

## PEPSICO, INC. (NYSE) - PEP

### **Company Description:**

Purchase, NY-based PepsiCo, Inc. operates four major businesses: Frito Lay North America, 22% of sales and 37% of operating profits; PepsiCo Beverages North America, 32% and 26%; Quaker Foods NA, 4% and 6%; and PepsiCo International. (snacks and beverages), 42% and 31%. Int'l 49% of sales. Majority interest in Pepsi Bottling Group sold, 4/99. Quaker Oats acquired, 8/01. Pepsi Bottling Group and PepsiAmericas acq. 2/10. Pepsi- Cola, Gatorade, Tropicana, Diet Pepsi, and Mountain Dew. Specialty snack foods: Frito-Lay (brand names include Doritos, Ruffles, and Lay's), Walker's, Smith's, Sabritas. Has about 271,000 employees, Chairman, Pres. & CEO: Indra Nooyi. www.pepsico.com

### **Basic Description:**

Net profits have consistently grown over time. However, this growth in business profits has been marked by enthusiasm for PEP's stock in the form of generally high P/Es, especially during the 1990's. PEP's returns on capital and equity are superior but ROCs dropped significantly in 2010 due to another expansion into bottling. At the same time, debt was increased (bottlers are more cap'l intensive). In addition, profit margins declined by 20% (bottlers - lower margins) and depreciation jumped up. In the meantime, PEP has increased its payout, moving from 35% to 60%. In addition, PEP generally repurchases stock at the level of 20% of profits - a good idea to weight dividends given the high P/E. Finally, PEP is affected by the USD - similar factors in late 90s and current period.

### **Profitability Description:**

PEP has consistently grown revenues steadily but slowly through a combination of volume growth, price increases and acquisitions. It is difficult to break out the segment growth rates as the segments have changed regularly. On the expense side, COGS has increased but SGA has decreased, despite a high employee count in comparison with KO and others. COGS has gone up and that seems a function of the higher cost, lower margined bottling business being reincorporated in 2010. PEP has much higher margins in the US, especially in the Frito-Lay division. This is in contrast to KO, where the margins are highest overseas. Tax management may not be as much of an issue as PEP as it has a "return of basis" strategy. As a result, short term cash is used when dividends and share repurchasing exceed net profits. While PEP has extraordinarily consistent margins, growth has become an issue. "Organic" growth has been difficult to achieve and the metrics are inconclusive, as the "organic growth" of Latin America looks more likely to be driven by inflation.

### **Core Advantage Description:**

PEP was founded in 1919 and has built a powerful collection of brands with over 20 of them generating over \$1 billion in revenues per line. In addition, PEP has built a powerful global distribution network. PEP has its most powerful advantage with US retailers where it can join beverages with foods. Domestically, PEP has turned to a "health and wellness" model, recognizing the U.S. consumers' desire to believe in healthy eating, despite their lack of restraint in volume and a lack of exercise. Internationally, PEP is able to target opportunities where KO has vulnerability and has long leveraged the power of the snacks division. It does appear that overseas markets have proven exceptionally challenging with lower margins. Growth has been challenging in all markets and PEP may face a "sugar tax" headwind with substitution risks higher than faced by tobacco.

### **Investment Thesis:**

It is difficult to separate out the effects of currency, bottling changes and changing mix in segments. However, if we provide the most favorable assumptions, then revenues would have grown 4% for the past three years (taking out currency and "one-off" changes). This would allow an assumption of topline growth of 4% with an increase in margins allowing for an earnings growth of 6% with an additional 1.5% of growth for share repurchasing for a total of 7.5% with the ability to maintain the same tax regime.

### **Purchase Description:**

ACM considers PEP a buy at \$77 per share as a Tier I up to 3%, and at \$70 per share up to 4.5%, (using e.bond, e.g. and cap'l charge models) because of its "brand" strength, almost amounting to a duopoly globally, and a sell of half at \$113 per share with the remaining at \$134 per share.

