PepsiCo

4Q Preview: Expect Continued Sales Momentum and Reiterated '22 Preliminary Guide Given in 3Q

PepsiCo (PEP, Overweight rated) is scheduled to report 4Q21 earnings results on Thursday, February 10, before the open. We have adjusted a few of our underlying assumptions to better reflect the likely more challenging operating environment during 4Q (i.e., increased pricing actions but more than offset by worsened supply chain pressures) as well as updated FX outlook, which results in our total/organic sales moving to +8.9%/+8.4%, from +9.2%/+8.6% previously. Even after reducing this outlook, we are still ahead of the current Consensus Metrix and implied company guided 4Q organic growth of +7.6% and +7.1%, respectively. From a bottom-line perspective, our 4Q21 EPS of $1.53 remains unchanged and is ahead of current Bloomberg consensus of $1.52 (and, for what it's worth the implied 4Q company guidance of $1.47 that is likely the bare minimum). We expect that underlying consumer demand remained strong at the end of the year and that the additional pricing actions in the fall began to flow though in the 4Q21 (although more so in 1Q22) and help to mitigate some of the inflationary pressures. While some of the operational issues experienced in 3Q should have resolved/lessened (e.g., FLNA plant disruption, Gatorade shortage), we would not be surprised to see other pain points in 4Q including potential for employee absenteeism impacting production/supply and publicized snacks issue in UK relating to SAP upgrade. Net-net, our estimates imply a +6.6% two-year organic sales CAGR, just in line with 3Q. Looking ahead to 2022, we think PEP got a good amount of credit for providing much-needed visibility earlier (in 3Q21) by committing to its long-term financial algorithm (+MSD% top line and +HSD% EPS) despite the significant inflationary pressures. As such, we are not expecting much of a surprise when the company provides official initial guidance (now with 4Q earnings under its belt), although expected dilution from juice brands divestiture (announced in August 2021) could lead to core EPS modestly below HSD% growth (we're modeling for +5.2% organic top-line and +6.1% EPS growth, or +7.7% pre-dilution). As has been the norm from staples earnings so far, in particular HPC, the operating environment has arguably gotten incrementally challenging from a supply chain perspective near term, which is the main reason we are now more conservative, although we think PEP has enough levers to mitigate (e.g., RGM, productivity). Net-net we expect continued solid performance from PEP, and its resilient and defensive business model is clearly in favor as evidenced by its outperformance of late (since 3Q results PEP +16.1% vs. XLP +11.1% and SPX +3.1%), and while current valuation is making it tougher to see more meaningful upside in shares near term, we think PEP remains a core staples holding given its resilience of above-average underlying top- and bottom-line growth and better visibility, which are the primary investment merits that investors look for in staples..

Overweight

PEP, PEP US

Price (03 Feb 22): $175.37

▲ **Price Target (Dec-22): $185.00**
Prior (Dec-22): $171.00

Beverage, Household & Personal Care Products

Andrea Teixeira, CFA AC
(1-212) 622-6735
andrea.f.teixeira@jpmorgan.com
Bloomberg JPMA TEIXEIRA <GO>

Drew Levine, CFA
(1-212) 622-0374
drew.levine@jpmorgan.com

Kojo Achiampong, CFA
(1-212) 622-2896
kojo.achiampong@jpmorgan.com

J.P. Morgan Securities LLC

Key Changes (FYE Dec)

	Prev	Cur
Adj. EPS - 21E ($)	6.26	6.25
Adj. EPS - 22E ($)	6.82	6.63
Revenue - 21E ($ mn)	78,749	78,620
Revenue - 22E ($ mn)	82,884	79,210

Quarterly Forecasts (FYE Dec)

Adj. EPS ($)

	2020A	2021E	2022E
Q1	1.07	1.21A	1.30
Q2	1.32	1.72A	1.79
Q3	1.66	1.79A	1.90
Q4	1.47	1.53	1.64
FY	5.52	6.25	6.63

Style Exposure

Quant Factors	Current %Rank	Hist %Rank (1=Top) 6M	1Y	3Y	5Y
Value	80	75	76	75	78
Growth	64	18	87	83	76
Momentum	29	41	80	43	69
Quality	42	24	14	22	7
Low Vol	1	17	18	3	1
ESGQ	23	20	17	6	12

Sources for: Style Exposure – J.P. Morgan Quantitative and Derivatives Strategy; all other tables are company data and J.P. Morgan estimates.

See page 13 for analyst certification and important disclosures.

Andrea Teixeira, CFA
(1-212) 622-6735
andrea.f.teixeira@jpmorgan.com

Price Performance

	YTD	1m	3m	12m
Abs	1.4%	1.0%	7.8%	26.8%
Rel	5.1%	4.7%	8.7%	6.9%

Company Data

Shares O/S (mn)	1,390
52-week range ($)	177.24-128.32
Market cap ($ mn)	243,764.30
Exchange rate	1.00
Free float(%)	99.8%
3M - Avg daily vol (mn)	4.83
3M - Avg daily val ($ mn)	817.1
Volatility (90 Day)	15
Index	S&P 500
BBG BUY|HOLD|SELL	12|8|2

Key Metrics (FYE Dec)

