

WE STAND OUT



THE PEPSI BOTTLING GROUP

ANNUAL REPORT 2001

WE SELL SODA

OUR MISSION

We have absolute clarity around what we do:

We Sell Soda.

We commit ourselves to these operating principles:

Rules of the Road

1. Drive Local Market Success.
2. Act Now. Do It Today. Get Results.
3. Set Targets. Keep Score. Win.
4. Respect Each Other.

Our success will ensure:

- Customers Build Their Business.
- Employees Build Their Futures.
- Shareholders Build Their Wealth.

ON THE COVER

This glowing sign, which contains more than 14,000 individual light fibers connected by 20 miles of fiber length, lights up the side of SAFECO Field in Seattle, Washington. It was a "partnership gift" from the Seattle Mariners to The Pepsi Bottling Group, in recognition of our sponsorship of the team.

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Financial Highlights

\$ in millions, except per share data

	2001 ⁽¹⁾	2000 ⁽¹⁾	1999 ⁽¹⁾
Net Revenues	\$ 8,443	\$ 7,982	\$ 7,505
Operating Income ⁽²⁾	\$ 676	\$ 590	\$ 396
EBITDA ⁽²⁾	\$ 1,190	\$ 1,061	\$ 901
EPS ⁽²⁾⁽³⁾⁽⁴⁾⁽⁶⁾	\$ 1.03	\$ 0.77	\$ 0.35
Operating Free Cash Flow ⁽⁵⁾	\$ 295	\$ 273	\$ 161

(1) Fiscal years 2001 and 1999 consisted of 52 weeks while fiscal year 2000 consisted of 53 weeks.

(2) Excludes the impact of unusual impairment and other charges and credits.

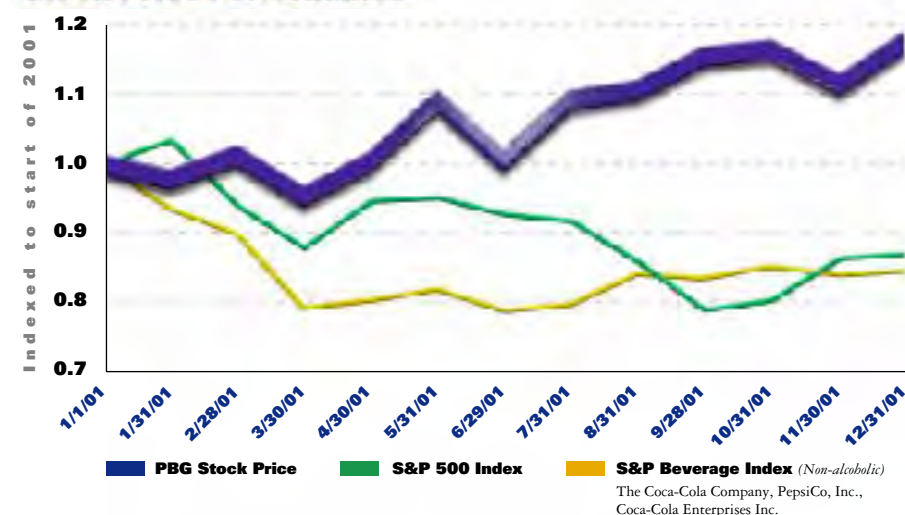
(3) Fiscal year 1999 reflects the impact of our initial public offering of 100 million shares of common stock on March 31, 1999 as if the shares were outstanding during the entire period presented.

(4) Fiscal years 2000 and 1999 EPS have been restated to reflect our 2001 two-for-one stock split.

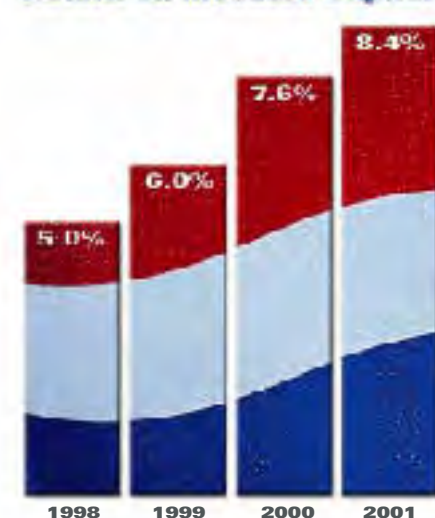
(5) Operating Free Cash Flow is defined as net cash provided by operations less net cash used for investments, excluding cash used for acquisitions.

(6) Fiscal year 2001 includes Canada tax law change benefits of \$0.08 per share.

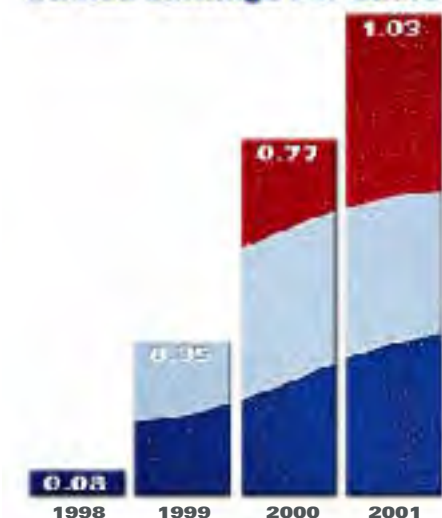
Stock Price Performance



Return on Invested Capital



Diluted Earnings Per Share



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ear Fellow Shareholders,
Customers and PBG Employees,

For the people of The Pepsi Bottling Group, 2001 was another banner year. We stood out with an exceptional brand portfolio, a powerful focus on execution, a clear go-to-market strategy, and a unique business model.

As we approach our third anniversary, we are very pleased to add a new list of outstanding accomplishments to the impressive results we achieved during our first two years of operation. In 2001, we:

- Capitalized on innovation after innovation, including Mountain Dew Code Red, SoBe brands, Pepsi Twist and Diet Sierra Mist, and new packaging for Aquafina.
- Continued to excel through execution, day in and day out, customer by customer, and account by account.
- Posted double-digit earnings growth each quarter, bringing the total to 12 consecutive quarters we have done so.
- Grew net revenue per case by 5% in the U.S. Earnings per share were \$0.95, excluding a one-time tax benefit of \$0.08.
- Recorded significant increases in our stock price, which has climbed more than 100% since our Initial Public Offering.
- Made our debut on the Standard and Poor's 500 list and the Fortune 500 list.
- Were delighted to be honored as Company of the Year by Beverage Marketing Corporation and *Beverage World* magazine.



Craig Weatherup and John Cahill

Our performance has been consistent and sustained. We are very proud of our continuing success.

The Year in Review

In 2001, our new product and package introductions contributed significantly to our results. Those innovations, coupled with the power of our direct store delivery system, were an unbeatable combination. We have the ability to move products virtually overnight and virtually everywhere – something that very few companies can do. In a year where we rolled out more innovations across our system than we have in the past decade, we proved once again that we are truly a selling and distribution machine.

PBG is poised to capitalize on the opportunities in our industry. The growth of colas has slowed, but consumer demand

for non-carbs and flavors is growing rapidly, and PBG is growing with it. Our broad product offering offers something for every taste, and leaves no question that we are definitely in the “sweet spot” for continuing growth.

Selling soda is all about location, location, location and we did a superb job in 2001 of adding new “real estate” for all our products in our customer accounts. In food stores, we added lobby space, expanded our end-cap presence, and penetrated the perimeter of stores, where many of our consumers do all their shopping. Our number of displays and our display inventory grew by double digits. In convenience and gas stores, we leveraged our market share leadership to increase our space in the

cold vault. Total cold drink growth results for both grocery and convenience and gas were also up double digits.

Our international operations continued to post gains. In Canada, we had significant increases in both volume and profit, and we applied great discipline to cost, resulting in a very balanced performance. Our business in Russia is essentially breaking even, years ahead of what we initially forecasted. We are very pleased with the consistency of growth in all our international businesses and with their contributions to our overall results.

Our outstanding operating performance led to significant investments in our business – in cold drink equipment, new capacity for our plants and warehouses, new fleet assets, and recruiting and hiring to ensure we’re developing tomorrow’s leaders today. After making these investments, our operating free cash flow was \$295 million dollars in 2001, up \$22 million from 2000. This strong cash position enabled us to invest in share repurchases and territory acquisitions.

We acquire other bottlers when we determine we can add value by leveraging our capability, our systems, and our infrastructure. In 2001, we added two bottlers to our operations – in Redding, California and Elmira, New York; and we announced our intent to purchase the Pepsi bottler in Macon, Georgia. As we integrate these operations with our existing ones, we can serve our customers more effectively and efficiently. We’re also examining a number of other domestic and international possibilities, and where the business case is strong and the price fits within our financial parameters, PBG will continue to make acquisitions that extend our reach.

In 2001, our stock split two-for-one, reflecting our confidence in the future and the tremendous growth in our stock price since our IPO. We also repurchased 11.8 million shares of our common stock, bringing the total number of shares repurchased to more than 31 million since we began our stock buy back program in October 1999.

Beyond their execution in the marketplace, our people also stood out in 2001 by giving back to the communities where we live and work. These volunteer and contribution efforts took place not only in the aftermath of September 11, but throughout the year wherever our employees saw an opportunity to make a difference to people and organizations that needed help. We are proud to be associated with such caring colleagues.

The Next Horizon

Our vision for the future is centered on driving growth for our customers. We start by providing the products, both old favorites and new offerings, to satisfy every consumer taste and to meet the needs of today’s “on-the-go” lifestyles through more package choices. Providing what our consumers want drives our customers’ businesses. We also focus on finding balance between consumer value and the right price, market by market. We will continue to bring strategic insights about the power of the category to our customers, design account-specific programs for them, and ensure they benefit from all the advantages of our direct store delivery system. And we are always aiming higher. We want to be even more responsive to our customers’ needs.

In 2002, we are making a significant investment to increase our already strong selling capability. Quite simply, we want

to be the most customer-focused, best sales company in our industry. We know that goal is within our reach. The reason is the people of PBG. They are talented, dedicated and committed to this business. Although our employees are diverse in many ways, they have a few things in common. The first is the clarity we all have about why we are in business. We sell soda. We help our customers sell soda. And we are all linked to those selling efforts, no matter what our job is. The second is we are very competitive. We love to win. But we hate to lose even more.

Finally, our partnership with PepsiCo grows stronger each year. They are committed to lead the industry in innovation, and, for our part, we’re committed to deliver the best results of any bottler in the industry. There is tremendous power in the synergy of our relationship, which helps to fuel our continuing success and results in positive benefits for the shareholders of both companies.

Our goal is to continue to stand out – as an industry leader, as a business partner, as an employer, as a good neighbor, and as an excellent choice for investors. We look forward to continued growth and the bright future we see ahead – for The Pepsi Bottling Group and for all of you who own a piece of this exciting business.

Craig E. Weatherup
Chairman of the Board

John T. Cahill
Chief Executive Officer

WE IMEAN BUSINESS

The future of PBG is all about profitable growth – our own and that of our customers. A healthy, growing beverage category for our accounts translates to a solid future for PBG and strong returns for our shareholders. Our customers know that we mean business – more and better business, for all of us.



Bob Matan, Service Technician, uses the new e-Pad, a small computer that expedites vending equipment service by eliminating paper work and locating the closest available technician. Technicians using e-Pad made 16 percent more service calls per day than they did without this tool in 2000, effectively balancing productivity with improved service.

From the largest supermarkets to the smallest independent businesses, our customers are our conduit into the homes – and the lives – of consumers. That's why our sales teams enter every account with an eye toward growing it.

The PBG-customer relationship flourished in 2001. It was a year in which we continued to improve service by stepping up merchandising standards, maximizing our products and promotions to increase sales, and using state-of-the-art technology to better manage marketplace demand and our customers' inventory.

We focused our organization on tailoring programs to individual accounts, targeting underdeveloped markets, and driving Pepsi brand sales by linking our marketing efforts to local communities and their activities. Our sales teams were coached and trained to use "fact-based" selling, based on specific store sales, and consumer and category data.

We applied our best manufacturing practices in our overseas operations to improve cost control, and we introduced our international markets to some favorite U.S. brands.

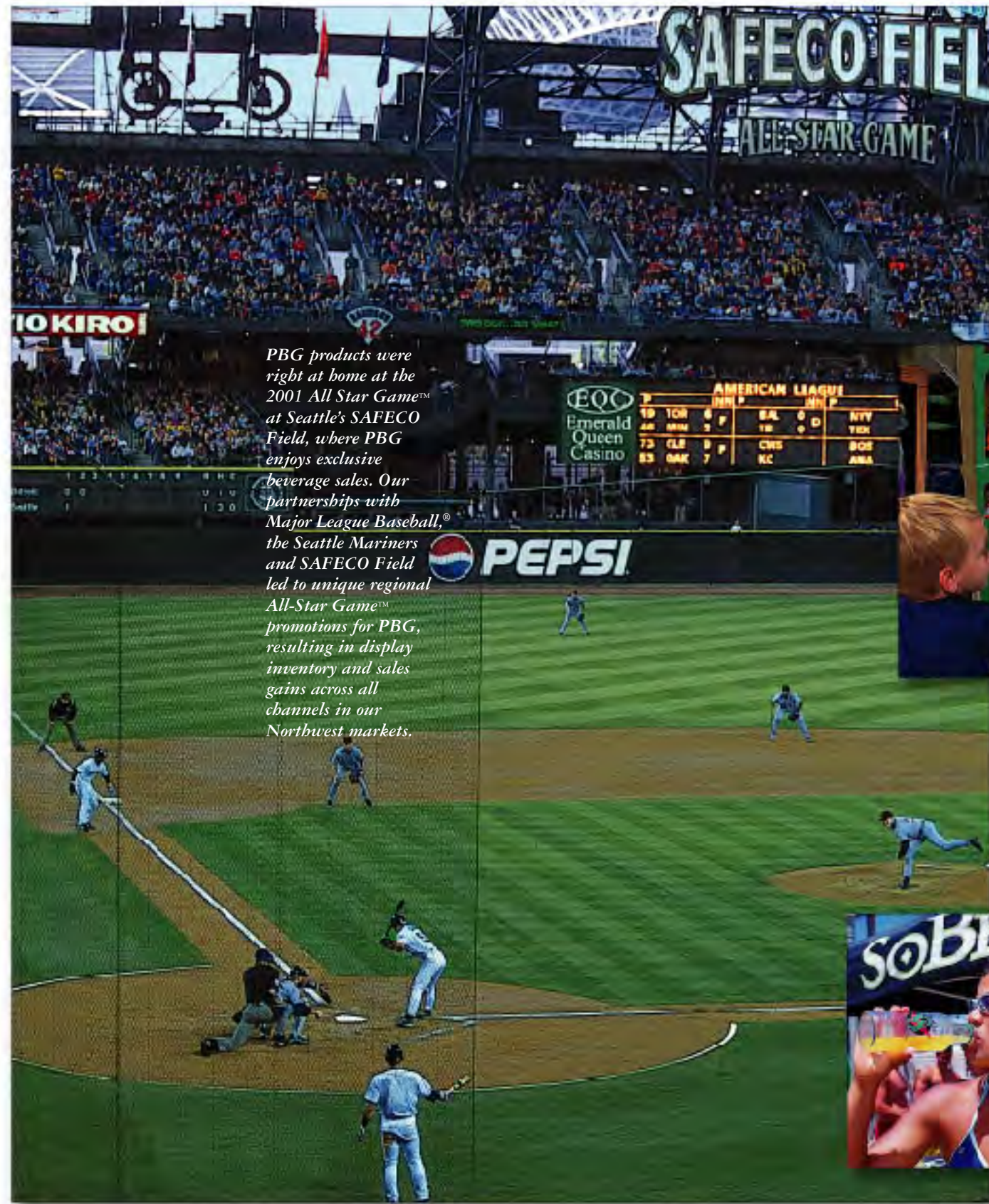
We, along with our business partners, also benefited from an unprecedented stream of new products flowing from the Pepsi-Cola pipeline, through the PBG system, and onto store shelves. Equipped with all the right plans, people, products and tools, we set out in 2001 to grow the business, and we did.

Our customers reaped the benefits of numerous new product introductions in 2001, including Mountain Dew Code Red.



PBG Customer Representative Scott Hunter shares ideas with Mike Van Alstine, the manager of Bashas, an independent grocery chain in Arizona, about opportunities to grow the store's beverage business.

PEPSI WE HIT HOME



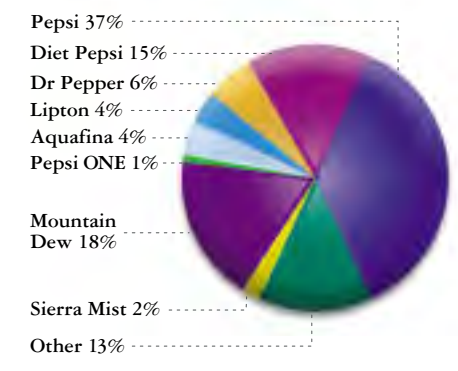
PBG products were right at home at the 2001 All Star Game™ at Seattle's SAFECO Field, where PBG enjoys exclusive beverage sales. Our partnerships with Major League Baseball®, the Seattle Mariners and SAFECO Field led to unique regional All-Star Game™ promotions for PBG, resulting in display inventory and sales gains across all channels in our Northwest markets.

Providing the right beverage at the right time is the name of our game. In 2001, we truly hit home with consumers, offering them more choices than ever from the broadest beverage portfolio in Pepsi history.

We began 2001 as we begin every year: selling some of the most frequently purchased items in supermarkets, and many of the biggest sellers and profit drivers in convenience stores. Trademark Pepsi products, along with powerhouse Mountain Dew, Sierra Mist, FruitWorks, and market leaders Lipton Iced Tea, Frappuccino, and Aquafina already provided "something for everyone." But customers and consumers have always looked to Pepsi for product innovation and excitement, and in 2001, they got a healthy dose of both.

This was the year that Pepsi invention and brand acquisition armed PBG with leading products in every one of the fastest-growing beverage categories. Cherry-flavored Mountain Dew Code Red took its place among "Flavor Carbonated Soft Drinks (CSDs)," a category growing more than triple the rate of colas. In an "extreme"-style launch that exceeded expectations, single-serve Code Red joined the top 10-selling stock keeping units (SKUs) in the convenience and gas (C&G) channel almost as soon as it hit the shelves. Success in take-home packaging followed.

U.S. Brand Mix
percent by volume 2001



PepsiCo's acquisition of SoBe led to PBG's integration of this leading line of Healthy Refreshment Beverages, one of the fastest-growing non-carbonated beverage categories in the C&G channel, into our portfolio. The dynamic duo of Mountain Dew AMP, launched in October, and SoBe's Adrenaline Rush gave us share leadership in the highly profitable Energy Drink category, also growing at a "caffeinated" pace. The Dole brand single-serve line of juices, a powerful player in the juice segment, joined the PBG lineup as well.

Lemon-spiked Pepsi Twist and its diet version were introduced in 2001, and are making headway toward reinvigorating the enormous but slower-growing cola category. Meanwhile, Aquafina bottled water has continued to evolve into the category leader and a household name.