	<b>FY End</b>			<b>Stock Price</b>		<b>Mkt (in mlns)</b>																						
	1995	1996	1997	<b>December</b>		<b>\$102.00</b>		<b>\$146,880.00</b>			1999	2000	2001	2002	2003	2004	2005	2006	2007	2008	2009	2010	2011	2012	2013	2014	2015	2016
<b>Earnings (mln)</b>	1,990	1,865	1,730	1,845	2,120	3,004	3,503	3,568	4,004	4,591	5,061	5,543	5,142	5,946	6,320	6,379	6,178	6,823	6,513	6,860	7,050	7,300						
<b>EPS</b>	\$1.00	\$0.82	\$1.10	\$1.37	\$1.48	\$1.52	\$1.85	\$2.05	\$2.20	\$2.42	\$3.34	\$3.41	\$3.31	\$3.80	\$4.00	\$4.08	\$4.00	\$4.46	\$4.38	\$4.74	\$4.90	\$5.14						
<b>Operating EPS</b>	\$1.24	\$1.17	\$1.10	\$1.23	\$1.48	\$1.66	\$1.96	\$2.05	\$2.32	\$2.69	\$3.00	\$3.34	\$3.31	\$3.80	\$4.00	\$4.08	\$4.00	\$4.46	\$4.38	\$4.74	\$4.90	\$5.14						
<b>Ave. P/E Ratios</b>	18.5	26.5	32.5	29.8	28.3	27.8	23.7	21.5	22.2	20.6	20.4	19.8	19.0	14.7	15.9	16.4	17.4	18.4	20.8	20.7								
<b>Yrly Price Low</b>	17.0	27.0	28.0	30.0	30.0	40.3	34.0	36.2	45.3	51.3	56.0	62.0	52.0	43.8	58.8	58.5	62.2	68.5	77.0	76.4	93.0							
<b>Yrly Price High</b>	29.0	36.0	41.0	43.0	50.0	50.5	53.5	48.9	55.7	60.3	66.0	79.0	79.8	62.8	68.1	71.8	73.9	85.0	97.0	103.2	110.0							
<b>Dividends Paid</b>	615	695	736	786	804	1,018	1,033	1,074	1,427	1,673	1,835	2,295	2,671	2,739	2,988	3,175	3,289	3,379	3,765	4,040	4,334	4,374						
<b>Dividends PS</b>	\$0.39	\$0.45	\$0.49	\$0.54	\$0.56	\$0.58	\$0.60	\$0.63	\$0.85	\$1.01	\$1.12	\$1.43	\$1.72	\$1.75	\$1.89	\$2.03	\$2.13	\$2.21	\$2.53	\$2.79	\$3.01	\$3.08						
<b>Ave. Div. Yld.</b>	1.70%	1.43%	1.42%	1.48%	1.40%	1.28%	1.37%	1.48%	1.68%	1.81%	1.84%	2.03%	2.61%	3.28%	2.98%	3.12%	3.13%	2.88%	2.91%	3.11%	2.97%							
<b>Shares Outstdg.</b>	1,576	1,545	1,502	1,455	1,435	1,756	1,722	1,705	1,679	1,656	1,638	1,605	1,553	1,565	1,581	1,564	1,544	1,529	1,488	1,448	1,440	1,420						
<b>Buyback \$ (mln)</b>	501	977	1,484	584	800	(14,573)	1,488	723	1,313	1,283	1,098	2,327	3,427	(640)	(1,015)	1,108	1,361	1,151	3,567	3,592	812	0						
<b>Shr. Equity (mln)</b>	7,313	6,623	6,936	6,881	7,249	8,674	9,291	11,874	13,523	14,251	15,447	17,234	12,203	17,442	21,476	20,899	22,399	24,279	17,438	12,175	12,250	12,500						
<b>Book Value PS</b>	\$4.64	\$4.29	\$4.62	\$4.73	\$4.95	\$4.92	\$5.37	\$6.94	\$8.03	\$8.58	\$9.43	\$10.71	\$7.86	\$11.12	\$13.58	\$13.36	\$14.51	\$15.88	\$11.72	\$8.41	\$8.51	\$8.80						
<b>LT Debt (mln)</b>	8,509	8,439	4,946	2,812	2,900	2,651	2,187	1,702	2,397	2,313	2,550	4,203	7,858	7,400	19,999	20,568	23,544	24,333	23,821	29,213	32,000	31,000						
<b>Return On Eq.</b>	27.20%	28.20%	#####	26.90%	30.00%	34.63%	37.70%	30.05%	29.61%	32.22%	32.76%	32.16%	42.14%	34.09%	29.43%	30.52%	27.58%	28.10%	37.35%	56.34%	57.55%	58.40%						
<b>Return On Cap</b>	14.30%	14.20%	#####	19.90%	22.00%	26.53%	30.52%	26.28%	25.15%	27.72%	28.12%	25.86%	25.63%	23.94%	15.24%	15.38%	13.45%	14.04%	15.79%	16.57%	15.93%	16.78%						

**Description:**

**Instructions:**

**Analysis:** After getting rid of bottlers, and cheering themselves for it, PEP is now repurchasing bottlers and, of course, cheering themselves for it.

