BEHIND THE NUMBERS

QUALITY EQUITY INCOME SOLUTIONS

BTN Thursday Thoughts

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Contents

Barron's had a nice interview with Mark Mobius as he was retiring from 30+ years looking at emerging markets with Franklin Templeton. The full interview was a great read with interesting market history which is linked above. Some of the thoughts that jumped out at us were:

1. The spread of knowledge in the emerging markets is a revolutionary change. Of one billion smartphones sold this year, 70% will be sold in emerging countries.

2. History shows interest rates rose from 2003-2007 and emerging markets increased.

3. Commodity demand is still rising, yet many plans for new supply were canceled after 2008. Prices could rise for many commodities as a result.

4. People are not rejecting trade, but many resent multilateral deals. He expects more smaller trade agreements, but world trade will still rise.

Deepwater Drilling – Deep Value Play?

Following the comments from Mark Mobius about the commodity cycle still seeing solid demand growth, but now suffering from years of underinvestment – we saw Diamond Offshore's (DO) earnings this week. This industry was in great shape until early 2014. Within a year of the financial crisis, oil was back to $80 in 2009 and stayed between $80-$100 into the summer of 2014. Offshore drilling was a huge moneymaker, charging over $600,000 per day for many rigs and more rigs were coming online. However, 2013 marked the end of rising capital spending for major oil companies as it peaked for ExxonMobil, Royal Dutch Shell, Statoil, BP, Chevron, Petrobras, and Total. With falling investment, the deepwater rig companies saw demand for their rigs evaporate and the rates charged fell 50%-70% for those that did find new work.

Oil demand continually rises. For all the talk of Tesla and windmills, the world consumes about 97 million barrels of oil per day and that daily demand rises about 1.0-1.5 million barrels every year. Growth in China, India, and Africa continues to drive this. The supply of oil is also basically about 97 millions per day. A big part of the equation for drilling is existing wells decay and production falls over time. Total decay is about 6%. So, doing some rough math, the production side has to replace 7 million barrels per day every year – 6% decay + 1% growth. That data comes from the U.S. Energy Information Administration (EIA).

Offshore drilling is one of the biggest boom-and-bust commodity-based industries there is. Every project is very expensive and new ones can be delayed or cut if oil prices are falling. Also, an offshore rig is a very expensive and technical piece of equipment that costs several hundred million dollars and takes years to build and be delivered. What made this downturn worse for companies like Diamond Offshore was equipment ordered was arriving as oil companies were cutting back on drilling. Thus, demand was falling as very expensive new rig supply was coming online. On top of that, high oil production drove oil in storage into the billions of barrels, so the decay curve of existing wells was offset by drawing down inventory to meet demand. Thus, the offshore drillers geared up for a typical 2-year drop in capital spending by their customers. However, they found that customers cut spending for a record 4 years in a row! Plus, the cuts were over 50% for some companies.

There are signs that this industry may be starting to turn around. Now we want to be clear – these are not for faint-hearted people. Companies like Diamond Offshore (DO), Seadrill (SDRL), Ensco (ESV), Noble (NE), and Transocean (RIG) used to pay hefty dividends and they have all essentially eliminated them. There is debt here, including moving some of it off balance sheet by doing sale-leasebacks of equipment with other companies. In addition, joint ventures for several rigs exist to cloud what is really on the balance sheets. Debt modifications have been necessary in some cases. Asset impairment charges have been substantial and profits difficult to find in several years. Diamond Offshore even promised another restructuring charge for 1Q'18 and its balance sheet is fairly clean. However, here is some evidence that things may be improving:

First, the industry is consolidating. Maersk (MAERSK DC) sold its offshore oil equipment to Total (TOT) in August 2017. Ensco bought Atwood (ATW) in October 2017. Transocean bought some rigs from Songa Offshore (SONG NO) in February 2018. Seadrill is also in bankruptcy looking to improve its balance sheet as it waits out the downturn. The result should be fewer and stronger companies in the industry to negotiate with the oil companies.