We didn't just hit home in 2001; we covered all the beverage bases and hit some big home runs. The year 2002 promises to bring even more sluggers up to the plate.



In spite of the slowing growth of the cola category, trademark Pepsi products still have some of the highest household penetration of any consumer packaged goods brands in the supermarket channel.



Exceptionally broad product variety ensures that PBG can "hit the spot" with consumers of all ages and lifestyles. Here, a beach volleyball player enjoys an ice-cold SoBe beverage.

WE MOVE MOUNTAINS

Transforming a product into a household name takes a combination of systematic distribution, product promotion, merchandising, and, over time, brand-building. The foundation for all of these efforts is a powerful operational infrastructure capable of moving mountains of product smoothly and efficiently, from the production floor and into our accounts every day.

As one of the largest bottling companies in the world, in 2001 PBG produced and sold well over a billion physical cases of beverages. The introduction of numerous new products and packages added dozens of SKUs to our product inventory, and brought a new level of complexity to every area of the business. Few bottling companies would be up to the task of handling this explosion of product variety and SKUs, yet PBG absorbed the innovation stream seamlessly and profitably. In North America, manufacturing and warehousing labor productivity continued to improve, bottle line efficiencies rose, and profitability climbed.

Technology was a great enabler for innovation in 2001, for both production and sales. On the manufacturing side, we installed additional high-tech, high-speed fillers to accommodate the growing number of different products and packages.

	U.S.	Outside the U.S.	Total
NUMBER OF PLANTS	49	21	70
NUMBER OF DISTRIBUTION CENTERS	255	73	328
PERCENTAGE OF PBG VOLUME	79%	21%	100%

The Pepsi Bottling Group, Inc. is the world's largest manufacturer, seller and distributor of carbonated and non-carbonated Pepsi-Cola beverages.

The SoBe Love Bus introduced thousands of consumers across PBG markets to the brand's extensive, cutting-edge flavor lineup. Here, the bus visits Hollywood Hills.



Sophisticated software redesigned hundreds of PBG routes in 2001, giving our sales representatives more time to spend with customers.

In sales, using sophisticated software, our engineers analyzed sales call data and local geography to redesign hundreds of sales routes. The resulting routes gave our sales representatives more time with their customers to plan and grow the business, and less time on the road. The year 2001 also marked the initial roll-out of our new "e-Pad," a sophisticated hand-held computer that supports our growing vending business by enabling us to provide service "on-demand," and eliminating paperwork. We will take the e-Pad nationwide in 2002.



The introduction of Mountain Dew Code Red was the most successful new product launch in CSD history, in terms of brand recognition and sales and share results. Demand for the product was immediately huge.

PEPSICO WE THINK BIG



The Phoenix Zoo signed a multi-year total beverage agreement with PBG that includes bottles-to-go and vending service throughout the park.

For PBG, thinking big means thinking in terms of both greater marketplace presence and more points of distribution, including placing our beverages in the old, familiar places, and in some unconventional venues.

For our products to remain “top of mind,” they need to be visible, displayed with high impact, and strategically placed within easy reach of thirsty consumers. In 2001, our North America markets took full advantage of national promotions linked to NCAA Basketball, Major League Baseball, NASCAR racing, and Major League Soccer, and capitalized on big-name movie tie-ins such as *Tomb Raider* and *Monsters, Inc.* to create large, exciting lobby and end-cap displays. Our displays enlivened our accounts and attracted consumers. To pick up incremental sales, we placed perimeter racks and register coolers at an aggressive pace in 2001, putting our products in the natural path of household shoppers.

Our big thinking led to big results. We had more total product inventory on display in large format accounts and a greater number of individual displays than our competition, even in markets where PBG is not the market share leader. Simply put, our in-store execution led the industry in 2001.

PBG's inventory on display, a key measure of our marketplace execution, grew in the double digits in 2001, outpacing our competitors.



The Pepsi All Star Challenge promotion tied our products to the nation's favorite pastime and sports heroes, providing a perfect centerpiece for large summertime displays.

By providing consumers with take-home packages of some of our biggest sellers, we made those products even bigger. For Aquafina, we offered a new 6-pack 24-ounce package, and 6-pack half-liter options that helped grow household penetration and contributed to the product's 40 percent growth in 2001. We also launched a variety of take-home packages for the new hot shot Mountain Dew Code Red, taking the product from “on-the-road” consumption into the home.

For the third consecutive year, PBG invested more than \$250 million in cold drink equipment for our markets. In shopping malls, sports arenas, casinos, movie theatres, campus student centers, and retail outlets, our strategic equipment placements contributed to the continuing growth of our U.S. cold drink volume in 2001.

WE DRAW CROWDS

Often the key to reaching consumers is to reach out to them, going beyond the boundaries of the supermarket or local convenience store, to where they work, study and play. The right “grass roots” marketing efforts have the power to draw crowds, to win new drinkers, and then to generate sales.

By developing locally driven marketing efforts that bring our products to the people who are most likely to drink them, PBG encourages consumers to try new beverages, or to think about our flagship brands in a fresh light. Particularly with new products, our first field marketing efforts often revolve around matching our products to the lifestyle, preferences and interests of segmented consumer audiences. The next step is drawing the attention of those potential consumers, to begin building product awareness and brand recognition.

One sip at a sampling event is all it took to win over these Arizona State college students to Mountain Dew AMP, Pepsi's new entry in the highly profitable Energy Drink category.



Sometimes grabbing the category requires grabbing center stage. The Pepsi Challenge was set up in selected high-traffic venues in 2001, where thousands of people were able to take the famous taste test.

Consumers are showing a growing taste for non-carbonated beverages, particularly bottled water, Healthy Refreshment Beverages, and Energy Drinks. So in 2001, we brought our leading products in those categories to where we knew our consumers would be. The SoBe Love Bus became the centerpiece for sampling events at beaches, parks and youth events, where thousands of consumers tried the distinctive, cutting-edge lineup for the first time. On college campuses, cold Mountain Dew AMP sampling events received a very warm reception among students.

We also enlisted the Mountain Dew Jeep and the Lipton Prowler – trendy, heavily branded vehicles – to generate interest and bring beverage excitement to carefully selected locations. And we once again challenged consumers to take our famous blind taste test by putting the Pepsi Challenge where the booths would draw the most participation. We challenged the competition in venues across the U.S., from an Oregon balloon festival, to a Texas rodeo, to a Massachusetts rock concert.



You gotta love the SoBe Love Bus. The graphics and music alone are enough to arouse curiosity. Add to that free samples of more than a dozen different flavors and the chance to win tee-shirts, stickers and other logo-wear, and the brand-recognition process begins.



WE OPEN DOORS



PBG Urban Development Reps Jorge Quijada (far left) and Anthony Vargas (center) have worked with Sam Marogil (right), owner of the In & Out Mini-Market, to grow her business by introducing the right products and packages for her on-the-go customers.

When we bring our products and our marketing muscle into urban and ethnic communities and low-share markets, we open doors to profitable category expansion for PBG and for local business owners. Beginning in 2000,

PBG's Key Account Manager Bill Brewer (left) worked with Robert Ortiz (right) of Food City to develop a custom promotion tied to TamaleFest, a month-long festival celebrated by Mr. Ortiz's Latino customers.



The Packing House, an independently owned grocery in South Dallas, grew its Pepsi beverage business by more than 70 percent in 2001 as part of PBG's Urban Market Development Program. This mural was painted by PBG at the request of the store's owner, a long-time cowboy who serves a rodeo-loving community.

we turned our attention to the independent groceries, "mom and pop" shops and other small format outlets that are central to urban culture and the mainstays of some of the fastest-growing consumer groups in North America. Our efforts include targeted advertising, the development of special exterior signage and point-of-purchase materials, and beverage category management aimed at maximum growth.

The first set of urban markets we targeted in 2000, including Detroit and parts of Los Angeles, achieved remarkable beverage sales growth in the first year of our efforts. In 2001, we focused on additional underdeveloped markets, many urban and some low-share. Again, the payoff was strong for both PBG and our customers. Many of the markets added to the program in 2001 experienced high double-digit volume growth. Across all of our 24 targeted urban markets, average Pepsi brand sales volume grew nearly 10 percent versus 2000, while revenue grew more than 20 percent.

While the strength of our brands is an asset to any small business, more power lies in PBG's ability to market those brands to specific consumer groups and communities. National and account-specific promotions are tailored to each market and are often linked to community cultural and social events. Our consumer research tells us the kinds of beverages preferred by different ethnic, age and socio-economic groups – and helps us provide the right beverage lineup and growth strategy for each account.

When we cater to the taste preferences, interests and needs of a community, we win the loyalty and sales of its members and leaders. And when we help small independent businesses prosper and grow, we give back to the community in ways that go beyond our beverages.



PBG continues to raise the bar for product quality and value, manufacturing and logistics, merchandising standards, and service. We aim higher in both established PBG markets and in newly acquired ones – because the nature of our industry demands it, and because it is what we expect of ourselves.

PBG drives for constant improvement at every point of our supply chain. We measure the elements of our business for efficiency, speed and quality, and search for ways to improve the end results. In 2001, we made measurable differences across the board, but we also initiated some dramatic upswings in markets that most needed to make gains.



Productivity and efficiency gains in our Russia facilities enabled 65 percent volume growth with minimal capital investments. Our Aqua Minerale brand, pictured here, is the leading bottled water in Russia.

One market in particular is Toronto, where manufacturing efficiencies resulted in reduced costs, while at the same time we invested in growing an underdeveloped small format channel. With the conversion of accounts to a “pre-sell” system and the addition of more “feet on the street,” our Toronto sales force signed on one new account after another. As a result, small format channel growth was nearly seven percent versus 2000, significantly higher than the growth of the overall Toronto market.

Another example is our Russia market, where the application of our best North American manufacturing and logistics practices resulted in dramatic improvements in efficiency, productivity and



PBG Toronto employee Jan Mikolajczyk watches the panel of the plant's new seamer, one of the many investments made in 2001 to improve performance at the Toronto manufacturing facility. While waste was reduced, output grew 15 and 10 percent on our Toronto can and bottle lines, respectively.

bottom line results. Those inroads enabled us to manage more than 65 percent volume and profitability growth in that market with minimal capital investments.

When we look at potential acquisitions, we consider businesses that offer similar opportunities for improvement and are priced right. Attractive bottling acquisitions are also those that are fundamentally sound, where we can add value to the existing business with our best practices, strategic investments, and the economies of scale brought by the sheer size of our company. We evaluate them judiciously – Pepsi-Cola Bottling of Northern California and the Pepsi-Cola Elmira Bottling Co., Inc. in upstate New York, were acquired in 2001.



Toronto's CN Tower, the center of the city's communications and a major tourist attraction, recently signed a three-year renewal agreement with PBG. PBG's focus in Toronto on signing and serving one account after another has resulted in significant marketplace gains.

WE ARE IT TRUE BLUE



Key Account Manager Vernon Stanfield has more than 40 years on the job, during which he has also become a community leader, involved with the NAACP and the Urban League. He is most proud of PBG's community outreach efforts, including the company's locally sponsored scholarships and internships.

Janet Faust, Marketing Manager from PBG's Great West Business Unit, is a 10-year Pepsi veteran. "I love the pace of this company," she says, "and the constant challenge of being both proactive, and reactive to the competition. I feel like I have Pepsi blue blood in my veins."



The Stars and Stripes hang boldly from PBG's Phoenix facility. The oversized flag has received an enthusiastic response from local community members and drivers on the adjacent highway.



Ernie Ruiz is a loyal 40-year Pepsi employee responsible for delivering CO₂ to PBG fountain accounts. His timely deliveries ensure that his customers' pop has just the right amount of fizz.

The 40,000 PBG employees in the U.S., Canada, Spain, Greece and Russia account for much more than their respective on-the-job functions – they are ambassadors of our brands and true-blue representatives of our company. They are community members, Pepsi brand consumers, and PBG shareholders. A substantial proportion of them has decades of on-the-job Pepsi experience. They wouldn't think of drinking or selling anything else.

The business of refreshment beverages cuts across all social, economic, racial and ethnic groups. Appropriately, so does our employee population. In 2001, we increased diversity among our front line and management teams, improved retention of diverse employees, and provided our entire workforce with formal training on diversity issues in the workplace. Our efforts in these areas are diligent, focused and ongoing.

What will always unite PBG employees is their pride in the brands they make and sell, and their overall spirit, patriotism and compassion. These qualities certainly did shine in 2001. In the wake of world events, PBG employees gave hundreds of

thousands of dollars to the Red Cross and the United Way for recovery initiatives. Our operations with close proximity to New York, Washington, D.C. and Pennsylvania supported efforts at Ground Zero, the Pentagon, military facilities and recovery sites with volunteer manpower and product donations. Across the nation, employees reached out through blood drives, fundraising efforts, and even a "Teddy Bear Drive" for victims' children. In support of their U.S. colleagues, employees in Russia conducted their own Red Cross drive.

The PBG "give-back" process was formalized in 2001 with the expanded scope of the PBG Foundation, that sets aside company resources to support our employees' outpouring of generosity. Part of the Foundation's mission is to match what our employees give, whether it's volunteer time or money.

To their local communities and markets, PBG people are the face – and the heart – of the Pepsi brands. While that's hard to measure, it is one of our greatest assets and a big competitive advantage.

WE SEE THE FUTURE

The dynamics of our industry are all evolving: the demographics and preferences of our consumers, the needs of our customers, the competitive issues, and the technology and work-force necessary to support and run the business.

We see the future, and we are ready for it. To manage the anticipated stream of product and packaging innovation, we are investing in greater production capacity and more efficient manufacturing and warehousing technology. State-of-the-art filters installed in more of our plants will help us meet the increasing demand for Aquafina, while additional high-speed fillers, slated for five U.S. facilities in 2002, will bring greater cost efficiency to the production of our growing number of PET packages. The next version of hand-held computers will also roll across PBG in 2002, providing our sales force and our customers with real-time information for advanced planning and more effective inventory management.



Aquafina will be a major growth engine for PBG going forward. The brand is growing three times the rate of the bottled water industry, in part due to the addition of take-home multi-packs in 2001 and expanding household penetration.

Through innovative recruitment and retention programs, the composition of our workforce will evolve to reflect our increasingly diverse consumers and customers. Employees who bring diverse experiences and backgrounds are indispensable for a company that develops targeted sales and marketing efforts.

Because PBG's long-term viability depends on the development of our future leadership, we now have an aggressive college campus



Additional high-speed fillers will add production capacity while lowering manufacturing costs for PBG. In PBG's Albany, New York plant, this filler can add up to 13,000,000 cases a year to existing capacity, and has reduced "go-to-market" costs and "out-of-stock" occurrences.

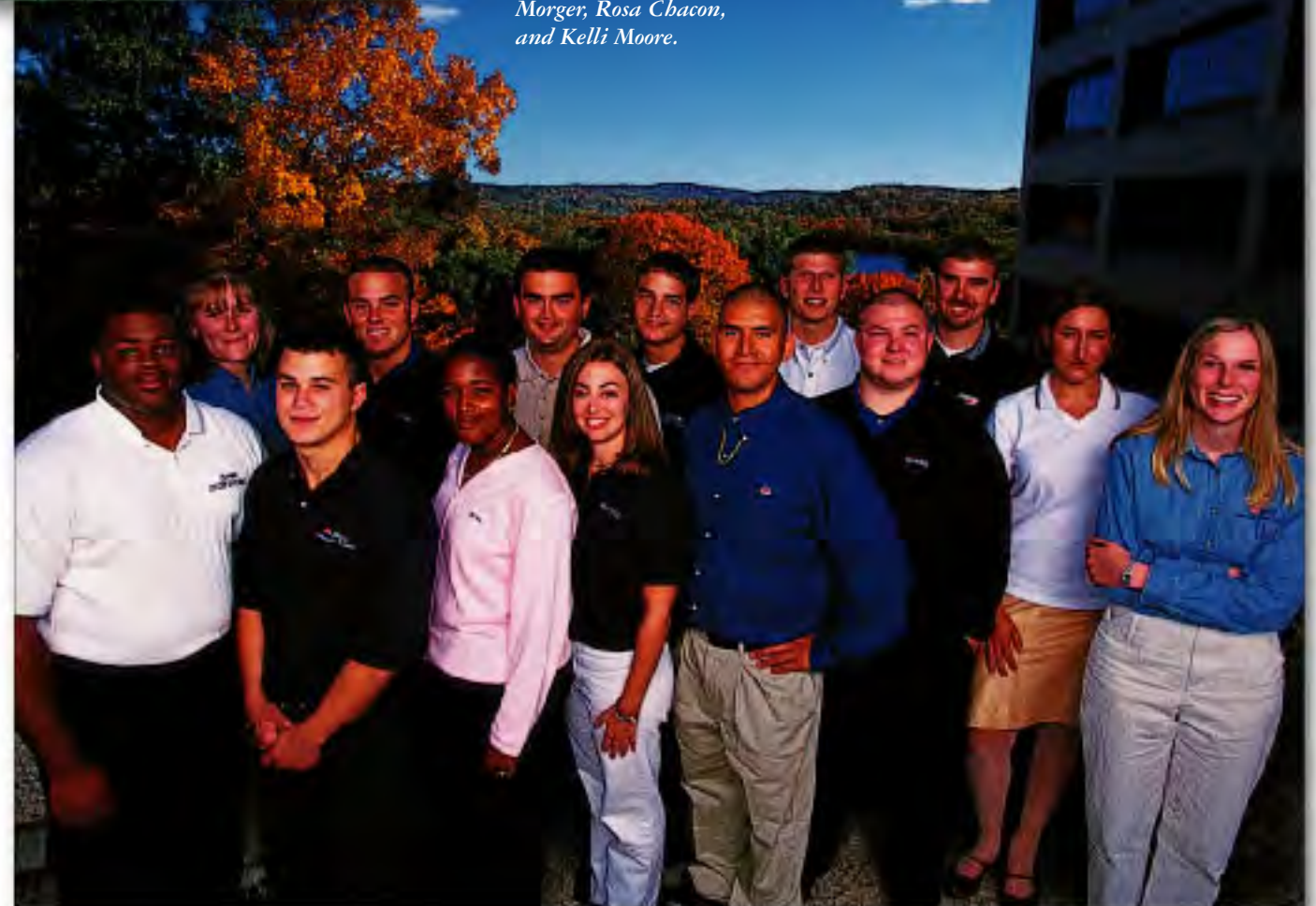
strategy to recruit sales and operations talent. Partnerships with selected colleges brought 250 graduates to our organization through 2001. One-third of those recruits represent minorities, and 40 percent are women. Among them are potential PBG general managers and company officers.

Our industry will always bring newness and change. Getting out ahead of those changes – anticipating and delivering the next generation of products and programs – is what makes the future both challenging and exciting.

