

Equity Research

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Price Target Change — February 11, 2021

Beverages

PepsiCo, Inc. (PEP)

PEP: Good Quarter, Reasonable Outlook; Doesn't Feel Like PBNA Margin 'Juices' Algorithm Anytime Soon

Our Call

PEP delivered a [strong Q420](#) though shares were -2.0% vs SPX +0.2%, XLP -0.4%. While a sell-the-news trend on EPS day across Staples recently is a factor, to the extent there is more to read into the move, we'd offer: (1) FY21 delivery builds through the FY with Q1 a low water mark; (2) we modestly lower EPS today; (3) language on PBNA margins seems to have evolved ever so slightly, with a mid-teens margin seen "long-term" without parameters of a timeline, though we acknowledge PEP never set an official timeline. Overall, we view PEP as one of the most consistently solid companies in Staples. We also think this is understood; and, with negative sentiment on Staples, and upside in shares dependent on multiple expansion (tough in the current tape), we stay Equal Weight.

PBNA 'mid-teens' margins seem a bit more elusive... While PEP has been clear it won't sacrifice sustainability in PBNA just to drive margins, and reiterated that stance today, mgmt noted today "we see this business long-term at mid-teens" and also the unit could get "into the teens margins over the long run." The use of longer term several times seemed a bit more incremental, eschewing any parameters on timeline; some margin is dependent on the success of Rockstar, of course, set for relaunch this year.

...PBNA margins are the one area we could see getting PEP EPS above algorithm. Recall in our Dec 7 deep-dive - [Pepsi's Challenge \(PBNA\) - Still Feel a Bit Blindfolded](#) - we argued that PBNA reaching a mid-teens margin over a timeline of a 'few years' (our understanding of the targeted glide path) was likely the one area in the PEP model that could drive profit growth above PEP's algorithm near-term (even if our ultimate view was that such a timeline was likely untenable).

Promos a potential swing factor. CEO Laguarta noted "we've all learned that there are some opportunities there. But I'm sure there will be a little bit of additional promotional efforts as the world opens." Our read is PEP (as with peers) likely tries to hold promos lower ahead. See our 2/8 promo deep-dive - [Heard About These Low Promotions? Here's Everything You Need to Know](#) - for promo cuts by PEP and peers in 2020.

Key considerations for Q121. PEP noted expectations for Q121 organic sales up +LSD with margins lower y/y cycling pre-COVID comps, and with negative FX, mix (including M&A, i.e. Pioneer), and remaining COVID costs. We model organic sales +1.5%, reflecting a flat two-year stack 9.4% with reported sales +4.9% on slightly negative FX and with M&A. We expect gross margin -90bps driving operating margin -60bps, with EPS \$1.11.

Lower 2021e/2022e EPS. PEP set FY21 guidance for EPS +HSD % ex-FX, with +1pt FX to EPS, implying core EPS +8-10% on a \$5.52 base, or \$5.96-6.07. We lower 2021e/2022e EPS to \$6.02/6.57 from \$6.08/\$6.63, with organic sales actually modestly higher to 4.3% vs prior +4.1%, with op profit+ 0.7% vs prior; below-the-line adjustments (higher pension, interest expense, and +50bps higher tax rate) drive the lower EPS.

PEP upside probably depends on multiple expansion. PEP has a history of hitting numbers and we see enough here in 2021; upside to algorithm is less clear though. The net is PEP needs multiple expansion, a hard pitch in a negative sentiment Staples tape.

Lower target to \$147 from \$157 on cut to multiple. Our new target is 22.5x our CY22e EPS, -1pt vs our prior target, reflecting multiple contraction in Staples.

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Rating Equal Weight

Ticker	PEP
Price Target/Prior:	\$147.00 / \$157.00
Upside/(Downside) to Target	8.9%
Price (02/11/2021)	\$134.97
52 Week Range	\$101.42 - 148.77
Shares Outstanding	1,381,956,485
Market Cap (MM)	\$186,523
Enterprise Value (MM)	\$222,419
Average Daily Volume	4,821,285
Average Daily Value (MM)	\$651
Dividend (NTM)	\$4.25
Dividend Yield	3.1%
Net Debt (MM) - last reported	\$35,896
ROIC - Current year est.	14%
3 Yr EPS CAGR from current year (unless otherwise noted)	9%