**Observations:** PEP has done, at best, a mediocre job of capital allocation; issuing at low and repurchasing at highs. In addition, the dividend payout has been rising, but formulaic and the acquisitions expensive.

## Investment Characteristics

### Earnings Analysis:

### Use Of Earnings Analysis:

**Growth Rate %:** 7.24%

**Avg Div Payout %:** 46.98%

**Quality %:** 99.17%

**Avg Stk Buyback %:** 27.18% excluding major acquisition in 2001

	1995	1996	1997	1999	2000	2001	2002	2003	2004	2005	2006	2007	2008	2009	2010	2011	2012	2013	2014	2015	2016	2017
<b>Sales (mln)</b>	30,421	31,645	20,917	20,367	20,438	24,218	25,112	26,971	29,261	32,562	35,137	39,474	43,251	43,232	57,838	66,504	65,492	66,415	66,683	63,056	61,750	64,500
<b>SPS</b>	\$19.30	\$20.48	\$13.93	\$14.00	\$14.00	\$13.79	\$14.58	\$15.82	\$17.43	\$19.66	\$21.45	\$24.59	\$27.85	\$27.62	\$36.58	\$42.52	\$42.42	\$43.44	\$44.81	\$43.55	\$42.88	\$45.42
<b>Adj. Sales (mln)</b>																						

### Sales Analysis:

### Sales Analysis (last 5 yrs.):

**Growth Rate %:** 4.01%

**Growth Rate %:** -1.47%

**Growth Rate PS %:** 4.48%

**Growth Rate PS %:** 0.17%

	1995	1996	1997	1999	2000	2001	2002	2003	2004	2005	2006	2007	2008	2009	2010	2011	2012	2013	2014	2015	2016	2017
<b>Oper. Margin</b>	17.20%	16.10%	19.40%	19.20%	21.20%	22.70%	24.20%	23.00%	22.60%	22.90%	22.00%	22.80%	19.60%	22.50%	18.40%	18.50%	18.00%	19.30%	18.40%	19.23%	19.00%	21.00%
<b>Tax Rate</b>	32.60%	35.00%	33.40%	32.20%	32.00%	32.00%	31.20%	28.50%	29.50%	29.00%	19.30%	28.00%	28.00%	26.00%	23.00%	27.00%	25.20%	25.70%	25.10%	26.10%	25.00%	25.00%
<b>Deprec. (mln)</b>	1,740	1,719	1,106	1,032	960	1,082	1,112	1,221	1,264	1,458	1,406	1,426	1,543	1,635	2,327	2,737	2,689	2,663	2,625	2,416	2,500	2,550
<b>Depreciation %</b>	87.44%	92.17%	63.93%	55.93%	45.28%	36.02%	31.74%	34.22%	31.57%	31.76%	27.78%	25.73%	30.01%	27.50%	36.82%	42.91%	43.53%	39.03%	40.30%	35.22%	35.46%	34.93%

**Description:**

**Instructions:**

**Analysis:**

**Observations:** Because of the bottling division, PEP has a fairly high capital intensity. PEP does not generally manage taxes or expenses aggressively.