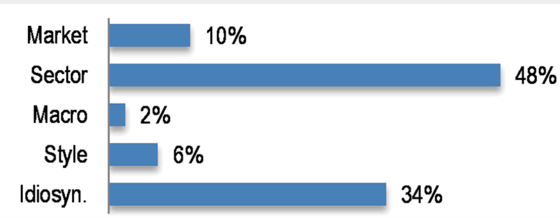
$ in millions	FY20A	FY21E	FY22E	FY23E
Financial Estimates				
Revenue	70,372	78,620	79,210	82,447
Adj. EBITDA	13,079	14,350	15,063	16,172
Adj. EBIT	10,531	11,607	12,205	13,172
Adj. net income	7,688	8,680	9,133	9,890
Adj. EPS	5.52	6.25	6.63	7.25
BBG EPS	5.52	6.25	6.73	7.30
Cashflow from operations	10,613	12,579	11,993	13,118
FCFF	8,276	10,612	9,671	10,641
Margins and Growth				
Revenue growth	4.8%	11.7%	0.8%	4.1%
Total Organic Sales Growth (%)	-	-	-	-
Gross margin	54.8%	53.6%	53.8%	54.0%
EBITDA margin	18.6%	18.3%	19.0%	19.6%
EBITDA growth	0.3%	9.7%	5.0%	7.4%
EBIT margin	15.0%	14.8%	15.4%	16.0%
Net margin	10.9%	11.0%	11.5%	12.0%
Adj. EPS growth	(0.0%)	13.2%	6.1%	9.2%
Ratios				
Net debt/EBITDA	2.6	2.2	2.0	1.9
ROIC	14.1%	-	-	-
ROE	54.4%	57.7%	55.3%	60.8%
Valuation				
FCFF yield	3.4%	4.4%	4.0%	4.4%
Dividend yield	2.3%	2.4%	2.5%	2.6%
EV/Revenue	3.9	3.5	3.4	3.3
EV/EBITDA	21.1	19.0	18.0	16.8
Adj. P/E	31.7	28.1	26.4	24.2

Summary Investment Thesis and Valuation

We rate PepsiCo Overweight. We believe PepsiCo has a product mix poised to deliver solid organic top-line growth and a track record of consistently beating Street expectations over the past few years, which compares favorably with large-cap Consumer Staples peers. As with our other large-cap multinationals, PEP's absolute earnings performance has been significantly hit by the stronger dollar over the past years (albeit by less than most of the multinational peers). With a sales mix that skews toward snacks and limited consumer destocking risk, which benefit from at-home consumption, we see a relative favorable risk/reward over the next 12 months.

PEP is currently trading at ~26.4x our 2022 EPS estimate, which is a ~11% premium to PEP's one-year average, which we believe is fair given the resilient top-/bottom-line growth and the positive outlook for reopening (~15% of sales are on-premises). Our Dec 22 PT of $185 is derived from a 50%/50% blend of P/E and EV/EBITDA, using average of non-alcohol peers of 26.2x and 17.1x, respectively. With a greater emphasis on growth post recent acquisitions, we think Pepsi is positioned to grow earnings in the HSDs post COVID-19 and therefore remain an earnings compounder. We also think Pepsi compares favorably to other large-cap multinational peers in our coverage because of its exposure to snacks and under-indexed presence in EM, where consumption during COVID-19 was negatively impacted and should rebound ahead.

Performance Drivers



Factors	6M Corr	1Y Corr
Market: MSCI US	0.37	0.32
Sect: Cons Staples	0.67	0.73
Ind: Food Bev & Tobacco	0.63	0.68
Macro:		
US 10yr yield	-0.31	-0.26
Crude Oil	-0.12	-0.10
Credit Spread	0.05	0.08
Quant Styles:		
LowVol	0.65	0.66
Size	0.48	0.52
Quality	0.52	0.49

Source: J.P. Morgan Quantitative and Derivatives Strategy for Performance Drivers; company data, Bloomberg Finance L.P. and J.P. Morgan estimates for all other tables. Note: Price history may not be complete or exact.

- **Framing Top-Line Expectations for 2022.** Following a very strong year from a top-line organic growth perspective in 2021 (expectation to close the year at approximately +8% on top of +4.3% organic growth in 2020 despite pandemic impact), the company is expecting 2022 to be consistent with its long-term financial algorithm, which calls for +MSD% (+4-6%) organic growth. While the company moved past the worst of the pandemic impacts in 2021, the year was not without challenges, and with still-recovering markets and various supply chain issues through the year, we see continued runway for recovery and underlying growth in 2022 across segments (excluding juice divestiture impact in PBNA) given pricing actions and volume growth with improving supply conditions, recovering away-from-home volumes, and resilient at-home performance. At a high level, we think the underlying momentum driven by investments in marketing and innovation position the company well to deliver in line with its +MSD% organic growth targets, particularly given momentum in FLNA and PBNA (which we discuss more in the note). All in, we are currently forecasting organic revenue growth of +5.2% (volumes up +1.6% and price/mix up +3.6%), which is very slightly ahead of Consensus Metrix consensus of +5.1%.

- **What Will Margins Look Like in 2022?** PEP's ability to potentially drive margin expansion in 2022 despite the significant inflationary pressures being seen throughout the industry should set it apart from the majority of CPG peers and highlight the resilience and attractiveness of its business model, which calls for core operating margin expansion of 20-30 bps per annum. PEP has solid visibility into expected cost pressures and has taken multiple rounds to price through higher inflation, including some over the summer and "much more" in the fall, with the full impact being seen in 1Q22. The company should also continue to execute against $1 billion annual productivity initiatives, which is mostly reliant on leveraging automation and digitization and should be particularly helpful in an environment with higher labor inflation. The divestiture of lower-margin juice business (we estimate the business generated HSD% EBIT margins) will be a benefit to margins, which we estimate could be worth about 20-30 bps to gross and EBIT margins. While the input cost environment continues to evolve, given the pricing and productivity efforts across the business, we think PEP can deliver about 20 bps gross margins expansion in 2022 (roughly flat pre-divestiture) and operating margin expansion of +65 bps (+33 bps pre-divestiture).

- **Updated FX Outlook.** With its 3Q21 earnings release, PEP reiterated its outlook for FX to be a +1% translational tailwind to both revenue and EPS, and since the day prior to that release (October 4, 2021) FX has turned less favorable by about 60 bps for 4Q according to our currency model, and looking ahead to 2022, the impact of currency has gotten incrementally unfavorable by about -50 bps. Net-net for 2022, we would expect currency to be a headwind of about -1%. For 4Q21 and 2022 we are now forecasting FX to be a 30 bps benefit and -100 bps headwind, respectively, vs. 60 bps benefit and flat previously.

