	407	435	385
Merger-related costs	59	224	356
Impairment and restructuring charges	147	–	31
Cash payments for merger-related costs and restructuring charges	(109)	(123)	(273)
Pension plan contributions	(535)	(820)	(446)
Bottling equity income, net of dividends	(276)	(222)	(103)
Deferred income taxes	(323)	174	45
Other noncash charges and credits, net	415	263	257
Changes in operating working capital, excluding effects of acquisitions and dispositions			
Accounts and notes receivable	(220)	(260)	7
Inventories	(49)	(53)	(75)
Prepaid expenses and other current assets	23	(78)	(6)
Accounts payable and other current liabilities	(11)	426	(236)
Income taxes payable	182	270	389
Net change in operating working capital	(75)	305	79
Other	(171)	279	7
Net Cash Provided by Operating Activities	4,328	4,627	3,820
Investing Activities			
Capital spending	(1,345)	(1,437)	(1,324)
Sales of property, plant and equipment	49	89	–
Acquisitions and investments in noncontrolled affiliates	(71)	(351)	(432)
Divestitures	46	376	–
Short-term investments, by original maturity			
More than three months — purchases	(981)	(62)	(2,537)
More than three months — maturities	6	833	2,078
Three months or less, net	25	(14)	(41)
Snack Ventures Europe consolidation	–	39	–
Net Cash Used for Investing Activities	(2,271)	(527)	(2,256)
Financing Activities			
Proceeds from issuances of long-term debt	52	11	324
Payments of long-term debt	(641)	(353)	(573)
Short-term borrowings, by original maturity			
More than three months — proceeds	88	707	788
More than three months — payments	(115)	(809)	(483)
Three months or less, net	40	40	(397)
Cash dividends paid	(1,070)	(1,041)	(994)
Share repurchases — common	(1,929)	(2,158)	(1,716)
Share repurchases — preferred	(16)	(32)	(10)
Quaker share repurchases	–	–	(5)
Proceeds from reissuance of shares	–	–	524
Proceeds from exercises of stock options	689	456	623
Net Cash Used for Financing Activities	(2,902)	(3,179)	(1,919)
Effect of exchange rate changes on cash and cash equivalents	27	34	–
Net (Decrease)/Increase in Cash and Cash Equivalents	(818)	955	(355)
Cash and Cash Equivalents, Beginning of Year	1,638	683	1,038
Cash and Cash Equivalents, End of Year	\$ 820	\$ 1,638	\$ 683

See accompanying notes to consolidated financial statements.

Consolidated Balance Sheet

PepsiCo, Inc. and Subsidiaries
December 27, 2003 and December 28, 2002

(in millions except per share amounts)	2003	2002
ASSETS		
Current Assets		
Cash and cash equivalents	\$ 820	\$ 1,638
Short-term investments, at cost	1,181	207
	2,001	1,845
Accounts and notes receivable, net	2,830	2,531
Inventories	1,412	1,342
Prepaid expenses and other current assets	687	695
Total Current Assets	6,930	6,413
Property, Plant and Equipment, net	7,828	7,390
Amortizable Intangible Assets, net	718	801
Goodwill	3,796	3,631
Other nonamortizable intangible assets	869	787
Nonamortizable Intangible Assets	4,665	4,418
Investments in Noncontrolled Affiliates	2,920	2,611
Other Assets	2,266	1,841
	25,327	23,474
Total Assets	\$25,327	\$23,474
LIABILITIES AND SHAREHOLDERS' EQUITY		
Current Liabilities		
Short-term obligations	\$ 591	\$ 562
Accounts payable and other current liabilities	5,213	4,998
Income taxes payable	611	492
Total Current Liabilities	6,415	6,052
Long-Term Debt Obligations	1,702	2,187
Other Liabilities	4,075	4,226
Deferred Income Taxes	1,261	1,486
Total Liabilities	13,453	13,951
Preferred Stock, no par value	41	41
Repurchased Preferred Stock	(63)	(48)
Common Shareholders' Equity		
Common stock, par value $1^{2}/_{3}\text{¢}$ per share (issued 1,782 shares)	30	30
Capital in excess of par value	548	207
Retained earnings	15,961	13,489
Accumulated other comprehensive loss	(1,267)	(1,672)
	15,272	12,054
Less: repurchased common stock, at cost (77 and 60 shares, respectively)	(3,376)	(2,524)
Total Common Shareholders' Equity	11,896	9,530
	25,327	23,474
Total Liabilities and Shareholders' Equity	\$25,327	\$23,474

See accompanying notes to consolidated financial statements.

Consolidated Statement of Common Shareholders' Equity

PepsiCo, Inc. and Subsidiaries

Fiscal years ended December 27, 2003, December 28, 2002 and December 29, 2001

(in millions)	2003		2002		2001	
	Shares	Amount	Shares	Amount	Shares	Amount
Common Stock						
Balance, beginning of year	1,782	\$ 30	1,782	\$ 30	2,029	\$ 34
Stock option exercises	-	-	-	-	9	-
Shares issued to effect merger	-	-	-	-	(256)	(4)
Balance, end of year	<u>1,782</u>	<u>30</u>	<u>1,782</u>	<u>30</u>	<u>1,782</u>	<u>30</u>
Capital in Excess of Par Value						
Balance, beginning of year		207		115		375
Stock compensation expense		407		435		385
Stock option exercises ^(a)		(66)		(339)		77
Reissued shares		-		-		150
Shares issued to effect merger		-		-		(873)
Other		-		(4)		1
Balance, end of year		<u>548</u>		<u>207</u>		<u>115</u>
Deferred Compensation						
Balance, beginning of year		-		-		(21)
Net activity		-		-		21
Balance, end of year		<u>-</u>		<u>-</u>		<u>-</u>
Retained Earnings						
Balance, beginning of year		13,489		11,535		16,510
Net income ^(b)		3,568		3,000		2,400
Shares issued to effect merger		-		-		(6,366)
Cash dividends declared — common		(1,082)		(1,042)		(1,005)
Cash dividends declared — preferred		(3)		(4)		(4)
Other		(11)		-		-
Balance, end of year		<u>15,961</u>		<u>13,489</u>		<u>11,535</u>
Accumulated Other Comprehensive Loss						
Balance, beginning of year		(1,672)		(1,646)		(1,374)
Currency translation adjustment ^(b)		410		56		(218)
Cash flow hedges, net of tax ^(b)		(12)		18		(18)
Minimum pension liability adjustment, net of tax ^(b)		7		(99)		(38)
Other ^(b)		-		(1)		2
Balance, end of year		<u>(1,267)</u>		<u>(1,672)</u>		<u>(1,646)</u>
Repurchased Common Stock						
Balance, beginning of year	(60)	(2,524)	(26)	(1,268)	(280)	(7,920)
Share repurchases	(43)	(1,946)	(53)	(2,192)	(35)	(1,716)
Stock option exercises	26	1,096	19	931	20	751
Reissued shares	-	-	-	-	13	374
Shares issued to effect merger	-	-	-	-	256	7,243
Other	-	(2)	-	5	-	-
Balance, end of year	<u>(77)</u>	<u>(3,376)</u>	<u>(60)</u>	<u>(2,524)</u>	<u>(26)</u>	<u>(1,268)</u>
Total Common Shareholders' Equity		\$11,896		\$ 9,530		\$ 8,766

(a) Includes total tax benefit of \$340 million in 2003, \$136 million in 2002 and \$207 million in 2001.

(b) Combined, these amounts represent total comprehensive income of \$3,973 million in 2003, \$2,974 million in 2002 and \$2,128 million in 2001. See accompanying notes to consolidated financial statements.

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 ownership interest. We do not control these other affiliates, as our ownership in these other affiliates is generally less than fifty percent. Our share of the net income of noncontrolled bottling affiliates is reported in our income statement as bottling equity income. See Note 8 for additional information on our noncontrolled bottling affiliates. Our share of other non-controlled affiliates is included in division operating profit. Intercompany balances and transactions are eliminated.

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. Actual results could differ from these estimates.

