

PepsiCo Inc. (PEP)

\$120.26 (As of 03/26/20)

Price Target (6-12 Months): **\$126.00**

Long Term: 6-12 Months

Zacks Recommendation:
Neutral

(Since: 04/17/19)

Prior Recommendation: Underperform

Short Term: 1-3 Months

Zacks Rank: (1-5)

3-Hold

Zacks Style Scores:

VGM:C

Value: C

Growth: C

Momentum: C

Summary

Shares of PepsiCo have outpaced the industry in the past year on a positive surprise trend and robust organic sales view. The company reported earnings and sales beat in fourth-quarter 2019, driven by strength in all segments, robust pricing and volume. This marked the continuation of positive surprise trend, surpassing earnings and sales estimates four times in a row. The company is on track to deliver its productivity savings goal of at least \$1 billion annually through 2023. Also, recent product launches depict its progress with the expansion of its snacking business. However, the company is grappling with higher SG&A expenses, which is hurting the operating margin. Adverse currency rates are also likely to hurt the company's results in 2020. Moreover, industry headwinds and stiff competition are concerns.

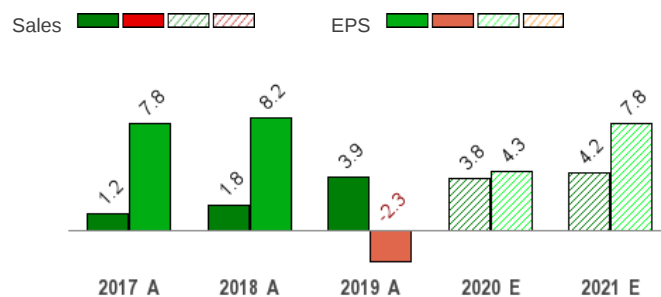
Price, Consensus & Surprise



Data Overview

52 Week High-Low	\$147.20 - \$101.42
20 Day Average Volume (sh)	10,479,148
Market Cap	\$167.1 B
YTD Price Change	-12.0%
Beta	0.55
Dividend / Div Yld	\$3.82 / 3.2%
Industry	Beverages - Soft drinks
Zacks Industry Rank	Top 37% (93 out of 253)

Sales and EPS Growth Rates (Y/Y %)



Last EPS Surprise	1.4%
Last Sales Surprise	1.3%
EPS F1 Est- 4 week change	-2.0%
Expected Report Date	04/28/2020
Earnings ESP	-1.2%
P/E TTM	21.8
P/E F1	20.8
PEG F1	3.0
P/S TTM	2.5

Sales Estimates (millions of \$)

	Q1	Q2	Q3	Q4	Annual*
2021	13,951 E	17,940 E	18,616 E	22,454 E	72,681 E
2020	13,236 E	17,341 E	18,114 E	21,766 E	69,726 E
2019	12,884 A	16,449 A	17,188 A	20,640 A	67,161 A

EPS Estimates

	Q1	Q2	Q3	Q4	Annual*
2021	\$1.11 E	\$1.72 E	\$1.76 E	\$1.66 E	\$6.22 E
2020	\$1.02 E	\$1.61 E	\$1.65 E	\$1.55 E	\$5.77 E
2019	\$0.97 A	\$1.54 A	\$1.56 A	\$1.45 A	\$5.53 A

*Quarterly figures may not add up to annual.

The data in the charts and tables, including the Zacks Consensus EPS and Sales estimates, is as of 03/26/2020. The reports text is as of 03/27/2020.

Overview

Headquartered in Purchase, NY, PepsiCo, Inc. is one of the leading global food and beverage companies. Its complementary brands/businesses include Frito-Lay snacks, Pepsi-Cola beverages, Gatorade sports drinks, Tropicana juices and Quaker foods. The company serves customers in more than 200 countries and territories.

The company is organized into six reportable segments:

Frito-Lay North America (FLNA - accounted for 25% of total revenues in 2019): The segment produces and sells snack foods in the United States, including some popular names like Cheetos cheese-flavored snacks, Doritos tortilla chips, Fritos corn chips, Lay's potato chips, Ruffles potato chips and Tostitos tortilla chips.

Quaker Foods North America (QFNA - 4%): The segment manufactures and sells cereals, rice, pasta, dairy and other branded products and includes some popular names like Quaker oatmeal and Aunt Jemima mixes and syrups, Quaker grits.