Second, the industry has been pulling rigs offline and cold stacking them. It has gone further and started to scrap many too. In February 2015, Diamond Offshore had 28 active rigs, 4 in cold storage, and 2 under construction. In February 2018, the company has 12 active rigs and 5 in cold storage and zero under construction. Transocean in January 2015 had 12 rigs under construction, 33 active, and 1 in cold storage. In October 2017, Transocean is only waiting on 3 more rigs in construction, 28 are active, and 13 are in storage. Noble in February 2015 had 29 active rigs, 3 in storage or undergoing modification, and 1 under construction. In January 2018, Noble has 13 active rigs and 13 in storage. Seadrill is a wildcard as it in bankruptcy and finding full information is a little more difficult. What we know from their last fleet report in August 2017 was there were 54 active rigs and 18 idle ones. Of the active rigs, 12 were completing their contracts before the end of 2017 and 12 more were completing contracts in the first half of 2018. Some of those would likely have had extensions at possibly lower rates and others may now be idle. Also, Seadrill had 14 rigs under construction that had already been delayed. In bankruptcy, it is possible to reject contracts and they may have cancelled some of the new rigs.

Third, there is evidence of some recovery. Capital spending by oil companies is rising again for offshore projects. Marc Edwards, the CEO of DO, noted this week that the North Sea is seeing more demand, day rates are moving up, and contract terms are lengthening. In the last quarter, DO saw five rigs secure new contracts at positive levels with one getting a higher rate on an extension. DO also obtained the first new contract from Petrobras (PBR) in two years as that company has continued to scale back drilling. Continuing the note on scrapping above, Mr. Edwards attributes some of the better rates in the North Sea due to heavy scrapping of older floating rigs:

> "Of the almost 100 floaters that have been scrapped since the beginning of this extended downturn, over 85 were in the moored class. This alone will help to incubate a recovery and utilization in a market segment that has started to tighten at current oil prices."

These types of rigs are used extensively in the North Sea and that helps explain why the North Sea is seeing better demand and pricing.

Areas of caution still remain and some may be overstated – we will need to see. The first is after being excited about the move in some parts of the market, even Mr. Edwards is quick to point out that these improvements are bouncing off some very deep lows and he expects it may be in 2019 and 2020 before this market sees signs of a more broad-based recovery. He expects significant recovery to occur between 2021-25. This also meshes with the timing laid out in the restructuring plan Seadrill filed.

There is also concern that stacked rigs and rigs under construction could come back into the market as well. Even Mr. Edwards offers some conflicting views. He sees an oversupply in the high-end rigs where 22 drillships and 11 high-end rigs are still in shipyards being built. Those could arrive during the recovery and dampen it. It is possible that some of these rigs under construction will not be completed. A large number are with Seadrill who is in bankruptcy. On top of that, there are many stacked rigs that would like to return to the market too. His belief is the high-end market may still need to see 60 rigs scrapped.

We said conflicting views because Mr. Edwards has also run the math to show that many of the higher-end idled/stacked rigs may never work again. His estimate is that reactivating a 6th generation rig is likely to cost $80-$100 million. The structure will need a complete survey and repairs, software and electronics need to updated and checked, and the whole rig has to be recertified and towed somewhere. A crew has to be found and trained. The blowout preventer and other subsystems have to be rechecked. By 2020, these rigs may have been stacked for 4-5 years. If the rig gets a contract for 2 years, $100 million in reactivation is $137,000 per day over a 2-year contract. Day rates are running below $300,000 per day now, so that doesn't work when adding in operating costs, interest expense and earning a return. And that rig being reactivated has to compete against a rig that has been working and coming off a contract. The customer doesn't have to wait for the working rig to get up to code. The rig company doesn't have all the start-up costs with a working rig. The currently working rig has a big edge over a stacked one. It would take a very hot market for rigs to make many of the stacked rigs return. If the market is that hot – all these companies may be having some stellar years.

