

PepsiCo	
Ticker Site BiG	PEP
Ticker BiGlobal Trade	PEP
Ticker BT24	PEP
Ticker BiG Power Trade	PEP
P/E Ratio 2019	23,57
P/BV Ratio	12,87
EV/EBITDA	15,30

Source: Big Research;

Price and Performance (Values in USD)	
Price	130,19
52 week high	130,90
52 week low	99,82
YTD	17,8%
Average daily volume (un)	5.077.022
Market Capitalization (mn)	182.503
Beta	0,69
Dividend	3,59
EPS	8,84

Source: BiG Research;

Analysts Consensus (last 3 months)	
Buy	9
Hold	15
Sell	1

Source: BiG Research;

Financial Data	
Sales (USD mn)	64.661
EBITDA (USD mn)	12.509
Number of Employees	267.000
ROA	16,0%
ROE	100,3%
D/E	2,21
Dividend Yield	2,93%

Source: BiG Research;

**Notes:**

All quotes were updated in Bloomberg at 15h05 of June 5<sup>th</sup>, 2019.

**Relevant Information:**

Use the following link to view our most recent publications:

<https://www.big.pt/InformacaoMercados/TradingIdeas/Index/-1>

Use the following link to see our recommendation history:

<https://www.big.pt/pdf/Newsletters/nld.pdf>

**Analyst:**

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**Guilherme Carpinteiro**

**Research:**

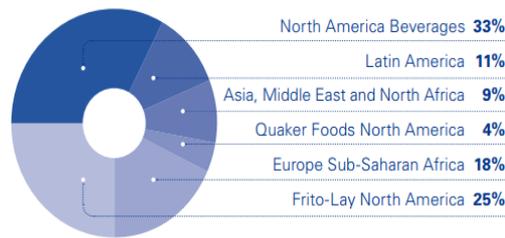
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**PEPSICO (Ticker: PEP)**

**Description**

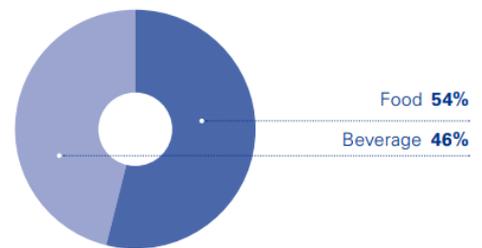
PepsiCo is a US multinational and one of the biggest foods and beverage company in the market. PepsiCo took its name in 1965 when Pepsi-Cola and Frito-Lay merged and created the company that now has its headquarters in Purchase, New York. The company sells and distributes in more than 200 countries its vast portfolio of brands such as Pepsi-Cola, Gatorade, Frito-Lay, Quaker, and Tropicana. Their operations are divided in six segments: North America Beverages (NAB); Latin America; Asia, Middle east and North Africa (AMENA); Quaker Foods North America (QFNA); Europe Sub-Saharan Africa (ESSA); and Frito-Lay North America (FLNA). The company has 267k employees and has a market cap of USD 182 bn.

**Net Revenues**



Source: Company's data

**Mix of Net Revenue**



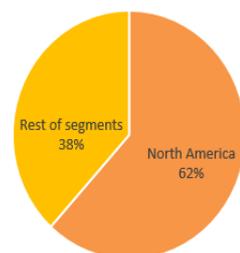
**Investment Thesis**

We believe that PepsiCo is a good company that has a strong business, delivers a good dividend, and has some interesting opportunities to grow especially in emerging markets. However, at this moment we also believe that the fundamentals are expensive with a P/E of 23.5 and it is unclear what are the company's plans to expand in other markets than the US market.