Impairment and restructuring charges and merger-related costs (described in Note 3), the net tax benefit (described in Note 5), the adoption of SFAS 142 (described in Note 4) and the consolidation of Snack Ventures Europe (SVE) affect the comparability of our consolidated results. See “Our Divisions” below and for additional unaudited information on these items, 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 year amounts to conform to the 2003 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.

Division results are based on how our Chairman and Chief Executive Officer manages our divisions. Beginning in 2003, we combined our North American beverage businesses as PepsiCo

Beverages North America and our international snack, beverage and food businesses as PepsiCo International to reflect operating management changes. Prior year results have been restated to reflect this change. In addition, division results exclude significant restructuring and impairment charges, merger-related costs and divested businesses and have been adjusted to reflect the adoption of SFAS 142 and consolidation of SVE. For additional unaudited information on our divisions, see “Our Operations” in Management’s Discussion and Analysis.



PEPSICO

**Frito-Lay
North America
(FLNA)**

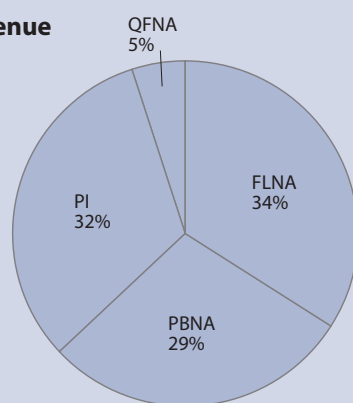
**PepsiCo
Beverages
North America
(PBNA)**

**PepsiCo
International
(PI)**

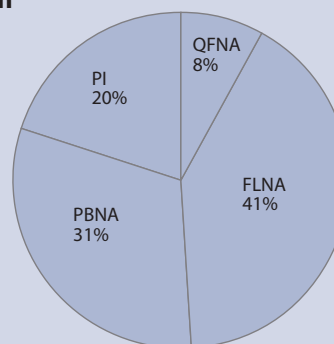
**Quaker Foods
North America
(QFNA)**

	2003	2002	2001	2003	2002	2001
	Net Revenue			Operating Profit		
FLNA	\$ 9,091	\$ 8,565	\$ 8,216	\$2,366	\$2,216	\$2,056
PBNA	7,733	7,200	6,888	1,775	1,577	1,466
PI	8,678	7,749	7,504	1,186	1,042	863
QFNA	1,467	1,464	1,437	486	473	389
Total division	26,969	24,978	24,045	5,813	5,308	4,774
Divested businesses	2	134	173	26	23	39
Corporate	-	-	-	(852)	(812)	(756)
	26,971	25,112	24,218	4,987	4,519	4,057
Impairment and restructuring charges	-	-	-	(147)	-	(31)
Merger-related costs	-	-	-	(59)	(224)	(356)
Other	-	-	-	-	-	2
SVE consolidation	-	-	(706)	-	-	(13)
SFAS 142 adoption	-	-	-	-	-	(23)
Total	\$26,971	\$25,112	\$23,512	\$ 4,781	\$4,295	\$3,636

Division Net Revenue Contribution



Division Operating Profit Contribution



Divested Businesses — During 2003, we sold our Quaker Foods North America Mission pasta business. As a result, net revenue of \$27 million in 2002 and \$29 million in 2001 and operating profit of \$8 million in 2002 and \$10 million in 2001 have been reclassified to divested businesses. During 2002, we sold our Quaker Foods North America bagged cereal business and our PepsiCo International food businesses in Colombia and Venezuela.

Corporate — Corporate includes costs of our corporate headquarters, centrally managed initiatives, unallocated insurance and benefit programs, foreign exchange transaction gains and losses and certain other charges. We voluntarily elected to expense stock options and, as a result, corporate unallocated expenses also reflect stock compensation expense for all years presented. See Note 6, and for additional unaudited information, see “Our Critical Accounting Policies” in Management’s Discussion and Analysis.

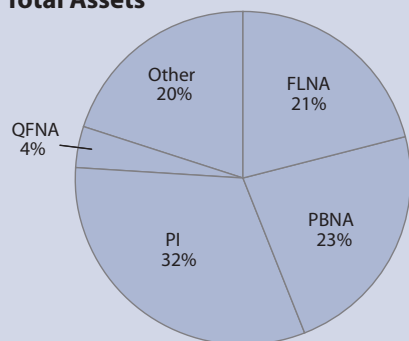
Impairment and Restructuring Charges and Merger-Related Costs

— See Note 3.
The following items are necessary to reconcile division results to consolidated results since, as noted above, division results are presented as managed.

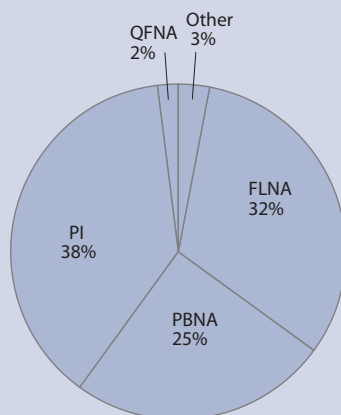
SVE Consolidation — As a result of changes in the operations of our European snack joint venture (SVE), we determined that effective in 2002, consolidation was required.

SFAS 142 Adoption — In 2002, we adopted SFAS 142, *Goodwill and Other Intangible Assets*, which eliminated amortization of goodwill and perpetual brands, and resulted in an acceleration of the amortization of certain of our other intangibles. See Note 4 for additional information, and the after-tax impact.

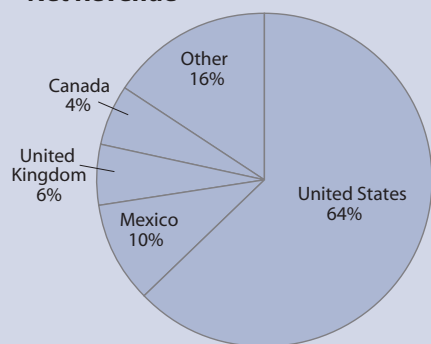
Total Assets



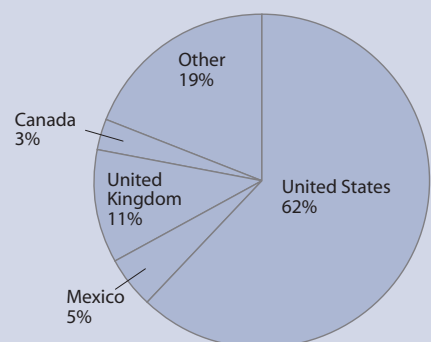
Capital Spending



Net Revenue



Long-Lived Assets



	2003	2002	2001	2003	2002	2001
	Total Assets			Capital Spending		
FLNA	\$ 5,332	\$ 5,099	\$ 4,623	\$ 426	\$ 523	\$ 514
PBNA	5,856	5,691	5,403	332	367	359
PI (a)	8,109	7,275	6,359	521	473	385
QFNA	995	1,001	878	32	50	55
Total division	20,292	19,066	17,263	1,311	1,413	1,313
Divested businesses	-	-	58	-	1	3
Corporate (b)	2,384	2,072	1,927	34	23	8
Investments in bottling affiliates	2,651	2,336	2,447	-	-	-
	\$25,327	\$23,474	\$21,695	\$1,345	\$1,437	\$1,324

	2003	2002	2001	2003	2002	2001
	Amortization of Intangible Assets			Depreciation and Other Amortization		
FLNA	\$ 3	\$ 3	\$ 7	\$ 416	\$399	\$377
PBNA	75	70	69	245	206	193
PI	66	64	68	350	300	310
QFNA	1	1	1	36	37	41
Total division	145	138	145	1,047	942	921
Divested businesses	-	-	-	-	3	4
Corporate	-	-	-	29	29	18
SVE consolidation	-	-	(3)	-	-	(26)
SFAS 142 adoption	-	-	23	-	-	-
	\$145	\$138	\$165	\$1,076	\$974	\$917

	2003	2002	2001	2003	2002	2001
	Net Revenue			Long-Lived Assets^(c)		
United States	\$ 17,377	\$16,588	\$15,976	\$ 9,907	\$ 9,767	\$ 9,439
Mexico	2,642	2,686	2,609	869	764	1,065
United Kingdom	1,510	1,106	954	1,724	1,529	1,104
Canada	1,147	967	896	508	410	375
All other countries	4,295	3,765	3,077	3,123	2,750	2,605
	\$26,971	\$25,112	\$23,512	\$16,131	\$15,220	\$14,588

(a) PepsiCo International assets include investments in noncontrolled affiliates, principally Productos SAS, of \$153 million in 2003, \$145 million in 2002 and \$155 million in 2001.