A final concern that investors should be aware of will be the news focus on US shale. The US has gone from producing about 4 million barrels a day on land to 10 million barrels with fracking tight oil. Offshore drilling produces over 25 billion barrels per day. Shale faces a problem in that the decay rate is about 25%, so the market has to drill and produce another 2.5 million barrels per day to hold production constant. Offshore fields tend to be much larger and the decay curve is about 8%. Energy Insights reported those figures in late 2016 and were highlighted in a Diamond Offshore presentation. Royal Dutch Shell noted when it cut back in capital spending following 2013 that it would focus more on offshore. The reasoning was the costs are minimal while waiting to drill, a short-period of heavy spending during drilling but they are experienced with that, and then minimal expense after drilling. That was versus continual spending to start and then maintain production. We do not think US shale can offset offshore given the decay curves, and the EIA is not projecting shale output to report much overall annual growth at this point because of that.

Our conclusions are that this industry is likely to see more impairment charges to write off stacked rigs, and even operating rigs may be marked down if they come off a high contract and get renewed at a lower fee. So, we would not put much faith in the book values here. Also, if the market does recover, there will be some stacked rigs that are reactivated and these companies would be reporting some sizeable cash outflows to pay for that. There should still be more lead-time between oil companies announcing they want to invest more and actual cash flow reaching these companies. With that said, there could be a significant turnaround given how deep the downturn was, and there are signs it is not getting worse at this point. The stocks are still selling for fractions of the peak prices.

Update on Ocean Yield (OCN NO, OYIEF)

Ocean Yield (OCN NO, OYIEF) added 6 new ships to its future fleet in the last week. It will add four VLCC crude tankers on 15-year charters that will arrive in Q2 and Q3 of 2019. This is a market that is very bifurcated with newer ships earning premium rates. In fact, many customers will not use ships over 15-years old because of maintenance and higher fuel consumption. Both Frontline (FRO NO) and Scorpio Tankers (STNG) have addressed this on recent conference calls. The market has been oversupplied with ships in the last year. However, with scrap steel prices rising due to a stronger economy and weak demand for older ships, many more of those are being scrapped and are coming out of the world fleet. Ocean Yield has a charter agreement in place for these new VLCCs and its customer should be able to earn profitable business for itself and cover the charter it pays Ocean Yield.

Ocean Yield will also add two new drybulk carriers in March 2018 on a 12-year charter. This is a market that has been through years of oversupply, but that has been correcting since 2015 with consolidation of the industry, a lack of new orders on the books, more older vessels being scrapped, and rising demand for iron ore and steel. This further mitigates one of the risks we discussed at the time of our report when the company had no new ships scheduled to arrive. Actions this week boosts that backlog to nine ships.

More evidence of bricks-and-mortar's role in e-commerce

During the PepsiCo fourth quarter conference call, CEO Indra Nooyi discussed the rapidly changing retail channel environment. We found the following comments very interesting as it relates to our theme of traditional bricks-and-mortar stores maintaining a feature role in the future of retail.

> "Actually, the retail disruption is happening globally. It's not just a U.S. phenomenon. The success of the newly emerging retail channels is still a work in process because none of them have really established a toehold in the U.S. But between the hard discounters, e-commerce, e-commerce of every kind, the pure play, the click and collect, the growth of dollar stores from a few years ago and, of course, the brilliant growth of Walmart, all of this has caused the retail industry to go through a fairly significant change because we are overbuilt in grocery in the country, and all of these alternate channels are now beginning to challenge all the square footage in the marketplace. So we are watching and waiting to see whether this disruption is just a low level of disruption that happens over many years or is this going to accelerate. It's something that we are watching. The good news is that our DSD system reaches virtually any outlet that's out there, whether it's convenience store, foodservice, whether it's the big supermarkets or the big hypermarkets, we reach every one of them. So we are watching the traffic through these outlets. **We are watching what kinds of products are being sold, what are people buying through e-commerce and what are people buying through brick-and-mortar. And more importantly, we're looking to see whether brick-and-mortar stores are really becoming the warehouse to pick for e-commerce, which breathes more life into them. So this is a evolving story, Vivien. And the outlook is not perfectly clear because the economics of many of these new digital channels is still being thought through. It's not perfectly clear that they're all going to make money.**