**Description & Analysis of Profitability (in mlns):**

	1999	2000	2002	2001	2003	2004	2009	2010	2011	2012	2013	2014	2015					
<b>Net Revenues:</b>	<b>5.9%</b>	<b>25,093</b>	<b>25,479</b>	<b>24,978</b>	<b>24,045</b>	<b>26,969</b>	<b>29,261</b>	<b>43,232</b>	<b>57,838</b>	<b>66,504</b>	<b>65,492</b>	<b>66,415</b>	<b>66,683</b>	<b>63,056</b>				
Frito-Lay North America	8,232	33%	8,971	8,565	8,216	9,091	9,560	13,224	13,397	13,322	13,574	21%	14,126	21%	14,502	22%	14,782	23%
Latin American Foods		0%								7,156	7,780	12%	8,350	13%	8,442	13%	8,228	13%
NorthAmericanBeverage	6,057	24%	7,130	7,200	6,888	7,733	8,313	10,116	20,401	22,418	21,408	33%	21,068	32%	21,154	32%	20,618	33%
AMENA		0%								7,392	6,653	10%	6,507	10%	6,727	10%	6,375	10%
Europe/SubSaharanAfr	6,681	27%	7,406	7,749	7,504	8,678	9,862	18,008	22,208	13,560	13,441	21%	13,752	21%	13,290	20%	10,510	17%
Quaker Foods North America	1,993	8%	1,972	1,464	1,437	1,467	1,526	1,884	1,832	2,656	2,636	4%	2,612	4%	2,568	4%	2,543	4%
Quaker divested businesses	7	0%	-	-	-	-	-	-	-	-	-	0%	-	0%	-	0%	-	0%
Bottling Operations/Inv.	2,123	8%	-	-	-	-	-	-	-	-	-	0%	-	0%	-	0%	-	0%
<b>Internal Costs:</b>	<b>5.8%</b>	<b>21,610</b>	<b>21,661</b>	<b>20,817</b>	<b>19,876</b>	<b>22,190</b>	<b>24,002</b>	<b>35,188</b>	<b>49,506</b>	<b>56,871</b>	<b>56,380</b>	<b>56,710</b>	<b>57,102</b>	<b>53,344</b>				
Cost of sales	10,326	41%	10,226	11,497	10,750	12,379	13,406	20,099	26,575	31,593	31,291	48%	31,243	47%	30,884	46%	28,384	45%
Selling, general and adm.	11,018	44%	11,104	8,958	8,574	9,460	10,299	15,026	22,814	25,145	24,970	38%	25,357	38%	26,126	39%	24,885	39%
Amortization of intang. assets	193	1%	147	138	165	145	147	63	117	133	119	0%	110	0%	92	0%	75	0%
Merger-related costs	0	0%	0	224	356	59	0	0	0	0	0	0%	0	0%	0	0%	0	0%
Other impairment/restruct.	73	0%	184	0	31	147	150	0	0	0	0	0%	0	0%	0	0%	0	0%
<b>EBITDA:</b>	<b>6.4%</b>	<b>4,515</b>	<b>4,778</b>	<b>5,243</b>	<b>5,281</b>	<b>6,000</b>	<b>6,523</b>	<b>9,679</b>	<b>10,659</b>	<b>12,370</b>	<b>11,801</b>	<b>12,368</b>	<b>12,206</b>	<b>12,128</b>				
Depreciation	1,032		960	1,082	1,112	1,221	1,264	1,635	2,327	2,737	2,689	2,663	2,625	2,416				
<b>"Free" Cash Flow</b>	<b>6.6%</b>	<b>3,397</b>	<b>3,454</b>	<b>3,806</b>	<b>3,936</b>	<b>4,613</b>	<b>4,787</b>	<b>7,551</b>	<b>7,406</b>	<b>9,031</b>	<b>9,087</b>	<b>9,573</b>	<b>9,462</b>	<b>9,456</b>				