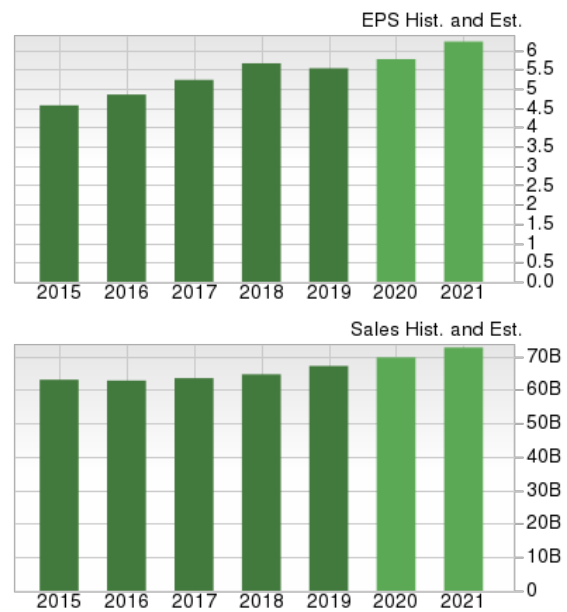
PepsiCo Beverages North America (PBNA - 33%): The segment includes all beverage businesses in the United States and Canada. The segment, formerly known as North America Beverages (NAB), manufactures and sells beverage concentrates, fountain syrups and many carbonated soft drinks (CSD) and non-carbonated beverages (NCB). It also sells ready-to-drink tea and coffee products through joint ventures (JV) with Unilever and Starbucks along with brands like Crush and Dr Pepper.

Latin America (LatAm - 11%): The segment includes all beverage, food and snack businesses in Latin America.

Europe (18%): The segment includes all beverage, food and snack businesses in Europe. It also sells ready-to-drink tea products through an international JV with Unilever (under the Lipton brand name) and some leading dairy products.

Africa, Middle East and South Asia (AMESA - 5%): The segment includes all beverage, food and snack businesses in Africa, Middle East and South Asia.

Asia Pacific, Australia and New Zealand and China (APAC - 4%): The segment includes all beverage, food and snack businesses in Asia Pacific, Australia and New Zealand and China.



Reasons To Buy:

▲ **Robust Surprise Trend, Strong Organic Sales View Boost Stock:** Although PepsiCo's shares have lost 1.3% in the past year, it fared better than the industry's decline of 14.9%. The outperformance can be attributed to the company's positive surprise trend and robust organic sales view. It reported top and bottom-line beat in fourth-quarter 2019. With this, it reported positive earnings and sales surprise in the last four quarters. Top-line gains in all its operating segments as well as robust pricing and volume aided the company's results. Strength in product and geographic portfolios, and progress on productivity targets also contributed to strong results. Moreover, growth across segments bolstered organic revenues, which grew 4.3% in the fourth quarter and 4.5% in 2019. Backed by the strong results, PepsiCo expects organic revenues for 2020 to increase 4%. For 2020, the company anticipates core earnings of \$5.88 per share, suggesting 6% growth from \$5.53 earned in 2019.

PepsiCo delivered robust organic revenue growth of 4.3% in fourth-quarter and 4.5% in 2019 driven by growth across the segments. For 2020, PepsiCo expects organic revenue growth of 4%.

▲ **Productivity Improvement and Cost Savings Program:** PepsiCo has been continually focused on driving greater efficiency and effectiveness, by driving down costs and plowing back these savings to develop scale and core capabilities. In 2019, the company delivered in excess of \$1 billion in productivity savings. This shows that the company is on track with its goal of generating productivity savings of at least \$1 billion annually through 2023. The company expects to achieve this productivity goal through savings generated from restructuring actions. These actions are likely to position the company to further simplify, synchronize and automate processes; re-engineer the go-to-market and information systems; simplify the organization and optimize its manufacturing and supply chain footprint. As part of these restructuring actions, the company estimates incurring pre-tax charges of nearly \$2.5 billion through 2023 (with cash portion of nearly \$1.6 billion). Savings from the productivity and restructuring plans should go a long way in driving top line and margins.

▲ **Strong Snacking Category:** PepsiCo has the competitive advantage of selling both snacks and beverages, which are complementary food categories. The complementary portfolio results in cost leverage, capability sharing, cross-category promotions and other commercial benefits. Notably, the company holds the number one position in the global snacks market with popular brands like Doritos, Cheetos and Lay's. The company's strong and growing snacks business has largely offset its sluggish beverages business in the past several quarters. The Frito-Lay North America snacks business is growing value share in salty, savory and macro snack categories. Gaining significant share in the snacking market, PepsiCo's Frito-Lay North America business reported core constant-currency operating profit growth of 1% and organic revenue growth of 3% in fourth-quarter 2019. Moreover, organic snacks/food volume increased 2% in the fourth quarter.