> Internationally, we have much the same phenomenon. China, I think, is the cutting edge of digital sales in the grocery channel. We are seeing Europe now grow in terms of e-commerce and the hard discounters taking a much bigger presence there. And we're seeing the same thing in Latin America. So I think China and the U.S. are cutting edge in terms of retail disruption. And we're going to have to watch and see how it evolves in the other markets. And our teams are all connected globally and thinking through the best strategy for us to play in this new retail environment."

Earnings Quality Reviews

Kellogg (K)

Kellogg (K) reported earnings in-line with expectations in the 12/17 quarter. However, the company continues to struggle to report any growth in cash flow, as seen in the following table:

	12/31/2017	12/31/2016	12/31/2015
T12 Operating Cash Flow	$1,646	$1,628	$1,691
T12 Capex	$501	$507	$553
T12 Free Cash Flow	$1,145	$1,121	$1,138
T12 Dividends	$736	$716	$700
T12 Net Stock Repurchases	$419	$58	$470
T12 Div % of T12 FCF	**64.3%**	**63.9%**	**61.5%**

Management is calling for another year of flat cash flow growth in 2018. Comparable sales adjusted for currency fell by 2.6% in the year and 1.5% in the quarter.

K is definitely a company in turnaround mode. In 2017, it began a major shift in distribution by eliminating direct store delivery for all of its snack foods and moving its inventories directly into customer warehouses. This has resulted in an overnight decrease in price to reflect the lower level of service which is negatively impacting the top line. However, it is simultaneously realizing significant cost savings from the elimination of the related distribution infrastructure. This is a bold plan, but one fraught with risk. While this may be the future of retailing, in our mind it is just more evidence of the power shift from branded packaged goods products to their ever larger and more powerful retail customers.

K is stretching payables

Despite the lack of cash flow growth in recent years and projections for flat results in 2018, management made the comment in the conference call that it expects to enjoy long-term growth in cash flow boosted by "sustainable" working capital improvements. However, the company has already gone a long way in milking accounts payable, as seen in the following table:

	12/31/2017	12/31/2016	12/31/2015	12/31/2014
Sales	$12,923	$13,014	$13,525	$14,580
Accounts payable	$2,269	$2,014	$1,907	$1,528
Sales YOY growth	-0.7%	-3.8%	-7.2%	-1.4%
Accounts payable YOY growth	12.7%	5.6%	24.8%	6.7%
Accounts payable DSPs	**64.1**	**56.5**	**51.5**	**38.3**

Accounts payable days-of-sales have risen from 38 days to 64 in just the last three years. We recognize that the company may indeed be able to stretch payables further for another year or so. However, it is already taking more than two months to pay suppliers, and we question how much longer that can be stretched, particularly at the current pace.

Receivables jumped in the quarter

K's accounts receivable showed a noticeable spike in the 12/17 quarter:

	12/31/2017	9/30/2017	6/30/2017	3/31/2017	12/31/2016	9/30/2016
Sales	$3,209	$3,273	$3,187	$3,254	$3,097	$3,254
Accounts Receivable	$1,389	$1,512	$1,427	$1,464	$1,231	$1,523
Sales YOY growth	3.6%	0.6%	-2.5%	-4.2%	-1.4%	-2.3%
Accounts Rec. YOY growth	26.5%	-0.7%	-3.1%	-2.7%	-6.0%	4.5%
Sales Seq growth	-2.0%	2.7%	-2.1%	5.1%	-4.8%	-0.4%
Accounts Rec. Seq growth	-8.1%	6.0%	-2.5%	33.3%	-19.2%	3.4%
Accounts Receivable DSOs	**39.5**	**42.2**	**40.9**	**41.1**	**36.3**	**42.7**