**Investment Case**

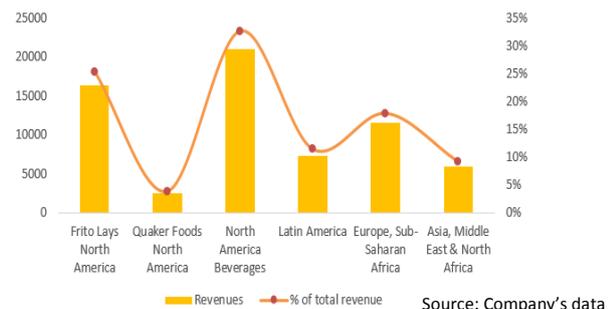
**Highly concentrated in North America:** PepsiCo has a 62% of its revenues coming from North America segment of which 33% comes from North America Beverages, 25% from Frito-Lays North America, and 4% from Quaker Foods North America. These segments focus on the US and Canada market. Therefore, there's a major opportunity for the company to grow in other markets, either developed or emerging, by refranchising its operations or acquiring new brands and with this expansion, the company could largely increase its growth.

Revenues per segment



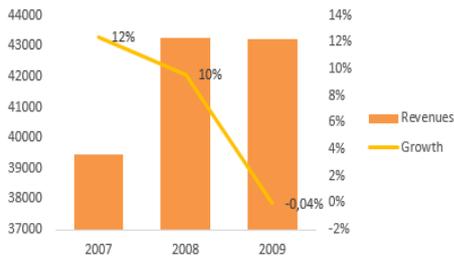
Source: Company's data

North America segment includes FLNA, NAB, and QFNA



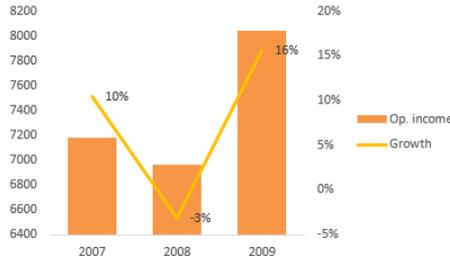
Source: Company's data

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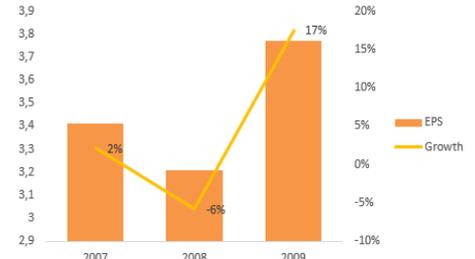


Source: Company's data

**Defensive stock:** PepsiCo is a strong, established, and safe business that generates a steady growth throughout the years. The fact that the company is well balanced between food and beverage products and brands, and has a strong brand globally, allows the company to be profitable during recession periods. During the recession of 2007-2009 the company's business didn't suffer a great impact. As shown in the graphs, revenues grew in 2008 by 10% and in 2009 only decreased 0.04%. Operating income decreased in 2008 by 3% but in 2009 increased 16%. The same happened with EPS that decreased 6% in 2008 but in 2009 increased 17%. Thus, PepsiCo is a company that in periods of recession still manages to provide a good performance.



Source: Company's data

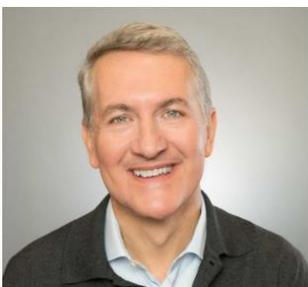


Source: Company's data

**Dividend aristocrat:** The company pays dividends since 1989. Dividends have grown constantly since then and in 2019 the company has raised its quarterly dividend to USD 0.955. It has a dividend yield of 2.98%, which is above its peer's average. The company has capacity of delivering its dividend since it generates strong cash flow that not only is used to pay dividends but also allows the company to do some buybacks, invest in capex, and reduce debt.



Source: Company's data



Source: Company's data

**Management**

Ramon Laguarta is the CEO of PepsiCo since October 2018 and in 2019 became Chairman of the board. The Former CEO and Chairman was Indra Nooyi who decided to step down her functions, first as CEO in 2018 and only in 2019 as Chairman to ensure a smooth transition. Ramon has worked at PepsiCo for 23 years and before taking responsibilities as CEO of PepsiCo, Ramon took several high positions in the company's segments since 2006, especially in Europe. In 2018 he made nearly USD 11 bn of which USD 0,996 mn of base salary, USD 4,4 mn of stock awards, USD 3,03 mn of annual and long-term payouts, and USD 2,36 mn in other compensation.

