



PepsiCo, Inc (PEP)

Updated July 10th, 2018 by Nate Parsh

Key Metrics

Current Price: \$113	5 Year CAGR Estimate: 6.5%	Quality Percentile: 3.4%
Fair Value Price: \$110	5 Year Growth Estimate: 4.0%	Momentum Percentile: 32.0%
% Fair Value: 99.1%	5 Year Valuation Multiple Estimate: -0.9%	Total Return Percentile: 54.5%
Dividend Yield: 3.4%	5 Year Price Target \$131	Valuation Percentile: 40.0%

Overview & Current Events

PepsiCo 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 released 2nd quarter earnings on July 10th. The company earned \$1.61 in Q2, \$0.09 above estimates. This was a 7.3% improvement from the same time frame in 2017. Pepsi has now topped earnings estimates in 17 out of the last 18 quarters. Revenue grew 2.4% year over year to \$16.09 billion, beating expectations by \$50 million.

Growth on a Per-Share Basis

Year	2008	2009	2010	2011	2012	2013	2014	2015	2016	2017	2018	2023
EPS	\$3.21	\$3.77	\$3.91	\$3.98	\$3.92	\$4.37	\$4.27	\$4.66	\$4.85	\$5.23	\$5.70	\$6.93
DPS	\$1.60	\$1.75	\$1.89	\$2.03	\$2.13	\$2.24	\$2.53	\$2.79	\$2.96	\$3.12	\$3.59	\$4.16

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%).

Pepsi had organic growth of 2.6% in the quarter, higher than last quarter's 2.3% figure. Frito-Lay North America was the star of the quarter, growing revenues 4% to \$3.84 billion. This is solid growth from the second largest division at Pepsi. International revenues continue to be a source of strength for the company with Latin America (+1%) and Europe Sub-Saharan Africa (+11%) growing sales year over year. Sales for North American Beverage, Pepsi's largest division, was down 1% compared to the previous year. This is the second consecutive quarter that NAB was down 1% and while that is a concern, it is better than the -6% growth this division posted in Q4 2017. Quaker Oats saw a decline of 5%, largely on promotional activity and lower net prices. Fortunately, Quaker Oats accounted for just ~3% of total revenues in the quarter.

Pepsi also reaffirmed its EPS (\$5.70), cash from operating activities (~\$9 billion) and free cash flow (~\$6 billion) guidance for 2018. We are maintaining our expected 4% annual expected earnings growth from our previous updates. If NAB can return to positive growth, we would likely lift this percentage higher. If Pepsi is able to deliver on its EPS forecast, then shareholders are looking at 9% earnings growth from 2017.

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 2/13/2018 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
Avg. P/E	20.5	14.7	16.5	16.4	17.4	18.4	20.8	20.7	21.4	21.7	19.8	18.9
Avg. Yld.	2.4%	3.2%	2.9%	3.1%	3.1%	2.8%	2.8%	2.9%	2.9%	2.7%	3.4%	3.2%

Disclosure: This analyst has a long position in the security discussed in this research report.

Post-recession, Pepsi's price-to-earnings ratio has expanded, though gradually over time. The average earnings multiple over the past 10 years is just slightly below the expected multiple for 2018. Pepsi's stock has increased slightly from our previous update, which means that the stock is just slightly overvalued based off of its recent history. If shares were to revert to their average price-to-earnings ratio then shares would experience a slight multiple contraction of just 0.9%.

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. If shares finish the year with a 3.4% average yield, this would be the highest yield in the last decade.

