Coke versus Pepsi*

A Comparison of Financial Strategies

At the end of the 20^{th} century, Coca-Cola and PepsiCo were the two largest beverage companies in the world. Their competition had been fierce and enduring, but some industry observers suggested that Coke already had won the 'cola wars.'[1] Pepsi's response was to spin off its restaurant businesses (Pizza Hut, KFC, Taco Bell) to focus exclusively on beverages and snack foods. Two important questions are:

- From the viewpoint of their shareholders, was Pepsi really being crushed as badly as it appeared?
- Had Pepsi's new focus already narrowed the gap?

The Coca-Cola Company

The Coca-Cola Company (Coke) began selling products in 1886 and was the largest beverage company in the world. Coke specialized in nonalcoholic drinks – principally soft drinks but also a variety of noncarbonated beverages. Out of approximately 48 billion beverages consumed worldwide each day, about 1 billion (or roughly 2%) bore a company trademark (1997 10-K). Coke sold its beverages in nearly 200 countries, and had the leading soft drink product(s) in most of these countries. Coke was also the world's largest distributor and marketer of juice and juice-drink products. Appendix A provides a partial list of company products.

Coke manufactured and sold soft drink and noncarbonated beverage concentrates and syrups to authorized bottling and canning operations.[2] These bottlers added the remaining ingredients (generally carbonated water) and packaged the finished soft drinks in authorized containers bearing the company's trademarks for sale to retailers and wholesalers.

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* This case was prepared by Professors Robert M. Bowen, Roland (Pete) Dukes, and Jane Kennedy of the University of Washington using publicly available data. Revised September 2008.

1 For example, see "How Coke is Kicking Pepsi's Can," *Fortune*, October 28, 1996.

2 The Company also sells fountain syrups and finished beverages to authorized bottlers or distributors, who in turn sell these products to retailers or, in some cases, wholesalers.

The New Pepsi Challenge?

In 1996, Pepsi-Cola products had 23% of the worldwide market for soft drinks (compared to 47% for Coca-Cola). However, despite a 30-year record of growth averaging 14% annually, earnings fell sharply in 1996 (28%) compared to the prior year. This led to in a major restructuring in 1997.

From 1988 through 1994, PepsiCo (Pepsi) invested almost $7 billion in an effort to sustain its high growth rate. Much of this was accomplished by adding thousands of restaurants to what was formerly a beverage (Pepsi-Cola) and snack food (Frito-Lay) company. When restaurant industry growth slowed in the mid-1990s, management discovered that it was difficult to run a large number of restaurants efficiently. As a solution, in 1995, Pepsi began selling its restaurants back to franchisees. Local owners were closer to the customer and were viewed as having a better chance of running the business profitably. By year-end 1996, over 1000 restaurants had been ‘refranchised’ and the financial situation of the restaurant business was stabilized. Despite this improvement, Pepsi management decided to refocus the company by splitting it into two distinct parts – PepsiCo (composed of Pepsi and Frito-Lay) and Tricon Global Restaurants (composed of Pizza Hut, KFC and Taco Bell). Tricon was spun off to PepsiCo shareholders as a separate public corporation in 1997. (See www.triconglobal.com.) The few remaining smaller restaurant chains (e.g., Hot’n Now, California Pizza Kitchen) and the restaurant supply distribution business were sold to outside investors. According to new CEO, Roger Enrico:

> So what does all of this mean for our future? Can we put PepsiCo on a sustainable, consistent 15% annual earnings growth trajectory? I believe we can. … In other words, (we need to) stick to the things we do well, and do them better. Stop doing things we don’t do well – no matter how alluring they seem. And put the power of the entire corporation behind a few very big initiatives – ones that really count. In short, we need to do throughout the corporation what we’ve been doing for years at out strongest businesses, Pepsi-Cola in the United States and Frito-Lay. (1996 annual report, pp. 4-5)

By year-end 1997, Pepsi was back exclusively in the packaged goods business. Appendix B provides a partial list of the company’s current products.

Pepsi’s balance sheet for year-end 1997 reports the financial condition of the ongoing beverage and snack foods company, i.e., the net assets of Tricon Global were transferred to Tricon’s separate balance sheet. In contrast, Pepsi’s income statement shows earnings from both companies through the date of the spin-off. However, earnings from continuing operations (PepsiCo) and from discontinued operations (Tricon Global) are shown as separate line items.

Coke's "49% solution" – reporting their Bottling companies as equity-method investments

A major purpose of this case is to understand the financial implications of 'consolidated' versus 'equity-method' accounting for affiliated companies. As of December 31, 1998 Coke had substantial investments in a number of bottling operations including Coca-Cola Enterprises. Despite owning less than 50% of each company, agreements with these bottlers gave Coke substantial control over their operations. However, ownership of less than 50% permitted Coke to account for these investments using the equity method. An alternative, if Coke controlled the bottlers, was to consolidate all the assets and liabilities and present financial statements *as if* they were one entity.[3] Note 2 to Coke's 1998 financial statements provides information about these investments. This note can be viewed as having four parts.