(b) Corporate assets consist principally of cash and cash equivalents, short-term investments primarily held outside the United States and property, plant and equipment.

(c) Long-lived assets represent net property, plant and equipment, nonamortizable and net amortizable intangible assets and investments in noncontrolled affiliates.

Revenue Recognition

We recognize revenue upon delivery to our customers in accordance with written sales terms that do not allow for a right of return. However, our policy for direct-store-delivery and chilled products is to remove and replace 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 product. For additional unaudited information on our revenue recognition and related policies, including our policy on bad debt, see “Our Critical Accounting Policies” in Management’s Discussion and Analysis. We are exposed to concentration of credit risk by our customers, PBG and Wal-Mart, as each represents approximately 10% of our net revenue. We have not experienced credit issues with these customers.

Sales Incentives and Other Marketplace Spending

We offer sales incentives through various programs to our customers and consumers. Sales incentives are accounted for as a reduction to revenue and totaled \$6.0 billion in 2003, \$5.5 billion in 2002 and \$4.7 billion in 2001. Most of these incentive arrangements have terms of no more than one year. However, we have arrangements, such as fountain pouring rights, which may extend up to 15 years. Costs incurred to obtain these arrangements are expensed over the contract period and the remaining balance of \$359 million at December 27, 2003 and \$349 million at December 28, 2002 is included in other assets in our Consolidated 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 \$1.6 billion in 2003, \$1.5 billion in 2002 and \$1.7 billion in 2001. 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 \$137 million at year-end 2003 and \$147 million at year-end 2002 are classified as prepaid expenses in the Consolidated Balance Sheet.

Distribution Costs

Distribution costs, including the costs of shipping and handling activities, are reported as selling, general and administrative expenses for direct-store-delivery distribution systems. For our other distribution systems, these costs are reported in cost of sales. Shipping and handling expenses classified as selling, general and administrative expenses were \$3.0 billion in 2003, \$2.8 billion in 2002 and \$2.6 billion in 2001.

Cash Equivalents

Cash equivalents are investments with original maturities of three months or less.

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.

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 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 Market Risks” in Management’s Discussion and Analysis.

Recent Accounting Changes

As further discussed in Note 6, we voluntarily adopted the fair value method of accounting for stock options at the end of 2003. We selected the retroactive method as described in SFAS 148, *Accounting for Stock-Based Compensation — Transition and Disclosure*, to adopt this accounting and restated our results.

The Financial Accounting Standards Board issued Interpretation No. 46 (FIN 46), *Consolidation of Variable Interest Entities*. This interpretation requires consolidation of existing noncontrolled affiliates if the affiliate is unable to finance its operations without investor support, or where the other investors do not have exposure to the significant risks and rewards of ownership. We do not expect our significant non-controlled affiliates to require consolidation under FIN 46. The Emerging Issues Task Force (EITF) issued EITF 01-8, *Determining Whether an Arrangement Contains a Lease*. EITF 01-8 did not have a significant impact on our financial statements.

Note 3 — Impairment and Restructuring Charges and Merger-Related Costs

Impairment and Restructuring Charges

In the fourth quarter of 2003, we incurred a charge of \$147 million (\$100 million after-tax or \$0.06 per share) in conjunction with actions taken to streamline our North American divisions and PepsiCo International. These actions are intended to increase focus and eliminate redundancies at PBNA and PI, and improve the efficiency of the supply chain at FLNA. Of this charge, \$81 million related to impairment, reflecting \$57 million for the closure of a snack plant in Kentucky, the retirement of snack manufacturing lines in Maryland and Arkansas and \$24 million for the closure of a PBNA office building in Florida. The remaining \$66 million includes employee-related costs of \$54 million and facility and other

exit costs of \$12 million. Employee-related costs primarily reflect the termination costs for approximately 850 sales, distribution, manufacturing, research and marketing employees. As of December 27, 2003, approximately 140 terminations have occurred. The majority of the remaining terminations are expected to occur in the first quarter of 2004. Through December 27, 2003, we have paid \$9 million leaving a remaining accrual of \$57 million. This accrual is included in other current liabilities.

In 2001, we incurred other impairment and restructuring costs for Quaker's supply chain reconfiguration and manufacturing and distribution optimization project initiated in 1999.

Merger-Related Costs

On August 2, 2001, we completed our merger with Quaker and accounted for it as a pooling-of-interests. We recognized the following costs associated with our merger with Quaker:

	2003	2002	2001
Transaction costs	\$ -	\$ -	\$117
Integration and restructuring costs	59	224	239
Total merger-related costs	\$59	\$224	\$356
After-tax	\$42	\$190	\$322
Per share	\$ 0.02	\$ 0.11	\$ 0.18

Transaction costs were incurred to complete the merger. Integration and restructuring costs represent incremental one-time merger-related costs. Such costs include consulting fees and expenses, employee-related costs, information system integration costs, asset impairments and other costs related to the integration of Quaker. Employee-related costs include retirement and other benefits, severance costs and expenses related to change-in-control provisions of pre-merger employment contracts.

Merger-related integration and restructuring reserves are as follows:

	Integration	Employee Related	Asset Impairment	Facility and Other Exit	Total
Reserves, December 29, 2001	\$ 22	\$ 51	\$ -	\$ 4	\$ 77
2002 costs	90	53	56	25	224
Cash payments	(62)	(43)	-	(13)	(118)
Reclassification to retiree medical/postemployment liabilities	(7)	(9)	-	-	(16)
Other noncash utilization	-	(4)	(56)	(10)	(70)
Reserves, December 28, 2002	43	48	-	6	97
2003 costs	46	10	-	3	59
Cash payments	(63)	(33)	-	(4)	(100)
Reclassification to retiree medical/postemployment liabilities	-	(3)	-	-	(3)
Other noncash utilization	4	-	-	(2)	2
Reserves, December 27, 2003	\$ 30	\$ 22	\$ -	\$ 3	\$ 55

The remaining integration and severance accruals at December 27, 2003 are included within other current liabilities in the Consolidated Balance Sheet.

Note 4 — Property, Plant and Equipment and Intangible Assets

	Useful Life	2003	2002	2001
Property, plant and equipment, net				
Land and improvements		\$ 557	\$ 504	
Buildings and improvements	20 – 40 yrs.	3,449	3,119	
Machinery and equipment, including fleet	5 – 15	10,170	9,005	
Construction in progress		579	767	
		14,755	13,395	
Accumulated depreciation		(6,927)	(6,005)	
		\$ 7,828	\$ 7,390	
Depreciation expense		\$1,020	\$929	\$843
Amortizable intangible assets, net				
Brands	5 – 40	\$ 985	\$ 938	
Other identifiable intangibles	3 – 15	212	203	
		1,197	1,141	
Accumulated amortization		(479)	(340)	
		\$ 718	\$ 801	
Amortization expense		\$145	\$138	\$165

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 for each of the next five years, based on existing intangible assets and 2003 foreign exchange rates, is expected to be \$147 million in 2004, \$139 million in 2005, \$138 million in 2006, and \$22 million in 2007 and thereafter.

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 generally 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. No impairment charges resulted from the adoption of SFAS 144, *Accounting for the Impairment or Disposal of Long-Lived Assets* in 2002. 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 to ensure that future cash flows continue to exceed the related book value. A perpetual brand is impaired if its book value exceeds its fair value. Goodwill is evaluated for impairment if the book value of its reporting unit exceeds its fair value. A reporting unit can be a division or business within a division. If the fair value of an evaluated asset is less than its book value, the asset is written down based on its discounted future cash flows to fair value. No impairment charges resulted from the required impairment evaluations. The change in the book value of nonamortizable intangible assets during 2003 is as shown.