K acquired RXBAR in October of 2017. The company disclosed that acquisitions added $90 million in sales for the quarter and accounted for the bulk of the reported increase in sales. If we assume the acquisition happened the last day of October, that scales to about $140 million of sales for the whole quarter. Assuming RXBAR carried a comparable amount of receivables as K relative to sales, that implies RXBAR had a receivables balance of about $60 million. If we adjust the DSO calculation for the 12/17 quarter to remove the $90 million in sales and the $60 million in receivables, it takes about a day off the result, which is still notably above the level of 36 in last year's fourth quarter. Inventories would have declined by 12% sequentially after the adjustment, but that is still a smaller decline than the 20%+ sequential declines seen in the 2016 and 2015 fourth quarters. Given the level of estimation and restructuring at the company, we take these numbers with a grain of salt. However, it does appear that the company did end 2017 with a higher than normal level of receivables that could be a drain on sales growth in the 3/18 quarter.

Depreciation and amortization declined in the quarter

K's depreciation and amortization expense can be volatile from quarter-to-quarter. However, the comparison was particularly favorable in the 12/17 quarter as shown below:

	12/31/2017	9/30/2017	6/30/2017	3/31/2017	12/31/2016	9/30/2016
Depreciation and amortization	$115	$126	$119	$121	$160	$106
Gross PPE	$9,366	$9,265	$9,143	$8,973	$8,849	$8,914
Net PPE	$3,716	$3,629	$3,613	$3,576	$3,569	$3,558
Intangibles	$2,639	$2,442	$2,423	$2,442	$2,369	$2,287
D&A to Gross PPE+Intangibles	**1.0%**	**1.1%**	**1.0%**	**1.1%**	**1.4%**	**0.9%**

Despite a gradual increase in both gross property plant and equipment (PPE) and intangibles, depreciation and amortization expense fell from $160 million in the 12/16 quarter to $115 million in the 12/17 quarter. This sequential decline added about $0.09 per share to reported EPS in the quarter. This could have been related to accelerated depreciation charges from the ongoing restructuring, or possibly the 12/16 acquisition of Parati in Brazil. If so, these would have been excluded from the company's adjusted EPS figures.

One of our main concerns surrounding restructuring is the possibility that a company takes an accelerated depreciation charge to write down an asset which is excluded in the adjusted earnings results, but then keeps the asset in service with reduced or no depreciation being charged against it. K has been restructuring for years and we know its changes to its direct store delivery started in 2017 which has resulted in the shutdown of multiple warehouses. However, it is interesting that both the company's gross and net property plant and equipment balances have continued to rise over time, and the percentage spread between the two has remained fairly constant. If assets were being removed from service, we would expect to see a decline in gross PPE. As is, it appears the company is adding/acquiring assets at a similar rate it is retiring them. It will also be worth reviewing the 10-K when released to see if there has been any change to the estimate of depreciable lives. The benefit to reported earnings seen in the 12/17 quarter from lower D&A cannot continue, and the trend should be monitored going forward for signs of more aggressive policies and asset write-downs.

Ongoing restructurings

K regularly reports sizeable "one-time" restructuring charges in its results which it then adds back to present a "comparable result" to investors. The below table shows that these amounts are both regular and very material in size relative to the adjusted EBITDA figures:

	12/31/2017	12/31/2016	12/31/2015	12/31/2014
Restructuring charges	$263	$325	$323	$298
Acquisition related expenses	$5.00	$10	$30	$43
EBITDA	$2,626	$2,512	$2,605	$2,622
% of Adjusted EBITDA	**10.2%**	**13.3%**	**13.6%**	**13.0%**

We found it interesting that during the conference call, management stated "we are completing the actions behind our ambitious Project K restructuring program while beginning plans on our next productivity opportunities." It sounds like an announcement quantifying the next round of restructuring charges is forthcoming. We would be pleasantly surprised to see the amounts of future charges significantly scaled down, as such large amounts always leave open the possibility that meaningful expenses that are operational in nature have been lumped into these charges, which leads to misleadingly high adjusted profitability.