The company recently added new flavors to keep with the tastes of consumers. Some of these included the launch of Lime and Jalapeno flavors for Ruffles in collaboration with Anthony Davis, Cheetos popcorn in stores nationwide, and three new Lay's chip flavors - Lay's Cheddar Jalapeno, Lay's Poppables Sea Salt & Vinegar, and Lay's Kettle Cooked Flamin' Hot. Moreover, Doritos launched two remixes of fan favorite flavors - Flamin' Hot Limon and Amped-Up Cool Ranch. It also signed an agreement to buy China's online snacks company - Hangzhou Haomusi Food Co., Ltd. ("Be & Cheery") for \$705 million. This snacking business is likely to continue delivering strong sales and profits as the demand for savory snacks is rising.

▲ **Strong International Presence:** PepsiCo generates a significant part of its revenues outside the United States. Developing and emerging markets have significant growth potential due to their relatively low per-capita consumption. Another reason is the burgeoning middle-class population with rising income levels which has increased the demand for convenient, on-trend, affordable food and beverages. The company is expanding in developing/emerging markets like Russia, Mexico, China, India, Brazil and Africa through tailored distribution models as well as by offering locally relevant innovation and value-added products. In Mexico and India, PepsiCo has a massive expansion plan in place over the next five years. In fourth-quarter 2019, the company delivered solid organic revenue growth in each of its international segments despite macroeconomic uncertainties in some markets. Notably, organic revenues improved 6% each at LatAm and Europe, 8% at AMESA and 9% at APAC.

Looking at the detailed picture, organic revenues for the developing and emerging markets rose 8% in 2019, backed by strength in several key markets. Organic revenues in Egypt and Pakistan improved in double-digits. Meanwhile, India and Saudi Arabia reported mid-single-digit growth in organic revenues.

▲ **Attractive Shareholder Returns:** PepsiCo regularly returns value through higher dividends and share buybacks and reinvests greatly in its business. Pepsi's six-year annualized dividend per share (as of Dec 2018) has grown at a compounded growth rate of 9%, while cash returns over the same period were more than \$45 billion. PepsiCo has been increasing dividend for 47 consecutive years, including increases of 3% in 2019, 15% in 2018, 7% in 2017, 7.1% in 2016, 7.3% in 2015, 15% for 2014 and 5.6% for 2013. Also, it bought back shares worth \$3.2 billion in 2012, \$3 billion in 2013, \$5 billion each in 2014 and 2015, \$3 billion in 2016, and \$2 billion in both 2017 and 2018. Recently, the company announced a quarterly dividend of 95.5 cents per share, which is payable on Mar 31, 2020 to its shareholders of record as of Mar 6. Moreover, management plans to return \$7.5 billion to shareholders in 2020, through dividend payments worth \$5.5 billion and share repurchases of \$2 billion. Free cash flow is estimated to be \$6 billion. Operating cash flow is expected to be \$11 billion, with net capital spending of \$5 billion.

Reasons To Sell:

- ▼ **SG&A Expenses Hurt Q4 Operating Margin & EPS:** While PepsiCo beat earnings estimates in fourth-quarter 2019, core earnings per share (EPS) declined year over year owing to increased SG&A expenses that also hurt the operating margin. Notably, core EPS declined 2.7% year over year. In constant currency, core earnings were down 2.5% from the year-ago period. Despite gross margin growth, the company's reported core operating margin declined 115 bps. The decline in operating margin was mainly due to a 9.3% increase in core SG&A expenses (up 135 bps as a percentage of sales). The increase in SG&A expenses can be attributed to rise in certain operating costs (including higher commodity costs) and advertising and marketing expenses.
- ▼ **Unfavorable Foreign Currency:** PepsiCo's significant international presence exposes it to foreign currency risks, which have been weighing on the performance. Although, foreign currency effects on revenues and earnings remained neutral in the fourth quarter, the company estimates currency to impact both reported revenues and EPS by nearly 1 percentage points in 2020, based on current rates.
- ▼ **Macro Challenges:** The beverage industry presents substantial challenges for PepsiCo, primarily related to dynamic retail and consumer landscape, a very competitive environment, as well as operating and commodity cost inflation. The company's profits and margins are particularly pressured due to higher transportation cost, product mix costs and stepped-up advertising expense.
- ▼ **Stiff Competition:** Aggressive competition is a major threat against the company. Though the company has an advantage of diversified snacks and beverage portfolio, competing with the leading soft-drinks maker Coca-Cola is crucial for the company's business growth. Additionally, the company is facing headwinds due to the growing healthy lifestyle trend, which is driving lower consumer preference for sugary sodas and salty snacks.