Our Class of 2000 recruits brought a number of outstanding first-year contributors to our sales and operations functions. Their achievements range from dramatic account volume growth to incredible productivity and efficiency gains in their facilities. Left to right, these high-flyers are: Marcus Allen, Kathy Hollis, Kevin Reim, Marc Dispense, Rasbeeda Joyner, Justin Turner, Stacie Bartlett, Joe Gusweiler, Bryan Pacheco, Brian Ford, Cameron Higley, Dan Morger, Rosa Cbacon, and Kelli Moore.



The promise of a continued stream of new Pepsi products, such as Code Red, aligns our product portfolio with the tastes and preferences of an ever-changing consumer audience.





BOARD OF DIRECTORS



1 **Thomas H. Kean**, 66, was elected to PBG's Board in March 1999. Mr. Kean has been the President of Drew University since 1990 and was the Governor of the State of New Jersey from 1982 to 1990.

2 **Linda G. Alvarado**, 49, was elected to PBG's Board in March 1999. She is the President and Chief Executive Officer of Alvarado Construction, Inc., a general contracting firm specializing in commercial, industrial, environmental and heavy engineering projects, a position she assumed in 1976.

3 **Margaret D. Moore**, 54, was elected to PBG's Board in January 2001. Ms. Moore is Senior Vice President, Human Resources of PepsiCo, a position she assumed in 1999. From November 1998 to December 1999, she was Senior Vice President and Treasurer of PBG. Prior to that, Ms. Moore spent 25 years with PepsiCo in a number of senior financial and human resources positions.

4 **Thomas W. Jones**, 52, was elected to PBG's Board in March 1999. Mr. Jones is the Chairman and Chief Executive Officer, Global Investment Management and Private Banking Group, for Citigroup. He has also served as Co-Chairman and CEO of CitiGroup Asset Management since October 1998. Mr. Jones will not stand for re-election to the Board.

5 **Craig E. Weatherup**, 56, was elected to PBG's Board in January 1999, and has been Chairman since March 1999. Mr. Weatherup was also the CEO of PBG from March 1999 to September 2001. Prior to becoming Chairman and CEO of PBG, he served as Chairman and CEO of the Pepsi-Cola Company.

6 **Barry H. Beracha**, 60, was elected to PBG's Board in March 1999. He has been the CEO of Sara Lee Bakery Group since August 2001. Previously, Mr. Beracha was the Chairman of the Board and CEO of The Earthgrains Company since 1993. Earthgrains was formerly part of Anheuser-Busch Companies, where Mr. Beracha served from 1967 to 1996.

7 **John T. Cahill**, 44, was elected to PBG's Board in January 1999. He has been PBG's CEO since September 2001. Previously, Mr. Cahill served as our President and Chief Operating Officer. Mr. Cahill served as our Executive Vice President and Chief Financial Officer prior to becoming our President and Chief Operating Officer in August 2000.

8 **Susan D. Kronick**, 50, was elected to PBG's Board in March 1999. Ms. Kronick has been Group President of Federated Department Stores since February 2001. Previously, Ms. Kronick was the Chairman and Chief Executive Officer of Burdines, a division of Federated Department Stores, a position she had held since June 1997.

Robert F. Sharpe, Jr. (not pictured), 50, was elected to PBG's Board in March 1999. He left the Board in March 2002, after stepping down as Senior Vice President, Public Affairs, General Counsel and Secretary of PepsiCo. He joined PepsiCo in January 1998 as Senior Vice President, General Counsel and Secretary.

DIRECTORS AND OFFICERS

Richard W. Almquist
Business Unit General Manager, Texoma
4 years

John T. Cahill
Chief Executive Officer
12 years

L. Kevin Cox
Senior Vice President and
Chief Personnel Officer
12 years

Alfred H. Drewes
Senior Vice President and
Chief Financial Officer
20 years

Andrea L. Forster
Vice President and Controller
14 years

Eric J. Foss
President, PBG North America
19 years

Christopher D. Furman
Business Unit General Manager,
Southern California
15 years

Scott J. Gillesby
Business Unit General Manager, Central
20 years

James Keown
Business Unit General Manager,
Southeast
26 years

Robert C. King
Vice President, National Sales and
Field Marketing
12 years

Harrald F. Kroeker
Business Unit General Manager,
Mid-Atlantic
16 years

Linda A. Kuga Pikulin
President, PBG Canada
20 years

Pamela C. McGuire
Senior Vice President, General Counsel
and Secretary
24 years

Yiannis Petrides
President, PBG Europe
14 years

Eric W. Reinhard
Business Unit General Manager,
Great West
18 years

William L. Robinson
Business Unit General Manager,
Pacific Northwest
17 years

Barry J. Shea
Business Unit General Manager, Russia
25 years

Paul T. Snell
Business Unit General Manager,
Northeast
25 years

Gary K. Wandschneider
Senior Vice President, Operations
20 years

Craig E. Weatherup
Chairman of the Board
27 years

Account-specific promotion: a program custom designed to drive sales in a particular account.

Bottles-to-go: single- or multi-serve bottles sold for consumption with “meals to go.”

Category management: development of the optimal marketing strategy to maximize category sales and profitability.

Cold drink equipment: includes coolers, ice chests, vending machines and fountain equipment.

Channel: outlets that are similar in size, and that buy, merchandise and sell soft drinks in similar ways.

End-cap display: a prominent display of soft drink products at the end of an aisle.

Energy Drinks: functional drinks containing unique energizing formulations (which may include ginseng, guarana, caffeine, vitamins, nutritional ingredients, carbohydrates, flavorings and other ingredients) that satisfy the consumer’s need for an energy boost.

Filler: plant equipment that dispenses product into bottles and cans.

Flavor CSD: non-cola carbonated soft drinks that are fruit-flavored, such as cherry, orange, lemon-lime and root beer.

Healthy Refreshment Beverages: the segment of non-carbonated beverages that contain nutritive ingredients.

Household penetration: the percentage of households in a defined market that has purchased a particular branded item.

Large format: accounts that are large chain foodstores, mass merchandisers, chain drug stores, club stores and military bases.

Merchandising standards: set patterns established by the company to display products.

“Mom and Pop” store: small, independently owned foodstore/grocery retailer, often run by a family.

Out-of-stock: refers to shelf space or vendors lacking product.

PET: Polyethylene Terephthalate. Resin material used to manufacture plastic bottles.

Physical case: the measurement bottlers use for the number of units that were actually produced, distributed and sold. Each case of product, regardless of package configuration, represents one physical case.

Point-of-purchase: advertising placed near the location of the product in the store.

Pre-sell: sales system in which the retail outlet is contacted to obtain an order in advance of delivery.

Sampling: offering small portions of a product free to consumers, in order to encourage trial.

SKU: Stock Keeping Unit. Every item that has a unique brand/package/price combination.

Small format: convenience stores, gas stations and independent store accounts.

Take-home: unchilled products sold for at-home or future consumption.

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MANAGEMENT'S FINANCIAL REVIEW

OVERVIEW

Fiscal year 2001 marked the third year for The Pepsi Bottling Group, Inc. (collectively referred to as "PBG," "we," "our" and "us") as an independent public company and the third consecutive year of generating outstanding operating results. Highlights of these results are as follows:

- We delivered 13% constant territory EBITDA growth in 2001.
- Our worldwide constant territory physical case volume grew by 3% in 2001.
- We increased our 2001 worldwide constant territory net revenue per case by 3% as compared to the same period in 2000.
- We increased our return on invested capital to 8.4% in 2001, an increase of 0.8 percentage points.
- We delivered 2001 diluted earnings per share of \$1.03, an increase of \$0.26, or 35%, over 2000. Diluted earnings per share in 2001 include tax benefits of \$0.08, resulting from reductions in Canadian income tax rates. Diluted earnings per share in 2000 reflect a \$0.02 favorable impact from the inclusion of an additional week in our 2000 fiscal year.

The following discussion and analysis covers the key drivers behind our success in 2001 and is broken down into six major sections. The first three sections provide an overview, discuss related party transactions, and focus on items that affect the comparability of historical or future results. The next two sections provide an analysis of our results of operations and liquidity and financial condition. The last section contains a discussion of our market risks and cautionary statements. The discussion and analysis throughout Management's Financial Review should be read in conjunction with the Consolidated Financial Statements and the related accompanying notes.

Constant Territory

We believe that constant territory performance results are the most appropriate indicators of operating trends and performance, particularly in light of our stated intention of acquiring additional bottling territories, and are consistent with industry practice. Constant territory operating results are derived by adjusting current year results to exclude significant current year acquisitions and adjusting prior year results to include the results of significant prior year acquisitions, as if they had occurred on the first day of the prior fiscal year. In addition, 2000 constant territory results exclude the impact from an additional week in our fiscal year ("53rd week"), that occurs every five or six years, as our fiscal

year ends on the last Saturday in December. Constant territory results also exclude any unusual impairment and other charges and credits discussed on page 29 and in Note 4 to the Consolidated Financial Statements.

Use of EBITDA

EBITDA, which is computed as operating income plus the sum of depreciation and amortization, is a key indicator management and the industry use to evaluate operating performance. It is not, however, required under accounting principles generally accepted in the United States of America ("GAAP"), and should not be considered an alternative to measurements required by GAAP such as net income or cash flows. In addition, EBITDA excludes the impact of the non-cash portion of the unusual impairment and other charges and credits discussed on page 29 and in Note 4 to the Consolidated Financial Statements.

Critical Accounting Policies

The preparation of our Consolidated Financial Statements in conformity with GAAP requires us to make estimates and assumptions that affect the reported amounts in our Consolidated Financial Statements and the related accompanying notes. We use our best judgment based on our knowledge of existing facts and circumstances and actions that we may undertake in the future, as well as advice of external experts, in determining the estimates that affect our Consolidated Financial Statements. We have policies and procedures in place to ensure conformity with GAAP and we focus your attention on the following:

Revenue Recognition We recognize revenue when our products are delivered to customers. Sales terms do not allow a right of return unless product freshness dating has expired.

Allowance for Doubtful Accounts We determine our allowance for doubtful accounts based on an evaluation of the aging of our receivable portfolio. Our reserve contemplates our historical loss rate on receivables and the economic environment in which we operate.

Recoverability of Long-Lived Assets We review all long-lived assets, including intangible assets, when facts and circumstances indicate that the carrying value of the asset may not be recoverable. When necessary, we write down an impaired asset to its estimated fair value based on the best information available. Estimated fair value is generally based on either appraised value or measured by discounting estimated future cash flows. Considerable management judgment is necessary to estimate discounted future cash flows, which are discounted based on our weighted-average cost of capital.

Income Taxes Our effective tax rate and the tax bases of our assets and liabilities reflect our best estimate of the ultimate outcome of our tax audits. Valuation allowances are established where expected future taxable income does not support the recognition of the related deferred tax asset.

Financial Instruments and Risk Management We use derivative instruments to hedge against the risk of adverse movements in the price of certain commodities and fuel used in our operations. Our use of derivative instruments is limited to interest rate swaps, forward contracts, futures and options on futures contracts. Our corporate policy prohibits the use of derivative instruments for trading or speculative purposes, and we have procedures in place to monitor and control their use. All derivative instruments are recorded at fair value as either assets or liabilities in our Consolidated Balance Sheets. The fair value of our derivatives is generally based on quoted market prices. The evaluation of hedge effectiveness is subject to assumptions based on terms and timing of underlying exposures.

Commitments and Contingencies We are subject to various claims and contingencies related to lawsuits, taxes, environmental and other matters arising out of the normal course of business. Liabilities related to commitments and contingencies are recognized when a loss is probable and reasonably estimable.

For a more detailed discussion of our significant accounting policies, refer to Note 2 of our Consolidated Financial Statements.

RELATED PARTY TRANSACTIONS

Relationship with PepsiCo, Inc.

PepsiCo, Inc. ("PepsiCo") owns 37.7% of our outstanding common stock and 100% of our outstanding Class B common stock, together representing 42.8% of the voting power of all classes of our voting stock at December 29, 2001. In addition, PepsiCo owns 7% of the equity of Bottling Group, LLC, our principal operating subsidiary. We fully consolidate the results of Bottling Group, LLC and present PepsiCo's share as minority interest in our Consolidated Financial Statements.

We have a number of agreements with PepsiCo. The most significant agreements that govern our relationship with PepsiCo consist of:

- (1) the master bottling agreement for cola beverages bearing the "Pepsi-Cola" and "Pepsi" trademark in the United States; bottling and distribution agreements for non-cola products in the United States, including Mountain Dew; and a master fountain syrup agreement in the United States;

- (2) agreements similar to the master bottling agreement and the non-cola agreements for each specific country, including Canada, Spain, Greece and Russia, as well as a fountain syrup agreement similar to the master syrup agreement for Canada;
- (3) a shared services agreement whereby PepsiCo provides us or we provide PepsiCo with certain administrative support, including procurement of raw materials, transaction processing, such as accounts payable and credit and collection, certain tax and treasury services, and information technology maintenance and systems development. The amounts paid or received under this contract are equal to the actual costs incurred by the company providing the service. From 1998 through 2001, a PepsiCo affiliate provided casualty insurance to us; and
- (4) transition agreements that provide certain indemnities to the parties, and provide for the allocation of tax and other assets, liabilities, and obligations arising from periods prior to the initial public offering. Under our tax separation agreement, PepsiCo maintains full control and absolute discretion for any combined or consolidated tax filings for tax periods ending on or before the initial public offering. PepsiCo has contractually agreed to act in good faith with respect to all tax audit matters affecting us. In addition, PepsiCo has agreed to use their best efforts to settle all joint interests in any common audit issue on a basis consistent with prior practice.

We purchase concentrate from PepsiCo that is used in the production of carbonated soft drinks and other ready-to-drink beverages. The price of concentrate is determined annually by PepsiCo at its sole discretion. We also produce or distribute other products and purchase finished goods and concentrate through various arrangements with PepsiCo or PepsiCo joint ventures. We reflect such purchases in cost of sales.

We share a business objective with PepsiCo of increasing the availability and consumption of Pepsi-Cola beverages. Accordingly, PepsiCo, at its sole discretion, provides us with various forms of marketing support to promote its beverages. This support covers a variety of initiatives, including marketplace support, marketing programs, capital equipment investment, and shared media expense. Based on the objective of the programs and initiatives, we record marketing support as an adjustment to net revenues or as a reduction of selling, delivery and administrative expense. There are no conditions or other requirements that could result in a repayment of marketing support received.

We manufacture and distribute fountain products and provide fountain equipment service to PepsiCo customers in some territories in accordance with the Pepsi beverage agreements.

MANAGEMENT'S FINANCIAL REVIEW

Amounts received from PepsiCo for these transactions are offset by the cost to provide these services and are reflected in selling, delivery and administrative expenses. We pay a royalty fee to PepsiCo for the Aquafina trademark.

Refer to the Items That Affect Historical or Future Comparability section of Management's Financial Review for further discussions of concentrate supply and bottler incentives. In addition, refer to Note 2 of our Consolidated Financial Statements for further discussions on accounting for bottler incentives and Note 16 for further discussions on our relationship with PepsiCo.

Board of Directors

Two of our board members are also employees of PepsiCo. In addition, certain members of our Board of Directors also serve on the boards of other companies affiliated with PepsiCo.

ITEMS THAT AFFECT HISTORICAL OR FUTURE COMPARABILITY

Stock Split

On November 27, 2001, our shareholders approved an amendment to our Certificate of Incorporation increasing the authorized shares of PBG common stock from 300 million to 900 million facilitating a two-for-one stock split of issued common stock. The stock split was effected in the form of a 100% stock dividend paid to our shareholders of record on November 27, 2001. As a result of the stock split, the accompanying Consolidated Financial Statements and Management's Financial Review reflect an increase in the number of outstanding shares of common stock and shares of treasury stock and the transfer of the par value of these incremental shares from additional paid-in capital. All PBG share and per share data have been restated to reflect the split, except for discussions of our capitalization.

New Accounting Standards

During 2001, the Financial Accounting Standards Board ("FASB") issued Statement of Financial Accounting Standard ("SFAS") 141, "Business Combinations," which requires that the purchase method of accounting be used for all business combinations initiated or completed after June 30, 2001, and SFAS 142, "Goodwill and Other Intangible Assets," which requires that goodwill and intangible assets with indefinite useful lives no longer be amortized, but instead tested for impairment. Effective the first day of fiscal year 2002 we will no longer amortize goodwill and certain franchise rights, but will evaluate them for impairment annually. We have completed the initial impairment review required by SFAS 142 and have determined that our intangible assets are not impaired. The adoption

of SFAS 142 will reduce our fiscal year 2002 amortization expense by approximately \$128 million, or \$0.31 per diluted share, based on the weighted-average number of diluted shares outstanding as of December 29, 2001.

In addition, during 2001 the FASB also issued SFAS 143, "Accounting for Asset Retirement Obligations" and SFAS 144, "Accounting for the Impairment or Disposal of Long-Lived Assets." SFAS 143 addresses financial accounting and reporting for obligations associated with the retirement of tangible long-lived assets and the associated asset retirement costs. It requires that we recognize the fair value of a liability for an asset retirement obligation in the period in which it is incurred if a reasonable estimate of fair value can be made. SFAS 144 superseded SFAS 121, "Accounting for the Impairment of Long-Lived Assets and for Long-Lived Assets to Be Disposed Of," and Accounting Principles Board Opinion 30, "Reporting the Results of Operations – Reporting the Effects of a Disposal of a Segment of a Business, and Extraordinary, Unusual and Infrequently Occurring Events and Transactions." SFAS 144 establishes a single accounting model for the impairment of long-lived assets and broadens the presentation of discontinued operations to include more disposal transactions. SFAS 143 is effective for fiscal year 2003 and SFAS 144 is effective for fiscal year 2002 and we do not anticipate that the adoption of these statements will have a material impact on our Consolidated Financial Statements.

During 2000 and 2001, the Emerging Issues Task Force ("EITF") addressed various issues related to the income statement classification of certain promotional payments. In May 2000, the EITF reached a consensus on Issue 00-14, "Accounting for Certain Sales Incentives," addressing the recognition and income statement classification of various sales incentives. Among its requirements, the consensus will require the costs related to consumer coupons currently classified as marketing costs to be classified as a reduction of revenue. In January 2001, the EITF reached a consensus on Issue 00-22, "Accounting for 'Points' and Certain Other Time-Based or Volume-Based Sales Incentive Offers, and Offers for Free Products or Services to Be Delivered in the Future." EITF 00-22 requires that certain volume-based cash rebates to customers currently recognized as marketing costs be classified as a reduction of revenue. In April 2001, the EITF reached a consensus on Issue 00-25, "Vendor Income Statement Characterization of Consideration Paid to a Reseller of the Vendor's Products." EITF 00-25 addresses the income statement classification of consideration, other than that directly addressed in EITF 00-14, from a vendor to a reseller or another party that purchases the vendor's products. In November 2001, the EITF codified Issues 00-14, 00-22 and 00-25 as Issue 01-9, "Accounting for Consideration Given by a Vendor to a Customer or a Reseller of the Vendor's Products." EITF 00-22 was effective for the first quarter of

2001 and was not material to our Consolidated Financial Statements. The remainder of EITF 01-9 is effective for 2002 and we do not anticipate that the adoption will have a material impact on our Consolidated Financial Statements.