- The first part provides summary financial data for Coca-Cola Enterprises (CCE), the world's largest bottling company. Coca-Cola owns approximately 42% of CCE.
- The second part provides summary financial data for Coca-Cola Amatil Limited (CCA), an Australian-based bottling company that operates in 18 countries. Coca-Cola owns approximately 43% of CCA.
- The third part provides summary financial data for Other Equity Investments.
- The final paragraphs discuss a) sales of Company ownership in other bottlers (e.g., 49% ownership in Coca-Cola Beverages Ltd. of Canada to Cola-Cola Enterprises), and b) the market value of Company investments in bottlers other than CCE and CCA.

Questions:

1. For some people, it is difficult to distinguish between the primary soft drink of these two competitors (Classic Coke versus Pepsi). Are their financial statements equally difficult to distinguish? Using the *as reported* data in the balance sheets and income statements of each company,
   a. Compare their assets, liabilities and shareholders' equity as of year-end 1998. Which company is larger? Which has relatively more debt in its financial structure?
   b. Compare their net income, return on assets and return on equity for 1998.[4] Which company appears to be more profitable?

2. Coke and Pepsi elected to pursue different *operating* and *investing* strategies.
   a. Compare the *operating* strategies of the two companies, e.g., to what extent are Coke and Pepsi in the same businesses and markets? What effect will any differences have on the financial performance of each and on a comparison of the two companies?
   b. Compare the *investing* strategies of the two companies, e.g., how do Coke and Pepsi differ in their ownership of bottling operations. What effect will these investing differences likely have on the financial performance of each and on a comparison of the two companies?

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[3] For example, Pepsi owned 100% of its bottlers and consolidated them in the financial statements.

[4] To simplify the analysis, use end-of-period assets and shareholders' equity in the denominator of these ratios.

3. As discussed above, Coke's note 2 provides summary information for Coca-Cola Enterprises (CCE) and other 'equity-basis' investments.
   a. How is an equity-basis investment shown in the financial statements of Coke (the parent company)?

   b. What effect would *consolidation* of these equity-basis investments have on the assets, liabilities and shareholders' equity of Coke at year-end 1998? How does this balance sheet comparison of Coke versus Pepsi change after consolidation of Coke's equity-basis investments? Hint: follow these steps to prepare the *as if* consolidated balance sheet for Coca-Cola:

      Step 1. Find the template provided in Appendix C on the last page of the case. It will be used in the steps below to approximate the consolidation of Coca-Cola (the parent) with a) Coca-Cola Enterprises (CCE), b) Coca-Cola Amatil (CCA), and c) other equity investments as described in note 2.[5]

      Step 2. Fill in the balance sheet amounts for the bottling companies in the appropriate columns in the spreadsheet using the information in note 2.

      Step 3. Adjust long-term assets, shareholders' equity (SE), and noncontrolling interest.

      - Step 3a. Note that *consolidated* shareholders' equity has been filled in for you – it should equal the amount on the parent's balance sheet before consolidation.
      - Step 3b. Long-term assets have to be adjusted to avoid double counting.
      - Step 3c. Finally, to determine noncontrolling interest, you can either "plug" the amount needed to make assets equal liabilities plus shareholders' equity on the consolidated balance sheet, or use the information in note 2 (but do <u>not</u> use the percentage ownership of the subsidiaries by the parent, which is also provided in note 2 but is misleading).

      Step 4. Add the column amounts across to create the consolidated balances.

   c. What effect would *consolidation* of these equity-basis investments have on the net income, return on assets and return on equity for Coke in 1998? (To avoid having to prepare a consolidation for 1997, use end-of-year assets and equity in the denominator of any ratios you calculate.) How do comparisons of Coke versus Pepsi change after consolidation of Coke's equity-basis investments?

4. What is your overall assessment of Coke's investing strategies?

5. If you were CEO of Pepsi, briefly how would you respond to Coke's operating and investing strategies?

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[5] To simplify the analysis, assume that all intercompany transactions (such as Coke's sale of syrup to CCE) have already been eliminated in the financial data in note 2.