PepsiCo is grappling with higher SG&A expenses, which is hurting the operating margin. The company's reported core operating margin declined 115 bps due to increase in core SG&A expenses.

Last Earnings Report

PepsiCo Surpasses Earnings and Sales Estimates in Q4

PepsiCo has reported solid fourth-quarter 2019 results, wherein earnings and sales surpassed estimates. However, the company's core earnings per share (EPS) declined year over year, owing to increased SG&A expenses, which also hurt its core operating margin.

Quarter in Detail

PepsiCo's fourth-quarter core EPS of \$1.45 beat the Zacks Consensus Estimate of \$1.43. However, core EPS declined 2.7% year over year. In constant currency, core earnings were down 2.5% from the year-ago period. The company's reported EPS of \$1.26 declined 73.9% year over year.

Net revenues of \$20,640 million advanced 5.7% year over year and surpassed the Zacks Consensus Estimate of \$20,349 million. On an organic basis, revenues rose 4.3%. Foreign currency effects on revenues and earnings remained neutral in the fourth quarter.

Revenue growth, on a reported and organic basis, was primarily driven by strength in all of the company's businesses as well as robust pricing and volume. Notably, all segments witnessed organic and reported revenue growth in the fourth quarter, except for QFNA, wherein revenues were flat. This was driven by strong progress in its strategic priorities, and investments made in its capabilities, brands, manufacturing and go-to-market capacity to boost growth.

Total volume was up 1% in the reported quarter. Meanwhile, volume for organic snacks/food and beverage increased 2% each in the reported quarter. Meanwhile, net pricing improved 3% in the fourth quarter, driven by strong pricing across all segments.

On a consolidated basis, reported gross margin expanded 49 basis points (bps), while core gross margin improved 20 bps. Reported operating margin expanded 62 bps, while core operating margin declined 115 bps. The decline in operating margin was mainly owing to higher SG&A expenses.

Segment Details

Reported revenues improved 15% in Europe, 8% in APAC, 5% in Latin America, 4% in PBNA, and 3% each at FLNA and AMESA segments. Meanwhile, organic revenues increased 9% at APAC, 8% at AMESA, 6% each at Europe and Latin America, and 3% each at FLNA and PBNA segments. Moreover, reported and organic revenues at the QFNA segment remained flat.

Operating profit (on a reported basis) declined 21% for the QFNA segment and 11% for AMESA. However, it grew 28% for Europe, 16% for Latin America, 5% for PBNA, and 3% each for APAC and FLNA segments.

Financials

The company ended 2019 with cash and cash equivalents of \$5,509 million, long-term debt of \$29,148 million, and shareholders' equity (excluding non-controlling interest) of \$14,786 million.

Net cash from operating activities was \$9,469 million as of Dec 28, 2019, compared with \$9,415 million as of Dec 29, 2018.

Guidance

For 2020, PepsiCo expects organic revenue growth of 4%. Further, the company anticipates a 7% increase in core constant-currency EPS. Core effective tax rate is estimated to be nearly 21% in 2020.

Moreover, the company estimates foreign currency to impact reported revenues and core EPS growth by nearly 1 percentage point in 2020 based on current rates. Including currency impacts, it anticipates core earnings of \$5.88 per share in 2020, suggesting 6% growth from \$5.53 earned in 2019.

Further, management plans to return \$7.5 billion to shareholders through dividend payments worth \$5.5 billion and share repurchases of \$2 billion. Free cash flow is estimated to be \$6 billion. Operating cash flow is expected to be \$11 billion, with net capital spending of \$5 billion.