Capital Expenditures	1,118		1,067	1,324	1,437	1,345	1,387	2,128	3,253	3,339	2,714	2,795	2,744	2,672				
<b>EBIT/Margin %:</b>	<b>6.6%</b>	<b>3,483</b>	<b>3,818</b>	<b>4,161</b>	<b>4,169</b>	<b>4,779</b>	<b>5,259</b>	<b>8,044</b>	<b>8,332</b>	<b>9,633</b>	<b>9,112</b>	<b>9,705</b>	<b>9,581</b>	<b>9,712</b>				
6% Frito-Lay North America	1,679	20%	1,915	2,216	2,056	2,366	2,389	3,258	3,549	3,621	3,684	27%	3,877	27%	4,054	28%	4,304	29%
Latin American Foods	0		0							1,126	1,109	14%	1,242	15%	1,211	14%	1,189	14%
NorthAmericanBeverage	1,184	20%	1,333	1,577	1,466	1,775	1,911	2,172	2,776	3,452	3,039	14%	2,955	14%	2,846	13%	2,785	14%
AMENA	0		0							896	925	14%	1,174	18%	1,043	16%	941	15%
Europe/SubSaharanAfr	563	8%	715	1,042	863	1,186	1,323	2,552	2,766	1,427	1,383	10%	1,293	9%	1,331	10%	1,081	10%
Quaker Foods North America	363	18%	392	473	389	486	475	628	568	803	704	27%	617	24%	621	24%	560	22%
<b>External Costs:</b>	<b>6.9%</b>	<b>978</b>	<b>1,275</b>	<b>1,295</b>	<b>1,236</b>	<b>1,213</b>	<b>1,085</b>	<b>2,065</b>	<b>1,994</b>	<b>3,171</b>	<b>2,898</b>	<b>2,918</b>	<b>3,023</b>	<b>2,852</b>				
Taxes	1,770		1,218	1,433	1,244	1,424	1,372	2,100	1,894	2,372	2,090	2,104	2,199	1,941				
Interest Exp: (Net)	291		187	142	152	112	93	330	835	799	808	814	824	911				
Bottling equity income	(1,083)		(130)	(280)	(160)	(323)	(380)	(365)	(735)	0	0	0	0	0				
<b>Earnings:</b>	<b>6.5%</b>	<b>2,505</b>	<b>2,543</b>	<b>2,866</b>	<b>2,933</b>	<b>3,566</b>	<b>4,174</b>	<b>5,979</b>	<b>6,338</b>	<b>6,462</b>	<b>6,214</b>	<b>6,787</b>	<b>6,558</b>	<b>6,860</b>				
<b>Dividend Paid/% of FCF:</b>	<b>10.8%</b>	<b>786</b>	<b>804</b>	<b>1,018</b>	<b>1,033</b>	<b>1,074</b>	<b>1,427</b>	<b>2,739</b>	<b>2,988</b>	<b>3,175</b>	<b>3,289</b>	<b>3,379</b>	<b>3,765</b>	<b>4,040</b>				
<b>Common Stock/% of FCF:</b>	<b>584</b>	<b>800</b>	<b>(14,573)</b>	<b>1,488</b>	<b>723</b>	<b>1,313</b>	<b>(640)</b>	<b>(1,015)</b>	<b>1,108</b>	<b>1,361</b>	<b>1,151</b>	<b>3,567</b>	<b>3,592</b>					
Strmt of CFS	584	800	(14,573)	1,488	723	1,313	(640)	(1,015)	1,108	1,361	1,151	4,143	4,363					
<b>Net Business Acquisitions:</b>								<b>0</b>	<b>2,249</b>	<b>427</b>	<b>(24)</b>	<b>(115)</b>	<b>(115)</b>					
Purchases									3,029	427	109	88	88					
Disposals									(780)		(133)	(203)	(203)					