Appendix A
Products of Coca-Cola

Coca-Cola products include:

Coca-Cola
Coca-Cola classic
caffeine free Coca-Cola
caffeine free Coca-Cola classic
diet Coke (sold under the trademark Coca-Cola light in many countries outside the U.S.)
caffeine free diet Coke
Cherry Coke
Sprite
diet Sprite
Mr. Pibb
Mello Yello
Diet Mello Yello
Tab
Fresca
Barq's root beer
Diet Barq’s root beer
Surge
POWERaDE
Fruitopia
Minute Maid orange
Diet Minute Maid orange
Minute Maid juices to go
Cool from Nestea
Le Bleu water (in certain markets)
Dr. Pepper (in most of its regions)
Seagrams’ products and Sundrop under franchise agreements with companies that manufacture concentrate for those products
Soft drinks for other Coca-Cola franchise bottlers

Source: 1998 10-K filed with the SEC

Appendix B
Products of PespiCo

Pepsi-Cola division beverages include:

Pepsi-Cola
Diet Pepsi
Pepsi Max
Mountain Dew
Slice
Mug
All Sport
7-Up
Diet 7-Up
Lipton ready-to-drink tea products
Miranda

Frito-Lay division snack foods include:

Lay's
Ruffles
Doritos
Tostitos
Fritos
Cheetos
Sunchips
Rold Gold pretzels
Walker's (U.K)
Wedel (Poland)
Gamesa (Mexico)
Alegro (Mexico)

Source: 1998 10-K filed with the SEC

Coca-Cola Financial Statements

CONSOLIDATED BALANCE SHEETS
THE COCA-COLA COMPANY AND SUBSIDIARIES

December 31,	1998	1997
(In millions except share data)		
ASSETS		
CURRENT		
Cash and cash equivalents	$ 1,648	$ 1,737
Marketable securities	159	106
	1,807	1,843
Trade accounts receivable, less allowances of $10 in 1998 and $23 in 1997	1,666	1,639
Inventories	890	959
Prepaid expenses and other assets	2,017	1,528
TOTAL CURRENT ASSETS	6,380	5,969
INVESTMENTS AND OTHER ASSETS		
Equity method investments		
Coca-Cola Enterprises Inc.	584	184
Coca-Cola Amatil Limited	1,255	1,204
Coca-Cola Beverages plc	879	-
Other, principally bottling companies	3,573	3,049
Cost method investments, principally bottling companies	395	457
Marketable securities and other assets	1,863	1,607
	8,549	6,501
PROPERTY, PLANT AND EQUIPMENT		
Land	199	183
Buildings and improvements	1,507	1,535
Machinery and equipment	3,855	3,896
Containers	124	157
	5,685	5,771
Less allowances for depreciation	2,016	2,028
	3,669	3,743
GOODWILL AND OTHER INTANGIBLE ASSETS	547	668
	$ 19,145	$ 16,881

(continued on next page)

CONSOLIDATED BALANCE SHEETS (continued)
THE COCA-COLA COMPANY AND SUBSIDIARIES

December 31,	1998	1997
LIABILITIES AND SHARE-OWNERS' EQUITY		
CURRENT		
Accounts payable and accrued expenses	$ 3,141	$ 3,249
Loans and notes payable	4,459	2,677
Current maturities of long-term debt	3	397
Accrued income taxes	1,037	1,056
TOTAL CURRENT LIABILITIES	8,640	7,379
LONG-TERM DEBT	687	801
OTHER LIABILITIES	991	1,001
DEFERRED INCOME TAXES	424	426
SHARE-OWNERS' EQUITY		
Common stock, $.25 par value		
Authorized: 5,600,000,000 shares		
Issued: 3,460,083,686 shares in 1998;		
3,443,441,902 shares in 1997	865	861
Capital surplus	2,195	1,527
Reinvested earnings	19,922	17,869
Accumulated other comprehensive income		
and unearned compensation on restricted stock	(1,434)	(1,401)
	21,548	18,856
Less treasury stock, at cost		
(994,566,196 shares in 1998;		
972,812,731 shares in 1997)	13,145	11,582
	8,403	7,274
	$ 19,145	$ 16,881

See Notes to Consolidated Financial Statements.

CONSOLIDATED STATEMENTS OF INCOME
THE COCA-COLA COMPANY AND SUBSIDIARIES

Year Ended December 31,	1998	1997	1996
(In millions except per share data)			
NET OPERATING REVENUES	$ 18,813	$ 18,868	$ 18,673
Cost of goods sold	5,562	6,015	6,738
GROSS PROFIT	13,251	12,853	11,935
Selling, administrative and general expenses	8,284	7,852	8,020
OPERATING INCOME	4,967	5,001	3,915
Interest income	219	211	238
Interest expense	277	258	286
Equity income	32	155	211
Other income-net	230	583	87
Gains on issuances of stock by equity investees	27	363	431
INCOME BEFORE INCOME TAXES	5,198	6,055	4,596
Income taxes	1,665	1,926	1,104
NET INCOME	$ 3,533	$ 4,129	$ 3,492
BASIC NET INCOME PER SHARE	$ 1.43	$ 1.67	$ 1.40
DILUTED NET INCOME PER SHARE	$ 1.42	$ 1.64	$ 1.38
AVERAGE SHARES OUTSTANDING	2,467	2,477	2,494
Dilutive effect of stock options	29	38	29
AVERAGE SHARES OUTSTANDING ASSUMING DILUTION	2,496	2,515	2,523

See Notes to Consolidated Financial Statements.