	2020A	2021E	2021E	2022E	2022E
		Curr.	Prior	Curr.	Prior
Q1 (Mar)	1.07 A	1.11 E	1.24E	1.20 E	1.34E
Q2 (Jun)	1.32 A	1.50 E	1.51E	1.64 E	1.65E
Q3 (Sep)	1.66 A	1.76 E	1.74E	1.92 E	1.90E
Q4 (Dec)	1.47 A	1.66 E	1.59E	1.81 E	1.73E
FY	5.52 A	6.02 E	6.08E	6.57 E	6.63E
P/E	24.4x	22.4x		20.5x	

Source: Company Data, Wells Fargo Securities estimates, and Refinitiv.
NA = Not Available, Volatility = Historical trading volatility

Exhibit 1 - PEP guidance vs. WFSe

FY 2021 Guidance		
Guidance Provided as of:	Q4 Earnings Feb 11, 2020	Our Estimate
EPS & Growth - Constant Currency	+HSD%	8.3% or \$6.02
Currency Impact on EPS	+1%	1%
Organic Revenue Growth - Constant Currency	+MSD%	4.3%
Currency Impact on Revenue	+1%	1%
Price/Mix		2%
Core Constant Currency Operating Profit Growth		7.7%
Currency Impact on OI		1%
Operating Margin		25 bps
Advertising & Marketing Spend		NA
Net Interest Expense		-\$10M Higher
Capital Expenditures		\$3.8 Bn
Operating Cash Flow		\$12 Bn
Free Cash Flow		\$8 Bn
Dividends	\$5.8B	\$6 Bn
Share Repurchases	\$100MM	\$0 Bn
Total Shareholder Return	\$5.9B	\$6 Bn
Tax Rate	21.0%	21.0%
Productivity Programs		

Our FY22 Estimate
9.1% or \$6.57
0%
4.5%
0%
3%
8.3%
0%
51 bps
NA
-\$15M Higher
\$4 Bn
\$13 Bn
\$9 Bn
\$6 Bn
\$1 Bn
\$7 Bn
21.0%

Source: Company reports, Wells Fargo Securities, LLC estimates

Financials

Exhibit 2 - PEP earnings model (\$MM except per share data)