	Balance, Beginning of Year	Acquisitions	Translation and Other	Balance, End of Year
Frito-Lay North America				
Goodwill	\$ 109	\$ –	\$ 21	\$ 130
PepsiCo Beverages North America				
Goodwill	2,149	–	8	2,157
Brands	59	–	–	59
	2,208	–	8	2,216
PepsiCo International				
Goodwill	1,186	24	124	1,334
Brands	720	–	88	808
	1,906	24	212	2,142
Quaker Foods North America				
Goodwill ^(a)	187	–	(12)	175
Corporate				
Pension intangible	8	–	(6)	2
Total goodwill	3,631	24	141	3,796
Total brands	779	–	88	867
Total pension intangible	8	–	(6)	2
	\$ 4,418	\$ 24	\$ 223	\$ 4,665

(a) Activity reflects the sale of our Mission pasta business.

We adopted SFAS 142, *Goodwill and Other Intangible Assets*, in 2002. Prior to the adoption of SFAS 142, our nonamortizable intangible assets had useful lives ranging from 20 to 40 years. The following table provides pro forma disclosure for 2001 of the elimination of goodwill and perpetual brands amortization and the acceleration of certain other amortization as if SFAS 142 had been adopted in 2001:

	Net Income	Earnings per common share	
		Basic	Diluted
Reported	\$ 2,400	\$ 1.36	\$ 1.33
Cease goodwill amortization	112	0.06	0.06
Adjust brands amortization	(67)	(0.03)	(0.03)
Cease equity investee goodwill amortization	57	0.03	0.03
Adjusted	\$ 2,502	\$ 1.42	\$ 1.39

For additional unaudited information on our goodwill and nonamortizable brand policies, see "Our Critical Accounting Policies" in Management's Discussion and Analysis.

Note 5 — Income Taxes

	2003	2002	2001
Income before income taxes			
U.S.	\$3,267	\$3,178	\$2,580
Foreign	1,725	1,255	1,064
	\$4,992	\$4,433	\$3,644
Provision for income taxes			
Current: U.S. Federal	\$1,326	\$ 948	\$ 921
Foreign	341	256	226
State	80	55	53
	1,747	1,259	1,200
Deferred: U.S. Federal	(274)	146	46
Foreign	(47)	11	(8)
State	(2)	17	6
	(323)	174	44
	\$1,424	\$1,433	\$1,244
Tax rate reconciliation			
U.S. Federal statutory tax rate	35.0%	35.0%	35.0%
State income tax, net of U.S. Federal tax benefit	1.0	1.0	1.0
Lower taxes on foreign results	(5.5)	(3.5)	(4.3)
Settlement of prior years audit	(2.2)	—	—
Merger-related costs and impairment and restructuring charges	0.1	1.0	2.5
Other, net	0.1	(1.2)	(0.1)
Annual tax rate	28.5%	32.3%	34.1%
Deferred tax liabilities			
Investments in noncontrolled affiliates	\$ 792	\$ 753	
Property, plant and equipment	806	746	
Pension benefits	512	327	
Intangible assets other than nondeductible goodwill	146	127	
Safe harbor leases	33	57	
Zero coupon notes	53	61	
Other	199	342	
Gross deferred tax liabilities	2,541	2,413	
Deferred tax assets			
Net carryforwards	535	504	
Stock compensation	332	232	
Retiree medical benefits	343	315	
Other employee-related benefits	333	228	
Various current and noncurrent liabilities	482	414	
Gross deferred tax assets	2,025	1,693	
Valuation allowances	(438)	(487)	
Deferred tax assets, net	1,587	1,206	
Net deferred tax liabilities	\$ 954	\$1,207	
Included within:			
Prepaid expenses and other current assets	\$307	\$279	
Deferred income taxes	\$1,261	\$1,486	

Operating loss carryforwards totaling \$3.5 billion at year-end 2003 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 2004, \$2.8 billion between 2005 and 2023 and \$0.5 billion may be carried forward indefinitely. In addition, certain tax credits generated in prior periods of approximately \$74 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.

We have not recognized any United States tax expense on undistributed international earnings since we have the intention to reinvest the earnings outside the United States for the foreseeable future. These undistributed earnings are approximately \$8.8 billion at December 27, 2003.

Analysis of valuation allowances:

	2003	2002	2001
Balance, beginning of year	\$487	\$511	\$ 813
(Benefit)/provision	(52)	(22)	(300)
Other additions/(deductions)	3	(2)	(2)
Balance, end of year	\$438	\$487	\$ 511

For additional unaudited information on our income tax policies, see "Our Critical Accounting Policies" in Management's Discussion and Analysis.

Note 6 — Stock Compensation

Our stock option program is a broad-based program designed to attract and retain employees while also aligning employees' interests with the interests of our shareholders. Employees at all levels participate in our stock option program. In addition, members of our Board of Directors receive stock options and restricted stock units for their service on our Board. Stock options are granted to employees under the 2003 Long-Term Incentive Plan (LTIP), our only active plan. At year-end 2003, 72 million shares were available for future executive and SharePower grants. For additional unaudited information on our stock option program, see "Our Critical Accounting Policies" in Management's Discussion and Analysis.

SharePower Grants

SharePower options are awarded under our 2003 LTIP to all eligible employees. Options become exercisable after three years, have a 10-year term, and through 2003, were based on annual earnings and tenure. In 2003, SharePower grants represented approximately 23% of our annual employee option grants.

Executive Grants

All senior management and certain middle management are awarded 2003 LTIP executive grants which, through 2003, were generally based on a multiple of base salary. LTIP executive grants generally become exercisable at the end of three years and have a 10-year term.

Fair Value Method of Accounting

Historically, we have accounted for our employee stock options using the intrinsic value method. This

method measures stock compensation expense as the amount by which the market price of the stock exceeds the exercise price on the date of grant. We did not recognize any stock compensation expense under this method because we grant our stock options at the current stock price. At the end of 2003, we voluntarily adopted the fair value method of accounting for stock options. We selected the retroactive restatement method as described in SFAS 148, *Accounting for Stock-Based Compensation — Transition and Disclosure*, to adopt this accounting. Under this method, we have restated our 2003, 2002 and 2001 results to recognize stock compensation expense as if we had always applied the fair value method to account for our unvested stock options in the years presented. The impact of the restatement is as follows:

	2003	2002	2001
Income before income taxes			
Income before income taxes, before restatement	\$5,399	\$ 4,868	\$ 4,029
Stock compensation expense	(407)	(435)	(385)
Restated income before income taxes	\$4,992	\$ 4,433	\$ 3,644
Net income			
Net income, before restatement	\$3,861	\$3,313	\$ 2,662
Stock compensation expense	(293)	(313)	(262)
Restated net income	\$3,568	\$3,000	\$ 2,400
Net income per common share — basic			
Net income per common share, before restatement	\$ 2.25	\$ 1.89	\$ 1.51
Stock compensation expense	(0.18)	(0.18)	(0.15)
Restated net income per common share	\$ 2.07	\$ 1.71	\$ 1.36
Net income per common share — diluted			
Net income per common share, before restatement	\$ 2.21	\$ 1.85	\$ 1.47
Stock compensation expense	(0.16)	(0.17)	(0.14)
Restated net income per common share	\$ 2.05	\$ 1.68	\$ 1.33

Our Assumptions

Under the fair value method of accounting, we measure stock compensation expense at the date of grant using a Black-Scholes valuation model. Our weighted-average Black-Scholes fair value assumptions include:

	2003	2002	2001
Expected life	6 yrs.	6 yrs.	5 yrs.
Risk free interest rate	3.1%	4.4%	4.8%
Expected volatility	27%	27%	29%
Expected dividend yield	1.15%	1.14%	0.98%

Our Stock Option Activity ^(a):

	2003		2002		2001	
	Options	Average Price ^(b)	Options	Average Price ^(b)	Options	Average Price ^(b)
Outstanding at beginning of year	190,432	\$36.45	176,922	\$32.35	170,640	\$28.08
Granted	41,630	39.89	37,376	48.75	40,432	43.53
Exercised	(25,833)	26.74	(19,558)	23.32	(29,064)	21.59
Forfeited/expired	(8,056)	43.56	(4,308)	39.01	(5,086)	34.83
Outstanding at end of year	198,173	38.12	190,432	36.45	176,922	32.35
Exercisable at end of year	97,663	\$32.56	82,620	\$30.14	83,521	\$26.32
Weighted average fair value of options granted		\$11.21		\$15.20		\$13.53

Stock options outstanding and exercisable at December 27, 2003 ^(a):

Range of Exercise Price	Options Outstanding			Options Exercisable	
	Options	Average Life ^(c)	Average Price ^(b)	Options	Average Price ^(b)
\$13.72 to \$21.31	6,688	1.20 yrs.	\$16.42	6,365	\$16.31
\$21.36 to \$38.25	72,455	4.52	31.57	71,035	31.62
\$38.50 to \$51.50	119,030	8.00	43.42	20,263	41.51
	198,173	6.41	38.12	97,663	32.56

(a) Options are in thousands and include options granted under Quaker plans.