Quarter Ending **12/2019**

Report Date	Feb 13, 2020
Sales Surprise	1.30%
EPS Surprise	1.40%
Quarterly EPS	1.45
Annual EPS (TTM)	5.52

Recent News

PepsiCo's Rockstar Buyout Likely to Step Up Energy Drinks Game – Mar 11, 2020

With the market buzzing with energy drink offerings, PepsiCo inked a deal to buy Rockstar Energy Beverages. Energy drinks have taken the whole beverage industry by storm, given consumers' growing health concerns and shifting preferences for caffeine-infused, low-sugar and non-carbonated options. PepsiCo's latest deal is worth \$3.85 billion and anticipated to be concluded by the first half of 2020. However, the transaction will not have any material impact on the company's 2020 results.

Notably, PepsiCo has had a long-standing partnership with Rockstar from 2009. Rockstar is involved in the production of beverages designed for athletes and rock stars with an active lifestyle. It offers products in more than 30 flavors, which are available in convenience and grocery stores in more than 30 countries.

The addition of Rockstar to PepsiCo's portfolio is in sync with the latter's plans to expand its energy drinks category in response to customers' growing demand for functional beverages. The company's energy product portfolio already includes Mountain Dew's Kickstart, GameFuel and AMP.

Despite false claims of PepsiCo discontinuing Mountain Dew, it is poised to getting it back on track. In doing so, the company is making efforts to move this product line to the energy drinks category by introducing variants, including Kickstart and GameFuel, along with non-sugar options and new flavors.

PepsiCo Acquires Chinese Snack Brand Be & Cheery – Feb 23, 2020

PepsiCo is on track with its snacking category. In sync with this, the company declared that it has entered into a definitive agreement to buy Hangzhou Haomusi Food Co., Ltd. ("Be & Cheery"), one of the largest online snacks companies in China, for \$705 million. Notably, the company has been operating in China for nearly 40 years and this transaction marks an important step in its goal to become China's leading consumer-centric food and beverage company.

PepsiCo Declares Quarterly Dividend – Feb 10, 2020

PepsiCo announced a quarterly dividend of 95.5 cents per share of PepsiCo common stock, a rise of 3% year over year, which is payable on Mar 31, 2020 to its shareholders of record as of Mar 6. This move is consistent with the company's previously announced increase in its annualized dividend to \$3.82 per share from \$3.71 per share, began with the June 2019 payment.

Valuation

PepsiCo shares are down 12% in the year-to-date period and 1.3% for the trailing 12-month period. Stocks in the Zacks sub-industry and the Zacks Consumer Staples sector are down 22.7% and 25.4%, respectively, in the year-to-date period. Over the past year, the Zacks sub-industry and the sector is down 14.9% and 19.8%, respectively.

The S&P 500 index is down 23.1% in the year-to-date period and 12.8% in the past year.

The stock is currently trading at 20.08X forward 12-month earnings, which compares to 18.24X for the Zacks sub-industry, 15.48X for the Zacks sector and 14.92X for the S&P 500 index.

Over the past five years, the stock has traded as high as 24.84X and as low as 16.44X, with a 5-year median of 20.87X. Our Neutral recommendation indicates that the stock will perform in-line with the market. Our \$126 price target reflects 21.04X forward 12-month earnings.

The table below shows summary valuation data for PEP

Valuation Multiples - PEP					
		Stock	Sub-Industry	Sector	S&P 500
P/E F12M	Current	20.08	18.24	15.48	14.92
	5-Year High	24.84	23.2	22.37	19.34
	5-Year Low	16.44	18.24	15.48	14.92
	5-Year Median	20.87	21.39	19.66	17.42
P/S F12M	Current	2.36	3.63	7.58	2.68
	5-Year High	2.91	5.31	11.16	3.43
	5-Year Low	2.02	3.63	7.58	2.54
	5-Year Median	2.41	4.48	9.89	3
EV/EBITDA TTM	Current	14.54	15.78	29.95	9.16
	5-Year High	29.18	21.04	45.11	12.88
	5-Year Low	9.7	12.21	27.89	8.27
	5-Year Median	13.59	17.56	38.49	10.78

As of 03/26/2020

Industry Analysis Zacks Industry Rank: Top 37% (93 out of 253)



Top Peers

Conagra Brands Inc. (CAG)	Neutral
Campbell Soup Company (CPB)	Neutral
Coca-Cola Company (The) (KO)	Neutral
Coca Cola Femsa S.A.B. de C.V. (KOF)	Neutral
Mondelez International, Inc. (MDLZ)	Neutral
Monster Beverage Corporation (MNST)	Neutral
Fomento Economico Mexicano S.A.B. de C.V. (FMX)	Underperform
Kellogg Company (K)	Underperform