**Description:**

**Instructions:**

**Analysis:** Top line growth stale, excepting international. Margins continue to expand with the most room in international. Total earnings growth benefits by the additional lowered taxes.

**Observations:**

## Balance Sheet (in millions):

	2000	2001	2002	2003	2004	2009	2010	2011	2012	2013	2014	2015	
<b>Assets:</b>	<b>8.4%</b>	<b>20,757</b>	<b>21,695</b>	<b>23,474</b>	<b>25,327</b>	<b>27,987</b>	<b>39,848</b>	<b>68,153</b>	<b>72,882</b>	<b>74,638</b>	<b>75,840</b>	<b>70,509</b>	<b>69,667</b>
16% Cash and Cash Equivalents	1,038	683	1,638	820	1,280	3,943	5,943	4,067	6,297	9,375	6,134	9,096	
13% Short-term investments, at cost	467	966	207	1,181	2,165	192	426	358	322	303	2,592	2,913	
8% Accounts and notes receivable, net	2,129	2,142	2,531	2,830	2,999	4,624	6,323	6,912	7,041	6,954	6,651	6,437	
6% Inventories	1,192	1,310	1,342	1,412	1,541	2,618	3,372	3,827	3,581	3,409	3,143	2,720	
6% Prepaid expenses and other	791	752	695	687	654	1,194	1,505	2,277	1,479	2,162	2,143	1,865	
6% Property, Plant and Equipment, net	6,558	6,876	7,390	7,828	8,149	12,671	19,058	19,698	19,136	18,575	17,244	16,317	
12% Intangible Assets, net	4,714	4,841	5,219	5,383	5,440	9,157	28,469	33,245	33,496	31,014	29,053	27,258	
-2% Investments in Unconsolidated Affiliates	2,979	2,871	2,611	2,920	3,284	4,484	1,368	1,477	1,633	1,841	2,689	2,311	
-1% Other Assets	889	1,254	1,841	2,266	2,475	965	1,689	1,021	1,653	2,207	860	750	
<b>Liabilities:</b>	<b>10.3%</b>	<b>13,153</b>	<b>13,047</b>	<b>13,944</b>	<b>13,431</b>	<b>14,415</b>	<b>22,302</b>	<b>46,568</b>	<b>51,867</b>	<b>52,116</b>	<b>52,959</b>	<b>52,821</b>	<b>57,492</b>
22% Short-term borrowings	202	354	562	591	1,054	464	4,898	6,205	4,815	5,306	5,076	4,071	
8% Accounts payable	4,529	4,461	4,998	5,213	5,599	8,127	10,923	11,757	11,903	12,533	13,016	13,507	
Income taxes payable	64	183	492	611	99	165	71	192	371	0	0		
16% Long-Term Debt	3,009	2,651	2,187	1,702	2,397	7,400	19,999	20,568	23,544	24,333	23,821	29,213	
3% Other Liabilities	3,960	3,876	4,226	4,075	4,099	5,591	6,729	8,266	6,543	4,931	5,744	5,887	
9% Deferred Income Taxes	1,367	1,496	1,486	1,261	1,216	659	4,057	4,995	5,063	5,986	5,304	4,959	
Preferred Stock, no par value	49	26	-7	-22	-49	-104	-109	-116	-123	-130	-140	-145	
Deferred Compensation – preferred	-27	–	–	–	–	–	–	–	–	–	–	–	
<b>Shareholder's Equity:</b>	<b>3.2%</b>	<b>7,604</b>	<b>8,648</b>	<b>9,530</b>	<b>11,896</b>	<b>13,572</b>	<b>16,908</b>	<b>21,585</b>	<b>21,015</b>	<b>22,522</b>	<b>24,519</b>	<b>17,688</b>	<b>12,175</b>
-2% Common Stock	34	30	30	30	30	30	31	26	26	25	25	24	
17% Capital in excess of par value	375	13	207	548	618	250	4,527	4,461	4,178	4,095	4,115	4,076	
Noncontrolling Interest	-21	–	–	–	–	–	312	311	105	110	110	107	
8% Retained Earnings	16,510	11,519	13,489	15,961	18,730	33,805	37,090	40,316	43,158	46,420	49,092	50,472	
16% Accumulated Other Comprehensive Loss	-1,374	-1,646	-1,672	-1,267	-886	-3,794	-3,630	-6,229	-5,487	-5,127	-10,669	-13,319	
9% Less: repurchased common stock, at	-7,920	-1,268	-2,524	-3,376	-4,920	-13,383	-16,745	-17,870	-19,458	-21,004	-24,985	-29,185	

**Description:**

**Instructions:** On debt side, borrowings are up significantly; some of short-term is long-term.

**Analysis:** Capital allocation is being done somewhat poorly; stocks repurchased primarily at highs with funds borrowed at increasingly high costs.

**Observations:** Retained earnings line grows at about 8%; given repurchases and dividends make 70% of earnings, with borrowings giving 15%, the return on capital is around 18-20%



## Industry Overview

PEP is in the branded foods business. This business is outstanding for its ability to cause consumers to view products as not commodity products. By virtue of a selectiveness about what is put in their mouths, consumers are particular about flavors. "It doesn't taste right," is the biggest asset for a company like PEP or KO that has spent years cultivating the "right taste."

## Industry Comparisons

### Operating Statistics:

Company	Yrs.Paybk	Sales	ROC	Operating Margin
KO	2.53	44,294	16.30%	27.50%
PEP	3.10	61,750	15.93%	19.00%
DPS	3.80	6,225	14.50%	21.00%
NSRGY	1.00	90,500	14.50%	16.50%

### Market Statistics:

Company	P/B	P/E	Divd. Yld.	EV/Sales
KO	7.74	22.5	3.18%	5.10
PEP	11.99	20.8	2.97%	2.90
DPS	4.88	20.0	2.47%	2.89
NSRGY	3.45	27.3	3.00%	2.83

# Qualitative Characteristics

## Positives:

## Negatives:

### Product/Service:

**Pricing Power:**

Good, careful investment

The "good for you" is not as profitable as "fun for you"

**Durability:**

Food brands must be continuously restocked.  
Americans are focused on "freshness."