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Income Statement (USD mn.)	2017	2018
Frito Lays North America	15798	16346
Quaker Foods North America	2503	2465
North America Beverages	20936	21072
Latin America	7208	7354
Europe, Sub-Saharan Africa	11050	11523
Asia, Middle East & North Africa	6030	5901
<b>Net Revenues</b>	<b>63525</b>	<b>64661</b>
COGS	28.796	29.381
Selling, general & administrative	24.453	25.170
<b>Operating Expenses</b>	<b>53249</b>	<b>54551</b>
<b>EBIT</b>	<b>10276</b>	<b>10110</b>
Other pension & retiree income (expense)	233	298
Net Interest	(907)	(1.219)
<b>EBT</b>	<b>9602</b>	<b>9189</b>
Taxes	4.694	(3.370)
<b>Net Income *</b>	<b>4857</b>	<b>12515</b>
<b>Earnings per share</b>	<b>8,84</b>	<b>0,29</b>

\*less net income attributable to noncontrolling interests

Source: Company's data

Free Cash Flow (USD mn)	2017	2018
<b>Operational Cash Flow</b>	<b>10.030</b>	<b>9.414</b>
Operating Profit	4908	12559
Depreciation and amortization	2369	2399
Pension & retiree medical plan	1	(1.487)
Taxes	2.732	(4.573)
Change Working Capital	(149)	464
Others	169	52
<b>Investment Cash Flow</b>	<b>(4.403)</b>	<b>4.564</b>
Capex	(2.789)	(3.148)
Change in securities	(1.849)	8.701
Acquisitions	(61)	(1.496)
Disentures	267	505
Others	29	2
<b>Financial Cash Flow</b>	<b>(4.186)</b>	<b>(13.769)</b>
Debt change	3.103	(4.007)
Tender offer	0	(1.589)
Short term borrowings	(1.053)	(1.366)
Share buyback	(2.005)	(2.002)
Dividends payment	(4.472)	(4.930)
Issuances of stock	0	0
Others	241	125
<b>Change in free cash flow</b>	<b>1.488</b>	<b>111</b>
<b>Cash and equivalents at end</b>	<b>10.657</b>	<b>10.769</b>

Source: Company's data

Balance Sheet (USD mn.)	2017	2018
<b>Assets</b>	<b>79804</b>	<b>77648</b>
Cash & Equivalents	10610	8721
Short term investments	8900	272
restricted cash	0	1.997
Goodwill	14744	14808
Receivables	7024	7142
Inventories	2947	3128
Property Plant & Equipment	17240	17589
Other Assets	18339	23991
<b>Liabilities</b>	<b>68823</b>	<b>63046</b>
Short term Debt	5485	4026
Long term Debt	33796	28295
Payables	15017	18112
Other liabilities	14525	12613
<b>Total Shareowner's Equity</b>	<b>10981</b>	<b>14602</b>
<b>Total Equity and Liabilities</b>	<b>79804</b>	<b>77648</b>

Source: Company's data

## Income Statement

PepsiCo revenues grew 1.8% from USD 63.5 bn in 2017 to approximately USD 64.7 bn. The segment that contributes more to net revenues is North America Beverages representing 33% of the total revenues in 2018. The operating profit decreased 2% to USD 10.1 bn and EBIT Margin to 15.6% vs 16.2% in 2017 due to an increase in COGS and some impacts of the refranchising of the Jordan business in 2017 and a divestiture of a minority stake in Britvic (bottling partner).

## Free Cash Flow

The PepsiCo is a company that generates strong operational cash flow although it decreased slightly more than 6% from USD 10 bn in 2017 to USD 9.4 bn in 2018. That decrease was mainly driven by USD 1.5 bn contributions to pension & retiree medical plan. The investment cash inflow of USD 4.5 bn was positively impacted by sales of USD 8.7 bn of securities with maturities greater than three months. The inflow was partially offset by an increase in Capex to USD 3.1 bn in 2018, and an increase in acquisitions, with the acquisition of SodaStream for USD 1.2 bn (other acquisitions accounted for USD 300 mn). The cash flow generated was mainly used to reduce long term debt by USD 4 bn, to pay dividends (USD 5 bn), to do buybacks of USD 2 bn, to do a tender offer of USD 1.6 bn, and to pay short term borrowing of USD 1.4 bn.

