



Rating
Hold

Company
PepsiCo

Date
10 July 2018

North America
United States

Consumer
Beverages

Reuters PEP.OQ Bloomberg PEP US Exchange NSM Ticker PEP

Results

Price at 9 Jul 2018 (USD)	107.76
Price target	116.00
52-week range	121.76 - 96.16

Quick Take – PEP's 2Q18 Results

How do we expect the market to react?

Overall, PEP reported solid 2Q results this morning—a headline beat on revenue, gross margin, EBIT, and EPS vs. both us and consensus—while reiterating full-year guidance of \$5.70 in EPS (vs. DBE \$5.62 and consensus at \$5.66). Especially in light of some de-risking ahead of results, we expect a positive stock reaction in response. Organic growth upside (+2.6% reported; +50 bps vs. our model) was driven mainly by FLNA (+4% vs. +3%) and ESSA (+7% vs. +3%), partially offset by Quaker (-5% vs. -2%) and LatAm (+3.5% vs. +4%), with NAB in line at -1%. As expected, PEP's EBIT included a ~\$145m gain from refranchising in Thailand (+5 pts on EBIT), lapping last year's Britvic gain (-3 pts on EBIT), which contributed ~40 bps net to operating margins. Additionally, certain insurance settlement adjustments in NAB, LatAm, and QFNA also benefitted EBIT by ~+1 pt (~+25 bps on operating margins). Still, the overall quality of results was high versus expectations, with FLNA top-line strength providing important mix benefits to overall gross margin. Moreover, the magnitude of PEP's 2Q beat will allow Street estimates to drift lower in 2H (something more bearish investors have felt necessary coming into 2Q results), while still aligning with PEP's higher full-year guidance.

Questions on the call are likely to focus on FLNA momentum, PEP's outlook on NAB reacceleration in 2H, and any strategic options PEP is considering related to NAB longer-term. We also expect some focus on emerging market conditions, ongoing productivity efforts, and PEP's core earnings "quality," which continues to be aided by one-time gains and adjustments.

Conference call at 7:45AM ET today: 1-212-931-9775 / ID: 7081409/ PW: Gatorade Zero

How do reported results compare with expectations?

PEP reported 2Q18 EPS of \$1.61 vs. DBE \$1.52/Street \$1.53, which included \$0.02 of headwind from a higher tax rate vs. our model. Gross margin of 54.8% (DBE: 54.4%/Street: 54.5%) was -35 bps YoY and +40 bps above our model. Overall operating income of \$3,057 million, beat our estimate by +5.8% and beat consensus by +4.0%. Overall organic growth was +2.6% (DBE: +2.1%/Street: +2.2%). By segment, organic growth in FLNA was +4% (DBE: +3.0%/Street: +2.8%); QFNA was -5% (DBE: -2.0%/Street: -0.1%); NAB was -1% (DBE: -1.0%/Street: -0.4%); LATAM was +3.5% (DBE: +4.0%/Street: +6.0%); ESSA was +7% (DBE: +3.0%/Street: +4.2%); and AMENA was +6% (DBE: +8.0%/Street: +4.7%).

Valuation & Risks

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Key indicators (FY1)

ROE (%)	66.9
ROA (%)	9.4
Net debt/equity (x)	174.3
Book value/share (USD)	8.47
Price/book (x)	12.7
Net interest cover (x)	11.2
EBIT margin (%)	16.5

Source: Deutsche Bank



Consolidated EBIT margins were 19.0% (DBe: 17.9%/Street: 18.3%). EBIT margins by segment were FLNA at 31.4% (DBe: 30.7%/Street: 31.2%); QFNA at 27.5% (DBe: 25.2%/Street: 26.9%); NAB at 14.6% (DBe: 13.0%/Street: 15.4%); LATAM at 14.8% (DBe: 13.5%/Street: 14.3%); ESSA at 14.2% (DBe: 15.5%/Street: 15.1%); and AMENA at 31.6% (DBe: 27.3%/Street: 22.8%). FCF of \$1,803 in the quarter was slightly worse than prior year and below our model.

[Has does the company's outlook compare to expectations?](#)

The company maintained its overall outlook of organic growth at least in line with 2017, or +2.3% (DBe: +2.6%/Street +2.8%) and Adjusted EPS of \$5.70 (DBe \$5.62/Street \$5.66), with growth of 9%, reflecting a tax rate in the "low-20s", about in-line with DBe 20%. FX is still expected to be neutral to both sales (DBe: -0.2%) and EPS. FCF is still expected to be \$6 billion (DBe: \$5.832 billion) including discretionary pension contribution of \$1.4 billion and capex of \$3.6 billion. Share repurchases are still expected to be \$2 billion (DBe: \$2.009 billion) and dividends are expected to be \$5 billion (DBe: \$5.109 billion).