**Brand Appeal:**

14 brands are selling over \$500 million per year with 11 selling more than \$1 billion.

**Unique Importance:**

"Momma's home cooking" is the underlying strength.

In increasingly sophisticated world, consumers are demanding more diversity, more options.

**Role Of Media:**

Advertising is critical, as food moves to health issues for adults and entertainment for others

**Toll Bridge:**

Supermarkets have to have some brands and convenience stores need the DSD model.

**Global Opportunity:**

Yes

Much lower margins, perhaps for long term.

**Competition:**

Limited

**Economic Risk:**

Beverages help snacks in emerging mkts,  
But snacks help beverages in developed mkts.

**Government Role:**

None

Dominance in chips could bring anti-trust.

**Role Of Technology:**

Not a threat

**Supply/Demand:**

Commodities are not a major factor.

### Financial:

**Business Model:**

Volume opportunity

**High Capital Reinv.:**

Low capital requirements

**Effective As Public:**

Yes

**Ownership:**

**Growth:**

Slow growth.

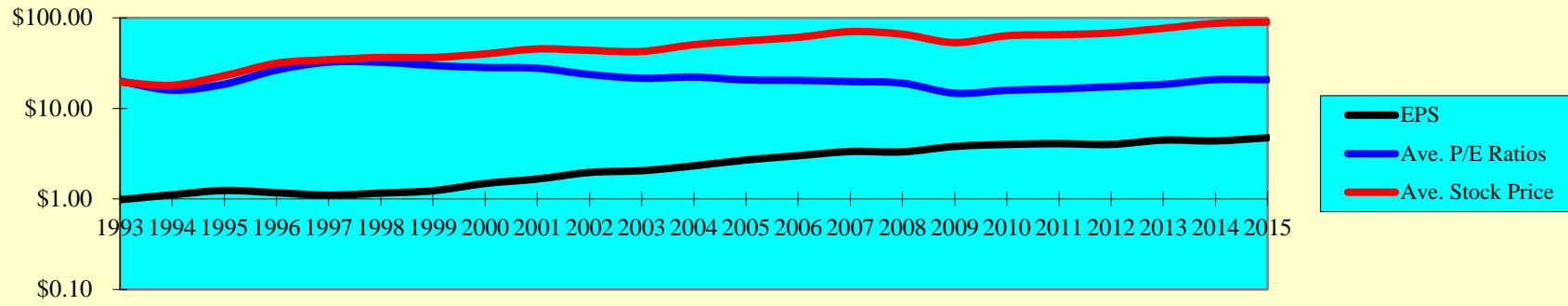
**Concentration:**

Diversified

### Management:



### Average Stock Price vs. Average P/E vs. EPS



	1993	1994	1995	1996	1997	1998	1999	2000	2001	2002	2003	2004	2005	2006	2007	2008	2009	2010	2011	2012	2013	2014	2015
<b>EPS</b>	\$0.98	\$1.11	\$1.24	\$1.17	\$1.10	\$1.16	\$1.23	\$1.48	\$1.66	\$1.96	\$2.05	\$2.32	\$2.69	\$3.00	\$3.34	\$3.31	\$3.80	\$4.00	\$4.08	\$4.00	\$4.46	\$4.38	\$4.74
<b>Ave. P/E Ratios</b>	20.0	15.9	18.5	26.5	32.5	32.4	29.8	28.3	27.8	23.7	21.5	22.2	20.6	20.4	19.8	19.0	14.7	15.9	16.4	17.4	18.4	20.8	20.7
<b>Ave. Stock Price</b>	19.6	18.0	23.0	31.5	34.5	36.5	36.5	40.0	45.4	43.8	42.6	50.5	55.8	61.0	70.5	65.9	53.3	63.5	65.2	68.1	76.8	87.0	89.8

Price/Earnings Ratio: used - **\$4.90**  
 Twenty year average low P/E - **19.1**  
 Twenty year average high P/E - **25.8**  
 If we set the purchase at the ave. Twenty year low P/E, the price implied is: **\$93.54**  
 If we set the sell at the ave. Twenty year high P/E, the price implied is: **\$126.46**