Our Consolidated Financial Statements reflect the implementation of SFAS 133, "Accounting for Derivative Instruments and Hedging Activities," as amended by SFAS 138, on the first day of fiscal year 2001. SFAS 133, which was issued in 1998, establishes accounting and reporting standards for hedging activities and derivative instruments, including certain derivative instruments embedded in other contracts, which are collectively referred to as derivatives. It requires that an entity recognize all derivatives as either assets or liabilities in the consolidated balance sheet and measure those instruments at fair value.

Asset Lives

At the beginning of fiscal year 2000, we changed the estimated useful lives of certain categories of assets primarily to reflect the success of our preventive maintenance programs in extending the useful lives of these assets. The changes, which are detailed in Note 3 to the Consolidated Financial Statements, lowered total depreciation cost by approximately \$69 million, or \$0.13 per diluted share in 2000 as compared to 1999. The estimated useful lives of our assets were the same in 2001 and 2000.

Fiscal Year

Our fiscal year ends on the last Saturday in December and, as a result, a 53rd week is added every five or six years. Fiscal years 2001 and 1999 consisted of 52 weeks while fiscal year 2000 consisted of 53 weeks. The following table illustrates the approximate dollar and percentage point impacts that the extra week had on our operating results:

	Dollars	Percentage Points	
		2001 vs. 2000	2000 vs. 1999
<i>dollars in millions, except per share amounts</i>			
Volume	N/A	(2)	2
Net Revenues	\$ 113	(1)	2
EBITDA	\$ 14	(2)	2
Diluted Earnings per Share	\$0.02	(4)	5

Initial Public Offering

PBG was incorporated in Delaware in January 1999 and, prior to our formation, we were an operating unit of PepsiCo. We became a public company through an initial public offering on March 31, 1999. Our initial public offering consisted of 100 million shares of common stock sold to the public, equivalent to 65% of our outstanding common stock, leaving PepsiCo the owner of the remaining 35% of outstanding common stock.

For the period prior to our initial public offering, we prepared our Consolidated Financial Statements as a "carve-out" from the financial statements of PepsiCo using the historical results of operations and assets and liabilities of our business. Certain costs reflected in the Consolidated Financial Statements may not necessarily be indicative of the costs that we would have incurred had we operated as an independent, stand-alone entity from the first day of fiscal year 1999. These costs include an allocation of PepsiCo's corporate overhead and interest expense, and income taxes:

- We included overhead related to PepsiCo's corporate administrative functions based on a specific identification of PepsiCo's administrative costs relating to the bottling operations and, to the extent that such identification was not practicable, based upon the percentage of our revenues to PepsiCo's consolidated net revenues. These costs are included in selling, delivery and administrative expenses in our Consolidated Statements of Operations.
- We allocated \$3.3 billion of PepsiCo's debt to our business and charged interest expense on this debt using PepsiCo's weighted-average interest rate. Once we issued \$3.3 billion of third-party debt in the first quarter of 1999, our actual interest rates were used to determine interest expense for the remainder of the year.
- We reflected income tax expense in the Consolidated Financial Statements as if we had actually filed a separate income tax return.

The amounts of the historical allocations described above are as follows:

<i>dollars in millions</i>	1999
Corporate overhead expense	\$ 3
Interest expense	\$28
PepsiCo weighted-average interest rate	5.8%

Unusual Impairment and Other Charges and Credits

Our operating results were affected by the following unusual charges and credits:

<i>dollars in millions</i>	1999
Non-cash compensation charge	\$ 45
Vacation policy change	(53)
Asset impairment and restructuring charges	(8)
	<u>\$(16)</u>
After minority interest and income taxes	\$ (9)

MANAGEMENT'S FINANCIAL REVIEW

• Non-cash Compensation Charge

In connection with the completion of our initial public offering, PepsiCo vested substantially all non-vested PepsiCo stock options held by our employees. As a result, we incurred a \$45 million non-cash compensation charge in the second quarter of 1999, equal to the difference between the market price of the PepsiCo capital stock and the exercise price of these options at the vesting date.

• Vacation Policy Change

As a result of changes to our employee benefit and compensation plans in 1999, employees now earn vacation time evenly throughout the year based upon service rendered. Previously, employees were fully vested at the beginning of each year. As a result of this change, we reversed an accrual of \$53 million into income in 1999.

• Asset Impairment and Restructuring Charge

In the fourth quarter of 1999, \$8 million of the remaining restructuring reserve recorded in 1998 relating to an asset impairment and restructuring in our Russian operations, was reversed into income. The reversal was necessitated as actual costs incurred to renegotiate manufacturing and leasing contracts in Russia and to reduce the number of employees were less than the amounts originally estimated.

Comparability of our operating results may also be affected by the following:

Concentrate Supply

We buy concentrate, the critical flavor ingredient for our products, from PepsiCo, its affiliates and other brand owners who are the sole authorized suppliers. Concentrate prices are typically determined annually.

In February 2001, PepsiCo announced an increase of approximately 3% in the price of U.S. concentrate. PepsiCo has recently announced a further increase of approximately 3%, effective February 2002. Amounts paid or payable to PepsiCo and its affiliates for concentrate were \$1,584 million, \$1,507 million and \$1,418 million in 2001, 2000 and 1999, respectively.

Bottler Incentives

PepsiCo and other brand owners provide us with various forms of marketing support. The level of this support is negotiated annually and can be increased or decreased at the discretion of

the brand owners. This marketing support is intended to cover a variety of programs and initiatives, including direct marketplace support, capital equipment funding and shared media, and advertising support. Direct marketplace support is primarily funding by PepsiCo and other brand owners of sales discounts and similar programs, and is recorded as an adjustment to net revenues. Capital equipment funding is designed to support the purchase and placement of marketing equipment and is recorded as a reduction to selling, delivery and administrative expenses. Shared media and advertising support is recorded as a reduction to advertising and marketing expense within selling, delivery and administrative expenses. There are no conditions or other requirements that could result in a repayment of marketing support received.

The total bottler incentives we received from PepsiCo and other brand owners were \$598 million, \$566 million and \$563 million for 2001, 2000 and 1999, respectively. Of these amounts, we recorded \$293 million, \$277 million and \$263 million for 2001, 2000 and 1999, respectively, in net revenues, and the remainder as a reduction of selling, delivery and administrative expenses. The amount of our bottler incentives received from PepsiCo was more than 90% of our total bottler incentives in each of the three years, with the balance received from the other brand owners.

Employee Benefit Plan Changes

We made several changes to our employee benefit plans that took effect in fiscal year 2000. The changes were made to our vacation policy, pension and retiree medical plans and included some benefit enhancements as well as cost containment provisions. These changes did not have a significant impact on our financial results in 2001 or 2000.

In 1999, our Board of Directors approved a matching company contribution to our 401(k) plan that began in 2000. The match is dependent upon the employee's contribution and years of service. The matching company contribution was approximately \$17 million and \$15 million in 2001 and 2000, respectively.

In the fourth quarter of 1999 we recognized a \$16 million compensation charge related to full-year 1999 performance. This expense was one-time in nature and was for the benefit of our management employees, reflecting our successful operating results, as well as providing certain incentive-related features.

CONSOLIDATED STATEMENTS OF OPERATIONS

Fiscal years ended December 29, 2001, December 30, 2000 and December 25, 1999

dollars in millions, except per share data

	2001	2000	1999
Net Revenues	\$8,443	\$7,982	\$7,505
Cost of sales	4,580	4,405	4,296
Gross Profit	3,863	3,577	3,209
Selling, delivery and administrative expenses	3,187	2,987	2,813
Unusual impairment and other charges and credits	—	—	(16)
Operating Income	676	590	412
Interest expense, net	194	192	202
Foreign currency loss	—	1	1
Minority interest	41	33	21
Income Before Income Taxes	441	364	188
Income tax expense before rate change	161	135	70
Income tax rate change benefit	(25)	—	—
Net Income	\$ 305	\$ 229	\$ 118
Basic Earnings Per Share	\$ 1.07	\$ 0.78	\$ 0.46
Weighted-Average Shares Outstanding	286	294	257
Diluted Earnings Per Share	\$ 1.03	\$ 0.77	\$ 0.46
Weighted-Average Shares Outstanding	296	299	257

See accompanying notes to Consolidated Financial Statements.

MANAGEMENT'S FINANCIAL REVIEW

RESULTS OF OPERATIONS

	Fiscal 2001 vs. 2000*		Fiscal 2000 vs. 1999*	
	Reported Change	Constant Territory Change	Reported Change	Constant Territory Change
EBITDA	12%	13%	18%	16%
Volume	2%	3%	3%	1%
Net Revenue per Case	3%	3%	3%	3%

* Fiscal years 2001 and 1999 consisted of 52 weeks while fiscal year 2000 consisted of 53 weeks.

EBITDA

On a reported basis, EBITDA was \$1,190 million in 2001, representing a 12% increase over 2000, including an approximate 2 percentage point negative impact from the 53rd week in 2000. Constant territory growth of 13% for 2001 was a reflection of higher pricing, an increased mix of higher margin cold drink volume, and solid volume growth in the U.S., as well as continued growth in our operations outside the U.S., particularly in Russia. These increases were partially offset by investments in our cold drink infrastructure.

In 2000, reported EBITDA was \$1,061 million, representing an 18% increase over 1999, with the 53rd week contributing approximately 2 percentage points of the growth. Constant territory EBITDA was 16% higher than in 1999, driven by continued pricing improvements in our take-home segment, mix shifts to higher-margin cold drink volume, favorable cost of sales trends, and improved results outside the United States.

VOLUME

Our worldwide physical case volume grew 2% in 2001, including an approximate 2 percentage point negative impact from the 53rd week in 2000. Constant territory volume growth was 3% in 2001, reflecting U.S. growth of more than 1% and 10% growth outside the United States. U.S. growth was led by the introductions of Mountain Dew Code Red and Pepsi Twist, expanded distribution of Sierra Mist, strong growth in Aquafina, as well as the integration of SoBe in the majority of our markets. This growth was partially offset by declines in brand Pepsi. New product innovation and consistent in-store execution resulted in positive cold drink and take-home volume growth in the United States. In addition, take-home volume growth in the U.S. benefited from significant growth in mass merchandiser volume. Outside the U.S., all countries delivered solid volume growth in 2001, led by our operations in Russia. Volume growth in Russia was driven by the introduction of Mountain Dew and continued growth of Aqua Minerale, our water product, and Fiesta, our value-brand beverage.

Our reported worldwide physical case volume grew 3% in 2000, with the 53rd week contributing approximately 2 percentage points of the growth. Worldwide constant territory volume grew 1% in 2000 with flat volume growth from our U.S. operations and 7% growth from our operations outside the United States. In the U.S., volume results reflected growth in our cold drink segment and the favorable impact of the launch of Sierra Mist in the fourth quarter of 2000, offset by declines in our take-home business. Our cold drink trends reflected our successful placement of additional cold drink equipment in the United States. Take-home volume remained lower for the year reflecting the effect of our price increases in that segment. Our volume growth outside the U.S. was led by Russia where we have reestablished brand Pepsi, introduced Fiesta, and continued to increase distribution of Aqua Minerale. Partially offsetting the growth in Russia were volume declines in Canada resulting from significant take-home price increases in that country.

NET REVENUES

Reported net revenues were \$8,443 million in 2001, representing a 6% increase over the prior year, including an approximate 1 percentage point negative impact from the 53rd week in 2000. On a constant territory basis, net revenues increased by 6%, reflecting 3% volume growth and 3% growth in net revenue per case. Constant territory U.S. net revenues grew 6%, consisting of 5% growth in net revenue per case and volume growth of more than 1%. U.S. net revenue per case results reflect higher pricing, primarily in foodstores, and an increased mix of higher-revenue cold drink volume from new product innovation and double-digit Aquafina growth. Constant territory net revenues outside the U.S. grew 7%, reflecting volume growth of 10%, offset by declines in net revenue per case of 3%. Excluding the negative impact from currency translations, net revenue per case growth was flat outside the U.S. and increased 4% worldwide.

Reported net revenues were \$7,982 million in 2000, a 6% increase over the prior year, with the 53rd week contributing approximately 2 percentage points of the growth. On a constant territory basis, worldwide net revenues grew more than 4%, driven by a 1% volume increase and a 3% increase in net revenue per case. Constant territory net revenue per case growth was driven by the U.S., which grew 6%, reflecting higher pricing, particularly in our take-home segment, and an increased mix of higher-revenue cold drink volume. These results were partially offset by account level investment spending aimed at sustainable

Aquafina and cold drink inventory gains in the marketplace. Outside the U.S., constant territory net revenues were down 1%, reflecting a 7% increase in volume, offset by an 8% decrease in net revenue per case. Excluding the negative impact from currency translations, net revenue per case decreased 1% outside the U.S. and increased 4% worldwide.

COST OF SALES

Cost of sales increased \$175 million, or 4% in 2001, including an approximate 2 percentage point favorable impact from the 53rd week in 2000. On a constant territory basis, cost of sales increased 5%, driven by a 3% increase in volume and a more than 1% increase in cost of sales per case. The increase in cost of sales per case reflects higher U.S. concentrate costs and mix shifts into higher-cost packages and products, offset by country mix and favorable currency translations.

Cost of sales increased \$109 million, or 3% in 2000, with the 53rd week contributing approximately 2 percentage points of the growth. On a per case basis, cost of sales was essentially flat in 2000. Included in cost of sales in 2000 were the favorable impacts from the change in our estimated useful lives of manufacturing assets, which totaled \$34 million in 2000 and an approximate 1 percentage point favorable impact from currency translations. Excluding the effects of the change in asset lives and currency translations, cost of sales on a per case basis was more than 1% higher, as higher U.S. concentrate costs were partially offset by favorable packaging and sweetener costs, favorable country mix, and efficiencies in production.

SELLING, DELIVERY AND ADMINISTRATIVE EXPENSES

Selling, delivery and administrative expenses grew \$200 million, or 7%, over the comparable period in 2000, including an approximate 1 percentage point favorable impact from the 53rd week in 2000. Approximately half of the increase came from higher selling and delivery costs, specifically our continued investments in our U.S. and Canadian cold drink strategy including people, routes and equipment. Also contributing to the growth in selling, delivery and administrative expenses are higher advertising and marketing costs and higher costs associated with investments in our information technology systems.

Selling, delivery and administrative expenses increased \$174 million, or 6% in 2000, with the 53rd week contributing approximately 1 percentage point of the growth. Included in selling, delivery and administrative expenses are the favorable

impacts from the change in estimated useful lives of certain selling and delivery assets, which lowered depreciation expense by \$35 million, and currency translations, which lowered selling, delivery and administrative expense growth by approximately 1 percentage point in 2000. Excluding the effects of the change in asset lives, currency translations and the inclusion of the 53rd week, selling, delivery and administrative expenses were approximately 7% higher in 2000. Driving this increase were higher selling and delivery costs primarily reflecting our significant investment in our U.S. cold drink infrastructure that began in 1999 and continued through 2000. In addition, higher performance-related compensation costs contributed to the cost growth. Growth in administrative costs associated with the company matching contribution for our new 401(k) plan in 2000 was offset by a one-time, \$16 million compensation charge in 1999.

INTEREST EXPENSE, NET

Net interest expense increased by \$2 million, or 1%, in 2001 primarily reflecting lower interest income in 2001. The reduction in interest income was due to lower average cash balances in 2001, consistent with increases in acquisition spending and share repurchases, which were primarily funded through cash generated from operations.

Net interest expense decreased by \$10 million, or 5%, in 2000, primarily driven by increases in interest income consistent with our increase in cash and cash equivalents in 2000 and reduced levels of debt outside the United States.

MINORITY INTEREST

Minority interest represents PepsiCo's 7% ownership in our principal operating subsidiary, Bottling Group, LLC. The growth in minority interest expense over the last three years is due to higher Bottling Group, LLC earnings over the same periods.

INCOME TAX EXPENSE BEFORE RATE CHANGE

Our full-year effective tax rate for 2001 was 36.5% before our income tax rate change benefit. This rate corresponds to an effective tax rate of 37.0% in 2000. The one-half point decrease is primarily due to the reduced impact of fixed non-deductible expenses on higher anticipated pre-tax income in 2001, partially offset by the decreased favorable impact of our foreign results.

Our full-year effective tax rate for 2000 was 37.0%, compared to 37.4% in 1999. Our effective tax rate, excluding unusual impair-

MANAGEMENT'S FINANCIAL REVIEW

ment and other charges and credits, would have been 37.0% and 38.0% in 2000 and 1999, respectively. The one point decrease is primarily due to the reduced impact of fixed non-deductible expenses on higher pre-tax income in 2000. This impact was partially offset by the decreased favorable impact of our foreign results.

INCOME TAX RATE CHANGE BENEFIT

During 2001, the Canadian Government enacted legislation reducing federal and certain provincial corporate income tax rates. These rate changes reduced deferred tax liabilities associated with our operations in Canada, and resulted in one-time gains totaling \$0.08 per diluted share in 2001.

EARNINGS PER SHARE

<i>shares in millions</i>	2001	2000	1999
Basic earnings per share on			
reported net income	\$1.07	\$0.78	\$0.46
Weighted-average shares outstanding	286	294	257
Diluted earnings per share on			
reported net income	\$1.03	\$0.77	\$0.46
Weighted-average shares outstanding	296	299	257

Dilution

Diluted earnings per share reflect the potential dilution that could occur if stock options from our stock compensation plan were exercised and converted into common stock that would then participate in net income. Our stock price improvement during the last two years has resulted in \$0.04 and \$0.01 per share of dilution in 2001 and 2000, respectively.

Weighted-Average Shares Outstanding

In 1999, immediately preceding our initial public offering, we had 55 million shares of common stock outstanding. In connection with the offering, we sold 100 million shares of common stock to the public. Since our initial public offering, shares outstanding reflect the effect of our share repurchase program, which began in October 1999. In addition, in November 2001 we executed a two-for-one stock split in the form of a 100% stock dividend, which doubled our weighted-average shares outstanding. As a result of the stock split in 2001, the amount of shares authorized by the Board of Directors to be repurchased totals 50 million shares, of which we have repurchased approximately 31 million shares since the inception of our share repurchase program.

Pro Forma Earnings per Share

The table below sets forth earnings per share adjusted for the initial public offering, the impact of our unusual impairment and other charges and credits and the impact of our income tax rate change benefit as previously discussed. In 1999, we assumed 310 million shares were outstanding from the beginning of the year and further adjusted shares outstanding for our share repurchase program.

<i>shares in millions</i>	2001	2000*	1999
Diluted earnings per share			
on reported net income	\$ 1.03	\$0.77	\$ 0.38
Unusual impairment and other charges and credits	—	—	(0.03)
Income tax rate change benefit	(0.08)	—	—
Adjusted diluted earnings per share	\$ 0.95	\$0.77	\$ 0.35
Assumed diluted shares outstanding	296	299	309

*Includes a favorable impact from the inclusion of the 53rd week in 2000 of \$0.02.