(b) Weighted average exercise price.

(c) Weighted average contractual life remaining in years.

Note 7 — Pension, Retiree Medical and Savings Plans

Our pension plans cover full-time employees in the United States and certain international employees. Benefits are determined based on either years of service or a combination of years of service and earnings. U.S. retirees are also eligible for medical and life insurance benefits (retiree medical) if they meet age and service requirements. Generally, our retiree medical costs are capped at a specified dollar amount, with retirees contributing the remainder. We use a September 30 measurement date. The cost or benefit of plan changes which increase or decrease benefits for prior employee service (prior service cost) is included in expense on a straight-line basis over the average remaining service period of employees expected to receive benefits.

Our 2003 disclosures do not reflect any impact of the Medicare Prescription Drug, Improvement and Modernization Act of 2003 (the Act) signed into law in December 2003, as it occurred after the measurement date for our plans. For 2004, we will account for the effect of the Act. We expect our 2004 retiree medical costs to be between \$5 million and \$10 million lower as a result of the Act and expect our liability to be reduced by approximately \$50 million. These amounts are based on preliminary estimates that are dependent on interpretative regulations not yet available, and therefore, subject to change.

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.

	2003	2002	2001
Weighted average pension assumptions			
Liability discount rate	6.1%	6.7%	7.4%
Expense discount rate	6.7%	7.4%	7.7%
Expected return on plan assets	8.2%	9.1%	9.8%
Rate of salary increases	4.4%	4.4%	4.6%

Components of pension expense

Service cost	\$ 178	\$156	\$127
Interest cost	284	265	233
Expected return on plan assets	(359)	(329)	(301)
Amortization of prior service cost	6	6	8
Amortization of experience loss/(gain)	48	4	(11)
Pension expense	157	102	56
Special termination benefits	4	9	27
Total	\$ 161	\$111	\$ 83

Weighted average retiree medical assumptions

Liability discount rate	6.1%	6.7%	7.5%
Expense discount rate	6.7%	7.5%	7.8%

Components of retiree medical expense

Service cost	\$ 33	\$ 25	\$ 20
Interest cost	73	66	63
Amortization of prior service benefit	(3)	(7)	(12)
Amortization of experience loss	13	3	-
Retiree medical expense	116	87	71
Special termination benefits	-	1	1
Total	\$ 116	\$ 88	\$ 72

	2003	2002	2003	2002
	Pension		Retiree Medical	
Change in projected benefit liability				
Liability at beginning of year	\$ 4,324	\$3,556	\$1,120	\$ 911
Service cost	178	156	33	25
Interest cost	284	265	73	66
Plan amendments	5	12	(63)	(25)
Participant contributions	6	6	-	-
Experience loss	541	514	171	205
Benefit payments	(208)	(234)	(70)	(63)
Special termination benefits	4	9	-	1
Foreign currency adjustment	80	40	-	-
Liability at end of year	\$5,214	\$4,324	\$1,264	\$1,120
Liability at end of year for service to date	\$4,350	\$3,678		

	2003	2002	2003	2002
	Pension		Retiree Medical	
Change in fair value of plan assets				
Fair value at beginning of year	\$3,537	\$3,129	\$ -	\$ -
Actual return on plan assets	281	(221)	-	-
Employer contributions/funding	552	820	70	63
Participant contributions	6	6	-	-
Benefit payments	(208)	(234)	(70)	(63)
Foreign currency adjustment	77	37	-	-
Fair value at end of year	\$4,245	\$3,537	\$ -	\$ -

Funded status as recognized in the Consolidated Balance Sheet

Funded status at end of year	\$ (969)	\$ (787)	\$(1,264)	\$(1,120)
Unrecognized prior service cost/(benefit)	44	44	(83)	(23)
Unrecognized experience loss	2,207	1,607	434	275
Fourth quarter benefit payments	6	23	19	19
Net amounts recognized	\$1,288	\$ 887	\$(894)	\$(849)

Net amounts as recognized in the Consolidated Balance Sheet

Other assets	\$1,581	\$1,097	\$ -	\$ -
Intangible assets	2	8	-	-
Accrued benefit liability	(334)	(283)	(894)	(849)
Accumulated other comprehensive income	39	65	-	-
Net amounts recognized	\$1,288	\$ 887	\$(894)	\$(849)

Components of increase in unrecognized experience loss

Decrease in discount rate	\$ 446	\$ 369	\$ 60	\$ 79
Employee-related assumption changes	(6)	53	80	76
Liability-related experience different from assumptions	100	89	32	50
Actual asset return different from expected return	78	550	-	-
Amortization of losses	(48)	(4)	(13)	(3)
Other, including foreign currency adjustments	30	16	-	-
Total	\$ 600	\$1,073	\$159	\$202

Selected information for plans with liability for service to date in excess of plan assets

Liability for service to date	\$(383)	\$(419)	\$(1,264)	\$(1,120)
Projected benefit liability	\$(727)	\$(656)	\$(1,264)	\$(1,120)
Fair value of plan assets	\$123	\$182	-	-

Of the total projected pension benefit liability at year-end 2003, \$535 million relates to plans that we do not fund because of unfavorable tax treatment.

Our estimated future benefit payments are as follows:

	2004	2005	2006	2007	2008	2009-13
Pension	\$190	\$190	\$200	\$215	\$225	\$1,385
Retiree medical	\$75	\$80	\$85	\$90	\$95	\$515

These benefit payments include payments made from both funded and unfunded pension plans. The above payments exclude any discretionary contributions we may make. We expect such contributions to be approximately \$400 million in 2004.

Pension Assets

The expected return on pension plan assets is based on our historical experience, our pension plan investment guidelines, and our expectations for long-term rates of return. Our pension plan investment guidelines are established based upon an evaluation of market conditions, tolerance for risk and cash requirements for benefit payments. Our target allocation for 2004 and actual pension plan asset allocation at year-end 2003 and 2002 are as follows:

Asset Category	Target Allocation	Actual Allocation	
	2004	2003	2002
Equity securities	60%	57%	48%
Debt securities	40%	34%	29%
Other, primarily cash	–	9%	23%
Total	100%	100%	100%

Pension assets include approximately 5.5 million shares of PepsiCo common stock with a market value of \$251 million in 2003, and 5.5 million shares with a market value of \$202 million in 2002. 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 12% in the cost of covered retiree medical benefits is assumed for 2004. This average increase is then projected to decline gradually to 5% in 2010 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
2003 service and interest cost components	\$ 4	\$(4)
2003 benefit liability	\$ 45	\$(35)

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 provide employees with retirement savings and strengthen their incentive to build shareholder value. Beginning in 2004, we will make matching contributions with PepsiCo stock for a portion of eligible pay based on years of service.

Note 8 — Noncontrolled Bottling Affiliates

Our most significant noncontrolled bottling affiliates are The Pepsi Bottling Group (PBG) and PepsiAmericas (PAS). Approximately 10% of our net revenue reflects sales to PBG.