## Balance Sheet

As for the balance sheet, total debt decreased, especially long-term debt, which was reduced from USD 33.8 bn in 2017 to USD 28.3 bn. Despite that, net debt increased 18% to USD 23.3 bn vs USD 19.8 bn in 2017, due to a reduction in short term investments, which was used to pay part of the debt, from USD 8.9 bn in 2017 to USD 272 mn.

## Earnings

In the 1Q19 the company's results were higher than estimates which is a positive sign of the good performance of PepsiCo. Its net revenues grew 2.2% to USD 12.9 bn vs. USD 12.6 bn YoY, estimates were USD 12.7 bn. EPS increased 6% YoY to USD 1. EBIT increased 11% from USD 1.8 bn in the 1Q18 to USD 2 bn in 1Q19 and the EBIT margin rose to 15.5% vs. 14% in the prior year. Regarding organic results, PepsiCo reported organic revenue growth of 5.2% driven mainly by the outstanding performance of the Frito-Lay North America segment.

## Guidance

For the FY 2019, the company expects to keep track of the performance of the 1Q19. Regarding revenues, it expects an organic revenue growth of 4%. It also predicts an increase in the effective tax rate to approximately 21%. As for the EPS it is expected by the company to decrease by 1%. PepsiCo predicts that will generate operational cash of USD 9 bn, of which USD 4.5 bn to be used in capex. The company intends to return cash to shareholders in a total of USD 8 bn, paying USD 5bn in dividends and using USD 3 bn to do buyback.

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▲ **Main Segments**

The PepsiCo owns many trademarks in the food and beverage sector. The company divides its operations per segments to distribute and sell their products. Some divisions only sell certain trademarks as it specializes either in food or beverage market, the segments are as follows:



Source: Company's data



**North America beverages – NAB (33% net revenues):** This segment includes operations of the beverage business in the US and Canada. NAB has its own plants and facilities to produce finished products that are sold directly to distributors and retailers. Also produces concentrates or finished products to independent bottlers that later will sell to independent distributors and retailers. Mainly, NAB produces, markets, distributes, and sells beverage concentrates, fountain syrups, and finished goods of several brands such as Aquafina, Diet Mountain Dew, Diet Pepsi, Gatorade, Mountain Dew, Pepsi, Propel, Sierra Mist, and Tropicana. It also has some joint ventures with Unilever and Starbucks to make, market, and sell ready-to-drink tea and coffee products.

**Quaker Foods North America – QFNA (4% net revenues):** Includes cereal, rice, pasta, and other branded food business in the US and Canada. Some of the products that QFNA produces, distribute, and sell are Aunt Jemima mixes and syrups, Cap'n Crunch cereal, Quaker Chewy granola bars, Quaker grits, Quaker oat squares, Quaker oatmeal, Quaker rice cakes, Quaker simply granola, and Rice-A-Roni side dishes.

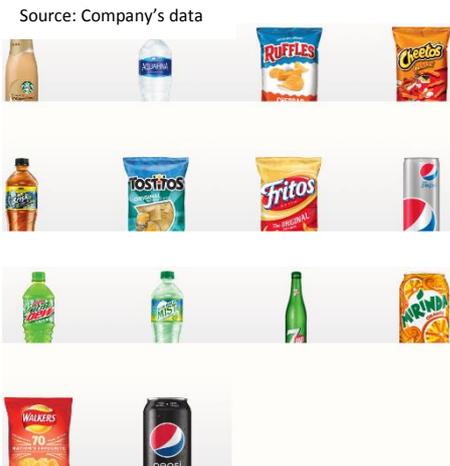
**Frito-Lay North America – FLNA (25% net revenues):** In this segment, the company itself or in partnership with third parties produces, then distributes and sells to independent distributors and retailers its branded food and snack business in the US and Canada. Some of the brands that FLNA sells are: Doritos tortilla chips, Fritos corn chips, Lay's potato chips, Ruffles potato chips, and Tostitos tortilla chips.