CONSOLIDATED STATEMENTS OF CASH FLOWS
THE COCA-COLA COMPANY AND SUBSIDIARIES

Year Ended December 31,	1998	1997	1996
(In millions)			
OPERATING ACTIVITIES			
Net income	$ 3,533	$ 4,129	$ 3,492
Depreciation and amortization	645	626	633
Deferred income taxes	(38)	380	(145)
Equity income, net of dividends	31	(108)	(89)
Foreign currency adjustments	21	37	(60)
Gains on issuances of stock by equity investees	(27)	(363)	(431)
Gains on sales of assets, including bottling interests	(306)	(639)	(135)
Other items	124	18	316
Net change in operating assets and liabilities	(550)	(47)	(118)
Net cash provided by operating activities	3,433	4,033	3,463
INVESTING ACTIVITIES			
Acquisitions and investments, principally bottling companies	(1,428)	(1,100)	(645)
Purchases of investments and other assets	(610)	(459)	(623)
Proceeds from disposals of investments and other assets	1,036	1,999	1,302
Purchases of property, plant and equipment	(863)	(1,093)	(990)
Proceeds from disposals of property, plant and equipment	54	71	81
Other investing activities	(350)	82	(175)
Net cash used in investing activities	(2,161)	(500)	(1,050)
Net cash provided by operations after reinvestment	1,272	3,533	2,413
FINANCING ACTIVITIES			
Issuances of debt	1,818	155	1,122
Payments of debt	(410)	(751)	(580)
Issuances of stock	302	150	124
Purchases of stock for treasury	(1,563)	(1,262)	(1,521)
Dividends	(1,480)	(1,387)	(1,247)
Net cash used in financing activities	(1,333)	(3,095)	(2,102)
EFFECT OF EXCHANGE RATE CHANGES ON CASH AND CASH EQUIVALENTS	(28)	(134)	(45)
CASH AND CASH EQUIVALENTS			
Net increase (decrease) during the year	(89)	304	266
Balance at beginning of the year	1,737	1,433	1,167
Balance at end of year	$ 1,648	$ 1,737	$ 1,433

See Notes to Consolidated Financial Statements.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

THE COCA-COLA COMPANY AND SUBSIDIARIES

NOTE 1: ORGANIZATION AND SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

ORGANIZATION - The Coca-Cola Company and subsidiaries (our Company) is predominantly a manufacturer, marketer and distributor of soft-drink and noncarbonated beverage concentrates and syrups. Operating in nearly 200 countries worldwide, we primarily sell our concentrates and syrups to bottling and canning operations, fountain wholesalers and fountain retailers. We have significant markets for our products in all the world's geographic regions. We record revenue when title passes to our customers.

BASIS OF PRESENTATION - Certain amounts in the prior years' financial statements have been reclassified to conform to the current year presentation.

CONSOLIDATION - Our Consolidated Financial Statements include the accounts of The Coca-Cola Company and all subsidiaries except where control is temporary or does not rest with our Company. Our investments in companies in which we have the ability to exercise significant influence over operating and financial policies, including certain investments where there is a temporary majority interest, are accounted for by the equity method. Accordingly, our Company's share of the net earnings of these companies is included in consolidated net income. Our investments in other companies are carried at cost or fair value, as appropriate. All significant intercompany accounts and transactions are eliminated upon consolidation.

ISSUANCES OF STOCK BY EQUITY INVESTEES - When one of our equity investees issues additional shares to third parties, our percentage ownership interest in the investee decreases. In the event the issuance price per share is more or less than our average carrying amount per share, we recognize a noncash gain or loss on the issuance. This noncash gain or loss, net of any deferred taxes, is generally recognized in our net income in the period the change of ownership interest occurs.

If gains have been previously recognized on issuances of an equity investee's stock and shares of the equity investee are subsequently repurchased by the equity investee, gain recognition does not occur on issuances subsequent to the date of a repurchase until shares have been issued in an amount equivalent to the number of repurchased shares. This type of transaction is reflected as an equity transaction and the net effect is reflected in the accompanying consolidated balance sheets. For specific transaction details, refer to Note 3.

ADVERTISING COSTS - Our Company expenses production costs of print, radio and television advertisements as of the first date the advertisements take place. Advertising expenses included in selling, administrative and general expenses were $1,597 million in 1998, $1,576 million in 1997 and $1,441 million in 1996. As of December 31, 1998 and 1997, advertising costs of approximately $365 million and $317 million, respectively, were recorded primarily in prepaid expenses and other assets in the accompanying consolidated balance sheets.