The Pepsi Bottling Group

In addition to approximately 41% of PBG's outstanding common stock that we own at year-end 2003, 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 45% of PBG's combined operations. PBG's summarized financial information is as follows:

	2003	2002
Current assets	\$ 3,039	\$ 1,737
Noncurrent assets	8,505	8,306
Total assets	\$11,544	\$10,043
Current liabilities	\$2,478	\$1,248
Noncurrent liabilities	6,789	6,623
Minority interest	396	348
Total liabilities	\$9,663	\$8,219
Our investment	\$1,353	\$1,107

	2003	2002	2001
Net revenue	\$10,265	\$9,216	\$8,443
Gross profit	\$5,050	\$4,215	\$3,863
Operating profit	\$956	\$898	\$676
Net income	\$416	\$428	\$305

In December 2002, PBG acquired Pepsi-Gemex, a franchise bottler in Mexico, in which we previously held a 34% ownership interest. The table above includes the results of Pepsi-Gemex from the transaction date forward.

Our investment in PBG was \$240 million higher than our ownership interest in their net assets at year-end 2003. Based

upon the quoted closing price of PBG shares at year-end 2003, the calculated market value of our shares in PBG, excluding our investment in Bottling Group, LLC, exceeded our investment balance by approximately \$1.6 billion.

PepsiAmericas

At year-end 2003, we owned approximately 40% of PepsiAmericas and their summarized financial information is as follows:

	2003	2002
Current assets	\$ 560	\$ 550
Noncurrent assets	3,022	3,013
Total assets	\$3,582	\$3,563
Current liabilities	\$ 599	\$ 698
Noncurrent liabilities	1,418	1,416
Total liabilities	\$2,017	\$2,114
Our investment	\$847	\$782

	2003	2002	2001
Net revenue	\$3,237	\$3,240	\$3,144
Gross profit	\$1,360	\$1,272	\$1,232
Operating profit	\$316	\$301	\$268
Income from continuing operations	\$158	\$136	\$90
Net income	\$158	\$130	\$19

Our investment in PAS was \$230 million higher than our ownership interest in their net assets at year-end 2003. Based upon the quoted closing price of PAS shares at year-end 2003, the calculated market value of our shares in PepsiAmericas exceeded our investment balance by approximately \$136 million.

Related Party Transactions

Our significant related party transactions involve our noncontrolled bottling affiliates. We sell concentrate to these affiliates that is used in the production of carbonated soft drinks and non-carbonated beverages. The sale of concentrate is reported net of bottler funding. We also sell certain finished goods to these affiliates and we receive royalties for the use of our trademarks for certain products. 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:

	2003	2002	2001
Net revenue	\$3,699	\$3,455	\$2,262
Selling, general and administrative expenses	\$128	\$105	\$75
Accounts and notes receivable	\$158	\$126	
Accounts payable and other current liabilities	\$138	\$122	

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 anchor bottlers, but we consider this exposure to be remote.

Note 9 — Debt Obligations and Commitments

	2003	2002
Short-term debt obligations		
Current maturities of long-term debt	\$ 446	\$485
Other borrowings (5.1% and 5.7%)	520	452
Amounts reclassified to long-term debt	(375)	(375)
	\$ 591	\$562
Long-term debt obligations		
Short-term borrowings, reclassified	\$ 375	\$ 375
Notes due 2004-2026 (5.7% and 4.0%)	1,186	1,716
Zero coupon notes, \$575 million due 2004-2012 (13.5%)	330	338
Other, due 2004-2015 (6.4% and 7.6%)	257	243
	2,148	2,672
Less: current maturities of long-term debt obligations	(446)	(485)
	\$ 1,702	\$2,187

The interest rates in the above table reflect weighted average rates.

Short-term borrowings are reclassified to long-term when we have the intent and ability, through the existence of the unused lines of credit, to refinance these borrowings on a long-term basis. At year-end 2003, we maintained \$750 million in corporate lines of credit subject to normal banking terms and conditions. These credit facilities support short-term debt issuances and remained unused at year-end 2003. Of the \$750 million, \$375 million expires in June 2004 with the remaining \$375 million expiring in June 2008. Upon consent of PepsiCo and the lenders, these facilities can be extended an additional year. In addition, \$395 million of our debt was outstanding on various lines of credit maintained for our international divisions. These lines of credit are subject to normal banking terms and conditions and are committed to the extent of our borrowings.

Long-Term Contractual Commitments and Off-Balance Sheet Arrangements

	Total	Payments Due by Year			
		Less Than 1 Year	1-3 Years	3-5 Years	More Than 5 Years
Long-term contractual commitments (a)					
Long-term debt obligations (b)	\$1,702	\$ —	\$ 274	\$ 902	\$ 526
Non-cancelable operating leases	610	154	209	99	148
Purchasing commitments (c)	3,363	844	1,070	565	884
Marketing commitments	584	218	290	63	13
Other commitments	44	27	13	2	2
	\$6,303	\$1,243	\$1,856	\$1,631	\$1,573

(a) Reflects non-cancelable commitments as of December 27, 2003 based on year-end foreign exchange rates.

(b) Excludes current maturities of long-term debt of \$446 million which are classified within current liabilities.

(c) Includes approximately \$50 million of long-term commitments which are reflected in other liabilities in our Consolidated Balance Sheet.

Most long-term contractual commitments, except for our long-term debt obligations, are not recorded in our Consolidated Balance Sheet. Non-cancelable purchasing and marketing commitments are in the normal course of our business for our projected needs. As bottler funding is negotiated on an annual basis, these commitments are not reflected in our long-term contractual commitments. 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 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 \$57 million of YUM! Brands, Inc. (YUM) outstanding obligations, primarily property leases. 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.

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 fuel;
- foreign exchange risks;
- 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 derivative instruments designated as cash flow and fair value hedges. See “Our Market Risks” in Management’s Discussion and Analysis for further unaudited information on our risks.

For cash flow hedges, changes in fair value are generally 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. 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 cash flow hedges. We use cash flow hedges, with terms of no more than two years, to hedge price fluctuations related to a portion of our anticipated commodity purchases, primarily for corn, natural gas and oats. Any ineffectiveness is recorded immediately. However, our commodity hedges have not had any significant ineffectiveness. We classify both the earnings and cash flow impact from these hedges consistent with the underlying hedged item. During the next 12 months, we expect to reclassify gains of approximately \$1 million from accumulated other comprehensive loss into net income.

Foreign Exchange

Our operations outside of the United States generated approximately 35% of our net revenue of which Mexico, the United Kingdom and Canada contributed nearly 20%. 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 on these hedges was not material to our results of operations. In 2002, we hedged 2.1 billion Mexican pesos related to our net investment in Pepsi-Gemex which resulted in a \$5 million gain upon our disposal of Pepsi-Gemex described in Note 8.

Stock Prices

The portion of our deferred compensation liability that is based on certain market indexes 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 in our Consolidated 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:

	2003		2002	
	Book Value	Fair Value	Book Value	Fair Value
Assets				
Cash and cash equivalents	\$820	\$820	\$1,638	\$1,638
Short-term investments ^(a)	\$1,181	\$1,181	\$207	\$207
Forward exchange contracts ^(b)	\$3	\$3	\$2	\$2
Commodity contracts ^(b)	\$4	\$4	\$6	\$6
Prepaid forward contracts ^(b)	\$107	\$107	\$96	\$96
Liabilities				
Forward exchange contracts ^(c)	\$33	\$33	\$3	\$3
Commodity contracts ^(c)	–	–	\$2	\$2
Debt obligations	\$2,293	\$2,569	\$2,749	\$3,134

Included in the Consolidated Balance Sheet under the captions noted above or as indicated below.

(a) Includes \$103 million at December 27, 2003 and \$82 million at December 28, 2002 of mutual fund investments used to manage a portion of market risk arising from our deferred compensation liability.

(b) Included within prepaid expenses and other current assets.

(c) Included within accounts payable and other current 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 27, 2003 and December 28, 2002 based on an external estimate of the cost to us of transferring the liability to an independent financial institution. See Note 9 for additional information on our guarantees.

Note 11 — Net Income per Common Share

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 preferred shares were converted

into common shares. Options to purchase 49.0 million shares in 2003, 37.9 million shares in 2002 and 0.3 million shares in 2001 were not included in the calculation of diluted earnings per common share because these options were out-of-the-money.