PepsiCo (PEP)

PepsiCo (PEP) reported EPS in the 12/17 quarter that was essentially in-line with consensus estimates. However, like most branded consumer products companies, PEP continues to struggle with competition, a strengthening retail customer, rising raw materials costs and a rapidly changing retail landscape. While PEP reported that it is increasing its dividend by 15%, the 46th straight annual increase, dividend growth in the future will be more difficult to come by as cash flow simply is not posting meaningful sustainable growth.

Operating cash flow has not grown meaningfully in years

PEP is considered a "dividend aristocrat" given its long history of dividend growth. In the last five years, the company's annual dividend growth rate has topped 8%. However, as the following table shows, this has been entirely driven by an increasing free cash flow payout ratio:

	12/31/2017	12/31/2016	12/31/2015	12/31/2014	12/31/2013
T12 Operating Cash Flow	$9,994	$10,673	$10,580	$10,506	$9,688
T12 Capex	$2,969	$3,040	$2,758	$2,859	$2,795
T12 Free Cash Flow	$7,025	$7,633	$7,822	$7,647	$6,893
T12 Dividends	$4,472	$4,227	$4,040	$3,730	$3,434
T12 Net Stock Repurchases	$1,688	$2,672	$4,368	$4,153	$1,768
T12 Div % of T12 FCF	**63.7%**	**55.4%**	**51.6%**	**48.8%**	**49.8%**

Cash flow from operations declined in 2017, which the company attributed to higher cash tax payments and negative working capital impacts from higher payments to suppliers and customers, partially offset by lower pension and retiree health benefit contributions. This is not expected to improve much in 2018. Management forecast operating cash flow of $9 billion for next year, which does include a $1.4 billion one-time pension payment. Even adjusting for the pension payment, operating cash flow of $10.4 billion is still below levels reported from 2014-2016.

Capital spending is also expected to jump to $3.6 billion in 2018 as the company is accelerating some of its capital plans. This implies free cash flow of $5.4 million next year. Even a pension charge-adjusted free cash flow number of $6.8 billion is well below trend.

Nevertheless, the company is boosting its return to shareholders this year given the increased flexibility to move cash around the world courtesy of tax reform. It plans to return $7 billion to shareholders in 2018 with $5 billion in dividend and $2 billion in buybacks. However, the 15% increase in the dividend should not be expected to continue. When asked about dividend growth trajectory in the conference call, the CFO responded:

> "In terms of our projections going forward on dividend and share repurchase, **with this 15% announcement, you've seen the payout ratio go up a little bit. I think that's likely where we're to maintain. This is not a signal of a longer-term increase in the payout ratio over time.** So we talk about dividends once a year, every year. I'm not going to talk about specifically what'll happen going forward. But I think what you

> see is just a modest uptick in the payout ratio. Beyond that, we'll see what happens as we get beyond 2018 regarding where the cash goes and what we do with it."

While management still has room to grow the dividend by expanding the free cash flow payout, at almost 65% and rising, the room is running out. Some room may be freed up after the accelerated capital plan in 2018 passes but in general, dividend growth is soon going to be limited to the growth in free cash flow, which the table above shows has been essentially nonexistent in recent years.

