

# Equity Research Report

## PepsiCo (NASDAQ:PEP)

Date - 26th June 2024



Current Price	Target Price	Potential Upside	Reccomendation	Industry
\$166.48	\$224.58	Δ37.5%	BUY	Food & Beverages

### Overview and Investment Thesis

We suggest a Buy recommendation on PepsiCo (NASDAQ: PEP) based on a 2-year target price of \$244.58, offering a 37.5% upside potential from its closing price of \$166.48 on 18/06/2024. These key points drive our suggestion:

#### Valuation

- The current price of PepsiCo is lower when compared to competitor averages and has recently been trading at a 3-month low suggesting a strong undervaluation. A Discounted-Cash-Flow model also suggests price upside.

#### Increased ROI

- PepsiCo has a low cost of debt and a low WACC. This means that there is less risk associated with the financing, and so the expected return on investment (ROI) will be higher - making PepsiCo a more stable investment.

#### Growth

- There is a strong potential for higher growth in both South America and Asia, with the soft drinks and beverage market expected to grow significantly. With this opportunity capitalised on appropriately, PepsiCo could become a main competitor in these markets.

#### Financial Health

- PepsiCo has seen solid revenue growth over the past 6 years, continuing to grow each year. In addition, they provide a good dividend yield. Both these factors are a sign of good financial health and show stability.

#### Product Portfolio Diversification

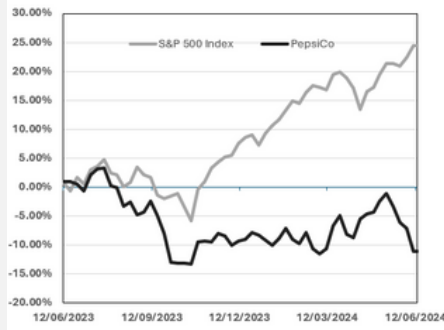
- PepsiCo holds a diversified product portfolio with strong brand value concerning both its beverage and snacks brands allowing PepsiCo to compete more efficiently with other rival companies such as Coca-Cola. This portfolio of products also allows them to compete in more than one market, diversifying risk.

#### Competitive R&D

- Extensive research and development is undertaken by the firm with targeted initiatives in health-conscious products and sustainable practices. Overall PepsiCo invests much more into research and development when compared to its competitors, which could allow for a greater market share in the future.

#### M&A Activity

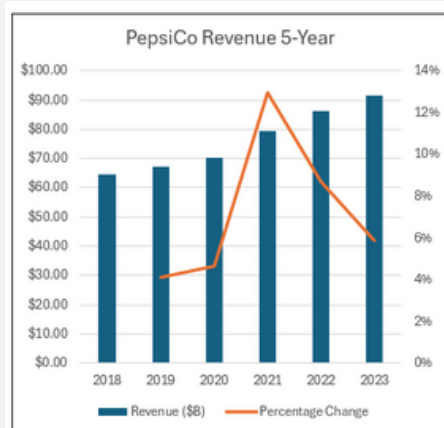
- PepsiCo has been active in acquiring companies to be a part of their portfolio over the last 5 years. These acquisitions have the potential to allow for greater market dominance and drive further revenue growth.



Price Performance	1M	3M	6M	1Y
PepsiCo	2.67%	-2.40%	-9.37%	-11.10%
S&P 500 Index	3.30%	1.61%	7.56%	24.40%

#### Market Profile

Closing price	\$166.48
52-Week High/Low	191.60/158.08
Avg. Volume (3M)	4,953,000
Dil. Shares Outst.(MM)	1,375
Market Cap.	\$228.41b
Dividend Yield	3.3%
Beta (5 Year)	0.53
EV / Revenue	2.8x
EV / EBITDA	16.0x
P / E	24.9x
Inst. Holdings	74.9%
Insider Holdings	0.135%



#### Scenario Analysis

Scenario	Implied Price	Upside	7 year Revenue CAGR	EBIT Margin Average	WACC	PGR
Optimistic Case	\$282.29	72.84%	4.72%	16.38%	6.17%	1.50%
Base Case	\$224.58	37.50%	3.58%	15.14%	6.89%	1.25%
Conservative Case	\$181.88	11.36%	2.47%	13.46%	7.67%	1.00%

# PepsiCo Company & Industry Overview



## Company Overview

Founded in 1965 through the merger of Pepsi-Cola and Frito-Lay, PepsiCo Inc. is a global leader in the food and beverage industry. Headquartered in New York, PepsiCo has a presence in over 200 countries and territories.