In the Following segments, the production, distribution, and selling include beverage, food, and snack operations. Each segment, on its own or with collaboration of other partners will manage the different trademarks of PepsiCo. Also, all these three segments have an international joint venture with Unilever to sell Lipton branded products. However, there are some differences regarding specific brands that the segment operates:

**Latin America (11% net revenues):** In this segment some of the snacks food brands that are sold are: Cheetos, Doritos, Emperador, Lay's, Marias Gamesa, Rosquinhas Mabel, Ruffles, Sabritas, Saladitas, and Tostitos, as well as some Quaker snacks. In the beverage brands, some are: 7up, Diet Pepsi, Gatorade, H2oh!, Manzanita Sol, irinda, Pepsi, Pepsi Black, Toddy. It also has a joint venture with Unilever to sell ready-to-drink lipton branded tea products.

**Europe Sub-Saharan Africa – ESSA (18% net revenues):** Snack brands include Cheetos, Chipita, Doritos, Lay's, Ruffles, Walkers, and some of the Quaker cereals and snacks. The beverage brands include 7up, Diet Pepsi, Mirinda, Pepsi, Pepsi Max, and Tropicana. It also operates in an international joint venture with Unilever to sell Lipton branded products. In this segment, ESSA sell some dairy products such as Agucha, Chudo, and Domik v Derevne.

**Asia; Middle east and North Africa – AMENA (9% net revenues):** In the snack and food products, AMENA sells Cheetos, Doritos, Kurkure, Lay's, and many Quarker cereals and food. In the beverage market, some of the products include 7up, Aquafina, Mirinda, Mountain Dew, Pepsi, Sting, and Tropicana.



Source: Company's data

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## M&A

PepsiCo has an acquisition strategy to increase its markets and diversify its products. Throughout the years the company strategy was to increase its range of products to meet different needs of customers while it refranchises some of its bottler's operations.

**SodaStream:** This was the latest acquisition of PepsiCo. SodaStream is a sparkling water manufacturer that transforms tap water into flavored, sparkling beverages. It is #1 in the sparkling water market in volume and their products are available in more than 80,000 markets across 45 countries. With this acquisition PepsiCo intends to compete and promote health and wellness, with environmental alternative to carbonated soft drinks. PepsiCo bought all SodaStream's stocks for USD 144 per share, totalizing a value of approximately USD 3.3 bn.

## Relative Valuation

Ticker	Name	Country	Market Cap (mn)	Currency	P/E 2019	P/E 2020E	P/BV	EV/EBITDA	EV/Sales	YTD	Div. Yield	NetDebt/EBITDA	Margin EBITDA
KO US Equity	COCA-COLA CO/THE	UNITED STATES	214.543	USD	23,9	22,2	12,1	22,7	7,3	6,2%	3,1%	3,1	32,0%
KDP US Equity	KEURIG DR PEPPER INC	UNITED STATES	39.880	USD	23,3	20,2	1,8	23,5	5,6	10,6%	3,7%	6,7	23,6%
MNST US Equity	MONSTER BEVERAGE CORP	UNITED STATES	34.767	USD	30,8	27,6	9,4	20,9	7,4	29,9%	-	-0,6	35,2%
NESN SW Equity	NESTLE SA-REG	SWITZERLAND	306.147	CHF	22,9	21,0	5,2	15,2	2,9	25,3%	2,5%	1,7	19,3%
MDLZ US Equity	MONDELEZ INTERNATIONAL INC-A	UNITED STATES	75.825	USD	21,1	19,6	2,9	22,4	3,5	31,5%	1,9%	4,6	15,7%
UN US Equity	UNILEVER N V -NY SHARES	BRITAIN	176.500	USD	21,4	19,4	-	10,1	2,8	13,1%	3,0%	1,4	28,1%
K US Equity	KELLOGG CO	UNITED STATES	18.697	USD	14,3	13,5	7,4	14,1	2,2	-3,7%	4,1%	4,5	15,3%
CPB US Equity	CAMPBELL SOUP CO	UNITED STATES	12.490	USD	16,8	16,3	9,8	28,0	2,0	25,7%	3,4%	13,2	7,2%
PEP US Equity	PEPSICO INC	UNITED STATES	182.503	USD	23,6	21,8	12,9	15,3	3,0	17,8%	2,8%	2,2	19,9%
Average exc. PepsiCo					21,8	20,0	6,9	19,6	4,2	17,33%	3,08%	4,3	22%