Also, despite management's claim that cash flow was hurt by higher payments to vendors, accounts payable has actually been on the rise. The following table shows accounts payable days of sales for the last four years:

	12/31/2017	12/31/2016	12/31/2015	12/31/2014
Sales	$63,525	$62,799	$63,056	$66,683
Accounts payable	$6,727	$6,158	$5,546	$5,127
Sales YOY growth	1.2%	-0.4%	-5.4%	0.4%
Accounts payable YOY growth	9.2%	11.0%	8.2%	10.7%
Accounts payable DSPs	**38.7**	**35.8**	**32.1**	**28.1**

Like most consumer products companies we look at, PEP is putting the pressure on its suppliers to boost cash flows. Accounts payable balances have outpaced sales growth for the last several years by a sizeable margin. Mondelez (MDLZ) and Kraft-Heinz (KHC) had fourth quarter days-payable numbers of 75 and 55, respectively, implying PEP may have more room to lean here. Still, this should be monitored going forward as it is an important source of cash flow growth.

Inventories jumped in the 12/17 quarter

Continuing on the subject of working capital, PEP's inventories jumped by almost two days over the year-ago period:

	12/31/2017	9/30/2017	6/30/2017	3/31/2017	12/31/2016	9/30/2016
COGS	$9,077	$7,366	$7,056	$5,286	$8,944	$7,284
Inventory	$2,947	$3,251	$3,612	$3,282	$2,723	$3,120
COGS YOY growth	1.5%	1.1%	3.3%	2.6%	5.4%	-2.8%
Inventory YOY growth	8.2%	4.2%	3.6%	2.0%	0.1%	-0.1%
COGS Seq growth	23.2%	4.4%	33.5%	-40.9%	22.8%	6.6%
Inventory Seq growth	-9.4%	-10.0%	10.1%	20.5%	-12.7%	-10.5%
Inventory DSIs	***29.6***	***40.3***	***46.7***	***56.7***	***27.8***	***39.1***

While a two-day increase is not especially large, it is out-of-trend for a company which typically does not show much fluctuation in its inventory days. Obviously, the company's inventories have a very limited shelf-life and would have to be discounted and moved quickly. With PEP's gross margin already under pressure, it hardly needs anything else putting pressure on prices.

Recurring one-time charges

Like most other consumer products companies, PEP seems to be in a perpetual state of restructuring. While its charges are not as large as Kraft-Heinz, P&G and Mondelez, it nonetheless does take regular charges that it adds back to its "core earnings" for investors.

	12/31/2017	12/31/2016	12/31/2015	12/31/2014	12/31/2013
Restructuring charges and write-offs	$295	$160	$169	$357	$53
EBITDA	$13,158	$12,761	$12,480	$12,938	$12,724
% of Adjusted EBITDA	**2.2%**	**1.3%**	**1.4%**	**2.8%**	**0.4%**

Note that the above amounts are for restructuring activities only and do not include other unusual amounts such as pension charges and write-downs of its Tingyi investments and impairment of its Venezuelan assets.

The company recently expanded its 2014 Productivity Plan through 2019 and is projecting charges of $254 million and $17 million in 2018 and 2019, respectively. Given the pattern, we fully expect a new plan or a further expansion to be announced in the next few quarters. As we already noted, PEP's charges are not as large as some of its peers, but any ongoing restructuring plan call into question the quality of the charge adjusted earnings amounts. We will be concerned if the next plan is larger is larger in scope.

One-time gain in the "core"

PEP took some heat in the 12/17 conference call for not excluding from its "core" profit figures its one-time gains from the refranchising of bottling operations in Jordan in the fourth quarter and the gain from its sale of its minority stake in Britvic in the second quarter. These added about 15 cents to EPS for the year. Management' defense was that these benefits were essentially more than offset by a 53rd week of sales in the previous year, incremental investments, and the impact of the hurricane. While this may be true, the amount of a one-time gain is very specific and is traditionally excluded from such adjusted earnings figures. We believe it would have been more appropriate to exclude the gains from the core profit amount and simply disclosed the amounts of the other items as an aside.

Disclosure

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