PepsiCo has demonstrated robust financial performance over the past 5 years, with a Revenue CAGR of 5.0%. In Q1 2024, PepsiCo reported a revenue of \$22.8bn and a net income of \$2.1bn. The consistent revenue growth is attributed to strong performance across its diverse portfolio, with significant contributions from both its beverage and snack divisions.

PepsiCo's business can be broken down into the following segments:

- **PepsiCo Beverages North America (PBNA):** This segment includes brands like Pepsi, Mountain Dew, Tropicana, and Gatorade. Despite the competitive beverage market, PBNA has shown steady growth due to strong brand loyalty and innovation in health-conscious product lines.
- **Frito-Lay North America (FLNA):** Known for popular snack brands such as Lay's, Doritos, and Cheetos, FLNA remains the company's fastest-growing segment. FLNA's revenue is driven by strong consumer demand and effective marketing strategies.
- **Quaker Foods North America (QFNA):** This segment includes Quaker Oats, Rice-A-Roni, and Aunt Jemima. While QFNA has experienced modest growth, it remains a stable revenue contributor.
- **Latin America, Europe, and APAC Segments:** These international segments contribute significantly to PepsiCo's revenue, with a growing market presence in developing regions.

PepsiCo has been active in expanding its portfolio through strategic acquisitions. Notable acquisitions in the past five years include SodaStream (2018), Rockstar Energy (2020), and Pioneer Foods (2020), enhancing its market position in the health-conscious and energy drink segments.

R&D is a crucial component of PepsiCo's strategy, with an expenditure of approximately \$800 million annually. This investment is significantly higher than most of its domestic competitors, except for Nestle S.A., which spends around \$1.9 billion. PepsiCo's R&D focus includes developing healthier product alternatives, sustainable packaging, and advanced manufacturing processes to support future growth.

PepsiCo's extensive brand portfolio includes Lay's, known internationally as Walker's Crisps, and Quaker Oats, solidifying its dominance in the snacks and cereals markets. These holdings, along with its beverage brands, provide a diversified revenue stream, mitigating risks associated with market fluctuations in any single category.

## Industry overview

PepsiCo operates in a competitive landscape with several major players. The top five competitors by market capitalisation include:

- Coca-Cola (\$270.41 billion)
- Keurig Dr Pepper (\$46.6 billion)
- Monster Beverage (\$51.15 billion)
- Mondelez International (\$89.21 billion)
- Nestle S.A. (\$274.89 billion)

PepsiCo's competitive advantage lies in its diversified product portfolio and strong brand equity across both beverages and snacks. Comparing operating margins, PepsiCo's margins are competitive with Coca-Cola but fall behind Nestle, which benefits from a broader range of product offerings. PepsiCo's ROA and ROE stand at 11.20% and 38.56%, respectively, highlighting efficient asset utilisation and shareholder value creation.

R&D investment is critical in maintaining competitive positioning. PepsiCo's \$800 million R&D expenditure focuses on innovation and sustainability, essential in responding to changing consumer preferences. While Nestle outspends PepsiCo significantly, the latter's targeted R&D initiatives in health-conscious products and sustainable practices provide a competitive edge.

Peers	Market Price	Market Cap	P/E Ratio	Debt	Revenue	PAT %	ROA	ROE	EPS
Coca-Cola	\$62.77	270.41B	25.1	43.8B	46.07B	23.4%	11.2%	38.6%	2.50
Keurig Dr Pepper	\$34.38	46.6B	21.5	15.1B	14.93B	14.5%	5.4%	8.8%	1.60
Monster Beverage	\$49.09	51.15B	30.5	0.0B	7.34B	22.8%	16.3%	19.5%	1.61
Mondelez International	\$66.5	89.21B	20.8	19.1B	36.14B	11.9%	6.2%	15.1%	3.20
NestleSA	\$104.87	274.89B	21.9	58.53B	104.48B	12.0%	9.9%	31.6%	4.28

PepsiCo  
Valuation



WACC	
Market Cap	224.42
% of Equity	83.03%
Cost of Equity ( RFR+ Beta x ERP)	7.38%
Risk Free Rate (RFR) - 10 Year T-bill Yield	4.33%
Beta (Bottom-up)	0.74
Equity Risk Premium (ERP) - Damodaran Online	4.12%
Debt	45.87
% of Debt	16.97%
Cost of Debt	5.40%
Tax Rate	17.00%
WACC	6.89%