The computations of basic and diluted net income per common share are as shown.

	2003		2002		2001	
	Income	Shares ^(a)	Income	Shares ^(a)	Income	Shares ^(a)
Net income	\$3,568		\$3,000		\$2,400	
Preferred shares:						
Dividends	(3)		(4)		(4)	
Redemption	—		—		(1)	
Net income available for common shareholders	\$3,565	1,718	\$2,996	1,753	\$2,395	1,763
Basic net income per common share	\$ 2.07		\$1.71		\$1.36	
Net income available for common shareholders	\$3,565	1,718	\$2,996	1,753	\$2,395	1,763
Dilutive securities:						
Stock options	—	17	—	25	—	37
ESOP convertible preferred stock	3	3	3	3	3	4
Unvested stock awards	—	1	—	1	—	1
Diluted	\$3,568	1,739	\$2,999	1,782	\$2,398	1,805
Diluted net income per common share	\$2.05		\$1.68		\$1.33	

(a) Weighted average common shares outstanding.

Note 12 — Preferred and Common Stock

As of December 27, 2003, 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 employee stock ownership plan (ESOP) established by Quaker and these shares are redeemable by the ESOP participants. The preferred stock accrues dividends at an annual rate of \$5.46 per share. At year-end 2003, there were 803,953 preferred shares issued and 531,453 shares outstanding. 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.

As of December 27, 2003, 0.5 million outstanding shares of preferred stock with a fair value of \$123 million and 21 million shares of common stock were held in the accounts of ESOP participants. Quaker made the final award to its ESOP plan in June 2001.

	2003		2002		2001	
	Shares	Amount	Shares	Amount	Shares	Amount
Preferred stock						
Balance, beginning of year	0.8	\$41	0.8	\$41	1.3	\$100
Adjustment to effect merger	—	—	—	—	(0.5)	(59)
Balance, end of year	0.8	\$41	0.8	\$41	0.8	\$41
Repurchased preferred stock						
Balance, beginning of year	0.2	\$48	0.1	\$15	0.5	\$51
Redemptions	0.1	15	0.1	33	0.1	23
Adjustment to effect merger	—	—	—	—	(0.5)	(59)
Balance, end of year	0.3	\$63	0.2	\$48	0.1	\$15

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 loss results from items deferred on the balance sheet in shareholders' equity. Other comprehensive

income was \$405 million in 2003 and other comprehensive loss was \$26 million in 2002 and \$272 million in 2001. The accumulated balances for each component of other comprehensive loss were as shown.

	2003	2002	2001
Currency translation adjustment	\$(1,121)	\$(1,531)	\$(1,587)
Cash flow hedges, net of tax ^(a)	(12)	—	(18)
Minimum pension liability adjustment ^(b)	(135)	(142)	(43)
Other	1	1	2
Accumulated other comprehensive loss	\$(1,267)	\$(1,672)	\$(1,646)

(a) Includes a \$8 million gain in 2003, a \$4 million loss in 2002 and a \$7 million loss in 2001 for our share of our equity investees' accumulated derivative activity. In addition, 2001 includes a \$3 million gain related to the cumulative effect of adopting SFAS 133.

(b) Net of taxes of \$67 million in 2003, \$72 million in 2002 and \$22 million in 2001. Also, includes \$110 million in 2003, \$99 million in 2002 and \$29 million in 2001 for our share of our equity investees' minimum pension liability adjustments.

Note 14 — Supplemental Financial Information

	2003	2002	2001
Accounts receivable			
Trade receivables	\$2,309	\$ 1,924	
Other receivables	626	723	
	2,935	2,647	
Allowance, beginning of year	116	121	\$ 126
Charged to expense	32	38	41
Other additions ^(a)	—	3	2
Deductions ^(b)	(43)	(46)	(48)
Allowance, end of year	105	116	\$ 121
Net receivables	\$2,830	\$ 2,531	
Inventory^(c)			
Raw materials	\$ 618	\$ 525	
Work-in-process	160	214	
Finished goods	634	603	
	\$1,412	\$ 1,342	
Accounts payable and other liabilities			
Accounts payable	\$1,638	\$ 1,543	
Accrued marketplace spending	1,243	1,240	
Accrued compensation and benefits	851	806	
Dividends payable	274	259	
Insurance accruals	151	168	
Other current liabilities	1,056	982	
	\$5,213	\$ 4,998	
Other liabilities ^(d)	\$4,075	\$ 4,226	
Other supplemental information			
Rent expense	\$231	\$194	\$165
Interest paid	\$175	\$119	\$159
Income taxes paid	\$1,580	\$1,056	\$857
Acquisitions^(e)			
Fair value of assets acquired	\$178	\$626	\$604
Cash paid and debt issued	(71)	(351)	(432)
Liabilities assumed	\$107	\$275	\$172

(a) Includes acquisitions and currency translation effects.

(b) Includes accounts written off and currency translation effects.

(c) Inventories are valued at the lower of cost or market. Cost is determined using the average, first-in, first-out (FIFO) or last-in, first-out (LIFO) methods. Approximately 10% in 2003 and 19% in 2002 of the inventory cost was computed using the LIFO method. The differences between LIFO and FIFO methods of valuing these inventories are not material.

(d) Includes reserves for tax positions when, despite our belief that our position is fully supportable, we believe that our position is likely to be challenged and that we may not succeed.

(e) Includes our acquisition of the Wotsits brand in the United Kingdom for \$228 million in 2002 and the SoBe brand in the United States for \$337 million in 2001.

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 auditors, 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.

This encompasses:

Maintaining a strong internal control environment with a focus on financial stewardship. Our system of internal controls includes written policies and procedures, segregation of duties and the careful selection and development of employees. 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 United States of America. 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 comprises independent directors with the financial 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, our independent auditors and with our General Auditor.

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 United States of America, 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



Indra K. Nooyi
President and Chief Financial Officer



Steven S. Reinemund
Chairman of the Board and Chief Executive Officer

Independent Auditors' Report

Board of Directors and Shareholders
PepsiCo, Inc.:

We have audited the accompanying Consolidated Balance Sheet of PepsiCo, Inc. and Subsidiaries as of December 27, 2003 and December 28, 2002 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 27, 2003. These consolidated financial statements are the responsibility of PepsiCo, Inc.'s management. Our responsibility is to express an opinion on these consolidated financial statements based on our audits.

We conducted our audits in accordance with auditing standards generally accepted in the United States of America. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

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 27, 2003 and December 28, 2002, and the results of their operations and their cash flows for each of the years in the three-year period ended December 27, 2003, in conformity

with accounting principles generally accepted in the United States of America.

As discussed in Note 6 to the consolidated financial statements, in 2003 PepsiCo, Inc. adopted the fair value method of accounting for employee stock options by retroactively restating all periods presented as described in the Financial Accounting Standards Board's Statement of Financial Accounting Standards No. 148, "Accounting for Stock Based Compensation — Transition and Disclosure." Furthermore, as discussed in Note 4 to the consolidated financial statements, in 2002 PepsiCo, Inc. adopted the provisions of the Financial Accounting Standards Board's Statement of Financial Accounting Standards No. 142, "Goodwill and Other Intangible Assets."