CONSOLIDATED STATEMENTS OF CASH FLOWS

Fiscal years ended December 29, 2001, December 30, 2000 and December 25, 1999

dollars in millions

Cash Flows – Operations

	2001	2000	1999
Net income	\$ 305	\$ 229	\$ 118
Adjustments to reconcile net income to net cash provided by operations:			
Depreciation	379	340	374
Amortization	135	131	131
Non-cash unusual impairment and other charges and credits	—	—	(32)
Deferred income taxes	23	—	(27)
Other non-cash charges and credits, net	182	176	141
Changes in operating working capital, excluding effects of acquisitions:			
Accounts receivable	(28)	13	(42)
Inventories	(50)	11	3
Prepaid expenses and other current assets	2	(97)	4
Accounts payable and other current liabilities	57	28	48
Net change in operating working capital	(19)	(45)	13
Net Cash Provided by Operations	1,005	831	718

Cash Flows—Investments

Capital expenditures	(593)	(515)	(560)
Acquisitions of bottlers	(120)	(26)	(176)
Sales of property, plant and equipment	6	9	22
Other, net	(123)	(52)	(19)
Net Cash Used for Investments	(830)	(584)	(733)

Cash Flows—Financing

Short-term borrowings – three months or less	50	12	(58)
Proceeds from long-term debt	—	—	3,260
Replacement of PepsiCo allocated debt	—	—	(3,300)
Net proceeds from initial public offering	—	—	2,208
Payments of long-term debt	—	(9)	(90)
Minority interest distribution	(16)	(3)	—
Dividends paid	(12)	(12)	(6)
Proceeds from exercise of stock options	18	—	—
Purchase of treasury stock	(249)	(103)	(90)
Decrease in advances from PepsiCo	—	—	(1,750)
Net Cash (Used for) Provided by Financing	(209)	(115)	174
Effect of Exchange Rate Changes on Cash and Cash Equivalents	(7)	(4)	(5)
Net Increase (Decrease) in Cash and Cash Equivalents	(41)	128	154
Cash and Cash Equivalents – Beginning of Year	318	190	36
Cash and Cash Equivalents – End of Year	\$ 277	\$ 318	\$ 190

Supplemental Cash Flow Information**Non-Cash Investing and Financing Activities:**

Liabilities incurred and/or assumed in conjunction with acquisitions of bottlers	\$ 25	\$ 9	\$ 65
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See accompanying notes to Consolidated Financial Statements.

CONSOLIDATED BALANCE SHEETS

December 29, 2001 and December 30, 2000

in millions, except per share data

	2001	2000
ASSETS		
Current Assets		
Cash and cash equivalents	\$ 277	\$ 318
Accounts receivable, less allowance of \$42 in 2001 and 2000	823	796
Inventories	331	281
Prepaid expenses and other current assets	117	189
Total Current Assets	1,548	1,584
Property, plant and equipment, net	2,543	2,358
Intangible assets, net	3,684	3,694
Other assets	82	100
Total Assets	\$7,857	\$7,736
LIABILITIES AND SHAREHOLDERS' EQUITY		
Current Liabilities		
Accounts payable and other current liabilities	\$1,004	\$ 941
Short-term borrowings	77	26
Total Current Liabilities	1,081	967
Long-term debt	3,285	3,271
Other liabilities	550	474
Deferred income taxes	1,021	1,072
Minority interest	319	306
Total Liabilities	6,256	6,090
Shareholders' Equity		
Common stock, par value \$0.01 per share: authorized 900 shares, issued 310 shares	3	2
Additional paid-in capital	1,739	1,736
Retained earnings	649	355
Accumulated other comprehensive loss	(370)	(254)
Treasury stock: 29 shares and 20 shares in 2001 and 2000, respectively	(420)	(193)
Total Shareholders' Equity	1,601	1,646
Total Liabilities and Shareholders' Equity	\$7,857	\$7,736

See accompanying notes to Consolidated Financial Statements.

MANAGEMENT'S FINANCIAL REVIEW**LIQUIDITY AND FINANCIAL CONDITION****LIQUIDITY AND CAPITAL RESOURCES***Liquidity Prior to our Separation from PepsiCo and our Initial Public Offering*

We financed our capital investments and acquisitions through cash flow from operations and advances from PepsiCo prior to our separation from PepsiCo and our initial public offering. Under PepsiCo's centralized cash management system, PepsiCo deposited sufficient cash in our bank accounts to meet our daily obligations, and withdrew excess funds from those accounts. These transactions are included in decrease in advances from PepsiCo in our Consolidated Statements of Cash Flows.

Liquidity After our Initial Public Offering

Subsequent to our initial public offering, we have financed our capital investments and acquisitions primarily through cash flow from operations. We believe that our future cash flow from operations and borrowing capacity will be sufficient to fund capital expenditures, acquisitions, dividends and working capital requirements.

Financing Transactions

On February 9, 1999, \$1.3 billion of 5³/₈% senior notes and \$1.0 billion of 5³/₈% senior notes were issued by Bottling Group, LLC and are guaranteed by PepsiCo. On March 8, 1999, we issued \$1 billion of 7% senior notes, which are guaranteed by Bottling Group, LLC. During the second quarter of 1999, we executed an interest rate swap converting 3% of our fixed-rate debt to floating-rate debt.

On March 31, 1999, we offered 100 million shares of PBG common stock for sale to the public in an underwritten initial public offering generating \$2.2 billion of net proceeds.

The proceeds from the above financing transactions were used to repay obligations to PepsiCo and fund acquisitions.

We also have a \$500 million commercial paper program that is supported by a credit facility. The credit facility consists of two \$250 million components, one of which expires in May 2002 and the other of which expires in April 2004. There were no borrowings outstanding under this program at December 29, 2001 or December 30, 2000.

Capital Expenditures

We have incurred and will continue to incur capital costs to maintain and grow our infrastructure, including acquisitions and investments in developing market opportunities.

- Our business requires substantial infrastructure investments to maintain our existing level of operations and to fund investments targeted at growing our business. Capital infrastructure expenditures totaled \$593 million, \$515 million and \$560 million during 2001, 2000 and 1999, respectively. We believe that capital infrastructure spending will continue to be significant, driven by our investments in the cold drink segment and capacity needs.
- We intend to continue to pursue acquisitions of independent PepsiCo bottlers in the U.S. and Canada, particularly in territories contiguous to our own, where they create shareholder value. These acquisitions will enable us to provide better service to our large retail customers, as well as to reduce costs through economies of scale. We also plan to evaluate international acquisition opportunities as they become available. Cash spending on acquisitions was \$120 million, \$26 million and \$176 million in 2001, 2000 and 1999, respectively.

CASH FLOWS*Fiscal 2001 Compared to Fiscal 2000*

Operating free cash flow grew \$22 million from \$273 million in 2000 to \$295 million in 2001. Operating free cash flow is defined as net cash provided by operations less net cash used for investments, excluding cash used for the acquisitions of bottlers.

Net cash provided by operating activities increased \$174 million to \$1,005 million in 2001, driven by strong EBITDA growth and the timing of casualty insurance payments, partially offset by higher net working capital due to growth in our business.

Net cash used for investments increased by \$246 million from \$584 million in 2000 to \$830 million in 2001, primarily due to acquisition spending and increased capital expenditures, which were driven by increases in the U.S. associated with our cold drink strategy. Also contributing to the increase were significantly higher pension contribution payments in 2001.

Net cash used for financing increased by \$94 million to \$209 million in 2001. This increase primarily reflects our share repur-

MANAGEMENT'S FINANCIAL REVIEW

chase program offset by higher short-term borrowings outside the U.S. and proceeds from stock option exercises.

Fiscal 2000 Compared to Fiscal 1999

Operating free cash flow grew \$112 million, or 70%, to \$273 million in 2000.

Net cash provided by operating activities increased \$113 million to \$831 million in 2000, driven by strong EBITDA growth partially offset by the timing of casualty insurance payments in 2000, which significantly contributed to our unfavorable change in operating working capital.

Net cash used for investments decreased by \$149 million from \$733 million in 1999 to \$584 million in 2000, primarily due to acquisition spending, which was \$150 million lower in 2000. Capital expenditures decreased by \$45 million, or 8%, as increases in the U.S. associated with our cold drink strategy were offset by decreases outside the United States.

Net cash (used for) provided by financing decreased from a source of cash of \$174 million in 1999 to a use of cash of \$115 million in 2000. This decrease resulted from net cash received from initial public offering activities in 1999 coupled with an increase of \$13 million of share repurchases in 2000.

MARKET RISKS AND CAUTIONARY STATEMENTS

QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK

In the normal course of business, the financial position of the company routinely is subject to a variety of risks. These risks include the risk associated with the price of commodities purchased and used in our business, interest rate on outstanding debt and currency movements of non-U.S. dollar denominated assets and liabilities. We are also subject to the risks associated with the business environment in which we operate, including the collectibility of accounts receivable. We regularly assess all of these risks and have policies and procedures in place to protect against the adverse effects of these exposures.

Our objective in managing our exposure to fluctuations in commodity prices, interest rates, and foreign currency exchange rates is to minimize the volatility of earnings and cash flows associated with changes in the applicable rates and prices. To achieve this objective, we primarily enter into commodity forward contracts, commodity futures and options on futures contracts and interest rate swaps. Our corporate policy prohibits the use of derivative instruments for trading or speculative purposes, and we have procedures in place to monitor and control their use.

A sensitivity analysis has been prepared to determine the effects that market risk exposures may have on the fair values of our debt and other financial instruments. To perform the sensitivity analysis, we assessed the risk of loss in fair values from the hypothetical changes in commodity prices, interest rates, and foreign currency exchange rates on market-sensitive instruments. Information provided by this sensitivity analysis does not necessarily represent the actual changes in fair value that we would incur under normal market conditions because, due to practical limitations, all variables other than the specific market risk factor were held constant. In addition, the results of the analysis are constrained by the fact that certain items are specifically excluded from the analysis, while the financial instruments that relate to the financing or hedging of those items are included. As a result, the reported changes in the values of some financial instruments that affect the results of the sensitivity analysis are not matched with the offsetting changes in the values of the items that those instruments are designed to finance or hedge.

The results of the sensitivity analysis at December 29, 2001 are as follows:

Commodity Price Risk

We are subject to market risks with respect to commodities because our ability to recover increased costs through higher pricing may be limited by the competitive environment in which we operate. We use futures contracts and options on futures in the normal course of business to hedge anticipated purchases of aluminum and fuel used in our operations. With respect to commodity price risk, we currently have various contracts outstanding for aluminum and fuel oil purchases in 2002, which establish our purchase price within defined ranges. These contracts have notional amounts of \$573 million and \$557 million at December 29, 2001 and December 30, 2000, respectively. These notional amounts do not represent amounts exchanged by

the parties and thus are not a measure of our exposure; rather, they are used as a basis to calculate the amounts due under the agreements. We estimate that a 10% decrease in commodity prices with all other variables held constant would have resulted in a decrease in the fair value of our financial instruments of \$15 million and \$18 million at December 29, 2001 and December 30, 2000, respectively.

Interest Rate Risk

The fair value of our fixed-rate long-term debt is sensitive to changes in interest rates. Interest rate changes would result in gains or losses in the fair market value of our debt representing differences between market interest rates and the fixed rate on the debt. With respect to this market risk, we currently have an interest rate swap converting 3% of our fixed-rate debt to floating-rate debt. This interest rate swap has a notional value of \$100 million at December 29, 2001 and December 30, 2000. We estimate that a 10% decrease in interest rates with all other variables held constant would have resulted in a net increase in the fair value of our financial instruments, both our fixed rate debt and our interest rate swap, of \$144 million and \$158 million at December 29, 2001 and December 30, 2000, respectively.

Foreign Currency Exchange Rate Risk

In 2001, approximately 15% of our net revenues came from Canada, Spain, Greece and Russia. Social, economic, and political conditions in these international markets may adversely affect our results of operations, cash flows, and financial condition. The overall risks to our international businesses include changes in foreign governmental policies, and other political or economic developments. These developments may lead to new product pricing, tax or other policies, and monetary fluctuations that may adversely impact our business. In addition, our results of operations and the value of the foreign assets are affected by fluctuations in foreign currency exchange rates.

As currency exchange rates change, translation of the statements of operations of our businesses outside the U.S. into U.S. dollars affects year-over-year comparability. We have not hedged currency risks because cash flows from international operations have generally been reinvested locally, nor historically have we entered into hedges to minimize the volatility of reported earnings. We estimate that a 10% change in foreign exchange

rates with all other variables held constant would have affected reported income before income taxes by less than \$30 million in 2001 and 2000.

Foreign currency gains and losses reflect translation gains and losses arising from the re-measurement into U.S. dollars of the net monetary assets of businesses in highly inflationary countries and transaction gains and losses. Russia is considered a highly inflationary economy for accounting purposes.

EURO

We have successfully executed our plans to address the issues raised by the Euro currency conversion. These issues include, among others, the need to adapt computer and financial systems, business processes and equipment, such as vending machines, to accommodate Euro-denominated transactions and the impact of one common currency on cross-border pricing. We have experienced no business interruption as a result of the issuance and circulation of Euro-denominated bills and coins beginning January 1, 2002. Our financial systems and processes have been successfully converted to accommodate the Euro. Due to numerous uncertainties, we cannot reasonably estimate the long-term effects one common currency may have on pricing, costs and the resulting impact, if any, on the financial condition or results of operations.

CAUTIONARY STATEMENTS

Except for the historical information and discussions contained herein, statements contained in this annual report on Form 10-K may constitute forward-looking statements as defined by the Private Securities Litigation Reform Act of 1995. These forward-looking statements are based on currently available competitive, financial and economic data and PBG's operating plans. These statements involve a number of risks, uncertainties and other factors that could cause actual results to be materially different. Among the events and uncertainties that could adversely affect future periods are lower-than-expected net pricing resulting from marketplace competition, material changes from expectations in the cost of raw materials and ingredients, an inability to achieve the expected timing for returns on cold drink equipment and related infrastructure expenditures, material changes in expected levels of marketing support payments from PepsiCo, an inability to meet projections for performance in newly acquired territories, and unfavorable interest rate and currency fluctuations.

CONSOLIDATED STATEMENTS OF CHANGES IN SHAREHOLDERS' EQUITY

Fiscal years ended December 29, 2001, December 30, 2000 and December 25, 1999

<i>in millions</i>	Common Stock	Additional Paid-In Capital	Retained Earnings	Accumulated Other Comprehensive Loss	Treasury Stock	C Total	Comprehensive Income/(Loss)
Balance at December 26, 1998	\$ —	\$ —	\$ —	\$(238)	\$ —	\$ (238)	
Comprehensive income:							
Net loss before IPO	—	—	—	—	—	—	\$ (29)
Net income after IPO	—	—	147	—	—	147	147
Currency translation adjustment	—	—	—	(4)	—	(4)	(4)
Minimum pension liability adjustment	—	—	—	19	—	19	19
Total comprehensive income							<u>\$ 133</u>
Initial public offering: 100 shares net of settlement of advances from PepsiCo	2	1,736	—	—	—	1,738	
Treasury stock transactions, net: 5 shares	—	—	—	—	(90)	(90)	
Cash dividends declared on common stock	—	—	(9)	—	—	(9)	
Balance at December 25, 1999	2	1,736	138	(223)	(90)	1,563	
Comprehensive income:							
Net income	—	—	229	—	—	229	\$ 229
Currency translation adjustment	—	—	—	(31)	—	(31)	(31)
Total comprehensive income							<u>\$ 198</u>
Treasury stock transactions, net: 5 shares	—	—	—	—	(103)	(103)	
Cash dividends declared on common stock	—	—	(12)	—	—	(12)	
Balance at December 30, 2000	2	1,736	355	(254)	(193)	1,646	
Comprehensive income:							
Net income	—	—	305	—	—	305	\$ 305
Currency translation adjustment	—	—	—	(49)	—	(49)	(49)
FAS 133 adjustment	—	—	—	(12)	—	(12)	(12)
Minimum pension liability adjustment	—	—	—	(55)	—	(55)	(55)
Total comprehensive income							<u>\$ 189</u>
Stock split: (shares: 145 outstanding – 9 treasury)	1	(1)	—	—	—	—	
Stock option exercises: 2 shares	—	(4)	—	—	22	18	
Tax benefit – stock option exercises	—	8	—	—	—	8	
Purchase of treasury stock: 12 shares	—	—	—	—	(249)	(249)	
Cash dividends declared on common stock	—	—	(11)	—	—	(11)	
Balance at December 29, 2001	\$ 3	\$1,739	\$649	\$(370)	\$(420)	\$1,601	

See accompanying notes to Consolidated Financial Statements.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

Tabular dollars in millions, except per share data

NOTE 1: BASIS OF PRESENTATION

The Pepsi Bottling Group, Inc. ("PBG") consists of bottling operations located in the United States, Canada, Spain, Greece and Russia. These bottling operations manufacture, sell and distribute Pepsi-Cola beverages including Pepsi-Cola, Diet Pepsi, Mountain Dew and other brands of carbonated soft drinks and ready-to-drink beverages. Approximately 90% of PBG's 2001 net revenues were derived from the sale of Pepsi-Cola beverages. References to PBG throughout these Consolidated Financial Statements are made using the first-person notations of "we," "our" and "us."

Prior to our formation, we were an operating unit of PepsiCo, Inc. ("PepsiCo"). On March 31, 1999, we offered 100 million shares of PBG common stock for sale at \$23 per share in an initial public offering generating \$2.2 billion in net proceeds. These proceeds were used to fund acquisitions and repay obligations to PepsiCo.

On November 27, 2001, our shareholders approved an amendment to our Certificate of Incorporation increasing the authorized shares of PBG common stock from 300 million to 900 million facilitating a two-for-one stock split of issued common stock. The stock split was effected in the form of a 100% stock dividend paid to our shareholders of record on November 27, 2001. As a result of the stock split, the accompanying Consolidated Financial Statements reflect an increase in the number of outstanding shares of common stock and shares of treasury stock and the transfer of the par value of these incremental shares from additional paid-in capital. All PBG share and per share data have been restated to reflect the split except for discussions of our capitalization.

Subsequent to the offering and the stock split, PepsiCo owned and continues to own 106,011,358 shares of common stock, consisting of 105,911,358 shares of common stock and 100,000 shares of Class B common stock. PepsiCo's ownership at December 29, 2001, represents 37.7% of the outstanding common stock and 100% of the outstanding Class B common stock, together representing 42.8% of the voting power of all classes of our voting stock. PepsiCo also owns 7% of the equity of Bottling Group, LLC, our principal operating subsidiary, as of December 29, 2001.

The common shares and Class B common shares are substantially identical, except for voting rights. Holders of our common stock are entitled to one vote per share and holders of our Class B common stock are entitled to 250 votes per share. Each share of Class B common stock held by PepsiCo is, at PepsiCo's option, convertible into one share of common stock. Holders of our common stock and holders of our Class B common stock share equally on a per share basis in any dividend distributions.