NET INCOME PER SHARE - Basic net income per share is computed by dividing net income by the weighted-average number of shares outstanding. Diluted net income per share includes the dilutive effect of stock options.

CASH EQUIVALENTS - Marketable securities that are highly liquid and have maturities of three months or less at the date of purchase are classified as cash equivalents.

INVENTORIES - Inventories consist primarily of raw materials and supplies and are valued at the lower of cost or market. In general, cost is determined on the basis of average cost or first-in, first-out methods.

PROPERTY, PLANT AND EQUIPMENT - Property, plant and equipment are stated at cost and are depreciated principally by the straight-line method over the estimated useful lives of the assets.

OTHER ASSETS - Our Company invests in infrastructure programs with our bottlers which are directed at strengthening our bottling system and increasing unit case sales. The costs of these programs are recorded in other assets and are subsequently amortized over the periods to be directly benefited.

GOODWILL AND OTHER INTANGIBLE ASSETS - Goodwill and other intangible assets are stated on the basis of cost and are amortized, principally on a straight-line basis, over the estimated future periods to be benefited (not exceeding 40 years). Goodwill and other intangible assets are periodically reviewed for impairment based on an assessment of future operations to ensure they are appropriately valued. Accumulated amortization was approximately $119 million and $105 million on December 31, 1998 and 1997, respectively.

USE OF ESTIMATES - In conformity with generally accepted accounting principles, the preparation of our financial statements requires our management to make estimates and assumptions that affect the amounts reported in our financial statements and accompanying notes. Although these estimates are based on our knowledge of current events and actions we may undertake in the future, actual results may ultimately differ from estimates.

NEW ACCOUNTING STANDARDS - In June 1998, the Financial Accounting Standards Board issued Statement of Financial Accounting Standards No. 133, "Accounting for Derivative Instruments and Hedging Activities." The new statement requires all derivatives to be recorded on the balance sheet at fair value and establishes new accounting rules for hedging instruments. The statement is effective for years beginning after June 15, 1999. We are assessing the impact this statement will have on the Consolidated Financial Statements.

In March 1998, the American Institute of Certified Public Accountants (AICPA) issued Statement of Position (SOP) 98-1, "Accounting for the Costs of Computer Software Developed or Obtained for Internal Use." SOP 98-1 provides guidance on accounting for the various types of costs incurred for computer software developed or obtained for internal use. Also, in June 1998, the AICPA issued SOP 98-5, "Reporting on the Costs of Start-Up Activities." SOP 98-5 requires costs of start-up activities and organizational costs, as defined, to be expensed as incurred. We will adopt these SOPs on January 1, 1999, and they will not materially impact our Company's Consolidated Financial Statements.

NOTE 2: BOTTLING INVESTMENTS

COCA-COLA ENTERPRISES INC. - Coca-Cola Enterprises is the largest soft-drink bottler in the world, operating in seven countries, and is one of our anchor bottlers. At December 31, 1998, our Company owned approximately 42 percent of the outstanding common stock of Coca-Cola Enterprises, and accordingly, we account for our investment by the equity method of accounting. The excess of our equity in the underlying net assets of Coca-Cola Enterprises over our investment is primarily amortized on a straight-line basis over 40 years. The balance of this excess, net of amortization, was approximately $442 million at December

31, 1998. A summary of financial information for Coca-Cola Enterprises is as follows (in millions).

December 31,	1998	1997
Current assets	$ 2,285	$ 1,813
Noncurrent assets	18,847	15,674
Total assets	$ 21,132	$ 17,487
Current liabilities	$ 3,397	$ 3,032
Noncurrent liabilities	15,297	12,673
Total liabilities	$ 18,694	$ 15,705
Share-owners' equity	$ 2,438	$ 1,782
Company equity investment	$ 584	$ 184

Year Ended December 31,	1998	1997	1996
Net operating revenues	$ 13,414	$ 11,278	$ 7,921
Cost of goods sold	8,391	7,096	4,896
Gross profit	$ 5,023	$ 4,182	$ 3,025
Operating income	$ 869	$ 720	$ 545
Cash operating profit{1}	$ 1,989	$ 1,666	$ 1,172
Net income	$ 142	$ 171	$ 114
Net income available to common share owners	$ 141	$ 169	$ 106
Company equity income	$ 51	$ 59	$ 53

{1} Cash operating profit is defined as operating income plus depreciation expense, amortization expense and other noncash operating expenses.