- **4Q21 Expectations.** Our 4Q21 EPS of $1.53 is unchanged (vs. Bloomberg consensus of $1.52 and company-guided implied 4Q EPS of at least $1.47) even as we tweak a number of our underlying assumptions to better reflect our view of the operating environment in 4Q and the scanner data, as well as updated FX outlook. As such, our 4Q organic growth estimate moves to +8.4% from +8.6% previously, but is still ahead of current Consensus Metrix of +7.6% and company-guided implies 4Q organic growth of +7.1%. We are expecting an acceleration of price/mix in the quarter as additional pricing actions begin to flow through (our +5.3% price/mix is ahead of consensus

Andrea Teixeira, CFA
(1-212) 622-6735
andrea.f.teixeira@jpmorgan.com

+5.0% and implies a modest sequential acceleration in the two-year CAGR) while our +3.0% volume growth is 20 bps ahead of consensus and implies roughly flat sequential two-year CAGR. From a margin perspective, we expect gross margin compression of -75 bps (to 52.7% vs. consensus 52.5%) and 5 bps of leverage on SG&A (to 40.7% vs. consensus 40.6%) as incremental pricing actions and productivity partially offset inflationary and supply chain pressures while increased A&M is offset by reduced COVID-19 costs. Additional details inside.

2022 Outlook

While the same sort of questions surround PEP as others in CPG for 2022, namely the magnitude of inflationary pressures, likely pricing actions to mitigate these cost pressures, and resulting elasticities, we think PEP has already done a good job in previewing the company's thoughts around these topics and importantly during 3Q21 results indicated that it expected organic top-line and EPS growth in line with its long-term algorithm (+MSD% organic top-line and +HSD% EPS growth), although completion of the juice divestiture could be about $0.10 dilutive to EPS (-1.5%) and FX figures to be somewhat more of a headwind now. That said, we expect these topics will continue to command a fair amount of airtime on the company's 4Q earnings Q&A, as will the sustainability of the strong top-line momentum seen in 2021. Beyond the top-line and margins, we expect FCF conversion and capital allocation to be key topics in 2022 as proceeds from the close of the juice brands divestiture and improved balance sheet position should also allow the company to resume share repurchases in 2022.

Organic Revenue Growth

PEP's expected 2021 organic growth of approximately +8% on top of +MSD% growth in 2020 (despite the pandemic impact) is impressive, and since 2019 (based on our estimates) the company could post a three-year organic revenue growth CAGR of +5.7%. While the company moved past the worst of the pandemic impacts in 2021, the year was not without challenges, and with still-recovering markets and various supply chain issues through the year (in particular for Gatorade), we see continued runway for recovery and growth in 2022 across segments given pricing actions and volume growth with improving supply conditions, recovering away-from-home volumes, and resilient at-home performance. At a high level, we think the underlying momentum driven by investments in marketing and innovation position the company well to deliver in line with its +MSD% organic growth targets, particularly given momentum in FLNA and PBNA. In FLNA the drivers of growth for 2022 are likely to be 1) continued growth in variety and multi-packs; 2) further away-from-home recovery; and 3) faster growth in "permissible" snacking (e.g., lightly salted, organic, Pop Corners). In PBNA, we see the segment benefitting from 1) strong pricing environment for CSDs (i.e., rational); 2) aforementioned investments in marketing and innovation; 3) further recovery in away-from-home (was indexing at around 90% of 2019 levels); and 4) improving supply conditions for Gatorade. All in, we are currently forecasting organic revenue growth of +5.2% (volumes up +1.6% and price/mix up +3.6%). On a divisional basis, our organic revenue forecasts are as follows: +4.9% in FLNA, +3.5% in QFNA, +4.3% in PBNA, +9.2% in Latin America, +4.1% in Europe, +6.7% in Asia, Middle East, and South Asia, and +6.3% in Asia-Pacific, Australia, and New Zealand/China. Below, we outline our 2022 forecasts vs. consensus.

Table 1: JPM 2022 Organic Revenue Estimates vs. Consensus Metrix

2022E			
Organic Sales	**JPMe**	**Consensus Metrix**	**+/-/=**
Total Company	**5.2%**	**5.1%**	**0.1%**
Volume	1.6%	1.7%	-0.1%
Price/Mix	3.6%	3.4%	0.2%
Organic Sales by Region:			
FLNA	4.9%	5.4%	-0.5%
QFNA	3.5%	2.8%	0.7%
PBNA	4.3%	3.7%	0.6%
Latin America	9.2%	6.9%	2.3%
Europe	4.1%	4.6%	-0.5%
AMESA	6.7%	6.0%	0.7%
APAC	6.3%	6.8%	-0.5%

Source: Consensus Metrix, J.P. Morgan estimates.

Outlook for Margins

PEP's ability to potentially drive margin expansion in 2022 despite the significant inflationary pressures being seen throughout the industry should set it apart from the majority of CPG peers and highlight the resilience and attractiveness of its business model that calls for core operating margin expansion of 20-30 bps per annum. PEP's cost base is well diversified (no single commodity accounts for >10%), and the company noted in 3Q21 that its supply chain was well managed (except for Gatorade, which continues to face stock outs due to disruptions from co-packer). From an inflation perspective, PEP typically forward hedges six to nine months, and as such the company is beginning to roll into higher costs, although PEP has solid visibility into expected cost pressures and has taken multiple rounds to price through higher inflation, including some over the summer and "much more" in the fall, with the full impact being seen in 1Q22. The company should also continue to execute against $1 billion annual productivity initiatives, which is mostly reliant on leveraging automation and digitization and should be particularly helpful in an environment with higher labor inflation. Also, the divestiture of the lower-margin juice business (we estimate this business generated EBIT margins in the HSD% range) should mechanically lift margins in 2022, which we estimate could be worth 20-30 bps to gross and EBIT margins. While the input cost environment continues to evolve, given the pricing and productivity efforts across the business and juice divestiture, we think PEP can deliver about +20 bps gross margins expansion and operating margin expansion of +65 bps.