Figure 1: PEP 1Q18 Highlights

PepsiCo (PEP) - 2Q18 Earnings Snapshot

\$ in millions, except per share data

INCOME STATEMENT

	2Q18	2Q17	chg.	DB Est.	Delta	Street	Delta
Organic growth	2.6%	3.1%	-52 bps	2.1%	48 bps	2.1%	47 bps
Net Sales	\$16,090	\$15,710	2.4%	\$16,132	(0.3%)	\$16,058	0.2%
Cost of Goods Sold	7,270	7,043	3.2%	7,353	(1.1%)	7,299	(0.4%)
Gross Profit	8,820	8,667	1.8%	8,779	0.5%	8,759	0.7%
SG&A	5,763	5,688	1.3%	5,889	(2.1%)	5,818	(1.0%)
Operating Income	3,057	2,979	2.6%	2,890	5.8%	2,940	4.0%
Net Interest Expense	210	216	(2.8%)	229	(8.1%)	178	18.2%
Other (income)/expense	(82)	(71)	15.5%	(74)	11.1%	0	NM
Pretax Income	2,929	2,834	3.4%	2,735	7.1%	2,763	6.0%
Taxes	616	666	(7.5%)	547	12.6%	581	6.1%
Non-controlling/other	10	13	(23.1%)	14	(28.6%)	10	3.6%
Net Income (continuing ops)	2,303	2,155	6.9%	2,174	5.9%	2,172	6.0%
Diluted EPS - Core	\$1.61	\$1.50	7.9%	\$1.52	5.9%	\$1.53	5.7%
Diluted Shares Outstanding	1,426	1,441	(1.0%)	1,426	(0.0%)	1,422	0.3%

MARGIN ANALYSIS

	1Q18	1Q17	chg.	DB Est.	Delta	Street	Delta
Gross Margin	54.8%	55.2%	(35 bps)	54.4%	40 bps	54.5%	27 bps
SG&A Ratio	35.8%	36.2%	(39 bps)	36.5%	(69 bps)	36.2%	(42 bps)
Operating Margin	19.0%	19.0%	4 bps	17.9%	109 bps	18.3%	69 bps
Pretax Margin	18.2%	18.0%	16 bps	17.0%	125 bps	17.2%	100 bps
Tax Rate	21.0%	23.5%	(247 bps)	20.0%	103 bps	21.0%	1 bps
Net Margin	14.3%	13.7%	60 bps	13.5%	84 bps	13.5%	79 bps

SALES BY SEGMENT

	2Q18	2Q17	chg.	DB Est.	Delta	Street	Delta
Frito-Lay NA	3,837	3,678	4.3%	3,788	1.3%	3,792	1.2%
Quaker Foods NA	527	553	(4.7%)	542	(2.8%)	551	(4.3%)
North America Beverages	5,193	5,242	(0.9%)	5,190	0.1%	5,179	0.3%
Latin America	1,843	1,823	1.1%	1,841	0.1%	1,898	(2.9%)
Europe Sub-Saharan Africa	3,116	2,812	10.8%	3,065	1.7%	3,025	3.0%
Asia, Middle East & North Africa	1,574	1,602	(1.7%)	1,706	(7.7%)	1,697	(7.2%)
Total	16,090	15,710	2.4%	16,132	(0.3%)	16,058	0.2%

OPERATING PROFIT BY SEGMENT

	2Q18	2Q17	chg.	DB Est.	Delta	Street	Delta
Frito-Lay NA	1,204	1,146	5.1%	1,163	3.5%	1,183	1.8%
Quaker Foods NA	145	145	0.0%	137	6.2%	148	(2.0%)
North America Beverages	756	890	(15.1%)	675	12.1%	799	(5.4%)
Latin America	272	253	7.5%	249	9.4%	271	0.4%
Europe Sub-Saharan Africa	442	495	(10.7%)	475	(7.0%)	457	(3.3%)
Asia, Middle East & North Africa	498	309	61.2%	466	6.9%	387	28.7%
Eliminations	(260)	(259)	0.4%	(274)	(5.1%)	(305)	(14.7%)
Total	3,057	2,979	2.6%	2,890	5.8%	2,940	4.0%

SEGMENT OPERATING MARGIN

	2Q18	2Q17	chg.	DB Est.	Delta	Street	Delta
Frito-Lay NA	31.4%	31.2%	22 bps	30.7%	68 bps	31.2%	18 bps
Quaker Foods NA	27.5%	26.2%	129 bps	25.2%	231 bps	26.9%	64 bps
North America Beverages	14.6%	17.0%	(242 bps)	13.0%	156 bps	15.4%	(87 bps)
Latin America	14.8%	13.9%	88 bps	13.5%	126 bps	14.3%	48 bps
Europe Sub-Saharan Africa	14.2%	17.6%	(342 bps)	15.5%	(132 bps)	15.1%	(92 bps)
Asia, Middle East & North Africa	31.6%	19.3%	1235 bps	27.3%	434 bps	22.8%	883 bps

SALES DERIVATION (Actual)

	Volume	Price	Organic	M&A/Cal	FX	Sales
Frito-Lay NA	2.0%	2.0%	4.0%	0.0%	0.0%	4.3%
Quaker Foods NA	(3.0%)	(2.0%)	(5.0%)	0.0%	0.5%	(4.7%)
North America Beverages	(2.0%)	1.0%	(1.0%)	0.0%	0.0%	(0.9%)
Latin America	(3.0%)	7.0%	3.5%	0.0%	(2.0%)	1.1%
Europe Sub-Saharan Africa	6.0%	1.0%	7.0%	0.0%	4.0%	10.8%
Asia, Middle East & North Africa	4.0%	2.0%	6.0%	(9.0%)	2.0%	(1.7%)
Total	1.0%	2.0%	2.6%	(1.0%)	1.0%	2.4%