Source: BiG Research

As for the relative valuation, PepsiCo's P/E ratio is above the average, 23.5 vs 21.8. EV/EBITDA of 15.3x is below the average of 19.6x. Net debt/EBITDA significantly inferior to peer's average, 2.2x vs 4.3x, although this high peer average is mainly affected by the high ratio of Campbell soup Co (13.2x). PepsiCo has less EBITDA margins compared to its peers, 19.9% vs 22%.

## Risks

**Regulations on plastic:** More concerns are being raised regarding the accumulation of plastic and waste in the environment, especially in the oceans and waterways. As a result, given that a part of the food and beverage products are sold in plastic or other type of packaging that may not be recyclable, compostable, or biodegradable, the company may incur two risks. First, the risk of bad publicity that would lead to consumers to opt to buy other alternatives that find to be more sustainable, causing a reduction in its revenues. Second, with more regulation to plastic and waste, the company would have to find other ways more ecofriendly to package its products and to reduce waste. This would lead to an increase in costs, and consequently a reduction in margins.

**Consumer preferences/ health concerns:** Consumers tend to be more demanding in what they buy since health concerns are more discussed. Therefore, consumers are changing their eating and drinking habits to healthier options with less sugar, sodium, and saturated fat. For this reason, and with more measures as taxes applied to these type of products, the company's revenues would decrease, and costs increase, reducing its margins. In line with this risk is the capacity of the company to innovate and create new products that meet the consumers needs.

Rating		
Agency	Rating	Outlook
S&P	A+	STABLE
Moody's	A1	STABLE
Fitch	A	STABLE

Source: BiG Research

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**Palm oil exploration:** PepsiCo uses in its production 450.000 metric tons of palm oil (less than 1% of total global supply). The company has gone through a controversy regarding some of its palm oil suppliers that were accused of abusing human rights such as child labor, gender discrimination, bad working conditions, among others. Other risks that are implied in the palm oil exploration are the forest deforestation and biodiversity loss. These problems occur mainly in local farms partners, especially in Indonesia and Malaysia where it is difficult to act without help of NGOs to identify this problematic. Controversies on this would originate not only bad image problems but also an increase in costs and lack of supply of palm oil, which is one of the main raw materials, especially in Frito-lays products. (see more details in the ESG separate ahead)

▲ **ESG**

**Health concerns**

PepsiCo is aware of these concerns and how they affect their business. So, the company has invested in a portfolio that includes even more nutritious beverages and foods so that it can meet their consumers new preferences.



Source: Company's data



Source: Company's data

Furthermore, the company set a target to reduce sugars, sodium, and saturated fat, which are the following ones:

FOCUS AREA	GOAL	2015	2016	2017	2025 TARGET
<b>Added sugars</b>	At least 2/3 of our global beverage portfolio volume will have 100 Calories or fewer from added sugars per 12-oz. serving	39% <sup>1</sup>	40% <sup>1</sup>	43% <sup>1</sup>	67% Global: 40%
<b>Sodium</b>	At least 3/4 of our global foods portfolio volume will not exceed 1.3 milligrams of sodium per Calorie	51% <sup>1</sup>	54% <sup>1,2</sup>	55% <sup>1</sup>	75% Global: 56%
<b>Saturated fat</b>	At least 3/4 of our global foods portfolio volume will not exceed 1.1 grams of saturated fat per 100 Calories	64% <sup>1</sup>	66% <sup>1</sup>	66% <sup>1</sup>	75% Global: 61%

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To reach these goals, PepsiCo has been substituting added sugars, sodium, and saturated fat by other substances that have significantly less calories. It is the case of Aspartame.