2022 EPS

On the bottom line, we forecast 2022 EPS of $6.63, which $0.10 below the current Bloomberg consensus (likely includes a mix of estimates including/excluding the juice brands divestiture), although excluding about $0.10 dilution from the juice divestiture our 2022 EPS would have been $6.73, in line with consensus. Our 2022 EPS forecast implies +6. 1% growth YOY, or +7.7% pre-divestiture (in line with PEP's long-term algorithm of +HSD core constant currency EPS growth). An unfavorable FX environment will likely also be a headwind, although excluding that we think PEP could have reached HSD% EPS growth even inclusive or the juice divestiture. Our 2022 EPS estimate also assumes 1 point of growth from share repurchases. Below, we outline our forecasts vs. consensus.

Andrea Teixeira, CFA
(1-212) 622-6735
andrea.f.teixeira@jpmorgan.com

Table 2: JPM 2022 Estimates vs. Bloomberg Consensus

	2022		Y/Y	JPMe
Income Statement	**JPMe**	**Consensus**	**%**	**vs. cons**
Net Sales	79,210.0	81,429.2	0.8%	-2.7%
Gross Profit	42,601.9	43,775.5	1.1%	-2.7%
Operating Income	12,205.2	12,428.4	5.2%	-1.8%
Interest, Net	1037.3			
Net Income	9,132.5	9,309.1	5.2%	-1.9%
Shares Outstanding	1,376.6		-0.9%	
EPS	**$6.63**	**$6.73**	6.1%	-1.5%
	2022		Y/Y	JPMe
Growth/Margins	**JPMe**	**Consensus**	**bps**	**vs. cons**
Sales Growth	0.8%	3.8%	(1,097)	(303)
Gross Margin	53.8%	53.8%	19	2
SG&A Margin	38.4%	38.5%	(46)	(12)
Operating Profit Margin	15.4%	15.3%	65	15
Tax Rate	21.0%			

Source: Bloomberg Finance L.P, J.P. Morgan estimates.

4Q21 Earnings Preview

Date: Thursday, February 10

Estimated Release Time: 6:00 AM ET

Conference Call Details:

Pre-recorded Management Discussion: 6:30 AM ET (transcript of prepared remarks will be released at this time as well)

Live Q&A Conference Call: 8:15 AM ET

PepsiCo (PEP, Overweight rated) is scheduled to report 4Q21 earnings results on Thursday, February 10, before the open. We have adjusted a few of our underlying assumptions to better reflect operating dynamics during the quarter, as well as for recent FX movements, which results in a modestly lower top-line expectation (4Q21 total/organic sales growth +8.6%/+8.4% vs. +9.2%/+8.6% previously), although our 4Q21 EPS remains $1.53. Our $1.53 EPS estimate for 4Q is $0.01 ahead of the current Bloomberg consensus. Overall, PEP's 2021 guidance calls for full-year organic growth of approximately +8% and "at least" +12% core EPS growth, implying core 2021 EPS of "at least" $6.20. PEP's 2021 guidance implies 4Q organic growth of approximately +7.1% and EPS of at least $1.47 (vs. current Consensus Metrix organic growth +7.6% and Bloomberg consensus EPS of $1.52).

Through PEP's 4Q (16-week period) ended December 25, we think the operating environment likely remained largely supportive of strong underlying organic growth trends seen in 3Q (+9.0%) and year to date (+8.4%), although during the quarter the company dealt with the brunt of the Delta variant (early September in the US) and the beginning of the Omicron surge. We don't see these events as having a material impact on underlying demand trends, which appeared to remain strong in the tracked channel data, although impacts to the supply chain, including likelihood of employee absenteeism at plants and on routes, could have had an impact on keeping shelves fully stocked (i.e., could have had lost sales despite the strength seen in scanner data). On the other hand, some limiting factors to 3Q growth, including a plant outage in FLNA in 3Q and bottle shortage for Gatorade in PBNA, should have resolved (in the case of FLNA) or lessened (in the case of Gatorade). Moreover, to the extent that a virus surge negatively impacts on-premise performance, for PEP we would expect there to be an offset in off-premise demand including in QFNA, which benefits from more at-home breakfast occasions.

Comparisons are tougher sequentially (lapping +5.7% organic from 4Q20 vs. +4.2% from 3Q2), although our current estimates, while a bit of a sequential deceleration (modeling +8.1% organic in 4Q21 vs. +9.0% reported in 3Q21), imply a flat two-year CAGR sequentially from +6.6% in 3Q21 with additional pricing actions taken in the marketplace potentially mitigated by some supply chain disruptions during the quarter. Specific to pricing, CFO Johnston noted that the company was taking additional pricing ("much more" relative to pricing taken earlier in the year) in the fall, which should begin to flow through in 4Q21, and we continue to expect a focus on RGM initiatives given the cost inflation throughout the supply chain.

From a profitability perspective, we are expecting less gross margin pressure in 4Q vs. 3Q given the aforementioned easier compares and pricing actions, although we are still forecasting -75 bps compression (to 52.7%), and on a two-year basis we are expecting slightly higher pressure relative to 3Q21 (i.e., modeling gross margin -190 bps vs. 4Q19 relative to -180 bps compression in 3Q21 vs. 3Q19). Our gross margin estimates are modestly higher than the current Bloomberg consensus (20 bps above consensus of 52.5%), although we are also modeling for slightly stronger top line (both volumes and pricing). On SG&A, we are conversely slightly higher than consensus with an SG&A ratio of 40.7% vs. current Bloomberg consensus of 40.6%. The company should have a sizable increase in A&M spending in the PBNA segment in 4Q21 given tougher compares vs. last year. On the other hand, while it's likely that there were COVID-19 costs in 4Q21 given Delta and Omicron, we would expect that costs incurred should be more moderated from prior-year levels of $106M (e.g., 1Q20-3Q20 COVID-19 costs $668M vs. 1Q21-3Q21 $114M and 3Q21 specifically COVID-19 costs $18M vs. $147M in 3Q20, or 0.6% to operating margins and roughly ~$0.07-0.08 to EPS).