KPMG LLP

KPMG LLP
New York, New York
February 9, 2004

Selected Financial Data

(in millions except per share amounts, unaudited)

QUARTERLY	2003	2002	2003	2002	2003	2002	2003	2002
	First Quarter		Second Quarter		Third Quarter		Fourth Quarter	
Net revenue	\$5,530	5,311	6,538	6,119	6,830	6,300	8,073	7,382
Gross profit	\$2,996	2,881	3,546	3,343	3,714	3,427	4,336	3,964
Merger-related costs ^(a)	\$ 11	36	11	65	9	33	28	90
Net income ^(b)								
As reported	\$ 777	689	1,009	875	1,077	953		
Stock compensation expense	(79)	(87)	(65)	(67)	(65)	(69)		
As restated	\$ 698	602	944	808	1,012	884	914	706
Net income per common share — basic ^(b)								
As reported	\$ 0.45	0.39	0.59	0.49	0.63	0.54		
Stock compensation expense	(0.04)	(0.05)	(0.04)	(0.03)	(0.04)	(0.04)		
As restated	\$ 0.41	0.34	0.55	0.46	0.59	0.50	0.53	0.41
Net income per common share — diluted ^(b)								
As reported	\$ 0.45	0.38	0.58	0.48	0.62	0.53		
Stock compensation expense	(0.05)	(0.05)	(0.04)	(0.03)	(0.04)	(0.03)		
As restated	\$ 0.40	0.33	0.54	0.45	0.58	0.50	0.52	0.40
Cash dividends declared per common share	\$ 0.15	0.145	0.16	0.15	0.16	0.15	0.16	0.15
Stock price per share ^(c)								
High	\$44.06	51.48	45.11	53.50	47.98	52.00	48.88	45.30
Low	\$36.24	47.43	38.06	49.88	43.10	35.01	44.11	34.00
Close	\$41.50	50.90	44.74	50.90	44.33	37.99	46.47	41.67

(a) Merger-related costs (see Note 3 to our consolidated financial statements):

	2003	2002	2003	2002	2003	2002	2003	2002
	First Quarter		Second Quarter		Third Quarter		Fourth Quarter	
Pre-tax	\$11	\$36	\$11	\$65	\$9	\$33	\$28	\$90
After-tax	\$10	\$30	\$9	\$52	\$6	\$27	\$17	\$81
Per share	—	\$0.02	—	\$0.03	—	\$0.02	\$0.01	\$0.05

(b) As described in Note 6 to our consolidated financial statements, we have restated our results to adopt the fair value method of accounting for stock options.

(c) Represents the composite high and low sales price and quarterly closing prices for one share of PepsiCo common stock. Pre-merger amounts are those of PepsiCo prior to the effective date of the merger.

FIVE-YEAR SUMMARY	2003	2002	2001	2000	1999
Net revenue	\$26,971	25,112	23,512	22,337	22,183
Net income	\$ 3,568	3,000	2,400	2,543	2,505
Income per common share — basic	\$ 2.07	1.71	1.36	1.45	1.41
Income per common share — diluted	\$ 2.05	1.68	1.33	1.42	1.38
Cash dividends declared per common share	\$ 0.630	0.595	0.575	0.555	0.535
Total assets	\$25,327	23,474	21,695	20,757	19,948
Long-term debt	\$ 1,702	2,187	2,651	3,009	3,527

As a result of the adoption of SFAS 142 and the consolidation of SVE in 2002, the bottling deconsolidation in 1999 and items identified below, the data provided above is not comparable.

• Includes Quaker merger-related costs of:

	2003	2002	2001
Pre-tax	\$ 59	\$224	\$356
After-tax	\$ 42	\$190	\$322
Per share	\$0.02	\$0.11	\$0.18

• Includes restructuring and impairment charges of:

	2003	2001	2000	1999
Pre-tax	\$147	\$31	\$184	\$73
After-tax	\$100	\$19	\$111	\$45
Per share	\$0.06	\$0.01	\$0.06	\$0.02

• The 2000 fiscal year consisted of fifty-three weeks compared to fifty-two weeks in our normal fiscal year. The 53rd week increased 2000 net revenue by an estimated \$294 million and net income by an estimated \$44 million (or \$0.02 per share).

• In 1999, includes a net gain on bottling transactions of \$1.0 billion (\$245 million after-tax or \$0.14 per share) and a Quaker favorable tax adjustment of \$59 million (or \$0.03 per share).

• In 2003, we voluntarily adopted the fair value method of accounting for stock options. We selected the retroactive restatement method as described in SFAS 148, *Accounting for Stock-Based Compensation — Transition and Disclosure*, to adopt this accounting. Under this method we have restated our 2003, 2002 and 2001 results to recognize stock compensation expense as follows:

	2003	2002	2001
Pre-tax	\$407	\$435	\$385
After-tax	\$293	\$313	\$262
Per share	\$0.16	\$0.17	\$0.14

Fiscal years 2000 and 1999 have not been restated for this adoption.

• Cash dividends per common share are those of pre-merger PepsiCo prior to the effective date of the merger.

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, Swiss and Tokyo Stock Exchanges.

Shareholders

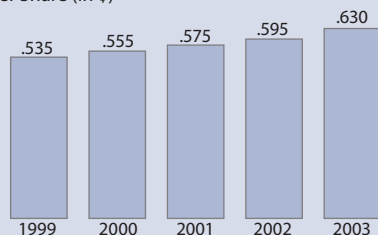
At year-end 2003, there were approximately 213,000 shareholders of record.

Dividend Policy

Our policy is to pay quarterly cash dividends at approximately one-third of our previous year's net income. 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, subject to approval of the Board of Directors, expected to be March 12, June 11, September 10 and December 10, 2004. We have paid quarterly cash dividends since 1965. Amounts in the chart reflect pre-merger PepsiCo for the dates prior to our merger with The Quaker Oats Company.

Cash Dividends Declared

Per Share (In \$)



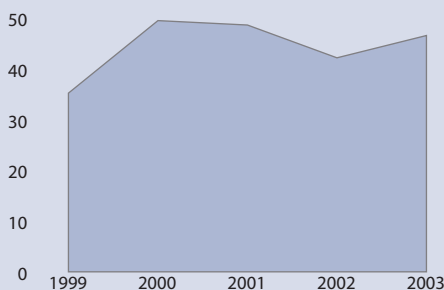
Stock Performance

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, 1998, was worth about \$1,216 on December 31, 2003, assuming the reinvestment of dividends. This performance represents a compounded annual growth rate of 4%.

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 1998-2003. These amounts reflect the closing price of pre-merger PepsiCo prior to our merger with The Quaker Oats Company. Past performance is not necessarily indicative of future returns on investments in PepsiCo common stock.

Year-end Market Price of Stock

(In \$) Based on calendar year-end.



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 5, 2004, at 11 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 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
610-312-5303 (Outside the U.S.)

E-mail: shareowner-svcs@bankofny.com

Web site: 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.

Beneficial Shareholders (shares held by your broker in the name of the brokerage house) should direct communications on all administrative matters to your stockbroker.

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:

Common Stock Purchase Program
Fidelity Investments
P.O. Box 77001
Cincinnati, OH 45277-0002
Telephone: 800-544-9354
(U.S., Puerto Rico and Canada)
800-544-0275 (all other locations)

E-mail, go to www.fidelity.com, select "Customer Service," then "Contact Us."

PepsiCo 401(k) Plan
Fidelity Investments
P.O. Box 9029
Boston, MA 02205
Telephone: 800-883-4015
877-833-9900 (outside U.S.)

Please have a copy of your most recent statement available when calling with inquiries.

Shareholder Services

Dividend Reinvestment Plan

A brochure explaining this convenient plan, for which PepsiCo pays all administrative costs, is available from our transfer agent:

The Bank of New York
Dividend Reinvestment Department
P.O. Box 1958
Newark, NJ 07101-9774
Telephone: 800-226-0083

Direct Deposit of Dividends

Information on the Direct Deposit service is available from our transfer agent:

The Bank of New York
Shareholder Services Department
P.O. Box 11258
Church Street Station
New York, NY 10286-1258
Telephone: 800-226-0083
610-312-5303 (Outside the U.S.)

Financial and Other Information

PepsiCo's 2004 quarterly earnings releases are expected to be issued the weeks of April 12, July 12, September 27, 2004, and January 30, 2005.

Copies of PepsiCo's SEC reports, earnings and other financial releases, corporate news and additional company information are available on our web site <http://www.pepsico.com> or contact PepsiCo's Manager of Shareholder Relations at 914-253-3055.

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

Jack Callahan
Senior Vice President, Investor Relations
PepsiCo, Inc.
Purchase, NY 10577
Telephone: 914-253-3035

Independent Auditors

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<http://www.pepsico.com>

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We want consumers to choose PepsiCo brands when they want enjoyment, great taste, variety, healthy choices and convenience. That means building trust — one product, one experience and one consumer at a time.