The accompanying Consolidated Financial Statements include information that has been presented on a "carve-out" basis for the period prior to our initial public offering. This information includes the historical results of operations and assets and liabilities directly related to PBG, and has been prepared from PepsiCo's historical accounting records. Certain estimates, assumptions and allocations were made in determining such financial statement information. Therefore, these Consolidated Financial Statements may not necessarily be indicative of the results of operations, financial position or cash flows that would have existed had we been a separate, independent company from the first day of fiscal year 1999.

NOTE 2: SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

The preparation of our consolidated financial statements in conformity with accounting principles generally accepted in the United States of America ("GAAP") 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.

New Accounting Standards During 2001, the Financial Accounting Standards Board ("FASB") issued Statement of Financial Accounting Standard ("SFAS") 141, "Business Combinations," which requires that the purchase method of accounting be used for all business combinations initiated or completed after June 30, 2001, and SFAS 142, "Goodwill and Other Intangible Assets," which requires that goodwill and intangible assets with indefinite useful lives no longer be amortized, but instead tested for impairment. Effective the first day of fiscal year 2002, we will no longer amortize goodwill and certain franchise rights, but will evaluate them for impairment annually. We have completed the initial impairment review required by SFAS 142 and have determined that our intangible assets are not impaired. The adoption of SFAS 142 will reduce our fiscal year 2002 amortization expense by approximately \$128 million, or \$0.31 per diluted share, based on the weighted-average number of diluted shares outstanding as of December 29, 2001.

In addition, during 2001 the FASB also issued SFAS 143, "Accounting for Asset Retirement Obligations" and SFAS 144, "Accounting for the Impairment or Disposal of Long-Lived Assets." SFAS 143 addresses financial accounting and reporting for obligations associated with the retirement of tangible long-lived assets and the associated asset retirement costs. It requires that we recognize the fair value of a liability for an asset retirement obligation in the period in which it is incurred if a reasonable estimate of fair value can be made. SFAS 144 superseded SFAS 121, "Accounting for the Impairment of Long-Lived Assets

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

Tabular dollars in millions, except per share data

and for Long-Lived Assets to Be Disposed Of,” and Accounting Principles Board Opinion 30, “Reporting the Results of Operations – Reporting the Effects of a Disposal of a Segment of a Business, and Extraordinary, Unusual and Infrequently Occurring Events and Transactions.” SFAS 144 establishes a single accounting model for the impairment of long-lived assets and broadens the presentation of discontinued operations to include more disposal transactions. SFAS 143 is effective for fiscal year 2003 and SFAS 144 is effective for fiscal year 2002 and we do not anticipate that the adoption of these statements will have a material impact on our Consolidated Financial Statements.

During 2000 and 2001, the Emerging Issues Task Force (“EITF”) addressed various issues related to the income statement classification of certain promotional payments. In May 2000, the EITF reached a consensus on Issue 00-14, “Accounting for Certain Sales Incentives,” addressing the recognition and income statement classification of various sales incentives. Among its requirements, the consensus will require the costs related to consumer coupons currently classified as marketing costs to be classified as a reduction of revenue. In January 2001, the EITF reached a consensus on Issue 00-22, “Accounting for ‘Points’ and Certain Other Time-Based or Volume-Based Sales Incentive Offers, and Offers for Free Products or Services to Be Delivered in the Future.” EITF 00-22 requires that certain volume-based cash rebates to customers currently recognized as marketing costs be classified as a reduction of revenue. In April 2001, the EITF reached a consensus on Issue 00-25, “Vendor Income Statement Characterization of Consideration Paid to a Reseller of the Vendor’s Products.” EITF 00-25 addresses the income statement classification of consideration, other than that directly addressed in EITF 00-14, from a vendor to a reseller or another party that purchases the vendor’s products. In November 2001, the EITF codified Issues 00-14, 00-22 and 00-25 as Issue 01-9, “Accounting for Consideration Given by a Vendor to a Customer or a Reseller of the Vendor’s Products.” EITF 00-22 was effective for the first quarter of 2001 and was not material to our Consolidated Financial Statements. The remainder of EITF 01-9 is effective for 2002 and we do not anticipate that the adoption will have a material impact on our Consolidated Financial Statements.

Our Consolidated Financial Statements reflect the implementation of SFAS 133, “Accounting for Derivative Instruments and Hedging Activities,” as amended by SFAS 138, on the first day of fiscal year 2001. SFAS 133, which was issued in 1998, establishes accounting and reporting standards for hedging activities and derivative instruments, including certain derivative instruments embedded in other contracts, which are collectively referred to as derivatives. It requires that an entity recognize all derivatives as either assets or liabilities in the consolidated balance sheets and measure those instruments at fair value.

Basis of Consolidation The accounts of all of our wholly and majority-owned subsidiaries are included in the accompanying Consolidated Financial Statements. We have eliminated intercompany accounts and transactions in consolidation.

Fiscal Year Our fiscal year ends on the last Saturday in December and, as a result, a 53rd week is added every five or six years. Fiscal years 2001 and 1999 consisted of 52 weeks while fiscal year 2000 consisted of 53 weeks.

Revenue Recognition We recognize revenue when our products are delivered to customers. Sales terms do not allow a right of return unless product freshness dating has expired. Reserves for returned product were \$4 million, \$3 million and \$2 million at fiscal years ended 2001, 2000 and 1999, respectively.

Advertising and Marketing Costs We are involved in a variety of programs to promote our products. We include advertising and marketing costs in selling, delivery and administrative expenses and expense such costs in the year incurred. Advertising and marketing costs were \$389 million, \$350 million and \$342 million in 2001, 2000 and 1999, respectively.

Bottler Incentives PepsiCo and other brand owners, at their sole discretion, provide us with various forms of marketing support. This marketing support is intended to cover a variety of programs and initiatives, including direct marketplace support, capital equipment funding and shared media, and advertising support. Based on the objective of the programs and initiatives, we record marketing support as an adjustment to net revenues or as a reduction of selling, delivery and administrative expenses. Direct marketplace support is primarily funding by PepsiCo and other brand owners of sales discounts and similar programs and is recorded as an adjustment to net revenues. Capital equipment funding is designed to support the purchase and placement of marketing equipment and is recorded as a reduction of selling, delivery and administrative expenses. Shared media and advertising support is recorded as a reduction to advertising and marketing expense within selling, delivery and administrative expenses. There are no conditions or other requirements that could result in a repayment of marketing support received.

The total bottler incentives we received from PepsiCo and other brand owners were \$598 million, \$566 million and \$563 million for 2001, 2000 and 1999, respectively. Of these amounts, we recorded \$293 million, \$277 million and \$263 million for 2001, 2000 and 1999, respectively, in net revenues, and the remainder as a reduction of selling, delivery and administrative expenses. The amount of our bottler incentives received from PepsiCo was

more than 90% of our bottler incentives in each of the three years, with the balance received from the other brand owners.

Shipping and Handling Costs We record shipping and handling costs within selling, delivery and administrative expenses. Such costs totaled \$947 million, \$925 million and \$915 million in 2001, 2000 and 1999, respectively.

Foreign Currency Gains and Losses We translate the balance sheets of our foreign subsidiaries that do not operate in highly inflationary economies at the exchange rates in effect at the balance sheet date, while we translate the statements of operations at the average rates of exchange during the year. The resulting translation adjustments of our foreign subsidiaries are recorded directly to accumulated other comprehensive loss. Foreign currency gains and losses reflect translation gains and losses arising from the re-measurement into U.S. dollars of the net monetary assets of businesses in highly inflationary countries and transaction gains and losses. Russia is considered a highly inflationary economy for accounting purposes.

Income Taxes Our effective tax rate and the tax bases of our assets and liabilities reflect our best estimate of the ultimate outcome of our tax audits. Valuation allowances are established where expected future taxable income does not support the recognition of the related deferred tax asset.

Earnings Per Share We compute basic earnings per share by dividing net income by the weighted-average number of common shares outstanding for the period. Diluted earnings per share reflect the potential dilution that could occur if securities or other contracts to issue common stock were exercised and converted into common stock that would then participate in net income.

Cash Equivalents Cash equivalents represent funds we have temporarily invested with original maturities not exceeding three months.

Allowance for Doubtful Accounts We determine our allowance for doubtful accounts based on an evaluation of the aging of our receivable portfolio. Our reserve contemplates our historical loss rate on receivables and the economic environment in which we operate.

Inventories We value our inventories at the lower of cost computed on the first-in, first-out method or net realizable value.

Property, Plant and Equipment We state property, plant and equipment (“PP&E”) at cost, except for PP&E that has been impaired, for which we write down the carrying amount to estimated fair-market value, which then becomes the new cost basis.

Intangible Assets Identifiable intangible assets arise principally from the allocation of the purchase price of businesses acquired, and consist primarily of territorial franchise rights. Our franchise rights are typically perpetual in duration, subject to compliance with the underlying franchise agreement. We assign amounts to such identifiable intangibles based on their estimated fair value at the date of acquisition. Goodwill represents the residual purchase price after allocation to all identifiable net assets. Identifiable intangible assets are evaluated at the date of acquisition and amortized on a straight-line basis over their estimated useful lives, which in most cases is from 20 – 40 years, the maximum period permitted by GAAP.

Recoverability of Long-Lived Assets We review all long-lived assets, including intangible assets, when facts and circumstances indicate that the carrying value of the asset may not be recoverable. When necessary, we write down an impaired asset to its estimated fair value based on the best information available. Estimated fair value is generally based on either appraised value or measured by discounting estimated future cash flows. Considerable management judgment is necessary to estimate discounted future cash flows, which are discounted based on our weighted-average cost of capital. Accordingly, actual results could vary significantly from such estimates.

Minority Interest PBG and PepsiCo contributed bottling businesses and assets used in the bottling businesses to Bottling Group, LLC, our principal operating subsidiary, in connection with the formation of Bottling Group, LLC. As a result of the contribution of these assets, PBG owns 93% of Bottling Group, LLC and PepsiCo owns the remaining 7%. Accordingly, the Consolidated Financial Statements reflect PepsiCo’s share of consolidated net income of Bottling Group, LLC as minority interest in our Consolidated Statements of Operations, and PepsiCo’s share of consolidated net assets of Bottling Group, LLC as minority interest in our Consolidated Balance Sheets.

Treasury Stock We record the repurchase of shares of our common stock at cost and classify these shares as treasury stock within shareholders’ equity. Repurchased shares are included in our authorized and issued shares but not included in our shares outstanding. We record shares reissued using an average cost. Since our initial public offering, shares issued and outstanding reflect the effect of our share repurchase program, which began in October 1999. In the second quarter of 2001, the Board of Directors authorized the repurchase of 10 million shares of common stock, increasing the cumulative amount of shares that can be repurchased to 25 million shares. As a result of our stock split in November of 2001, the amount of shares authorized by

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the Board of Directors to be repurchased now totals 50 million shares. Share repurchases were approximately 12 million in 2001 for \$249 million and approximately 9 million in 2000 for \$103 million. We have repurchased approximately 31 million shares since the inception of our program and have reissued approximately 2 million for stock option exercises.

Financial Instruments and Risk Management We use derivative instruments to hedge against the risk of adverse movements in the price of certain commodities and fuel used in our operations. Our use of derivative instruments is limited to interest rate swaps, forward contracts, futures and options on futures contracts. Our corporate policy prohibits the use of derivative instruments for trading or speculative purposes, and we have procedures in place to monitor and control their use.

All derivative instruments are recorded at fair value as either assets or liabilities in our Consolidated Balance Sheets. Derivative instruments are designated and accounted for as either a hedge of a recognized asset or liability ("fair value hedge") or a hedge of a forecasted transaction ("cash flow hedge"). For a fair value hedge, both the effective and ineffective portions of the change in fair value of the derivative instrument, along with an adjustment to the carrying amount of the hedged item for fair value changes attributable to the hedged risk, are recognized in earnings. For a cash flow hedge, changes in the fair value of the derivative instrument that are highly effective are deferred in accumulated other comprehensive loss until the underlying hedged item is recognized in earnings. The ineffective portion of fair value changes on qualifying hedges is recognized in earnings immediately and is recorded consistent with the expense classification of the underlying hedged item. If a fair value or cash flow hedge were to cease to qualify for hedge accounting or be terminated, it would continue to be carried on the balance sheet at fair value until settled but hedge accounting would be discontinued prospectively. If a forecasted transaction were no longer probable of occurring, amounts previously deferred in accumulated other comprehensive loss would be recognized immediately in earnings.

On occasion, we may enter into a derivative instrument for which hedge accounting is not required because it is entered into to offset changes in the fair value of an underlying transaction recognized in earnings ("natural hedge"). These instruments are reflected in the Consolidated Balance Sheets at fair value with changes in fair value recognized in earnings.

Stock-Based Employee Compensation We measure stock-based compensation expense in accordance with Accounting Principles Board Opinion 25, "Accounting for Stock Issued

to Employees," and its related interpretations. Accordingly, compensation expense for stock option grants to PBG employees is measured as the excess of the quoted market price of common stock at the grant date over the amount the employee must pay for the stock. Our policy is to grant stock options at fair value on the date of grant.

Commitments and Contingencies We are subject to various claims and contingencies related to lawsuits, taxes, environmental and other matters arising out of the normal course of business. Liabilities related to commitments and contingencies are recognized when a loss is probable and reasonably estimable.

Reclassifications Certain reclassifications were made in our Consolidated Financial Statements to 2000 and 1999 amounts to conform with the 2001 presentation.

NOTE 3: COMPARABILITY OF RESULTS**Stock Split**

On November 27, 2001, our shareholders approved an amendment to our Certificate of Incorporation increasing the authorized shares of PBG common stock from 300 million to 900 million facilitating a two-for-one stock split of issued common stock. The stock split was effected in the form of a 100% stock dividend paid to our shareholders of record on November 27, 2001. As a result of the stock split, the accompanying Consolidated Financial Statements reflect an increase in the number of outstanding shares of common stock and shares of treasury stock and the transfer of the par value of these incremental shares from additional paid-in capital. All PBG share and per share data have been restated to reflect the split except for discussions of our capitalization.

Asset Lives

At the beginning of fiscal year 2000, we changed the estimated useful lives of certain categories of assets primarily to reflect the success of our preventive maintenance programs in extending the useful lives of these assets. The changes, which are detailed in the table below, lowered total depreciation cost by approximately \$69 million, or \$0.13 per diluted share in 2000. In 2001, we are utilizing the same asset lives as in 2000.

Estimated Useful Lives <i>in years</i>	2000	1999
Manufacturing equipment	15	10
Heavy fleet	10	8
Fountain dispensing equipment	7	5
Small specialty coolers and specialty marketing equipment	3	5 to 7

Fiscal Year

Our fiscal year ends on the last Saturday in December and, as a result, a 53rd week is added every five or six years. Fiscal years 2001 and 1999 consisted of 52 weeks while fiscal year 2000 consisted of 53 weeks. The extra week in 2000 contributed approximately \$0.02 of additional diluted earnings per share to our 2000 operating results.

Initial Public Offering

For the period prior to our initial public offering, we prepared our Consolidated Financial Statements as a "carve-out" from the financial statements of PepsiCo using the historical results of operations and assets and liabilities of our business. Certain costs reflected in the Consolidated Financial Statements may not necessarily be indicative of the costs that we would have incurred had we operated as an independent, stand-alone entity from the first day of fiscal year 1999. These costs include an allocation of PepsiCo's corporate overhead and interest expense, and income taxes:

- We included overhead related to PepsiCo's corporate administrative functions based on a specific identification of PepsiCo's administrative costs relating to the bottling operations and, to the extent that such identification was not practicable, based upon the percentage of our revenues to PepsiCo's consolidated net revenues. These costs are included in selling, delivery and administrative expenses in our Consolidated Statements of Operations.
- We allocated \$3.3 billion of PepsiCo's debt to our business and charged interest expense on this debt using PepsiCo's weighted-average interest rate. Once we issued \$3.3 billion of third-party debt in the first quarter of 1999, our actual interest rates were used to determine interest expense for the remainder of the year.
- We reflected income tax expense in the Consolidated Financial Statements as if we had actually filed a separate income tax return.

The amounts of the historical allocations described above are as follows:

	1999
Corporate overhead expense	\$ 3
Interest expense	\$28
PepsiCo weighted-average interest rate	5.8%

In addition, our historical capital structure is not representative of our current structure due to our initial public offering. In 1999, immediately preceding the offering, we had 55 million shares of common stock outstanding. In connection with the offering, we sold 100 million shares to the public.

NOTE 4: UNUSUAL IMPAIRMENT AND OTHER CHARGES AND CREDITS

Our operating results were affected by the following unusual charges and credits:

	1999
Non-cash compensation charge	\$ 45
Vacation policy change	(53)
Asset impairment charges and restructuring charges	(8)
	\$(16)
After minority interest and income taxes	\$ (9)

- **Non-cash Compensation Charge**
In connection with the completion of our initial public offering, PepsiCo vested substantially all non-vested PepsiCo stock options held by our employees. As a result, we incurred a \$45 million non-cash compensation charge in the second quarter of 1999, equal to the difference between the market price of the PepsiCo capital stock and the exercise price of these options at the vesting date.
- **Vacation Policy Change**
As a result of changes to our employee benefit and compensation plans in 1999, employees now earn vacation time evenly throughout the year based upon service rendered. Previously, employees were fully vested at the beginning of each year. As a result of this change, we reversed an accrual of \$53 million into income in 1999.
- **Asset Impairment and Restructuring Charges**
In the fourth quarter of 1999, \$8 million of the remaining restructuring reserve recorded in 1998, relating to an asset impairment and restructuring in our Russian operations, was reversed into income. The reversal was necessitated as actual costs incurred to renegotiate manufacturing and leasing contracts in Russia and to reduce the number of employees were less than the amounts originally estimated.

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NOTE 5: INVENTORIES

	2001	2000
Raw materials and supplies	\$117	\$107
Finished goods	214	174
	\$331	\$281

NOTE 6: PROPERTY, PLANT AND EQUIPMENT, NET

	2001	2000
Land	\$ 145	\$ 145
Buildings and improvements	925	903
Manufacturing and distribution equipment	2,308	2,169
Marketing equipment	1,846	1,745
Other	121	106
	5,345	5,068
Accumulated depreciation	(2,802)	(2,710)
	\$ 2,543	\$ 2,358

We calculate depreciation on a straight-line basis over the estimated lives of the assets as follows:

Building and improvements	20 – 33 years
Production equipment	15 years
Distribution equipment	5 – 10 years
Marketing equipment	3 – 7 years

NOTE 7: INTANGIBLE ASSETS, NET

	2001	2000
Franchise rights and other identifiable intangibles	\$ 3,636	\$ 3,557
Goodwill	1,574	1,591
	5,210	5,148
Accumulated amortization	(1,526)	(1,454)
	\$ 3,684	\$ 3,694

NOTE 8: ACCOUNTS PAYABLE AND OTHER CURRENT LIABILITIES

	2001	2000
Accounts payable	\$ 362	\$344
Trade incentives	205	206
Accrued compensation and benefits	141	147
Accrued interest	71	71
Accounts payable to PepsiCo	17	—
Other current liabilities	208	173
	\$1,004	\$941

NOTE 9: SHORT-TERM BORROWINGS AND LONG-TERM DEBT

	2001	2000
Short-term borrowings		
Current maturities of long-term debt	\$ 3	\$ 1
Other short-term borrowings	74	25
	\$ 77	\$ 26
Long-term debt		
5½% senior notes due 2009	\$1,300	\$1,300
5½% senior notes due 2004	1,000	1,000
7% senior notes due 2029	1,000	1,000
Other	18	6
	3,318	3,306
Less: Unamortized discount	30	34
Current maturities of long-term debt	3	1
	\$3,285	\$3,271

Maturities of long-term debt as of December 29, 2001 are 2002: \$3 million, 2003: \$3 million, 2004: \$1,008 million, 2005: \$0, 2006: \$0 and thereafter, \$2,304 million.