Our net concentrate/syrup sales to Coca-Cola Enterprises were $3.1 billion in 1998, $2.5 billion in 1997 and $1.6 billion in 1996, or approximately 16 percent, 13 percent and 9 percent of our 1998, 1997 and 1996 net operating revenues. Coca-Cola Enterprises purchases sweeteners through our Company; however, related collections from Coca-Cola Enterprises and payments to suppliers are not included in our consolidated statements of income. These transactions amounted to $252 million in 1998, $223 million in 1997 and $247 million in 1996. We also provide certain administrative and other services to Coca-Cola Enterprises under negotiated fee arrangements.

Our direct support for certain marketing activities of Coca-Cola Enterprises and participation with them in cooperative advertising and other marketing programs amounted to approximately $899 million in 1998, $604 million in 1997 and $448 million in 1996. Additionally, in 1998 and 1997, we committed approximately $324 million and $190 million, respectively, to Coca-Cola Enterprises under a Company program that encourages bottlers to invest in building and supporting beverage infrastructure.

If valued at the December 31, 1998, quoted closing price of publicly traded Coca-Cola Enterprises shares, the calculated value of our investment in Coca-Cola Enterprises would have exceeded its carrying value by approximately $5.5 billion.

COCA-COLA AMATIL LIMITED - We own approximately 43 percent of Coca-Cola Amatil, an Australian-based anchor bottler that operates in seven countries. Accordingly, we account for our investment in Coca-Cola Amatil by the equity method. The excess of our investment over our equity in the underlying net assets of Coca-Cola Amatil is being amortized on a straight-line basis over 40 years. The balance of this excess, net of amortization, was approximately $205 million at December 31, 1998. A summary of financial information for Coca-Cola Amatil is as follows (in millions):

December 31,	1998{1}	1997
Current assets	$ 1,057	$ 1,470
Noncurrent assets	4,002	4,590
Total assets	$ 5,059	$ 6,060
Current liabilities	$ 1,065	$ 1,053
Noncurrent liabilities	1,552	1,552
Total liabilities	$ 2,617	$ 2,605
Share-owners' equity	$ 2,442	$ 3,455
Company equity investment	$ 1,255	$ 1,204

Year Ended December 31,	1998{1}	1997	1996
Net operating revenues	$ 2,731	$ 3,290	$ 2,905
Cost of goods sold	1,567	1,856	1,737
Gross profit	$ 1,164	$ 1,434	$ 1,168
Operating income	$ 237	$ 276	$ 215
Cash operating profit{2}	$ 435	$ 505	$ 384
Net income	$ 65	$ 89	$ 80
Company equity income	$ 15	$ 27	$ 27

{1} 1998 reflects the spin-off of Coca-Cola Amatil's European operations.
{2} Cash operating profit is defined as operating income plus depreciation expense, amortization expense and other noncash operating expenses.

Our net concentrate sales to Coca-Cola Amatil were approximately $546 million in 1998, $588 million in 1997 and $450 million in 1996. We also participate in various marketing, promotional and other activities with Coca-Cola Amatil.

If valued at the December 31, 1998, quoted closing price of publicly traded Coca-Cola Amatil shares, the calculated value of our investment in Coca-Cola Amatil would have exceeded its carrying value by approximately $364 million.

In August 1998, we exchanged our Korean bottling operations with Coca-Cola Amatil for an additional ownership interest in Coca-Cola Amatil.

OTHER EQUITY INVESTMENTS - Operating results include our proportionate share of income from our equity investments. A summary of financial information for our equity investments in the aggregate, other than Coca-Cola Enterprises and Coca-Cola Amatil, is as follows (in millions):

December 31,	1998	1997
Current assets	$ 4,453	$ 2,946
Noncurrent assets	16,825	11,371
Total assets	$ 21,278	$ 14,317
Current liabilities	$ 4,968	$ 3,545
Noncurrent liabilities	6,731	4,636
Total liabilities	$ 11,699	$ 8,181
Share-owners' equity	$ 9,579	$ 6,136
Company equity investment	$ 4,452	$ 3,049

Year Ended December 31,	1998	1997	1996
Net operating revenues	$ 15,244	$ 13,688	$ 11,640
Cost of goods sold	9,555	8,645	8,028
Gross profit	$ 5,689	$ 5,043	$ 3,612
Operating income	$ 668	$ 869	$ 835
Cash operating profit(1)	$ 1,563	$ 1,794	$ 1,268
Net income	$ 152	$ 405	$ 366
Company equity income (loss)	$ (34)	$ 69	$ 131

Equity investments include certain non-bottling investees.

(1) Cash operating profit is defined as operating income plus depreciation expense, amortization expense and other noncash operating expenses.

Net sales to equity investees other than Coca-Cola Enterprises and Coca-Cola Amatil were $2.1 billion in 1998, $1.5 billion in 1997 and $1.5 billion in 1996. Our direct support for certain marketing activities with equity investees other than Coca-Cola Enterprises, the majority of which are located outside the United States, was approximately $640 million, $528 million and $354 million for 1998, 1997 and 1996, respectively.