SALES DERIVATION (DBe)

	Volume	Price	Organic	M&A/Cal	FX	Sales
Frito-Lay NA	1.0%	2.0%	3.0%	0.0%	0.0%	3.0%
Quaker Foods NA	(3.0%)	1.0%	(2.0%)	0.0%	0.0%	(2.0%)
North America Beverages	(2.0%)	1.0%	(1.0%)	0.0%	0.0%	(1.0%)
Latin America	1.0%	3.0%	4.0%	0.0%	(3.0%)	1.0%
Europe Sub-Saharan Africa	2.0%	1.0%	3.0%	0.0%	6.0%	9.0%
Asia, Middle East & North Africa	7.0%	1.0%	8.0%	(3.5%)	2.0%	6.5%
Total	0.6%	1.5%	2.1%	(0.4%)	0.9%	2.7%

Source: FactSet, Company filings, Deutsche Bank estimates and analysis



Appendix 1

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*Other information available upon request

Disclosure checklist			
Company	Ticker	Recent price*	Disclosure
PepsiCo	PEP.OQ	107.76 (USD) 9 Jul 2018	7, 8, 11, 14, 15

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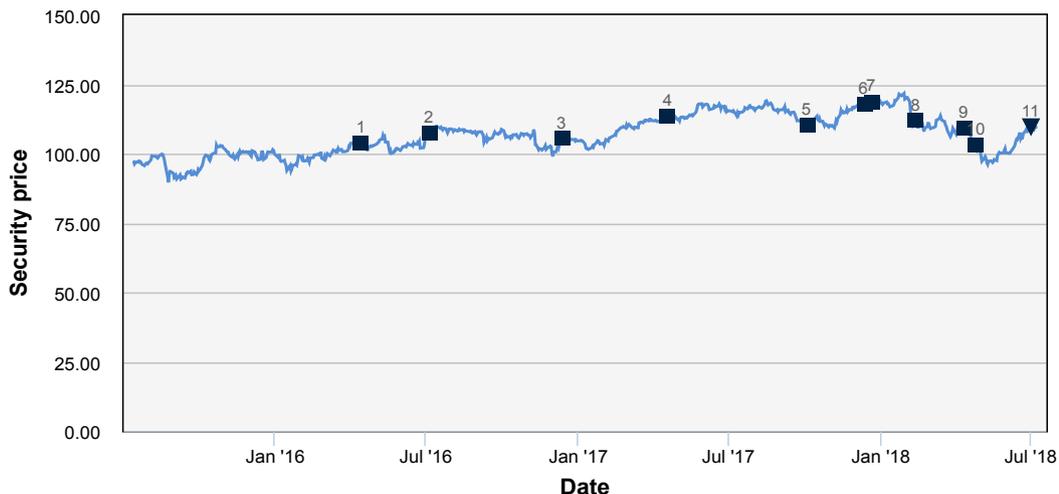
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Historical recommendations and target price. PepsiCo (PEP.OQ)

(as of 07/09/2018)



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- Buy
- Hold
- Sell
- Not Rated
- Suspended Rating

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2.	07/07/2016	Buy, Target Price Change USD 120.00 William Schmitz**	8.	02/13/2018	Buy, Target Price Change USD 129.00 Stephen Powers
3.	12/13/2016	Buy, Target Price Change USD 113.00 William Schmitz**	9.	04/13/2018	Buy, Target Price Change USD 122.00 Stephen Powers
4.	04/20/2017	Buy, Target Price Change USD 125.00 Faiza Alwy	10.	04/27/2018	Buy, Target Price Change USD 116.00 Stephen Powers
5.	10/05/2017	Buy, Target Price Change USD 122.00 Faiza Alwy	11.	07/03/2018	Downgraded to Hold, Target Price Change USD 116.00 Stephen Powers
6.	12/13/2017	Buy, Target Price Change USD 132.00 Stephen Powers			

Equity Rating Key

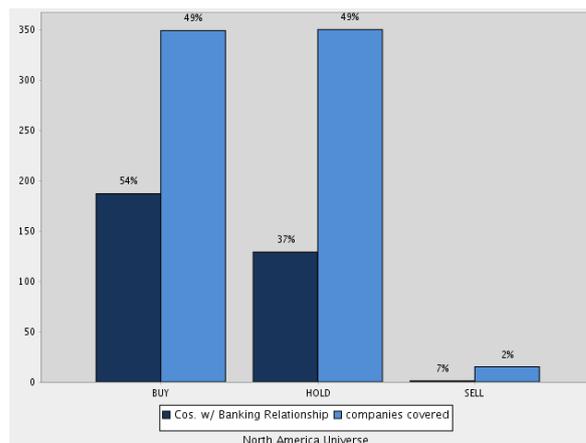
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