The \$1.3 billion of 5½% senior notes and the \$1.0 billion of 5½% senior notes were issued on February 9, 1999, by our subsidiary Bottling Group, LLC and are guaranteed by PepsiCo. We issued the \$1.0 billion of 7% senior notes, which are guaranteed by Bottling Group, LLC, on March 8, 1999. During the second quarter of 1999 we executed an interest rate swap converting 3% of our fixed-rate debt to floating-rate debt.

We allocated \$3.3 billion of PepsiCo's long-term debt in our financial statements prior to issuing the senior notes referred to above. Our interest expense includes the related allocated interest expense of \$28 million in 1999, and is based on PepsiCo's weighted-average interest rate of 5.8% in 1999.

We also have a \$500 million commercial paper program that is supported by a credit facility. The credit facility consists of two \$250 million components, one of which expires in May 2002 and the other of which expires in April 2004. There were no borrowings outstanding under this program at December 29, 2001 or December 30, 2000.

We have available short-term bank credit lines of approximately \$177 million and \$135 million at December 29, 2001 and December 30, 2000, respectively. These lines are used to support the general operating needs of our businesses outside the United States. The weighted-average interest rate for these lines of credit outstanding at December 29, 2001 and December 30, 2000 was 4.3% and 8.9%, respectively.

Amounts paid to third parties for interest were \$191 million, \$202 million and \$108 million in 2001, 2000 and 1999, respectively. In 1999, allocated interest expense was deemed to have been paid to PepsiCo, in cash, in the period in which the cost was incurred.

NOTE 10: LEASES

We have noncancellable commitments under both capital and long-term operating leases. Capital and operating lease commitments expire at various dates through 2021. Most leases require payment of related executory costs, which include property taxes, maintenance and insurance.

Our future minimum commitments under noncancellable leases are set forth below:

	Commitments	
	Capital	Operating
2002	\$ —	\$ 22
2003	—	20
2004	—	17
2005	—	16
2006	—	14
Later years	3	82
	\$ 3	\$171

At December 29, 2001, the present value of minimum payments under capital leases was \$1 million, after deducting \$2 million for imputed interest. Our rental expense was \$40 million, \$42 million and \$55 million for 2001, 2000 and 1999, respectively.

NOTE 11: FINANCIAL INSTRUMENTS AND RISK MANAGEMENT

These Consolidated Financial Statements reflect the implementation of SFAS 133, as amended by SFAS 138, on the first day of fiscal year 2001. In June 1998, the FASB issued SFAS 133, "Accounting for Derivative Instruments and Hedging Activities." This statement establishes accounting and reporting standards for hedging activities and derivative instruments, including certain derivative instruments embedded in other contracts, which are collectively referred to as derivatives. It requires that an entity recognize all derivatives as either assets or liabilities in the consolidated balance sheet and measure those instruments at fair value. In June 2000, the FASB issued SFAS 138, amending the accounting and reporting standards of SFAS 133. Prior to the adoption of SFAS 133, there were no deferred gains or losses from our hedging activities recorded in our Consolidated Financial

Statements. The adoption of these statements resulted in the recording of a deferred gain in our Consolidated Balance Sheets, which was recorded as an increase to current assets of \$4 million and a reduction of accumulated other comprehensive loss of \$4 million. Furthermore, the adoption had no impact on our Consolidated Statement of Operations.

As of December 29, 2001, our use of derivative instruments is limited to an interest rate swap, forward contracts, futures and options on futures contracts. Our corporate policy prohibits the use of derivative instruments for trading or speculative purposes, and we have procedures in place to monitor and control their use.

Cash Flow Hedge We are subject to market risk with respect to the cost of commodities because our ability to recover increased costs through higher pricing may be limited by the competitive environment in which we operate. We use futures contracts and options on futures in the normal course of business to hedge the risk of adverse movements in commodity prices related to anticipated purchases of aluminum and fuel used in our operations. These contracts, which generally range from 1 to 12 months in duration, establish our commodity purchase prices within defined ranges in an attempt to limit our purchase price risk resulting from adverse commodity price movements and are designated as and qualify for cash flow hedge accounting treatment.

In 2001, the amount of deferred losses from our commodity hedging that we recognized into income was \$4 million. At December 29, 2001 a \$19 million deferred loss remained in accumulated other comprehensive loss in our Consolidated Balance Sheets resulting from our commodity hedges. We anticipate that this loss, which is \$12 million on an after-tax basis, will be recognized in cost of sales in our Consolidated Statements of Operations over the next 12 months. The ineffective portion of the change in fair value of these contracts was not material to our results of operations in 2001.

Fair Value Hedges We finance a portion of our operations through fixed-rate debt instruments. At December 29, 2001 our debt instruments primarily consisted of \$3.3 billion of fixed-rate long-term senior notes, 3% of which we converted to floating rate debt through the use of an interest rate swap with the objective of reducing our overall borrowing costs. This interest rate swap, which expires in 2004, is designated as and qualifies for fair value hedge accounting and is 100% effective in eliminating the interest rate risk inherent in our long-term debt as the notional amount, interest payment, and maturity date of the swap matches the notional amount, interest payment and matu-

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rity date of the related debt. Accordingly, any market risk or opportunity associated with this swap is fully offset by the opposite market impact on the related debt. The change in fair value of the interest rate swap was a gain of \$7 million in 2001. The fair value change was recorded in interest expense, net in our Consolidated Statements of Operations and in prepaid expenses and other current assets in our Consolidated Balance Sheets. An offsetting adjustment was recorded in interest expense, net in our Consolidated Statements of Operations and in long-term debt in our Consolidated Balance Sheets representing the change in fair value in long-term debt.

Equity Derivatives We use equity derivative contracts with financial institutions to hedge a portion of our deferred compensation liability, which is based on our stock price. These prepaid forward contracts for the purchase of PBG common stock are accounted for as natural hedges. The earnings impact from these hedges is classified as selling, delivery and administrative expenses consistent with the expense classification of the underlying hedged item.

Fair Value Financial assets with carrying values approximating fair value include cash and cash equivalents and accounts receivable. Financial liabilities with carrying values approximating fair value include accounts payable and other accrued liabilities and short-term debt. The carrying value of these financial assets and liabilities approximates fair value due to the short maturity of our financial assets and liabilities, and since interest rates approximate fair value for short-term debt.

Long-term debt at December 29, 2001 had a carrying value and fair value of \$3.3 billion and \$3.4 billion, respectively, and at December 30, 2000 had a carrying value and fair value of \$3.3 billion and \$3.2 billion, respectively.

NOTE 12: PENSION AND POSTRETIREMENT BENEFIT PLANS**Pension Benefits**

Our U.S. employees participate in noncontributory defined benefit pension plans, which cover substantially all full-time salaried employees, as well as most hourly employees. Benefits generally are based on years of service and compensation, or stated amounts for each year of service. All of our qualified plans are funded and contributions are made in amounts not less than minimum statutory funding requirements and not more than the maximum amount that can be deducted for U.S. income tax purposes. Our net pension expense for the defined benefit pension plans for our operations outside the U.S. was not significant.

Postretirement Benefits

Our postretirement plans provide medical and life insurance benefits principally to U.S. retirees and their dependents. Employees are eligible for benefits if they meet age and service requirements and qualify for retirement benefits. The plans are not funded and since 1993 have included retiree cost sharing.

Components of net periodic benefit costs:

	Pension		
	2001	2000	1999
Service cost	\$ 28	\$ 27	\$ 30
Interest cost	50	49	42
Expected return on plan assets	(60)	(56)	(49)
Amortization of net loss	—	—	4
Amortization of prior service amendments	4	5	5
Net periodic benefit costs	\$ 22	\$ 25	\$ 32

	Postretirement		
	2001	2000	1999
Service cost	\$ 3	\$ 3	\$ 4
Interest cost	16	14	12
Amortization of net loss	1	1	—
Amortization of prior service amendments	(6)	(6)	(5)
Net periodic benefit costs	\$ 14	\$ 12	\$ 11

We amortize prior service costs on a straight-line basis over the average remaining service period of employees expected to receive benefits.

Changes in the benefit obligation:

	Pension		Postretirement	
	2001	2000	2001	2000
Obligation at beginning of year	\$664	\$647	\$212	\$206
Service cost	28	27	3	3
Interest cost	50	49	16	14
Plan amendments	10	4	—	(10)
Actuarial loss/(gain)	48	(19)	14	11
Benefit payments	(40)	(40)	(17)	(12)
Acquisitions and other	—	(4)	—	—
Obligation at end of year	\$760	\$664	\$228	\$212

Changes in the fair value of assets:

	Pension		Postretirement	
	2001	2000	2001	2000
Fair value at beginning of year	\$ 665	\$ 597	\$ —	\$ —
Actual (loss)/gain on plan assets	(117)	96	—	—
Employer contributions	70	16	17	12
Benefit payments	(40)	(40)	(17)	(12)
Acquisitions and other	—	(4)	—	—
Fair value at end of year	\$ 578	\$ 665	\$ —	\$ —

Selected information for the plans with accumulated benefit obligations in excess of plan assets:

	Pension		Postretirement	
	2001	2000	2001	2000
Projected benefit obligation	\$760	\$31	\$228	\$212
Accumulated benefit obligation	690	14	228	212
Fair value of plan assets	604	—	—	—

Funded status recognized on the Consolidated Balance Sheets:

	Pension		Postretirement	
	2001	2000	2001	2000
Funded status at end of year	\$(182)	\$ 1	\$(228)	\$(212)
Unrecognized prior service cost	36	31	(16)	(21)
Unrecognized loss/(gain)	153	(73)	57	45
Unrecognized transition asset	(1)	(1)	—	—
Fourth quarter employer contributions	26	10	5	7
Net amounts recognized	\$ 32	\$(32)	\$(182)	\$(181)

Net amounts recognized in the Consolidated Balance Sheets:

	Pension		Postretirement	
	2001	2000	2001	2000
Prepaid expenses	\$ —	\$ 31	\$ —	\$ —
Other liabilities	(101)	(63)	(182)	(181)
Intangible assets, net	37	—	—	—
Accumulated other comprehensive loss	96	—	—	—
Net amounts recognized	\$ 32	\$(32)	\$(182)	\$(181)

At December 29, 2001, the accumulated benefit obligation of certain PBG pension plans exceeded the fair market value of the plan assets resulting in the recognition of an additional unfunded

liability as a minimum balance sheet liability. As a result of this additional liability, an intangible asset of \$37 million and an increase to accumulated other comprehensive loss of \$96 million was recognized. The adjustment to accumulated other comprehensive loss is reflected after minority interest and taxes in our Consolidated Statements of Changes in Shareholders' Equity.

The weighted-average assumptions used to compute the above information are set forth below:

	Pension		
	2001	2000	1999
Discount rate for benefit obligation	7.5%	7.8%	7.8%
Expected return on plan assets	10.0%	10.0%	10.0%
Rate of compensation increase	4.3%	4.6%	4.3%

	Postretirement		
	2001	2000	1999
Discount rate for benefit obligation	7.5%	7.8%	7.8%

Components of Pension Assets

The pension plan assets are principally invested in stocks and bonds. None of the assets are invested directly into PBG stock.

Health Care Cost Trend Rates

We have assumed an average increase of 8.0% in 2002 in the cost of postretirement medical benefits for employees who retired before cost sharing was introduced. This average increase is then projected to decline gradually to 4.5% in 2009 and thereafter.

Assumed health care cost trend rates have an impact on the amounts reported for postretirement medical plans. A one-percentage point change in assumed health care costs would have the following effects:

	1%	1%
	Increase	Decrease
Effect on total fiscal year 2001 service and interest cost components	\$—	\$—
Effect on the fiscal year 2001 accumulated postretirement benefit obligation	7	(6)

Other Employee Benefit Plans

We made several changes to our employee benefit plans that took effect in fiscal year 2000. The changes were made to our vacation policy, pension and retiree medical plans and included some benefit enhancements as well as cost containment provisions. These changes did not have a significant impact on our financial results in 2001 or 2000.

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Tabular dollars in millions, except per share data

In 1999, our Board of Directors approved a matching company contribution to our 401(k) plan that began in 2000. The match is dependent upon the employee's contribution and years of service. The matching company contribution was approximately \$17 million and \$15 million in 2001 and 2000, respectively.

In the fourth quarter of 1999 we recognized a \$16 million compensation charge related to full-year 1999 performance. This expense was one-time in nature and was for the benefit of our management employees, reflecting our successful operating results as well as providing certain incentive-related features.

NOTE 13: EMPLOYEE STOCK OPTION PLANS

Under our long-term incentive plan, stock options are issued to middle and senior management employees and vary according to salary and level within PBG. Except as noted below, options granted in 2001 and 2000 had exercise prices ranging from \$18.88 per share to \$22.50 per share, and \$9.38 per share to \$15.88 per share, respectively, expire in 10 years and become exercisable 25% after the first year, 25% after the second year and the remainder after the third year. Options granted in 1999 had exercise prices ranging from \$9.63 per share to \$11.50 per share and, with the exception of our chairman's options, are exercisable after three years and expire in 10 years. Our chairman's 1999 options are exercisable ratably over the three years following our initial public offering date.

In 2001, two additional option grants were made to certain senior management employees. One grant had an exercise price of \$19.50 per share, expires in 10 years and became exercisable on the grant date. The other grant had an exercise price of \$22.50 per share, expires in 10 years and becomes exercisable in 5 years.

In conjunction with our initial public offering, we issued a one-time founders' grant of options to all full-time non-management employees in 1999 to purchase 200 shares of PBG stock. These options have an exercise price equal to the initial public offering price of \$11.50 per share, are exercisable after three years and expire in 10 years.

In connection with the completion of our initial public offering, PepsiCo vested substantially all non-vested PepsiCo stock options held by PBG employees. As a result, we incurred a \$45 million non-cash compensation charge in the second quarter of 1999, equal to the difference between the market price of the PepsiCo capital stock and the exercise price of these options at the vesting date.

The following table summarizes option activity during 2001:

<i>options in millions</i>	Options	Weighted-Average Exercise Price
Outstanding at beginning of year	33.2	\$10.75
Granted	10.2	20.47
Exercised	(1.8)	10.84
Forfeited	(1.9)	12.01
Outstanding at end of year	39.7	\$13.20
Exercisable at end of year	6.6	\$13.38
Weighted-average fair value of options granted during the year		\$ 8.55

The following table summarizes option activity during 2000:

<i>options in millions</i>	Options	Weighted-Average Exercise Price
Outstanding at beginning of year	22.4	\$11.49
Granted	13.2	9.57
Exercised	(0.2)	10.53
Forfeited	(2.2)	11.20
Outstanding at end of year	33.2	\$10.75
Exercisable at end of year	1.8	\$11.11
Weighted-average fair value of options granted during the year		\$ 4.68

The following table summarizes option activity during 1999:

<i>options in millions</i>	Options	Weighted-Average Exercise Price
Outstanding at beginning of year	—	\$ —
Granted	24.2	11.49
Exercised	—	—
Forfeited	(1.8)	11.50
Outstanding at end of year	22.4	\$11.49
Exercisable at end of year	—	\$ —
Weighted-average fair value of options granted during the year		\$ 5.15

Stock options outstanding and exercisable at December 29, 2001:

<i>options in millions</i>	Options Outstanding			Options Exercisable	
	Options	Weighted-Average Remaining Contractual Life in Years	Weighted-Average Exercise Price	Options	Weighted-Average Exercise Price
Range of Exercise Price					
\$ 9.38–\$11.49	10.4	7.99	\$ 9.38	2.2	\$ 9.40
\$11.50–\$15.88	19.5	7.02	\$11.55	2.3	\$11.57
\$15.89–\$22.50	9.8	9.00	\$20.47	2.1	\$19.59
	39.7	7.77	\$13.20	6.6	\$13.38

We adopted the disclosure provisions of SFAS 123, "Accounting for Stock-Based Compensation," but continue to measure stock-based compensation cost in accordance with the Accounting Principles Board Opinion 25 and its related interpretations. If we had measured compensation cost for the stock options granted to our employees under the fair value based method prescribed by SFAS 123, net income would have been changed to the pro forma amounts set forth below:

	2001	2000	1999
Net Income			
Reported	\$ 305	\$ 229	\$ 118
Pro forma	269	204	102
Diluted Earnings per Share			
Reported	\$1.03	\$0.77	\$0.46
Pro forma	0.91	0.69	0.39

The fair value of PBG stock options used to compute pro forma net income disclosures was estimated on the date of grant using the Black-Scholes option-pricing model based on the following weighted-average assumptions:

	2001	2000	1999
Risk-free interest rate	4.6%	6.7%	5.8%
Expected life	6 years	7 years	7 years
Expected volatility	35%	35%	30%
Expected dividend yield	0.20%	0.43%	0.35%

NOTE 14: INCOME TAXES

The details of our income tax provision are set forth below:

	2001	2000	1999
Current:			
Federal	\$ 93	\$107	\$ 79
Foreign	5	1	(1)
State	15	27	19
	113	135	97
Deferred:			
Federal	43	7	(17)
Foreign	(1)	—	—
State	6	(7)	(10)
	48	—	(27)
	161	135	70
Rate change benefit	(25)	—	—
	\$136	\$135	\$ 70

Our 2001 income tax provision includes a nonrecurring reduction in income tax expense of \$25 million due to enacted tax rate changes in Canada during the year.