**Aspartame:** This substance is a sweetener that is much sweeter than sugar and is very low in calories. To reduce the quantity of sugar, beverage producers now mix aspartame with other substances. Since aspartame is much sweet than sugar, it's needed less quantity of that substance, and since it has low levels of calories the drink ends up having no sugar and less calories.

Product	Calories	Total Fat (g)	Sodium (mg)	Sugars (g)	Protein (g)
Pepsi	150	0	30	41	0
Diet Pepsi	0	0	35	0	0
Pepsi Max Zero	0	0	40	0	0

Source: BiG Research

It important to notice that when calories and sugar drop, level of sodium and other substances like aspartame increase since they are used to replace the flavor that is lost by the decrease in sugar and calories.

**Palm oil**

**Controversy:** Some of the company's palm oil suppliers were accused of committing human right abuses, especial related to child labor, gender discrimination, and bad working conditions. Later in 2018 the company ended its ties with Indofood that was one of the main companies involved in the situation. PepsiCo recognizes this difficulty of implementing and controlling working procedures of their suppliers, but it's working with a NGO to ensure that Human rights are respected.

**Solutions:** Although there are still some suppliers that may have suspicions on human rights abuses or being related to other companies that do that mainly in local farmers, PepsiCo reinstates that is dealing with the situation and establishing goals to prevent more similar situations.



Source: Company's data

GOAL	2015	2016	2017	2025 TARGET
Sustainably source 100% of our palm oil by 2020	8%	16%	32%	100% (2020 TARGET)
% of required tier-1 palm oil and cane sugar suppliers assessed in calendar year	1	75%	98%	100%

Source: Company's data

Thus, by 2020 the company expects to have 100% of certified sustainable source of palm oil supply. In 2017 the company fulfilled 32% of sustainable source. Also, the company has a target to 2025 to have only tier 1 suppliers of palm oil that ensure that human rights are respected.

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▲ **Graph**

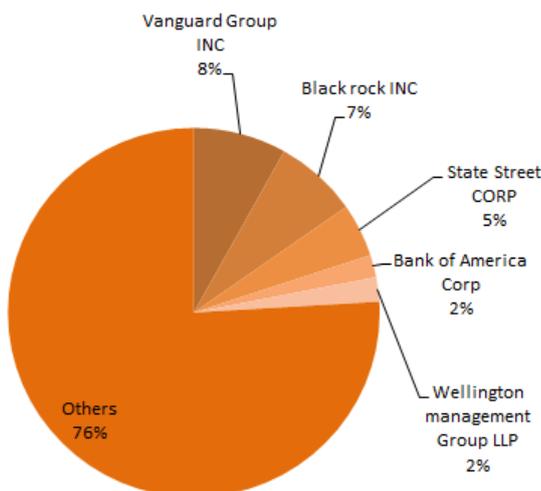


Source: BiG Global Trade

▲ **Calendar**

09<sup>th</sup> July 2019 - 2Q19 results

▲ **Shareholders**



Source: Company's data

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  - Buy, expected absolute return above 15%;
  - Accumulate, expected absolute return between +5% and +15%;
  - Keep/Neutral, expected absolute return between -5% and +5%;
  - Reduce, expected absolute return between -5% and -15%;
  - Sell, expected absolute return below -15%;
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PSI20 Notes in the last 12 months as of 31st of March of 2019:

	Number of Recommendations	%
Accumulate/Buy	1	33,3%
Keep/Neutral	1	33,3%
Reduce/Sell	1	33,3%
<b>Total</b>	<b>3</b>	<b>100,0%</b>

Source: BiG Research

Trading Ideas in the last 12 months as of 31st of March of 2019:

	Number of Recommendations	%
Profit Taking	8	50,0%
Stop Loss	8	50,0%
In Place	0	0,0%
<b>Total</b>	<b>16</b>	<b>100,0%</b>

Pair Trades in the last 12 months as of 31st of March of 2019:

	Number of Recommendations	%
Profit Taking	0	0%
Stop Loss	0	0%
In Place	0	0%
<b>Total</b>	<b>0</b>	<b>0%</b>

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