	2018	1Q19	2Q19	3Q19	4Q19	2019	1Q20	2Q20	3Q20	4Q20	2020	1Q21E	2Q21E	3Q21E	4Q21E	2021E	1Q22E	2Q22E	3Q22E	4Q22E	2022E	2023E
Total Net Revenue	64,661	12,884	16,449	17,188	20,640	67,161	13,881	15,945	18,091	22,455	70,372	14,562	17,897	19,141	23,530	75,130	15,187	18,771	20,078	24,698	78,734	82,468
Cost of Sales (GAAP)	29,381	5,688	7,404	7,694	9,346	30,132	6,127	7,088	8,156	10,426	31,797	6,517	7,985	8,580	10,830	33,912	6,735	8,300	8,940	11,294	35,269	36,777
Cost of Sales % of sales	45.3%	44.1%	44.5%	44.6%	45.4%	44.7%	43.9%	44.4%	45.2%	46.5%	45.2%	44.8%	44.6%	44.8%	46.0%	45.1%	44.4%	44.2%	44.5%	45.7%	44.8%	44.6%
Gross Profit (GAAP)	35,280	7,196	9,045	9,494	11,294	37,029	7,754	8,857	9,935	12,029	38,575	8,046	9,912	10,561	12,699	41,218	8,451	10,471	11,138	13,404	43,465	45,691
Gross Profit % of sales	54.7%	55.9%	55.5%	55.4%	54.6%	55.3%	56.1%	55.6%	54.8%	53.5%	54.8%	55.2%	55.4%	55.2%	54.0%	54.9%	55.6%	55.8%	55.5%	54.3%	55.2%	55.4%
Change (bps)	4	68	71	84	20	58	27	6	(80)	(114)	(40)	(90)	(20)	40	50	5	40	40	30	30	34	20
Selling, general and administrative expenses (GAAP)	25,170	5,188	6,316	6,639	8,595	26,738	5,830	6,538	6,924	9,203	28,495	5,908	7,060	7,248	9,574	29,790	6,150	7,377	7,546	10,011	31,084	32,465
Selling, general and administrative expenses % of sales	38.3%	40.4%	37.8%	38.2%	41.4%	39.5%	40.9%	39.8%	38.0%	40.8%	39.8%	40.6%	39.4%	37.9%	40.7%	39.7%	40.5%	39.3%	37.6%	40.5%	39.5%	39.4%
Change (bps)	13	(10)	198	127	135	122	46	201	(20)	(59)	36	(29)	(36)	(9)	(9)	(20)	(7)	(19)	(28)	(16)	(17)	(11)
Amortization of intangible assets																						
Operating profit (GAAP)	10,110	2,008	2,729	2,855	2,699	10,291	1,924	2,319	3,011	2,826	10,080	2,138	2,852	3,313	3,125	11,428	2,302	3,094	3,592	3,393	12,381	13,226
Operating Profit % of sales	16.4%	15.5%	17.7%	17.2%	15.2%	15.8%	15.3%	15.8%	16.8%	12.7%	15.0%	14.7%	15.9%	17.3%	13.3%	15.2%	15.2%	16.8%	17.9%	13.7%	15.7%	16.0%
Change (bps)	(9)	78	(127)	(42)	(119)	(64)	(18)	(199)	(39)	(55)	(82)	(61)	16	49	59	25	47	55	58	46	51	31
Other Pension and Post-Retirement Income (Expense) - GAAP	298	64	61	38	(207)	(44)	77	84	86	(130)	117	105	100	100	100	405	106	101	101	101	409	413
Other Pension and Post-Retirement Income (Expense) % of sales	0.4%	0.5%	0.4%	0.2%	-1.0%	-0.1%	0.6%	0.5%	0.5%	-0.6%	0.2%	0.7%	0.6%	0.6%	0.4%	0.5%	0.7%	0.6%	0.6%	0.6%	0.6%	0.6%
Botting equity income	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-
Interest (expense) income - GAAP	(1,219)	(204)	(223)	(224)	(264)	(935)	(290)	(235)	(264)	(339)	(1,128)	(281)	(280)	(279)	(278)	(1,118)	(277)	(276)	(275)	(274)	(1,103)	(1,088)
Interest (expense) income % of sales	(1.9%)	(1.6%)	(1.4%)	(1.3%)	(1.3%)	(1.4%)	(2.1%)	(1.5%)	(1.5%)	(1.5%)	(1.7%)	(1.9%)	(1.6%)	(1.5%)	(1.2%)	(1.5%)	(1.7%)	(1.7%)	(1.4%)	(1.4%)	(1.6%)	(1.6%)
Income before Income Taxes	9,189	1,868	2,567	2,669	2,208	9,312	1,711	2,168	2,833	2,357	9,069	1,962	2,672	3,134	2,947	10,715	2,130	2,919	3,418	3,220	11,687	12,551
Income before Income Taxes % of sales	15.4%	14.4%	16.7%	16.2%	12.2%	14.7%	13.8%	14.8%	15.8%	11.6%	13.8%	13.5%	14.9%	16.4%	12.5%	14.3%	14.0%	15.6%	17.0%	13.0%	14.8%	15.2%
Provision for Income Taxes (GAAP)	(3,370)	446	524	559	430	1,959	360	510	526	499	1,894	412	561	658	619	2,250	447	613	718	676	2,454	2,636
Provision for Income Taxes % of sales	(5.1%)	3.5%	3.2%	3.3%	2.1%	2.9%	2.6%	2.9%	2.9%	2.2%	2.7%	2.8%	3.1%	3.4%	2.7%	3.0%	2.9%	3.3%	3.3%	2.9%	3.0%	3.2%