Our U.S. and foreign income before income taxes is set forth below:

	2001	2000	1999
U.S.	\$375	\$318	\$188
Foreign	66	46	—
	\$441	\$364	\$188

Our reconciliation of income taxes calculated at the U.S. federal statutory rate to our provision for income taxes is set forth below:

	2001	2000	1999
Income taxes computed at the U.S. federal statutory rate	35.0%	35.0%	35.0%
State income tax, net of federal tax benefit	3.1	3.2	3.2
Impact of foreign results	(9.0)	(7.5)	(9.1)
Goodwill and other nondeductible expenses	3.9	5.1	7.8
Unusual impairment and other charges and credits	—	—	(0.6)
Other, net	3.5	1.2	1.1
	36.5	37.0	37.4
Rate change benefit	(5.7)	—	—
Total effective income tax rate	30.8%	37.0%	37.4%

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

Tabular dollars in millions, except per share data

The details of our 2001 and 2000 deferred tax liabilities (assets) are set forth below:

	2001	2000
Intangible assets and property, plant and equipment	\$1,094	\$1,098
Other	109	96
Gross deferred tax liabilities	1,203	1,194
Net operating loss carryforwards	(121)	(139)
Employee benefit obligations	(141)	(112)
Bad debts	(13)	(15)
Various liabilities and other	(72)	(70)
Gross deferred tax assets	(347)	(336)
Deferred tax asset valuation allowance	122	148
Net deferred tax assets	(225)	(188)
Net deferred tax liability	\$ 978	\$1,006
Included in:		
Prepaid expenses and other current assets	\$ (43)	\$ (66)
Deferred income taxes	1,021	1,072
	\$ 978	\$1,006

We have net operating loss carryforwards totaling \$370 million at December 29, 2001, which are available to reduce future taxes in the U.S., Spain, Greece and Russia. Of these carryforwards, \$2 million expire in 2002 and \$368 million expire at various times between 2003 and 2021. We have established a full valuation allowance for the net operating loss carryforwards attributable to Spain, Greece and Russia based upon our projection that it is more likely than not that these losses will not be realized. In addition, at December 29, 2001 we have a tax credit carryforward in the U.S. of \$7 million with an indefinite carryforward period.

Our valuation allowances, which reduce deferred tax assets to an amount that will more likely than not be realized, have decreased by \$26 million, in 2001 and increased \$1 million in 2000.

Deferred taxes are not recognized for temporary differences related to investments in foreign subsidiaries that are essentially permanent in duration. Determination of the amount of unrecognized deferred taxes related to these investments is not practicable.

Income taxes receivable were \$15 million and \$12 million at December 29, 2001 and December 30, 2000, respectively. Such amounts are recorded within prepaid expenses and other current assets in our Consolidated Balance Sheets. Amounts paid to taxing authorities for income taxes were \$101 million, \$147 million and \$111 million in 2001, 2000 and 1999 respectively.

NOTE 15: GEOGRAPHIC DATA

We operate in one industry, carbonated soft drinks and other ready-to-drink beverages. We conduct business in 41 states and the District of Columbia in the United States. Outside the U.S., we conduct business in eight Canadian provinces, Spain, Greece and Russia.

	Net Revenues		
	2001	2000	1999
U.S.	\$7,197	\$6,830	\$6,352
Other countries	1,246	1,152	1,153
	\$8,443	\$7,982	\$7,505
	Long-Lived Assets		
	2001	2000	1999
U.S.	\$5,395	\$5,192	\$5,139
Other countries	914	960	987
	\$6,309	\$6,152	\$6,126

NOTE 16: RELATIONSHIP WITH PEPSICO

At the time of the initial public offering we entered into a number of agreements with PepsiCo. The most significant agreements that govern our relationship with PepsiCo consist of:

- (1) the master bottling agreement for cola beverages bearing the "Pepsi-Cola" and "Pepsi" trademark in the United States; bottling and distribution agreements for non-cola products in the United States, including Mountain Dew; and a master fountain syrup agreement in the United States;
- (2) agreements similar to the master bottling agreement and the non-cola agreements for each specific country, including Canada, Spain, Greece and Russia, as well as a fountain syrup agreement similar to the master syrup agreement for Canada;
- (3) a shared services agreement whereby PepsiCo provides us or we provide PepsiCo with certain administrative support, including procurement of raw materials, transaction processing, such as accounts payable and credit and collection, certain tax and treasury services, and information technology maintenance and systems development. The amounts paid or received under this contract are equal to the actual costs incurred by the company providing the service. From 1998 through 2001, a PepsiCo affiliate has provided casualty insurance to us; and
- (4) transition agreements that provide certain indemnities to the parties, and provide for the allocation of tax and other assets, liabilities, and obligations arising from periods prior to the

initial public offering. Under our tax separation agreement, PepsiCo maintains full control and absolute discretion for any combined or consolidated tax filings for tax periods ending on or before the initial public offering. PepsiCo has contractually agreed to act in good faith with respect to all tax audit matters affecting us. In addition, PepsiCo has agreed to use their best efforts to settle all joint interests in any common audit issue on a basis consistent with prior practice.

We purchase concentrate from PepsiCo that is used in the production of carbonated soft drinks and other ready-to-drink beverages. The price of concentrate is determined annually by PepsiCo at its sole discretion. We also produce or distribute other products and purchase finished goods and concentrate through various arrangements with PepsiCo or PepsiCo joint ventures. We reflect such purchases in cost of sales.

We share a business objective with PepsiCo of increasing the availability and consumption of Pepsi-Cola beverages. Accordingly, PepsiCo, at its sole discretion, provides us with various forms of marketing support to promote its beverages. This support covers a variety of initiatives, including marketplace support, marketing programs, capital equipment investment, and shared media expense. Based on the objective of the programs and initiatives, we record marketing support as an adjustment to net revenues or as a reduction of selling, delivery and administrative expense.

We manufacture and distribute fountain products and provide fountain equipment service to PepsiCo customers in some territories in accordance with the Pepsi beverage agreements. Amounts received from PepsiCo for these transactions are offset by the cost to provide these services and are reflected in selling, delivery and administrative expenses. We pay a royalty fee to PepsiCo for the Aquafina trademark.

The Consolidated Statements of Operations include the following income (expense) amounts as a result of transactions with PepsiCo and its affiliates:

	2001	2000	1999
Net revenues	\$ 262	\$ 244	\$ 236
Cost of sales	(1,927)	(1,626)	(1,488)
Selling, delivery and administrative expenses	259	266	285

We are not required to pay any minimum fees to PepsiCo, nor are we obligated to PepsiCo under any minimum purchase requirements. There are no conditions or requirements that could result in the repayment of any marketing support payments received by us from PepsiCo.

With respect to PepsiCo's 7% ownership of Bottling Group, LLC, Bottling Group, LLC guarantees that to the extent there is available cash, it will distribute pro rata to PepsiCo and PBG sufficient cash such that aggregate cash distributed to PBG will enable us to pay income taxes and interest on our \$1 billion 7% senior notes due 2029.

Net amounts payable to PepsiCo and its affiliates were \$17 million at December 29, 2001 and net amounts receivable from PepsiCo and its affiliates were \$8 million at December 30, 2000. Such amounts are recorded within accounts payable and other current liabilities and accounts receivable in our Consolidated Balance Sheets, respectively.

NOTE 17: CONTINGENCIES

We are involved in a lawsuit with current and former employees concerning wage and hour issues in New Jersey. We are unable to predict the amount of any costs or implications of this case at this time as legal proceedings are ongoing.

We are subject to various claims and contingencies related to lawsuits, taxes, environmental and other matters arising out of the normal course of business. We believe that the ultimate liability arising from such claims or contingencies, if any, in excess of amounts already recognized is not likely to have a material adverse effect on our results of operations, financial condition or liquidity.

NOTE 18: ACQUISITIONS

During 2001, PBG acquired the operations and exclusive right to manufacture, sell and distribute Pepsi-Cola beverages from two PepsiCo franchise bottlers. In May and August of 2001, we acquired Pepsi-Cola Bottling of Northern California, and Pepsi-Cola Elmira Bottling Co. Inc., respectively, for an aggregate purchase price of \$125 million of cash and assumed debt. In December 2001, we signed a letter of intent to purchase the Pepsi-Cola Bottling Company of Macon, Inc. The transaction is expected to close in the first quarter of 2002. During 2000, we acquired two territories in Canada for an aggregate purchase price of \$26 million in cash.

These acquisitions were accounted for by the purchase method, and were made to enable us to provide better service to our large retail customers, as well as reduce costs through economies of scale. The aggregate purchase price exceeded the fair value of net tangible assets acquired, including the resulting tax effect, by approximately \$108 million and \$14 million in 2001 and 2000, respectively. The excess was recorded in intangible assets.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

Tabular dollars in millions, except per share data

NOTE 19: COMPUTATION OF BASIC AND DILUTED EARNINGS (LOSS) PER SHARE

shares in thousands	2001	2000	1999
Number of shares on which basic earnings per share is based:			
Weighted-average outstanding during period	286,024	294,294	256,852
Add – Incremental shares under stock compensation plans	9,655	4,376	—
Number of shares on which diluted earnings per share is based	295,679	298,670	256,852
Basic and diluted net income applicable to common shareholders	\$ 305	\$ 229	\$ 118
Basic earnings per share	\$1.07	\$0.78	\$0.46
Diluted earnings per share	\$1.03	\$0.77	\$0.46

Diluted earnings per share reflect the potential dilution that could occur if the stock options from our stock compensation plan were exercised and converted into common stock that would then participate in net income. The calculation of earnings per share above reflects the two-for-one stock split as discussed in Note 3. Our stock price improvement has resulted in \$0.04 and \$0.01 per share of dilution in 2001 and 2000, respectively.

In 1999, immediately preceding our initial public offering, we had 55 million shares of common stock outstanding. In connection with the offering, we sold 100 million shares of common stock to the public. Since our initial public offering, shares outstanding reflect the effect of our share repurchase program, which began in October 1999. In addition, in November 2001 we executed a two-for-one stock split in the form of a 100% stock dividend, doubling our weighted-average shares outstanding. As a result of the stock split in 2001, the amount of shares authorized by the Board of Directors to be repurchased totals 50 million shares, of which we have repurchased approximately 31 million shares since the inception of our share repurchase program.

NOTE 20: SUBSEQUENT EVENT (UNAUDITED)

During the first quarter of 2002, we acquired the operations and exclusive right to manufacture, sell and distribute Pepsi-Cola's international beverages in Turkey for a purchase price of \$100 million in cash and assumed debt.

NOTE 21: SELECTED QUARTERLY FINANCIAL DATA (UNAUDITED)

2001	First Quarter	Second Quarter	Third Quarter	Fourth Quarter	Full Year
Net revenues	\$1,647	\$2,060	\$2,274	\$2,462	\$8,443
Gross profit	765	952	1,052	1,094	3,863
Operating income	90	217	285	84	676
Net income ⁽¹⁾	26	116	150	13	305
2000	First Quarter	Second Quarter	Third Quarter	Fourth Quarter	Full Year
Net revenues	\$1,545	\$1,913	\$2,125	\$2,399	\$7,982
Gross profit	700	880	962	1,035	3,577
Operating income	75	191	256	68	590
Net income	17	85	123	4	229

(1) During 2001, the Canadian Government passed laws reducing federal and certain provincial corporate income tax rates. These rate changes resulted in one-time gains of \$16 million and \$9 million in the second and third quarters of 2001, respectively.

The first, second and third quarters of each year consisted of 12 weeks, while the fourth quarter consisted of 16 weeks in 2001 and 17 weeks in 2000. The extra week in fiscal year 2000 contributed \$7 million of additional net income to our fourth quarter and fiscal year 2000 results.

MANAGEMENT'S RESPONSIBILITY FOR FINANCIAL STATEMENTS**To Our Shareholders:**

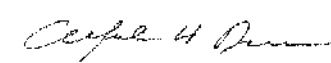
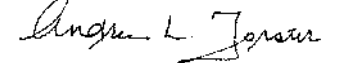
We are responsible for the preparation, integrity and fair presentation of the Consolidated Financial Statements, related notes and other information included in this annual report. The Consolidated Financial Statements were prepared in accordance with accounting principles generally accepted in the United States of America and include certain amounts based upon our estimates and assumptions, as required. Other financial information presented in the annual report is derived from the Consolidated Financial Statements.

We maintain a system of internal control over financial reporting, designed to provide reasonable assurance as to the reliability of the Consolidated Financial Statements, as well as to safeguard assets from unauthorized use or disposition. The system is supported by formal policies and procedures, including an active Code of Conduct program intended to ensure employees adhere to the highest standards of personal and professional integrity. Our internal audit function monitors and reports on the adequacy of and compliance with the internal control system, and appropriate actions are taken to address significant control deficiencies and other opportunities for improving the system as they are identified.

The Consolidated Financial Statements have been audited and reported on by our independent auditors, KPMG LLP, who were given free access to all financial records and related data, including minutes of the meetings of the Board of Directors and Committees of the Board. We believe that management representations made to the independent auditors were valid and appropriate.

The Audit Committee of the Board of Directors, which is composed solely of outside directors, provides oversight to our financial reporting process and our controls to safeguard assets through periodic meetings with our independent auditors, internal auditors and management. Both our independent auditors and internal auditors have free access to the Audit Committee.

Although no cost-effective internal control system will preclude all errors and irregularities, we believe our controls as of December 29, 2001 provide reasonable assurance that our assets are safeguarded.

Senior Vice President
and Chief Financial Officer

Andrea L. Forster
Vice President
and Controller

REPORT OF INDEPENDENT AUDITORS**The Board of Directors and Shareholders
The Pepsi Bottling Group, Inc:**

We have audited the accompanying Consolidated Balance Sheets of The Pepsi Bottling Group, Inc. as of December 29, 2001 and December 30, 2000, and the related Consolidated Statements of Operations, Cash Flows and Changes in Shareholders' Equity for each of the fiscal years in the three-year period ended December 29, 2001. These Consolidated Financial Statements are the responsibility of management of The Pepsi Bottling Group, Inc. 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 The Pepsi Bottling Group, Inc. as of December 29, 2001 and December 30, 2000, and the results of its operations and its cash flows for each of the fiscal years in the three-year period ended December 29, 2001, in conformity with accounting principles generally accepted in the United States of America.



KPMG LLP

New York, New York
January 24, 2002

SELECTED FINANCIAL AND OPERATING DATA

Fiscal years ended in millions, except per share data	2001	2000 ⁽¹⁾	1999	1998	1997	1996
Statement of Operations Data:						
Net revenues	\$8,443	\$7,982	\$7,505	\$7,041	\$6,592	\$6,603
Cost of sales	4,580	4,405	4,296	4,181	3,832	3,844
Gross profit	3,863	3,577	3,209	2,860	2,760	2,759
Selling, delivery and administrative expenses	3,187	2,987	2,813	2,583	2,425	2,392
Unusual impairment and other charges and credits ⁽²⁾	—	—	(16)	222	—	—
Operating income	676	590	412	55	335	367
Interest expense, net	194	192	202	221	222	225
Foreign currency loss (gain)	—	1	1	26	(2)	4
Minority interest	41	33	21	—	—	—
Income (loss) before income taxes	441	364	188	(192)	115	138
Income tax expense (benefit) ⁽³⁾⁽⁶⁾	136	135	70	(46)	56	89
Net income (loss)	\$ 305	\$ 229	\$ 118	\$ (146)	\$ 59	\$ 49

Per Share Data:⁽⁵⁾

Basic earnings (loss) per share	\$ 1.07	\$ 0.78	\$ 0.46	\$ (1.33)	\$ 0.54	\$ 0.45
Diluted earnings (loss) per share	\$ 1.03	\$ 0.77	\$ 0.46	\$ (1.33)	\$ 0.54	\$ 0.45
Cash dividend per share	\$ 0.04	\$ 0.04	\$ 0.03	—	—	—
Weighted-average basic shares outstanding	286	294	257	110	110	110
Weighted-average diluted shares outstanding	296	299	257	110	110	110

Other Financial Data:

EBITDA ⁽⁴⁾	\$1,190	\$1,061	\$ 901	\$ 721	\$ 774	\$ 792
Cash provided by operations	1,005	831	718	625	548	451
Capital expenditures	(593)	(515)	(560)	(507)	(472)	(418)

Balance Sheet Data (at period end):

Total assets	\$7,857	\$7,736	\$7,624	\$7,322	\$7,188	\$7,052
Long-term debt:						
Allocation of PepsiCo long-term debt	—	—	—	3,300	3,300	3,300
Due to third parties	3,285	3,271	3,268	61	96	127
Total long-term debt	3,285	3,271	3,268	3,361	3,396	3,427
Minority interest	319	306	278	—	—	—
Advances from PepsiCo	—	—	—	1,605	1,403	1,162
Accumulated other comprehensive loss	(370)	(254)	(223)	(238)	(184)	(102)
Shareholders' equity (deficit)	1,601	1,646	1,563	(238)	(184)	(102)

(1) Our fiscal year 2000 results were impacted by the inclusion of an extra week in our fiscal year. The extra week increased net income by \$7 million, or \$0.02 per share.

(2) Unusual impairment and other charges and credits comprise the following:

- \$45 million non-cash compensation charge in the second quarter of 1999.
- \$53 million vacation accrual reversal in the fourth quarter of 1999.
- \$8 million restructuring reserve reversal in the fourth quarter of 1999.
- \$222 million charge related to the restructuring of our Russian bottling operations and the separation of Pepsi-Cola North America's concentrate and bottling organizations in the fourth quarter of 1998.

(3) 1998 includes a \$46 million income tax benefit in the fourth quarter for the settlement of a disputed claim with the Internal Revenue Service relating to the deductibility of the amortization of acquired franchise rights.

(4) Excludes the non-cash component of unusual impairment and other charges and credits.

(5) Reflects the 2001 two-for-one stock split.

(6) Fiscal year 2001 includes Canada tax law change benefits of \$25 million.

SHAREHOLDER INFORMATION**CORPORATE HEADQUARTERS**

The Pepsi Bottling Group, Inc.
1 Pepsi Way
Somers, New York 10589
914.767.6000

ANNUAL MEETING

The annual meeting of shareholders will be held at 10:00 a.m., Wednesday, May 22, 2002, at PBG headquarters in Somers, New York.

TRANSFER AGENT

For services regarding your account such as change of address, replacement of lost stock certificates or dividend checks, direct deposit of dividends, or change in registered ownership, contact:

The Bank of New York
Shareholder Services Dept.
P.O. Box 11258
Church Street Station
New York, New York 10286-1258
Telephone: 800.432.0140
E-mail:
shareowner-svcs@bankofny.com
Website: <http://stock.bankofny.com>

Or:

The Pepsi Bottling Group, Inc.
Shareholder Relations Coordinator
1 Pepsi Way
Somers, New York 10589
Telephone: 914.767.6339

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

STOCK EXCHANGE LISTING

Common shares (symbol: PBG) are traded on the New York Stock Exchange.

**INDEPENDENT PUBLIC****ACCOUNTANTS**

KPMG LLP
345 Park Avenue
New York, New York 10154

INVESTOR RELATIONS

PBG's 2002 quarterly releases are expected to be issued the weeks of April 15, July 8 and September 30, 2002 and January 27, 2003.

Earnings and other financial results, corporate news, and other company information are available on PBG's website: <http://www.pbg.com>

Investors desiring further information about PBG may contact Investor Relations as follows:

Institutional Investors
Please call Mary Winn Settino,
Director - Investor Relations,
at 914.767.7216

Individual Shareholder Services
Please call LoriJean Rooney,
Coordinator - Shareholder Relations,
at 914.767.6339

E-mail:
Shareholder.relations@pepsi.com

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SoBe is a registered trademark of South Beach Beverage Company, Inc.

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Somers, NY 10589

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