In June 1998, we sold our wholly owned Italian bottling operations in northern and central Italy to Coca-Cola Beverages plc (Coca-Cola Beverages). This transaction resulted in proceeds valued at approximately $1 billion and an after-tax gain of approximately $.03 per share (basic and diluted).

In February 1997, we sold our 49 percent interest in Coca-Cola & Schweppes Beverages Ltd. to Coca-Cola Enterprises. This transaction resulted in proceeds for our Company of approximately $1 billion and an after-tax gain of approximately $.08 per share (basic and diluted). In August 1997, we sold our 48 percent interest in Coca-Cola Beverages Ltd. of Canada and our 49 percent ownership interest in The Coca-Cola Bottling Company of New York, Inc., to Coca-Cola Enterprises in exchange for aggregate consideration valued at approximately $456 million. This sale resulted in an after-tax gain of approximately $.04 per share (basic and diluted).

If valued at the December 31, 1998, quoted closing prices of shares actively traded on stock markets, the calculated value of our equity investments in publicly traded bottlers other than Coca-Cola Enterprises and Coca-Cola Amatil would have exceeded our carrying value by approximately $559 million.

PepsiCo Financial Statements

Consolidated Statement of Income
(in millions except per share amounts)
PepsiCo, Inc. and Subsidiaries
Fiscal years ended December 26, 1998, December 27, 1997 and December 28, 1996

	1998	**1997**	**1996**
Net Sales........................	$22,348	$20,917	$20,337
Costs and Expenses, net			
Cost of sales....................	9,330	8,525	8,452
Selling, general and administrative expenses.........	9,924	9,241	9,063
Amortization of intangible assets	222	199	206
Unusual impairment and other items	288	290	576
Operating Profit.................	2,584	2,662	2,040
Interest expense.................	(395)	(478)	(565)
Interest income..................	74	125	91
Income from Continuing Operations Before Income Taxes............	2,263	2,309	1,566
Provision for Income Taxes.......	270	818	624
Income from Continuing Operations	1,993	1,491	942
Income from Discontinued Operations, net of tax.........	-	651	207
Net Income.......................	$ 1,993	$ 2,142	$ 1,149
Income Per Share - Basic			
Continuing Operations............	$ 1.35	$ 0.98	$ 0.60
Discontinued Operations..........	-	0.42	0.13
Net Income	$ 1.35	$ 1.40	$ 0.73
Average shares outstanding.......	1,480	1,528	1,564
Income Per Share - Assuming Dilution			
Continuing Operations............	$ 1.31	$ 0.95	$ 0.59
Discontinued Operations..........	-	0.41	0.13
Net Income.......................	$ 1.31	$ 1.36	$ 0.72
Average shares outstanding.......	1,519	1,570	1,606

See accompanying Notes to Consolidated Financial Statements.

Consolidated Statement of Cash Flows (page 1 of 2)

(in millions)
PepsiCo, Inc. and Subsidiaries
Fiscal years ended December 26, 1998, December 27, 1997 and December 28, 1996

	1998	1997	1996
Operating Activities			
Income from continuing operations.....	$ 1,993	$ 1,491	$ 942
Adjustments to reconcile income from continuing operations to net cash provided by operating activities			
Depreciation and amortization.......	1,234	1,106	1,073
Noncash portion of 1998 tax benefit.......................	(259)	-	-
Noncash portion of unusual impairment and other items...................	254	233	366
Deferred income taxes..............	150	51	160
Other noncash charges and credits, net......................	237	342	505
Changes in operating working capital, excluding effects of acquisitions and dispositions			
Accounts and notes receivable......	(104)	(53)	(67)
Inventories.......................	29	79	(97)
Prepaid expenses and other current assets...........................	(12)	(56)	84
Accounts payable and other current liabilities..............	(195)	84	297
Income taxes payable..............	(116)	142	(71)
Net change in operating working capital..................	(398)	196	146
Net Cash Provided by Operating Activities..........................	3,211	3,419	3,192
Investing Activities			
Capital spending.....................	(1,405)	(1,506)	(1,630)
Acquisitions and investments in unconsolidated affiliates.........	(4,537)	(119)	(75)
Sales of businesses..................	17	221	43
Sales of property, plant and equipment.......................	134	80	9
Short-term investments, by original maturity			
More than three months-purchases....	(525)	(92)	(115)
More than three months-maturities...	584	177	192
Three months or less, net...........	839	(735)	736
Other, net...........................	(126)	(96)	(214)
Net Cash Used for Investing Activities..........................	(5,019)	(2,070)	(1,054)

(Continued on following page)

Consolidated Statement of Cash Flows (page 2 of 2)