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%	43%	47.1%
Debt/A	66.4%	57.8%	68.9%	71.8%	70.1%	68.7%	75.3%	82.7%	84.7%	86.2%	87%	79.5%
Int. Cov.	25.6	25.7	10.9	12.1	11.4	12	11.7	9.2	8	11.9	11.6	10.6
Payout	49.8%	46.4%	48.3%	51%	54.3%	52.5%	59.3%	59.9%	61%	59.7%	63%	60.0%
Std. Dev.	32.1%	22.8%	15%	17.3%	10.6%	13.5%	12.9%	15.2%	13.5%	9.8%	11.1%	16.3%

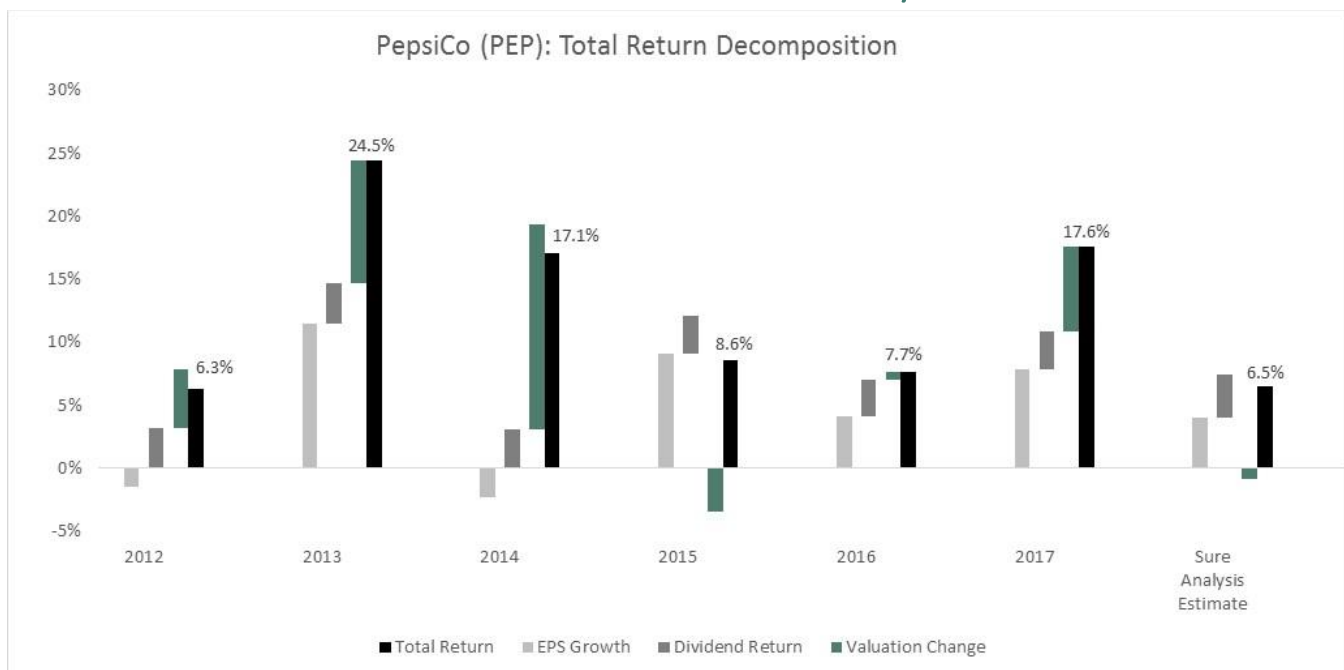
Pepsi is a relatively recession proof company. EPS grew at the height of the last recession and the stock often offers a very generous dividend yield. While debt has climbed higher in recent years, the company is expecting \$6 billion in cash flow in 2018. Pepsi often generates more cash flow than its 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

Shares of Pepsi have increased \$4 since our pre-earnings update, largely on the strength of Q2 results. As such we have lowered our annual return outlook to 6.5% from 7.2%. This is based off of growth (4%), dividends (3.4%) and a slightly higher multiple reversion (0.9%). We continue to believe that Pepsi's long dividend history, stability, and general safety make it a reasonable hold for risk averse investors. We maintain our 2023 price target of \$131.

Total Return Breakdown by Year



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