



PepsiCo

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Introduction

PepsiCo (PEP) is an American-based global food, snack, and beverage company. It was formed in 1965 by the merger between Pepsi-Cola Company and Frito-Lay, Inc. PEP has a track record of success and growth reaching markets all around the world. It sells its products in over 200 countries and territories, and nearly 20% of the world population consumes a PepsiCo product serving each day. PEP carries thousands of products and has 22 brands that each generate over \$1 billion in revenue annually by themselves. These include Pepsi, Mountain Dew, Gatorade, Quaker, and Tostitos, among others. It is the second largest food and beverage company in terms of revenue in the world, behind Nestlé. The company is comprised of six divisions: North America Beverages, Frito-Lay North America, Quaker Foods North America, Latin America, Europe & Sub-Saharan Africa (ESSA), and Asia, Middle East, & North Africa. PepsiCo strives to achieve sustainable financial growth while responding to the needs of the world.

Recommendation

At a March 11th price of \$116.59 and target price range of \$133 to \$143, we give PepsiCo a BUY rating. We recommend purchasing PEP based on the following factors:

- Various distinct product holdings allow it to reach a large consumer base
- History/future plans of reducing costs has helped it remain competitive
- Strong history of successful M&A has allowed it to expand its business
- Increased R&D leading to more market share

Investment Thesis

Diversified Product Portfolio: PEP is the only company that is a key player in both the snack and beverages industry. Having exposure to both industries that are complementary to one another gives PEP a competitive advantage. With consumer preferences changing to healthier foods, PEP has an advantage when compared to its peers because of its exposure to both industries. PEP has more opportunities to expand its product line according to the change in preferences which hedges the risk of being driven out of the market due to consumer trend changes. The revenue streams from PEP's beverage production accounts for 71% of its revenues while food production accounts for 29% of its total revenues.

Cost Cutting Initiative: PEP has implemented several ways to cut costs throughout the years in order to increase its profit margins. In line with their 2019 Multi-year Productivity Plan, PEP is initiating a restructuring plan to simplify its business model through new technologies and automating suitable processes which will help cut costs. PEP recently announced that they will be closing their 50-year-old plant in Kansas City this May, laying off workers as a result of the productivity plan. Production will most likely be shifted to newer plants that have the latest technology, which will in turn increase efficiency and productivity.

Acquisitions: PEP is committed to expanding its business according to changes in consumer preferences through M&A. Over the years, PEP has acquired several companies to keep up with the changes of consumer preferences towards healthier foods. Most recently, PEP has acquired SodaStream, a carbonated water machine maker, as a step to add healthier and more personalized products to its portfolio. Noticing the strong growth of the sparkling water products,

which have a perception of being a healthier alternative to other carbonated drinks, PEP acquired SodaStream - the number one sparkling brand by volume in the world and the leading manufacturer of Sparkling Water Makers.

Product Innovation: PEP has increased R&D expenses since 2011 by 45%, which has resulted in new healthy product offerings. Its latest release, Bubly, a sparkling water brand, is the result of increased R&D spending. Their R&D has also focused on ways to promote environmental sustainability through its packaging methods. As consumer preferences tilt towards healthier options, sparkling water has had 38% growth against the 7% growth of the bottled water segment over the last year. PEP has continually committed itself to understanding consumer tastes and investing in new product offerings that will satisfy its consumers.

Valuation

Our valuation for PEP has included a 60% weight of the Discounted Dividend Model (DDM) and a 40% weight on the EBITDA Multiple Method. We have arrived at a target price of \$132.97, representing a 14.0% upside potential from their March 11th price of \$116.59.

For the DDM, we have used a two-stage dividend growth model. We assumed that PEP will increase their dividends at their 5-year average of 9% for the next five years. After that, we expect that PEP will grow at its perpetuity growth rate of 3%, which is slightly higher than the GDP growth rate, since PEP is in a non-cyclical sector. We then discounted these cash flows using the WACC at 7%, resulting in a target price of \$126.30.

For the EBITDA Multiple Method, we have compared PEP to five of its peers found in the Peer Analysis section and derived an EV/EBITDA of 14.86x, resulting in a target price of \$142.97.

Risks

Increased Regulation Aimed at Their Products: Certain jurisdictions have imposed or have considered imposing taxes aimed at some of their products. For example, in April 2018, the United Kingdom enacted a per-ounce tax rate on beverages proportional to the amount of added sugar. These taxes make their products more expensive, decrease overall consumption, and give consumers the perception (whether valid or not) that their products do not meet their health and wellness needs. Additional labeling or warning requirements about ingredients in their products would also lead to negative publicity (whether based on scientific fact or not).

Unfavorable Economic Conditions in Their Markets: Being a global company, PEP's customers are located in several countries which have experienced or may experience unfavorable economic conditions. Changes in interest rates, tax rates, or government policy could adversely affect PEP's profitability.