(in millions)
PepsiCo, Inc. and Subsidiaries
Fiscal years ended December 26, 1998, December 27, 1997 and December 28, 1996

	1998	1997	1996
Financing Activities			
Proceeds from issuances of long-term debt.................	990	-	1,772
Payments of long-term debt......	(2,277)	(1,875)	(1,432)
Short-term borrowings, by original maturity			
More than three months-proceeds	2,713	146	740
More than three months-payments	(417)	(177)	(1,873)
Three months or less, net.....	1,753	(1,269)	89
Cash dividends paid............	(757)	(736)	(675)
Share repurchases...............	(2,230)	(2,459)	(1,651)
Proceeds from exercises of stock options..................	415	403	323
Other, net.....................	-	5	(9)
Net Cash Provided by (Used for) Financing Activities...........	190	(5,962)	(2,716)
Net Cash Provided by Discontinued Operations.....................	-	6,236	605
Effect of Exchange Rate Changes on Cash and Cash Equivalents......	1	(2)	(5)
Net (Decrease) Increase in Cash and Cash Equivalents...........	(1,617)	1,621	22
Cash and Cash Equivalents - Beginning of Year...........	1,928	307	285
Cash and Cash Equivalents - End of Year..................	$ 311	$ 1,928	$ 307
Supplemental Cash Flow Information			
Interest paid..................	$ 367	$ 462	$ 538
Income taxes paid..............	$ 521	$ 696	$ 611
Schedule of Noncash Investing and Financing Activities			
Fair value of assets acquired...	$ 5,359	$ 160	$ 81
Cash paid and stock issued......	(4,537)	(134)	(76)
Liabilities assumed............	$ 822	$ 26	$ 5

See accompanying Notes to Consolidated Financial Statements.

Consolidated Balance Sheet

(in millions)
PepsiCo, Inc. and Subsidiaries
December 26, 1998 and December 27, 1997

	1998	1997
ASSETS		
Current Assets		
Cash and cash equivalents................	$ 311	$ 1,928
Short-term investments, at cost..........	83	955
	394	**2,883**
Accounts and notes receivable, less allowance: $127 in 1998 and $125 in 1997...........	2,453	2,150
Inventories.............................	1,016	732
Prepaid expenses, deferred income taxes and other current assets................	499	486
Total Current Assets.................	4,362	6,251
Property, Plant and Equipment, net.......	7,318	6,261
Intangible Assets, net...................	8,996	5,855
Investments in Unconsolidated Affiliates.	1,396	1,201
Other Assets.............................	588	533
Total Assets.......................	$22,660	$20,101
LIABILITIES AND SHAREHOLDERS' EQUITY		
Current Liabilities		
Short-term borrowings....................	$ 3,921	$ -
Accounts payable and other current liabilities	3,870	3,617
Income taxes payable.....................	123	640
Total Current Liabilities...........	7,914	4,257
Long-Term Debt...........................	4,028	4,946
Other Liabilities........................	2,314	2,265
Deferred Income Taxes....................	2,003	1,697
Shareholders' Equity		
Capital stock, par value 1 2/3(cent) per share: authorized 3,600 shares, issued 1,726 shares	29	29
Capital in excess of par value...........	1,166	1,314
Retained earnings........................	12,800	11,567
Accumulated other comprehensive loss.....	(1,059)	(988)
	12,936	**11,922**
Less: Treasury stock, at cost: 255 shares and 224 shares in 1998 and 1997, respectively....................	(6,535)	(4,986)
Total Shareholders' Equity...........	6,401	6,936
Total Liabilities and Shareholders' Equity..............	$22,660	$20,101

See accompanying Notes to Consolidated Financial Statements.

Appendix C: Template for Consolidation of Coca-Cola and its Bottling Companies in 1998

Account	Parent	Coca-Cola Enterprises	Coca-Cola Amatil Ltd.	Other Equity Investmts	Adjustment*	Consolidated
Current assets	6,380	2,285				
Noncurrent assets	12,765	18,847				
Total assets	19,145	21,132				
Current liab.	8,640	3,397				
Noncurrent liab.	2,102	15,297				
Total liabilities	10,742	18,694				
Shareholders' equity	8,403	2,438				8,403
Noncontrolling Interest**						
Total	19,145	21,132				

Other information and Notes:

Parent's investment

Noncontrolling Interest

*Hints: CCE column has been filled in for you, as has consolidated SE.
Consolidated SE should be the same before and after consolidation.
"Plug" for noncontrolling interest and we will discuss how it can be derived.
Noncurrent assets, noncontrolling interest, and shareholders' equity require adjustment.

**This is equivalent to 'minority interest' in a typical consolidation, but since Coke does not have a majority interest in these companies, noncontrolling interest may be a better term.