On PEP's Q&A conference call, we expect investors to focus on the overall cost/inflationary environment, progress on pricing actions and any associated elasticities being seen in the marketplace, as well as general impacts from evolution of the COVID-19 virus around the globe, in particular recent impacts from Omicron on away-from-home demand and supply chain (e.g., absent sick employees impacting DSD system).

Table 1: JPM 4Q and 2021 Estimates vs. Bloomberg Consensus

	4Q21E		Y/Y	JPMe	2021E		Y/Y	JPMe
Income Statement	**JPMe**	**Consensus**	**%**	**vs. cons**	**JPMe**	**Consensus**	**%**	**vs. cons**
Net Sales	24,394	24,230	8.6%	0.7%	78,620	78,462	11.7%	0.2%
Gross Profit	12,861	12,724	7.1%	1.1%	42,135	41,984	9.2%	0.4%
Operating Income	2,933	2,890	2.9%	1.5%	11,607	11,577	10.2%	0.3%
Interest, Net	333				1,064			
Net Income	2,121	2,115	4.0%	0.3%	8,680	8,676	12.9%	0.0%
Shares Outstanding	1,390		0.2%		1,389		-0.2%	
EPS	**$1.53**	**$1.52**	3.8%	0.6%	**$6.25**	**$6.25**	13.2%	0.1%
	4Q21E		Y/Y	JPMe	2021E		Y/Y	JPMe
Growth/Margins	**JPMe**	**Consensus**	**bps**	**vs. cons**	**JPMe**	**Consensus**	**bps**	**vs. cons**
Sales Growth	8.6%	7.9%	(16)	73	11.7%	11.5%	694	22
Gross Margin	52.7%	52.5%	(75)	21	53.6%	53.5%	(122)	9
SG&A Margin	40.7%	40.6%	(8)	11	38.8%	38.8%	(102)	8
Operating Profit Margin	12.0%	11.9%	(67)	10	14.8%	14.8%	(20)	1
Tax Rate	20.0%				20.4%			

Source: Bloomberg Finance L.P., J.P. Morgan estimates.

Organic Revenue Growth in 4Q

As noted above, we broadly expect another solid quarter from a top-line perspective ahead of the implied 4Q guidance, and at the company level our organic growth estimate of +8.6% for 4Q is 100 bps ahead of the Consensus Metrix consensus of +7.6% and implied 4Q company guidance of about +7.1%. Our estimate implies a modest acceleration in the two-year CAGR to +7.1% from +6.6% in 3Q, while consensus assumes a sequentially flat two-year CAGR. We do not believe we are being overly aggressive in our higher estimates as we assume volumes largely flat sequentially from a two-year CAGR perspective (+3.0%) and pricing to accelerate to +4.1% two-year CAGR in 4Q from +3.7% in 3Q. Consensus Metrix is likewise contemplating an acceleration in pricing but to a lesser extent than we are, and on volumes we are broadly in line.

We expect investors to focus mostly on FLNA and PBNA organic growth trends, as is typically the case, to gauge the resiliency of the snacks and beverages business as the company deals with potential supply chain impacts from COVID-19 and executes on additional marketplace pricing actions. In other segments like QFNA, we expect investors to focus on the sustainability of breakfast occasions and to look to any potential benefits from more cautious return to office habits given Omicron surge, and in International markets we expect investors to focus on the overall pace of recovery given varying timing and levels of mobility restrictions in some International markets. Putting it all together, our forecasted 4Q organic revenue growth of +8.1% is driven by volumes +3.0% and price/mix +5.3%. On a divisional basis, our organic revenue forecasts are as follows: +9.0% in FLNA, -1.0% in QFNA, +7.0% in PBNA, +14.9% in Latin America, +6.0% in Europe, +10.8% in Asia, Middle East, and South Asia, and +11.4% in Asia Pacific, Australia, New Zealand/China.

Table 2: JPM 4Q Organic Revenue Estimates vs. Consensus Metrix

4Q21			
Organic Sales	**JPMe**	**Consensus Metrix**	**+/-/=**
Total Company	**8.4%**	**7.6%**	**0.8%**
Volume	3.0%	2.7%	0.3%
Price/Mix	5.3%	5.0%	0.3%
Organic Sales by Region:			
FLNA	9.0%	7.4%	1.6%
QFNA	-1.0%	0.1%	-1.1%
NAB	7.0%	6.4%	0.6%
Latin America	14.9%	12.4%	2.5%
Europe	6.0%	6.4%	-0.4%
AMESA	10.8%	9.7%	1.1%
APAC	11.4%	11.1%	0.3%

Source: Consensus Metrix, J.P. Morgan estimates.