Valuation							
Company and Ticker	EV/Revenue	EV/EBITDA	P/E	Price/Sales			
PepsiCo - PEP	2.86x	16.04x	24.45x	2.44x			
Coca-Cola - KO	6.41x	20.14x	25.01x	5.85x			
Dr Pepper - KDP	4.17x	15.15x	21.33x	3.10x			
Monster Bev. Co - MNST	5.96x	20.44x	27.19x	6.22x			
Mondelēz Int. Co - MDLZ	2.95x	12.65x	20.57x	2.44x			
Nestle Ltd - NSGRY	3.58x	18.42x	24.95x	3.00x			
High	6.41x	20.44x	27.19x	6.22x			
75th Percentile	5.51x	19.71x	25.00x	5.16x			
Average	4.32x	17.14x	23.92x	3.84x			
Median	3.88x	17.23x	24.70x	3.05x			
25th Percentile	3.11x	15.37x	22.11x	2.58x			
Low	2.86x	12.65x	20.57x	2.44x			
PepsiCo Valuation With Average							
Implied EV	\$397.03	\$280.77	\$265.43	\$398.95			
Net Debt	45.87	45.87	45.87	45.87			
Implied Market Value	\$351.16	\$234.91	\$219.56	\$353.08			
Shares Outstanding	1.37	1.37	1.37	1.37			
Implied Value Per Share	\$256.32	\$171.46	\$160.27	\$257.72			
PepsiCo Valuation With Median							
Implied EV	\$356.23	\$282.20	\$272.60	\$325.96			
Net Debt	45.87	45.87	45.87	45.87			
Implied Market Value	\$310.37	\$236.33	\$226.73	\$280.09			
Shares Outstanding	1.37	1.37	1.37	1.37			
Implied Value Per Share	\$226.54	\$172.50	\$165.50	\$204.44			
Unlevered FCF	17.41	18.22	19.18	20.02	21.07	21.95	22.77
Present Value of	16.79	16.45	16.20	15.82	15.57	15.18	14.73
Discount Period	0.54	1.54	2.54	3.54	4.54	5.54	6.54
Terminal Value							409.00
PV of Terminal Value							302.27
Enterprise Value							413.01
(+) Cash							8.05
(-) Preferred Shares							0.00
(-) Minority Interest							0.14
(-) Debt							80.85
Equity Value							340.06
Diluted Shares (In billions)							1.38
Implied Stock Price							\$247.32
PGR Implied Share Price							\$247.32
Relative Valuation Implied Price							\$201.85
Final Implied Share Price							\$224.58
Current Market Price							\$163.33
Implied Gain / (Loss)							37.50%

Sensitivity Analysis						
Perpetuity Growth Rate						
WACC	\$224.58	2.00%	1.50%	1.25%	1.00%	1.00%
5.80%	\$288.19	\$267.44	\$258.77	\$251.01	\$251.01	\$251.01
6.17%	\$269.95	\$252.75	\$245.46	\$238.88	\$238.88	\$238.88
6.89%	\$242.39	\$229.97	\$224.58	\$219.65	\$219.65	\$219.65
7.67%	\$220.17	\$211.06	\$207.04	\$203.31	\$203.31	\$203.31
8.50%	\$202.37	\$195.55	\$192.50	\$189.65	\$189.65	\$189.65

Scenario Analysis						
Scenario	Implied Price	Upside	7 year Revenue CAGR	EBIT Margin Average	WACC	PGR
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Revenue and EBIT Forecasts Analysis

The base, optimistic, and conservative scenarios for revenue growth indicate a 7-year Compound Annual Growth Rate (CAGR) of 3.58%, 4.72%, and 2.47% respectively. By 2030, the optimistic scenario projects that revenues from the US and Mexico, which accounted for 65% of total revenue in 2023, will make up 68.7% of total revenue. Meanwhile, the base and conservative cases predict they will make up 66% and 62% respectively.

The conservative case places greater emphasis on the impact of the introduction of new weight-loss drugs such as Wegovy and Ozempic. These drugs are expected to have a significant negative effect on PepsiCo's revenues in Western countries such as the U.S., UK, and Mexico due to their ability to reduce hunger and cravings

In contrast, the base and optimistic scenarios anticipate a lesser impact on revenue due to these weight-loss drugs and a steady growth rate in the U.S. and Mexico. These scenarios also predict a higher growth rate in South American regions as well as Asia, where the soft drinks and beverage market is expected to grow significantly in the coming years, positively impacting PepsiCo's revenues (Statista).

