



# PepsiCo, Inc (PEP)

Updated July 2<sup>nd</sup>, 2018 by Nate Parsh

## Key Metrics

<b>Current Price:</b> \$109	<b>5 Year CAGR Estimate:</b> 7.2%	<b>Volatility Percentile:</b> 3.5%
<b>Fair Value Price:</b> \$110	<b>5 Year Growth Estimate:</b> 4.0%	<b>Momentum Percentile:</b> 29.9%
<b>% Fair Value:</b> 99.1%	<b>5 Year Valuation Multiple Estimate:</b> -0.2%	<b>Total Return Percentile:</b> 60.4%
<b>Dividend Yield:</b> 3.4%	<b>5 Year Price Target</b> \$131	<b>Valuation Percentile:</b> 43.7%

## Overview & Current Events

Pepsi is a global food and beverage company that had more than \$63 billion in sales in 2017. The company's products include Pepsi, Mountain Dew, Frito-Lay chips, Gatorade, Tropicana orange juice and Quaker foods. The company has 23 \$1 billion brands in its portfolio. Pepsi was founded in 1898 and currently employs 264,000 people around the world.

Pepsi reported 1<sup>st</sup> quarter earnings on April 26<sup>th</sup>. The company earned \$0.96 per share, which beat estimates by \$0.03. This was a 2% improvement from Q1 2017. Pepsi's revenue was \$12.56 billion in the quarter, a 4.2% improvement year over year. This topped estimates by \$160 million.

## Growth on a Per-Share Basis

Year	2008	2009	2010	2011	2012	2013	2014	2015	2016	2017	2018	2023
<b>EPS</b>	\$3.21	\$3.77	\$3.91	\$3.98	\$3.92	\$4.37	\$4.27	\$4.66	\$4.85	\$5.23	<b>\$5.70</b>	<b>\$6.93</b>
<b>DPS</b>	\$1.60	\$1.75	\$1.89	\$2.03	\$2.13	\$2.24	\$2.53	\$2.79	\$2.96	\$3.12	<b>\$3.47</b>	<b>\$4.16</b>

Pepsi has grown earnings at a rate of 4.2% per year from 2010-2017. Pepsi's growth over this time period came from sales growth (~1.5%), margin improvements (~1%), and share repurchases (~1.5%). We expect sales to continue growing at between 1% and 3% per year going forward, with share repurchases and margin gains adding another 1% to 3% to growth.

As with Q4, organic growth was up 2.3%. This was higher than analysts had expected. Also like last quarter, international revenues were strong with Latin America (14%) and Frito-Lay North America (3%) both showing impressive growth. Unlike last quarter, revenue from Pepsi's two largest divisions, North American Beverages and Frito-Lay North America, didn't pull down results as much. NAB was down just 1%, compared to down 6% in Q4, and FLNA was flat, compared to down 1%. Even with these results, we are maintaining our expected 4% annual expected growth from our previous update. If, however, if Pepsi is able to show that the NAB and FLNA performance in Q1 is a sign that these divisions are returning to growth, then we would be inclined to lift our EPS growth forecast. Growth in 2018 should be much higher as the company reaffirmed that it expects to earn \$5.70 per share for the full year, 9% growth from 2017. We maintain our 2023 price target of \$131.

Pepsi has raised its dividend for the past 46 years and the average increase over the past 10 years is 8.9%. The company announced on February 13<sup>th</sup> that the dividend would be raised 15.2% for the June payment. Pepsi has historically raised the dividend on the third payment of the year (the company pays a dividend in January, March, June and September). We expect Pepsi's dividend payout ratio to remain at 60% out to 2023, which implies \$4.16 in DPS by that time.

## Valuation Analysis

Year	2008	2009	2010	2011	2012	2013	2014	2015	2016	2017	Now	2023
<b>Avg. P/E</b>	20.5	14.7	16.5	16.4	17.4	18.4	20.8	20.7	21.4	21.7	<b>19.1</b>	<b>18.9</b>
<b>Avg. Yld.</b>	2.4%	3.2%	2.9%	3.1%	3.1%	2.8%	2.8%	2.9%	2.9%	2.7%	<b>3.0%</b>	<b>3.1%</b>

Post-recession, Pepsi's P/E has expanded, though gradually over time. The average P/E over the past 10 years is just slightly below the expected multiple for 2018. Pepsi's stock has declined slightly from our early April update, which means that the stock is just slightly overvalued based off of its recent history. If shares were to revert to their average P/E then shares would experience a slight multiple contraction of just 0.2%.

Pepsi's current dividend yield is above the S&P 500 and 10-year Treasury Bond. The company also has one of the longest dividend growth streaks in the market and just gave investors an above average dividend increase for the most recent payment. With an expected payout ratio of 61% for 2018, Pepsi has room for continued dividend growth going forward.

### Safety, Quality, Competitive Advantage, & Recession Resiliency

Year	2008	2009	2010	2011	2012	2013	2014	2015	2016	2017	2018	2023
GP/A	63.6%	58.1%	45.9%	47.9%	45.8%	45.4%	50.3%	49.3%	47.1%	43.5%	<b>43%</b>	<b>47.1%</b>
Debt/A	66.4%	57.8%	68.9%	71.8%	70.1%	68.7%	75.3%	82.7%	84.7%	86.2%	<b>87%</b>	<b>79.5%</b>
Int. Cov.	25.6	25.7	10.9	12.1	11.4	12	11.7	9.2	8	11.9	<b>11.6</b>	<b>10.6</b>
Payout	49.8%	46.4%	48.3%	51%	54.3%	52.5%	59.3%	59.9%	61%	59.7%	<b>60.9%</b>	<b>60.0%</b>
Std. Dev.	32.1%	22.8%	15%	17.3%	10.6%	13.5%	12.9%	15.2%	13.5%	9.8%	<b>11.1%</b>	<b>16.3%</b>

Pepsi is a relatively recession proof company. EPS grew at the height of the last recession and the stock often offers a very generous dividend yield. While debt has climbed higher in recent years, the company is expecting \$6 billion in cash flow in 2018. Pepsi often generates more cash flow than its competitors, so the company can use this capital to pay down existing debt while still returning cash to shareholders.

While known for their carbonated beverages, Pepsi's food and snacks make up approximately 52% of sales. Pepsi's line of "Better for You" offerings are designed to meet consumers' desire for healthier food and drink options. These items had double digit growth during 2017. Products with less than 70 calories from added sugar make up ~45% of sales.

### Final Thoughts & Recommendation

After a slight price decline, we forecast that Pepsi shares can offer a total return of 7.2% per year through 2023, up from our previous estimate of 6.5%. This estimate is based off a combination of growth (4%), dividends (3.4%) and multiple mean revision (-0.2%). Pepsi's long dividend history, stability, and general safety make it a reasonable hold for risk averse investors. Given the uptick in total return estimates and a solid dividend yield, we feel that investors looking for income and stability from the consumer staples sector should consider initiating a position in this iconic chip and beverage company.

### Total Return Breakdown by Year