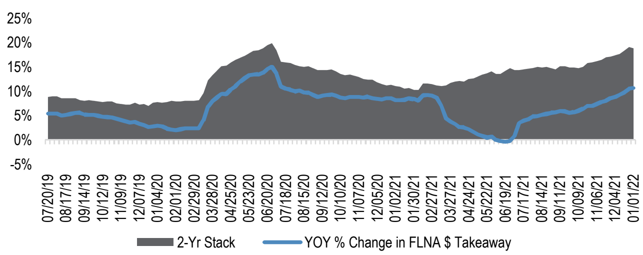
US Trends Accelerated across Beverages and Food in 4Q21 Driven by Price/Mix

Looking at the NielsenIQ scanner data over PEP's 4Q21 ending December 25 (16-week period), trends accelerated across PEP's US segments including beverages, FLNA categories (i.e., salty snacks), and QFNA categories (i.e., breakfast foods) both on a one- and two-year basis. Takeaway growth in the period corresponding to PEP's 4Q was driven predominantly by price/mix as volume growth was largely lackluster. **Specifically, for the 16-week period ending December 25, total PEP dollar takeaway grew +10.9%, which accelerated from the +5.1% growth in the 12-week period ending September 4 (corresponds to PEP's 3Q)** as year-ago comparisons eased by about 110 bps (i.e., lapping +8.3% growth in the 16-week

Andrea Teixeira, CFA
(1-212) 622-6735
andrea.f.teixeira@jpmorgan.com

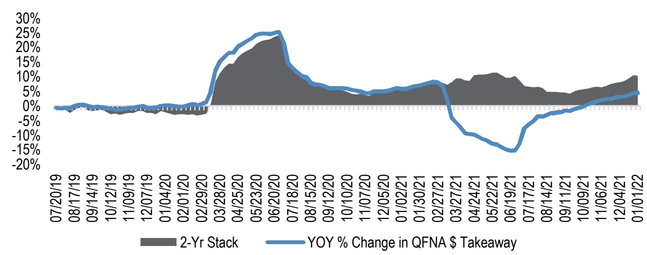
period ending 12/26/20 vs. +9.4% growth in the 12-week period ending 9/5/20). **As such, two-year stack growth likewise accelerated to +19.2% in the 16-week period ending 12/25/21 vs. +14.5% in the 12-week period ending 9/4/21).** Within the segments, for the 16-week period ending 12/25/21 PBNA grew +11.4% (volumes +1.2%, price/mix +10.2%), FLNA grew +10.5% (volumes +0.2%, price/mix +10.3%), and QFNA grew +4.4% (volumes +7.3%, price/mix -2.9%), all of which accelerated sequentially from the 12-week period ending 9/4/21 where PBNA grew +4.5% (volumes -0.3%, price/mix +4.8%), FLNA grew +5.7% (volumes +2.2%, price/mix +3.5%), and QFNA declined -2.2% (volumes -0.1%, price/mix -2.1%). On a two-year stack basis in the 16 weeks ending 12/25/21 relative to the 12 weeks ending 9/4/21, Beverages growth of +20.1% accelerated +300 bps sequentially, FLNA growth of +19.1% accelerated +480 bps sequentially, and QFNA growth of +10.4% accelerated +620 bps sequentially.

Figure 1: FLNA Trends up +LDD in Q4 from +MSD% in Q3
YOY % Change in $ Takeaway (16-Weeks) vs. 2-Year Stack



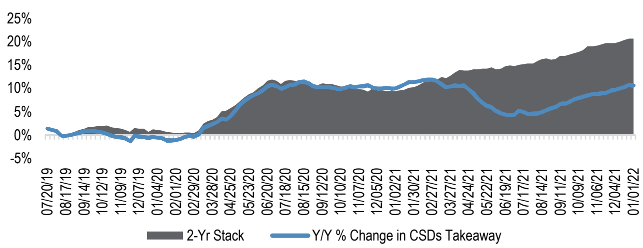
Source: NielsenIQ.

Figure 2: QFNA Trends +MSD in Q4 from -LSD in Q3
YOY % Change in $ Takeaway (16-Weeks) vs. 2-Year Stack



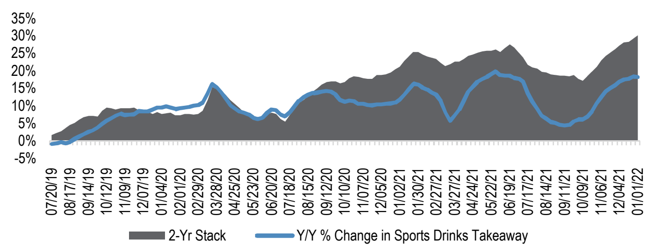
Source: NielsenIQ.

Figure 3: CSD Trends Accelerated to Solid +DD Growth during Q4
YOY % Change in $ Takeaway (16-Weeks) vs. 2-Year Stack



Source: NielsenIQ.

Figure 4: Sports Drinks Accelerated into Strong +DD Range in Q4
YOY % Change in $ Takeaway (16-Weeks) vs. 2-Year Stack



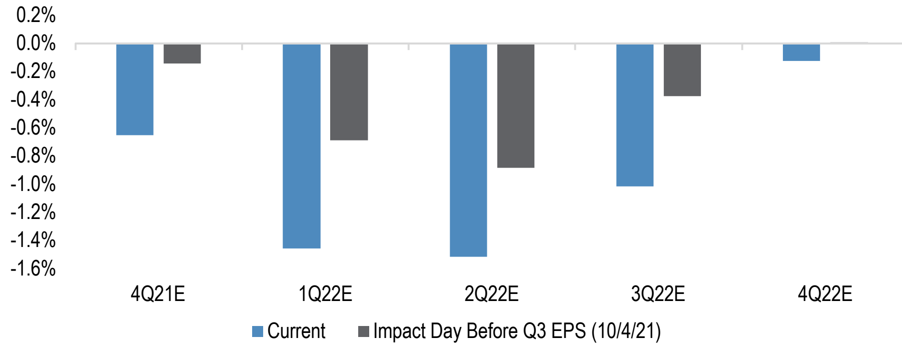
Source: NielsenIQ.

Updated FX Outlook

With its 3Q21 earnings release, PEP reiterated its outlook for FX to be a +1% translational tailwind to both revenue and EPS, and since the day prior to that release (October 4, 2021) FX has turned less favorable by about 60 bps for 4Q according to our currency model, and looking ahead to 2022, the impact of currency has gotten incrementally unfavorable by about -50 bps. Net-net for 2022, we would expect currency to be a headwind of about -1%. For 4Q21 and 2022 we are now forecasting FX to be a 30 bps benefit and -100 bps headwind, respectively, vs. 60 bps benefit and flat previously.