Price/Sales Ratio: used - **\$42.88**  
 Twenty year average low P/S - **2.01**  
 Twenty year average high P/S - **2.71**  
 If we set the purchase at the ave. Twenty year low P/S, the price implied is: **\$86.39**  
 If we set the sell at the ave. Twenty year high P/S, the price implied is: **\$116.22**

Price/Book Ratio: used - **\$8.51**  
 Twenty year average low P/B - **5.89**  
 Twenty year average high P/B - **7.98**  
 If we set the purchase at the ave. Twenty year low P/B, the price implied is: **\$50.11**  
 If we set the sell at the ave. Twenty year high P/B, the price implied is: **\$67.89**

Price/Cash Flow Ratio: used - **\$6.63**  
 Twenty year average low P/CF - **12.9**  
 Twenty year average high P/CF - **17.4**  
 If we set the purchase at the ave. Twenty year low P/CF, the price implied is: **\$85.37**  
 If we set the sell at the ave. Twenty year high P/CF, the price implied is: **\$115.19**

<b>Initial Rate of Investment</b>	
<b>Current Price</b>	\$102.00
<b>Current EPS</b>	\$4.90
<b>Initial ROI</b>	<b>4.80%</b>

<b>Relative Value to Investment In T-Bonds</b>	
<b>Current EPS</b>	\$4.90
<b>T-Bond Rate</b>	4.00%
<b>Relative Value</b>	<b>\$122.40</b>

<b>Valuation as an Equity Bond:</b>	
<b>Current BV</b>	\$8.51
<b>Current ROE</b>	57.55%
<b>Retained %</b>	15.84%
<b>Net BV Growth</b>	9.11%
<b>BV in Year 10</b>	\$20.35
<b>EPS in Year 10</b>	\$11.71
<b>Valueat20.P/E</b>	\$234.24
<b>Total Dividends</b>	\$54.09
<b>Total F. Value</b>	\$288.32
<b>Purchaseat14%</b>	<b>\$77.77</b>

<b>Valuation on Earnings Growth:</b>	
<b>Current EPS</b>	\$4.90
<b>EPS in Year 10</b>	\$9.85
<b>Ave. P/E Ratio</b>	21.88
<b>Valueat20.P/E</b>	\$251.14
<b>Price Return</b>	6.81%
<b>Dividend Return</b>	2.97%
<b>Total Return</b>	9.77%
<b>Purchaseat14%</b>	<b>\$67.74</b>
<b>Sellat6%</b>	<b>\$140.24</b>

Capital "charge" approach

12,128 ebitda  
 0.12 required return  
 0.06 growth rate (not on EPS basis)  
 0.9 % not required (inc. increase in debt)  
 0.066 denominator  
 183757.6 ev  
 21,275 debt  
 162,483 equity value  
 1440 shares  
 112.8351 share value  
 67.70107 buy at 60%  
 135.4021 sell at 120%

### History of Buys/Sells

by	Pepsico In	3/21/2011	250	16,071.40	64.29	3.00%
by	Pepsico In	7/14/2011	10	689.58	68.96	3.00%
by	Pepsico In	7/26/2011	150	9,633.39	64.22	4.50%

### Discussion of Buys/Sells

**What:** The return of the first purchase of PEP (bought 3/21/2011 to present) was 59% and SP 54% for an outperformance of 5% (nearly 5 years).  
 The return of the second purchase of PEP (bought 7/26/2011 to present) was 54% and SP 54% for an underperformance of 0% (nearly 4.5 years).  
 Since 1995, PEP has had almost identical returns with the SP with a period of underperformance during the tech bubble and outperformance during Great Recession.

**So what:** It appears that we purchased an equity "bond" as a "brand" and were able to buy at 16X earnings as a Tier I.  
 It appears that we made the second price, based on raising to following years earnings and estimating strong growth.  
 It appears that growth slowed, but P/E expansion and dividend desirability moved price up.

**Now what:** Our discipline has benefitted by P/E expansion where dividends have made a company more attractive despite slowed growth.  
 The continuing slowdown is making it more difficult to purchase these companies and more likely to sell  
 PEP has performed as a good substitute for bonds and yet yielded SP results.

Takeaway: PEP is not as pricey as KO.