With concern to EBIT margins; they are expected to level out at 15.4% by 2028 as per the base case and remain stationary at that level for the remainder of the forecasted years. The optimistic and conservative cases permit for a deviation from the 15.4% base of plus or minus 1.4%.

WACC and PGR assumptions

Regarding the Weighted Average Cost of Capital(WACC), the base case of this valuation yields a WACC of 6.89% and utilises a bottom-up Beta of 0.74. The optimistic case yields a WACC of 6.17% and uses a 5-year Beta of 0.53. This lower WACC allows for a lower discount rate regarding the unlevered free cash flow (UFCF) in the DCF which allows for a greater Enterprise Value and therefore implied share price.

PepsiCo's EV is comprised of 83% equity and 17% debt, with the Cost of Equity being (in the optimistic case) 6.51% and 6.89% assuming a Base case. PepsiCo's cost of Debt (pre-tax) is 5.40% with this being considered very low and in this case due to the low percentage of debt as a part of its EV.

The DCF part of this valuation assumes a base case Perpetual Growth Rate (PGR) or terminal growth rate of 1.25%. This PGR is typically lower when compared to another company's valuation and is this way because of how established PepsiCo is as a brand and as a company.

Relative Valuation

PepsiCo's current price of \$166.X can be seen as cheaper when compared to the peer averages as listed in the Excel chart on the left.

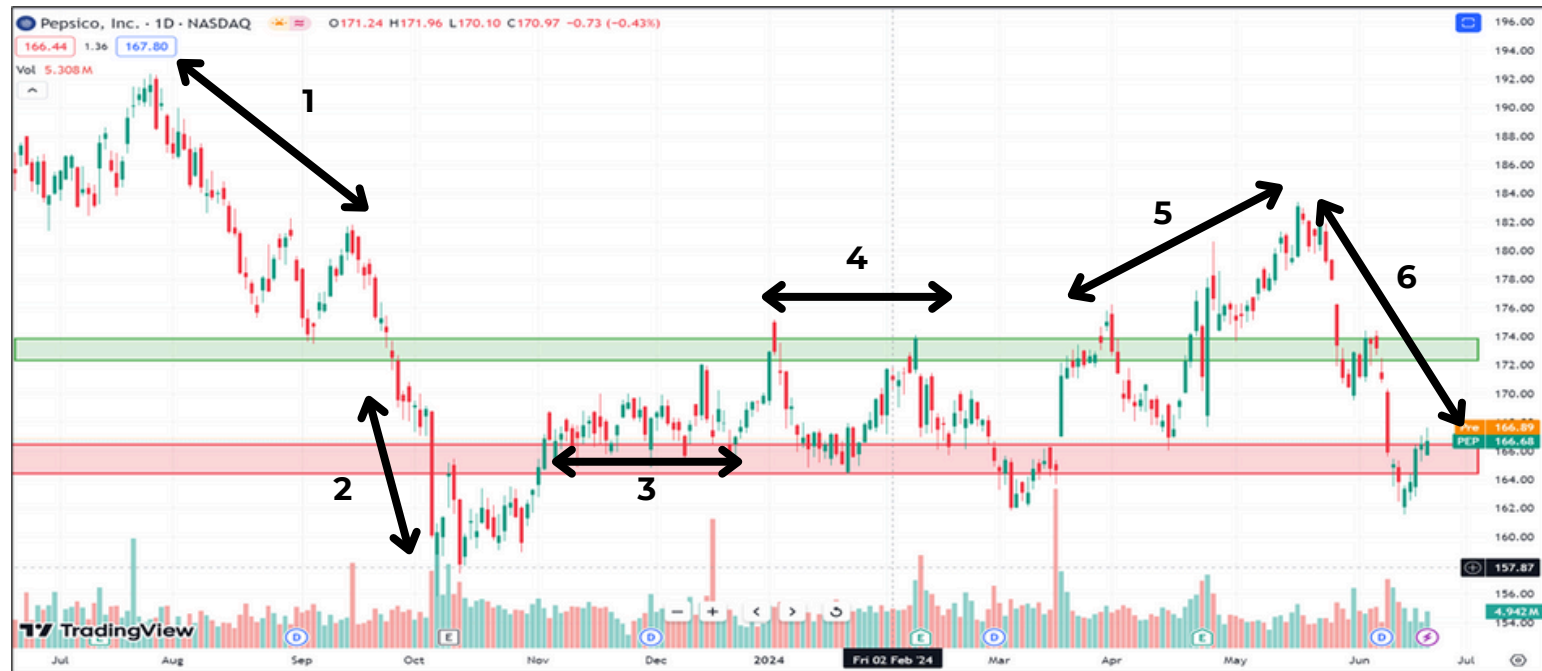
Using the average as a valuation bridge gives out a higher Average Implied Share Price than using the Median. This means that PepsiCo's current price sits at the lower end of the negatively skewed peer comparables data, or to summarise, PepsiCo's current price is undervalued when comparing it to how its peers are trading. A technical analysis on the next page shows that PEP is trading close to a recent 3-month low of \$163.31.