Andrea Teixeira, CFA
(1-212) 622-6735
andrea.f.teixeira@jpmorgan.com

Figure 5: FX has Gotten Worse for PEP Since Reporting 3Q21 Results



Source: J.P. Morgan estimates, Bloomberg Finance L.P.

Andrea Teixeira, CFA
(1-212) 622-6735
andrea.f.teixeira@jpmorgan.com

Investment Thesis, Valuation and Risks

PepsiCo, Inc. *(Overweight; Price Target: $185.00)*

Investment Thesis

We rate PepsiCo Overweight. We believe PepsiCo has a product mix poised to deliver solid organic top-line growth and a track record of consistently beating Street expectations over the past few years, which compares favorably with large-cap Consumer Staples peers. As with our other large-cap multinationals, PEP's absolute earnings performance has been significantly hit by the stronger dollar over the past years (albeit by less than most of its multinational peers). With a sales mix that skews toward snacks, which benefit from at-home consumption, we see a relatively favorable risk/reward over the next 12 months and believe PEP is one of the few large-cap names where we see limited downside risk from a multiple perspective.

Valuation

PEP is currently trading at ~26.4x our 2022 EPS estimate, which is a ~11% premium to PEP's one-year average, which we believe is fair given the resilient top-/bottom-line growth and the positive outlook for reopening (~15% of sales are on-premises). Our Dec 2022 price target of $185 is derived from a 50%/50% blend of P/E and EV/EBITDA, using the averages of non-alcohol peers of 26.2x and 17.1x, respectively. With a greater emphasis on growth post recent acquisitions, we think Pepsi is positioned to grow earnings in the HSDs post COVID-19 and therefore remain an earnings compounder. We also think Pepsi compares favorably to other large-cap multinational peers in our coverage because of its exposure to snacks and under-indexed presence in EM where consumption during COVID-19 was negatively impacted and should rebound ahead.

Risks to Rating and Price Target

We think the primary risks to our Overweight rating and price target on PepsiCo include (1) greater than anticipated disruptions from COVID-19, in particular in the on-premise channels; (2) increased competition; (3) concerns around health and wellness and the impact this could have on the company's top- and bottom-line results; (4) commodities cost increases or potential for additional taxes on sugary beverages in more jurisdictions, both in the United States and internationally; and (5) FX volatility.

Andrea Teixeira, CFA
(1-212) 622-6735
andrea.f.teixeira@jpmorgan.com

PepsiCo: Summary of Financials

Income Statement - Annual	FY19A	FY20A	FY21E	FY22E	FY23E
Revenue	**67,161**	**70,372**	**78,620**	**79,210**	**82,447**
COGS	(30,040)	(31,799)	(36,485)	(36,608)	(37,907)
Gross profit	**37,121**	**38,573**	**42,135**	**42,602**	**44,541**
SG&A	(26,519)	(28,042)	(30,528)	(30,397)	(31,369)
Adj. EBITDA	**13,034**	**13,079**	**14,350**	**15,063**	**16,172**
D&A	(2,432)	(2,548)	(2,743)	(2,858)	(3,000)
Adj. EBIT	**10,602**	**10,531**	**11,607**	**12,205**	**13,172**
Net Interest	(912)	(1,128)	(1,064)	(1,037)	(1,042)
Adj. PBT	**9,898**	**9,745**	**10,993**	**11,643**	**12,605**
Tax	(2,079)	(2,002)	(2,248)	(2,445)	(2,647)
Minority Interest	(43)	(55)	(65)	(65)	(68)
Adj. Net Income	**7,776**	**7,688**	**8,680**	**9,133**	**9,890**
Reported EPS	5.53	5.52	6.25	6.63	7.25
Adj. EPS	**5.53**	**5.52**	**6.25**	**6.63**	**7.25**
DPS	**3.77**	**3.96**	**4.19**	**4.40**	**4.62**
Payout ratio	68.2%	71.7%	67.0%	66.3%	63.8%
Shares outstanding	1,407	1,392	1,389	1,377	1,365

Income Statement - Quarterly	1Q21A	2Q21A	3Q21A	4Q21E
Revenue	**14,820A**	**19,217A**	**20,189A**	**24,394**
COGS	(6,705)A	(8,877)A	(9,370)A	(11,533)
Gross profit	**8,115A**	**10,340A**	**10,819A**	**12,861**
SG&A	(5,851)A	(7,171)A	(7,578)A	(9,928)
Adj. EBITDA	**2,824A**	**3,822A**	**3,891A**	**3,813**
D&A	(560)A	(653)A	(650)A	(880)
Adj. EBIT	**2,264A**	**3,169A**	**3,241A**	**2,933**
Net Interest	(258)A	(241)A	(232)A	(333)
Adj. PBT	**2,132A**	**3,053A**	**3,128A**	**2,680**
Tax	(439)A	(647)A	(626)A	(536)
Minority Interest	(9)A	(14)A	(19)A	(23)
Adj. Net Income	**1,684A**	**2,392A**	**2,483A**	**2,121**
Reported EPS	1.21A	1.72A	1.79A	1.53
Adj. EPS	**1.21A**	**1.72A**	**1.79A**	**1.53**
DPS	**1.03A**	**1.02A**	**1.07A**	**1.07**
Payout ratio	84.9%A	59.1%A	59.8%A	70.1%
Shares outstanding	1,387A	1,388A	1,389A	1,390