Industry Comparison Industry: Beverages - Soft Drinks				Industry Peers		
	PEP Neutral	X Industry	S&P 500	FMX Underperform	KO Neutral	MNST Neutral
VGM Score	C	-	-	D	D	D
Market Cap	167.11 B	123.55 M	18.50 B	22.77 B	190.02 B	31.05 B
# of Analysts	8	2	13	3	9	7
Dividend Yield	3.18%	0.00%	2.35%	2.32%	3.70%	0.00%
Value Score	C	-	-	C	D	D
Cash/Price	0.04	0.12	0.07	0.19	0.07	0.05
EV/EBITDA	14.79	4.20	11.16	8.46	15.76	20.07
PEG Ratio	2.98	2.98	1.74	2.99	3.42	NA
Price/Book (P/B)	11.28	2.69	2.44	1.34	8.99	7.46
Price/Cash Flow (P/CF)	16.43	9.53	9.87	10.70	18.13	26.52
P/E (F1)	20.84	15.80	15.29	16.04	21.11	25.82
Price/Sales (P/S)	2.49	0.88	1.93	0.87	5.19	7.39
Earnings Yield	4.80%	5.83%	6.47%	6.24%	4.74%	3.87%
Debt/Equity	1.96	0.44	0.70	0.44	1.30	0.00
Cash Flow (\$/share)	7.32	0.40	7.01	5.94	2.44	2.18
Growth Score	C	-	-	F	C	B
Hist. EPS Growth (3-5 yrs)	5.35%	5.35%	10.85%	3.87%	0.87%	19.63%
Proj. EPS Growth (F1/F0)	4.29%	5.26%	2.89%	29.21%	-0.58%	10.34%
Curr. Cash Flow Growth	-2.46%	9.45%	5.93%	-32.42%	4.40%	9.91%
Hist. Cash Flow Growth (3-5 yrs)	1.04%	1.86%	8.55%	1.86%	-1.10%	18.17%
Current Ratio	0.86	1.30	1.23	1.26	0.76	3.50
Debt/Capital	66.22%	31.61%	42.57%	30.51%	56.60%	0.00%
Net Margin	10.89%	-0.50%	11.64%	4.37%	24.38%	26.37%
Return on Equity	54.16%	1.47%	16.74%	6.73%	44.39%	27.63%
Sales/Assets	0.88	0.83	0.54	0.80	0.42	0.84
Proj. Sales Growth (F1/F0)	3.82%	1.24%	2.37%	5.43%	1.48%	8.11%
Momentum Score	C	-	-	C	D	C
Daily Price Chg	6.90%	0.59%	6.21%	2.40%	6.44%	7.79%
1 Week Price Chg	-18.45%	-13.79%	-16.96%	-18.20%	-20.98%	-16.49%
4 Week Price Chg	-11.81%	-17.44%	-15.70%	-24.25%	-19.37%	-9.26%
12 Week Price Chg	-11.46%	-30.52%	-23.67%	-33.88%	-19.46%	-9.20%
52 Week Price Chg	-1.30%	-46.66%	-13.99%	-31.11%	-4.92%	6.21%
20 Day Average Volume	10,479,148	173,912	4,286,768	850,362	33,111,316	6,264,098
(F1) EPS Est 1 week change	-1.20%	-0.74%	-0.15%	-5.41%	-4.86%	-1.69%
(F1) EPS Est 4 week change	-2.01%	-1.42%	-2.28%	-3.37%	-6.65%	-0.95%
(F1) EPS Est 12 week change	-2.89%	-2.26%	-3.22%	-3.95%	-6.49%	-0.44%
(Q1) EPS Est Mthly Chg	-0.42%	-1.96%	-1.60%	NA	-5.39%	-2.97%

Zacks Style Scores

The Zacks Style Score is as a complementary indicator to the Zacks rating system, giving investors a way to focus on the highest rated stocks that best fit their own stock picking preferences.

Academic research has proven that stocks with the best Value, Growth and Momentum characteristics outperform the market. The Zacks Style Scores rate stocks on each of these individual styles and assigns a rating of A, B, C, D and F. We also produce the VGM Score (V for Value, G for Growth and M for Momentum), which combines the weighted average of the individual Style Scores into one score. This is perfectly suited for those who want their stocks to have the best scores across the board.

Value Score	C
Growth Score	C
Momentum Score	C
VGM Score	C

As an investor, you want to buy stocks with the highest probability of success. That means buying stocks with a Zacks Recommendation of Outperform, which also has a Style Score of an A or a B.

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