Changes in Consumer Preferences: Consumer trends and preferences have been evolving towards locally sourced, organic, and fresh foods. Consumers are valuing healthy, convenient, and sustainable foods at an increasing rate. Inability to capitalize on this trend would leave PEP a step behind its direct competitors, as well as companies who specialize in these foods.

Shortage or Disruption of Supply: PEP is very reliant on its business partners for their use of raw materials, water, energy, ingredients, and packaging materials. Some of these supplies are sourced in countries experiencing civil unrest, economic downturn, and/or political instability. Environmental disasters, changes in currency exchange rates, and increases of seasonal demand could significantly weaken PEP's capability to carry its products.

Management

PepsiCo has 29 members on its management team with an average age of 55 years and tenure of 10 years. It has 12 members on its board of directors that have various backgrounds and connections to the leaders in their respective industries - such as Google, NBC, and 3M. The board has an average age of 61 years and tenure of 5 years. The management and board members of PEP are highly educated and either have extensive management/business experience or hold significant accomplishments within the food and beverage industries.

PepsiCo's CEO, Ramon Laguarta assumed his current role in October 2018. He has been with PepsiCo for 22 years and previously held roles as President of PepsiCo and CEO of the ESSA division from 2015 to 2017. During this time, he was responsible for transforming ESSA's beverage portfolio, developing the company's juice business, and performing successful M&A into Russia's dairy market. Prior to joining PepsiCo, Laguarta worked for a Spanish candy company; he has held various board positions for snack and juice companies during his tenure at Pepsi.

Stock Chart



PEP (Black) is compared with the S&P 500 (Green) in the stock chart above, which depicts the last year of performance. It is interesting to note that PEP and the S&P 500 have mirrored each other over the last 5 months.

Peer Analysis

Name	Market Cap (Billions)	Sales (Millions)	Payout Ratio	Div Yld	EV/EBITDA	ROE
PepsiCo, Inc.	\$161.9	\$64,660	40.86%	3.2%	14.3	53.2%
Coca-Cola Company	\$191.8	\$31,697	104%	3.6%	20.7	24.2%
Monster Beverage Corporation	\$32.9	\$3,807	-	-	8.4	24.5%
Mondelez International, Inc.	\$67.2	\$25,938	54.8%	2.2%	3.3	12.14%
Keurig Dr Pepper Inc.	\$36.1	\$7,442	164.8%	2.3%	27.6	31.15%
National Beverage Corp.	\$2.7	\$975.7	-	-	11.8	44.43%

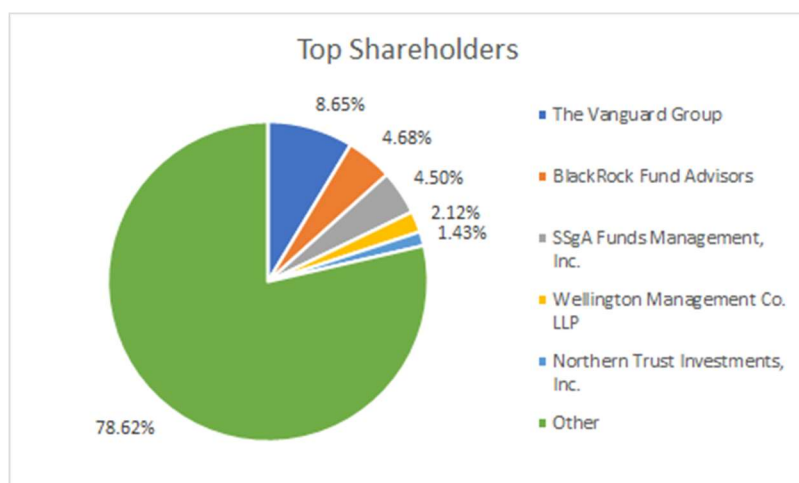
The table above shows a peer group comparison selected based on pure competition. PepsiCo had the leading sales as compared to its peers. PEP also had a payout ratio that is lower than its peers, which reveals its potential to increase its dividend payout in the future, as well as the ability to sustain a consistent dividend payout in the future. Additionally, PepsiCo had the highest return on equity amongst its peers, which proves the ability of PEP to generate profits from its equity-financed funds.

Ownership

High institutional ownership implicates the notion that the “smart money” believes in PEP.

Distribution

Type of Owner	Percentage Ownership
Insiders	0.41%
Institutions	73.38%
Unknown	26.61%



The top five shareholders of PEP have all increased their position in the company within the last year. This is a good sign, as it suggests that these successful asset management institutions value PEP highly. The top five shareholders make up roughly a quarter of total ownership. This indicates that PEP is less likely to be influenced by the demands of one single owner.