# PepsiCo

## Price Movement Analysis



### Chart Appendix

- From a 52-week perspective, Pepsi's stock fell steadily from its peak price of 192.83 in July to its lowest price of 155.83 in October following a bearish trend.
- 1-August to September**
  - Disputes from governments for business in Russia resulted in the Finnish government withdrawing from selling Pepsi in parliamentary restaurants, which generated negative publicity.
- 2-October**
  - A panic that weight loss drugs would impact sales on PepsiCo products created the selloff sending the share price below the support line. However, the last earnings of the year beat the consensus by 1.25%, with the RSI going below 30 due to overselling pressure, an indicator to buy that raised the share price. This stock stabilized and found its support with a range of 164 – 167.
- 3-December**
  - The state of New York state sued PepsiCo for single-use plastics. There was little market reaction after the news broke out and the price moved in a sideways pattern.
- 4-January to February**
  - Pepsi had a rocky start to the year as the supermarket Carrefour removed PepsiCo products from its shelves because of the company's increasing prices, which were a response to rising expenses for labour, energy, and commodities resulting in their prolonged continuation of share price in the support zone. In its first earnings of the year, we saw a build-up in price until PepsiCo missed the consensus estimate causing the price to fall.
- 5-March to May**
  - March was a bullish month because a well-respected analyst from Morgan Stanley upgraded his outlook which sent the stock price flying and breaking the resistance level which has a range between 172 – 174. Furthermore, Quaker Oats which is owned by PepsiCo had to recall some of its products due to a health risk which led to the close of a facility in April 2024. Due to that, we saw a pullback in the share price.
- 6-May to June**
  - More recently, we see PepsiCo being very bullish and reaching a high this year of 183.41. This is because PepsiCo beat the consensus estimate by 0.94%. However, we see a hard pullback going below the support zone and then a bounce off of resistance as price moves upwards.

### Investment Risks

- High prices: Carrefour pulled PepsiCo products from its stores in France, Italy, Spain and Belgium. Europe contributed to 12.1% of the final revenue in 2023. PepsiCo may lose market share in Europe.
- Conflict in Sudan: 70% of Gum Arabic a crucial ingredient in the making of Pepsi and candy is found in Sudan. In addition, there's no alternative so this conflict threatens the production and distribution of this important component. So, there is a possibility of shortages in the future.
- Weight loss: It's still early days for these 'diet' drugs but the future of this product is threatening PepsiCo's bottom line. Ozempic provided by Novo Nordisk and Mounjaro provided by Eli Lilly these drugs suppress your appetite leading to less snacking. PepsiCo products include Pepsi, Lay's, Quaker, Gatorade, Doritos and Cheetos this list doesn't not exhaust the product selection that PepsiCo offers. From the plethora of snacking options PepsiCo provides less snacking equals less sales, which will harm their profitability and their share price.

# Equity Research Report

# Disclaimer and Authors

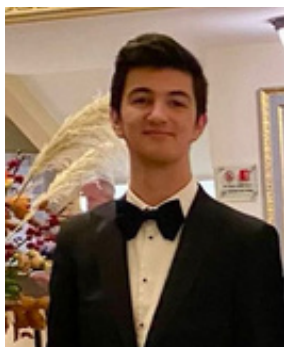
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Named after the University of Surrey's Austin Pearce building, we thought it was only right to give credit to the place which truly ignited our immersion into economics and finance, and more specifically, our passion for understanding financial markets.