Balance Sheet & Cash Flow Statement	FY19A	FY20A	FY21E	FY22E	FY23E
Cash and cash equivalents	5,509	8,185	7,652	8,838	7,811
Accounts receivable	7,822	8,404	9,130	9,224	9,622
Inventories	3,338	4,172	4,605	4,633	4,813
Other current assets	976	2,240	1,309	1,315	1,352
Current assets	**17,645**	**23,001**	**22,695**	**24,009**	**23,598**
PP&E	19,305	21,369	21,840	22,943	24,065
LT investments	-	-	-	-	-
Other non current assets	41,597	48,548	48,287	45,687	45,687
Total assets	**78,547**	**92,918**	**92,823**	**92,639**	**93,350**
Short term borrowings	2,920	3,780	4,234	4,234	4,234
Payables	17,541	19,592	21,627	21,757	22,601
Other short term liabilities	0	0	0	0	0
Current liabilities	**20,461**	**23,372**	**25,861**	**25,991**	**26,835**
Long-term debt	29,148	40,370	35,023	35,023	35,023
Other long term liabilities	14,070	15,624	15,164	15,164	15,164
Total liabilities	**63,679**	**79,366**	**76,048**	**76,178**	**77,022**
Shareholders' equity	14,786	13,454	16,657	16,343	16,211
Minority interests	82	98	118	118	118
Total liabilities & equity	**78,547**	**92,918**	**92,823**	**92,639**	**93,350**
BVPS	**10.51**	**9.67**	**12.00**	**11.87**	**11.88**
y/y Growth	*3.1%*	*(8.0%)*	*24.1%*	*(1.0%)*	*0.1%*
Net debt/(cash)	26,330	34,599	31,261	30,075	31,102
Cash flow from operating activities	**9,649**	**10,613**	**12,579**	**11,993**	**13,118**
o/w Depreciation & amortization	2,432	2,548	2,743	2,858	3,000
o/w Changes in working capital	(479)	(303)	1,647	3	228
Cash flow from investing activities	**(6,437)**	**(11,619)**	**(2,494)**	**(1,361)**	**(4,122)**
o/w Capital expenditure	(4,232)	(4,240)	(3,740)	(3,961)	(4,122)
as % of sales	*6.3%*	*6.0%*	*4.8%*	*5.0%*	*5.0%*
Cash flow from financing activities	**(8,489)**	**3,819**	**(10,557)**	**(9,446)**	**(10,023)**
o/w Dividends paid	(5,304)	(5,509)	(5,814)	(6,059)	(6,306)
o/w Net debt issued/(repaid)	651	11,979	(4,454)	0	0
Net change in cash	**(5,199)**	**2,684**	**(501)**	**1,186**	**(1,027)**
Adj. Free cash flow to firm	**7,198**	**8,276**	**10,612**	**9,671**	**10,641**
y/y Growth	*(9.7%)*	*15.0%*	*28.2%*	*(8.9%)*	*10.0%*

Ratio Analysis	FY19A	FY20A	FY21E	FY22E	FY23E
Gross margin	55.3%	54.8%	53.6%	53.8%	54.0%
EBITDA margin	19.4%	18.6%	18.3%	19.0%	19.6%
EBIT margin	15.8%	15.0%	14.8%	15.4%	16.0%
Net profit margin	11.6%	10.9%	11.0%	11.5%	12.0%
ROE	53.1%	54.4%	57.7%	55.3%	60.8%
ROA	10.0%	9.0%	9.3%	9.8%	10.6%
ROCE	17.9%	16.0%	16.3%	17.3%	18.7%
SG&A/Sales	39.5%	39.8%	38.8%	38.4%	38.0%
Net debt/equity	1.8	2.6	1.9	1.8	1.9
P/E (x)	31.7	31.7	28.1	26.4	24.2
P/BV (x)	16.7	18.1	14.6	14.8	14.8
EV/EBITDA (x)	20.5	21.1	19.0	18.0	16.8
Dividend Yield	2.1%	2.3%	2.4%	2.5%	2.6%
Sales/Assets (x)	0.9	0.8	0.8	0.9	0.9
Interest cover (x)	14.3	11.6	13.5	14.5	15.5
Operating leverage	(4.4%)	(14.0%)	87.2%	687.0%	193.8%
Revenue y/y Growth	3.9%	4.8%	11.7%	0.8%	4.1%
EBITDA y/y Growth	0.1%	0.3%	9.7%	5.0%	7.4%
Tax rate	21.0%	20.5%	20.4%	21.0%	21.0%
Adj. Net Income y/y Growth	(3.6%)	(1.1%)	12.9%	5.2%	8.3%
EPS y/y Growth	(2.3%)	(0.0%)	13.2%	6.1%	9.2%
DPS y/y Growth	9.0%	5.0%	5.8%	5.1%	5.0%

Source: Company reports and J.P. Morgan estimates.

Note: $ in millions (except per-share data).Fiscal year ends Dec. o/w - out of which

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Andrea Teixeira, CFA
(1-212) 622-6735
andrea.f.teixeira@jpmorgan.com

PepsiCo (PEP, PEP US) Price Chart

Date	Rating	Price ($)	Price Target ($)
15-Feb-19	OW	112.59	127
17-Apr-19	OW	122.41	134
09-Jul-19	OW	132.56	148
03-Oct-19	OW	133.94	154
14-Feb-20	OW	146.47	158
21-Apr-20	OW	134.55	142
29-Apr-20	OW	136.32	145
13-Jul-20	OW	134.46	154
17-Sep-20	OW	134.98	149
01-Oct-20	OW	138.60	152
05-Feb-21	OW	139.68	151
12-Feb-21	OW	134.97	152
12-Apr-21	OW	142.57	155
01-Jul-21	OW	148.17	154
13-Jul-21	OW	149.51	171

Source: Bloomberg Finance L.P. and J.P. Morgan; price data adjusted for stock splits and dividends.
Initiated coverage Sep 25, 2002. All share prices are as of market close on the previous business day.

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IB clients**	53%	46%	34%
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IB clients**	74%	68%	50%

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Andrea Teixeira, CFA
(1-212) 622-6735
andrea.f.teixeira@jpmorgan.com

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