Effective tax rate	18.8%	25.2%	20.6%	20.8%	18.6%	21.0%	21.1%	21.8%	18.8%	20.5%	20.5%	21.0%	21.0%	21.0%	21.0%	21.0%	21.0%	21.0%	21.0%	21.0%	21.0%	21.0%
Net Income (GAAP)	12,559	1,422	2,043	2,110	1,778	7,353	1,351	1,658	2,307	1,859	7,175	1,550	2,111	2,476	2,328	8,465	1,683	2,306	2,700	2,544	9,233	9,915
Net Income % of sales	19.4%	11.0%	12.4%	12.4%	8.6%	11.0%	9.8%	9.4%	12.6%	8.5%	10.1%	10.6%	11.8%	12.9%	10.0%	11.3%	10.9%	12.1%	12.8%	11.4%	13.6%	14.6%
Less: Net Income Attributable to Noncontrolling Interests (GAAP)	44	9	8	10	12	39	13	12	16	14	55	11	15	17	16	59	12	16	19	18	65	69
Less: Net Income Attributable to Noncontrolling Interests % of Consolidated Net Income	0.4%	0.7%	0.5%	0.5%	0.6%	0.6%	0.9%	0.6%	0.7%	0.7%	0.7%	0.7%	0.7%	0.7%	0.7%	0.7%	0.7%	0.7%	0.7%	0.7%	0.7%	0.7%
Net Income Attributable to PepsiCo (GAAP)	12,515	1,413	2,035	2,100	1,766	7,314	1,338	1,646	2,291	1,845	7,120	1,539	2,096	2,458	2,312	8,405	1,671	2,290	2,681	2,526	9,168	9,846
Net Income Attributable to PepsiCo % of sales	19.3%	11.1%	12.4%	12.4%	8.5%	10.9%	9.7%	9.3%	12.5%	8.4%	10.0%	10.5%	11.7%	12.8%	9.9%	11.2%	10.8%	12.0%	12.6%	11.3%	13.5%	14.5%
EPS (GAAP)	\$8.78	\$1.00	\$1.44	\$1.49	\$1.26	\$5.20	\$0.96	\$1.18	\$1.65	\$1.33	\$5.11	\$1.11	\$1.50	\$1.76	\$1.66	\$6.02	\$1.20	\$1.64	\$1.92	\$1.81	\$6.57	\$7.06
EPS (Non-GAAP)	\$5.66	\$0.97	\$1.54	\$1.56	\$1.45	\$5.53	\$1.07	\$1.32	\$1.66	\$1.47	\$5.52	\$1.11	\$1.50	\$1.76	\$1.66	\$6.02	\$1.20	\$1.64	\$1.92	\$1.81	\$6.57	\$7.06
Basic Average Shares Outstanding	1,415	1,406	1,401	1,397	1,392	1,399	1,390	1,387	1,384	1,382	1,386	1,386	1,387	1,388	1,389	1,388	1,388	1,389	1,388	1,389	1,389	1,388
Diluted Average Shares Outstanding	1,425	1,413	1,409	1,405	1,401	1,407	1,396	1,393	1,390	1,388	1,392	1,392	1,392	1,393	1,394	1,395	1,395	1,394	1,395	1,394	1,395	1,394
Depreciation & Amortization Expense	2,399.0	498.0	558.0	578.0	798.0	2,432.0	533.0	589.0	609.0	817.0	2,548.0	617.5	649.7	672.6	888.1	2,827.7	644.2	677.8	701.8	926.5	2,950.7	3,146.5
EBITDA	13,019.0	2,492.0	3,475.0	3,537.0	3,530.0	13,032.0	2,656.0	3,105.0	3,652.0	3,666.0	13,079.0	2,755.4	3,501.8	3,985.2	4,013.2	14,255.6	2,945.8	3,772.1	4,293.8	4,319.9	15,331.6	16,372.2
EBITDA Margin	20.1%	19.3%	21.1%	20.6%	17.1%	19.4%	18.1%	19.5%	20.2%	16.3%	18.6%	18.9%	19.8%	20.8%	17.1%	19.0%	19.4%	20.1%	21.4%	17.5%	19.5%	19.9%
EBITDA per Share	\$9.14	\$1.76	\$2.47	\$2.52	\$2.52	\$9.26	\$1.90	\$2.23	\$2.63	\$2.64	\$9.40	\$1.98	\$2.51	\$2.86	\$2.88	\$10.22	\$2.11	\$2.70	\$3.08	\$3.10	\$10.99	\$11.74
Dividend paid per share	\$3.59	\$0.93	\$0.96	\$0.96	\$0.96	\$3.79	\$0.96	\$1.02	\$1.02	\$1.02	\$4.02	\$1.02	\$1.08	\$1.08	\$1.08	\$4.25	\$1.08	\$1.13	\$1.13	\$1.13	\$4.46	\$4.68
Dividend Growth Rate (%)	13.3%	15.2%	3.0%	3.0%	3.0%	5.7%	3.0%	7.1%	7.1%	7.1%	6.1%	7.1%	5.1%	5.1%	5.1%	5.6%	5.1%	5.0%	5.0%	5.0%	5.0%	5.0%

Growth Rates Y/Y	2018	1Q19	2Q19	3Q19	4Q19	2019	1Q20	2Q20	3Q20	4Q20	2020	1Q21E	2Q21E	3Q21E	4Q21E	2021E	1Q22E	2Q22E	3Q22E	4Q22E	2022E	2023E
Net Revenue	1.8%	2.6%	2.2%	4.3%	5.7%	3.9%	7.7%	-3.1%	5.3%	8.8%	4.8%	4.9%	12.2%	5.8%	4.8%	6.8%	4.3%	4.9%	4.9%	5.0%	4.8%	4.7%
Organic Net Revenue (Ex-Currency)	4.6%	5.2%	4.5%	4.3%	4.3%	4.5%	7.9%	-0.3%	4.2%	6.7%	4.3%	1.6%	8.0%	3.8%	3.9%	4.3%	4.0%	4.6%	4.6%	4.7%	4.8%	4.5%
Costs of Sales	1.7%	1.0%	0.6%	2.3%	5.3%	2.5%	7.1%	-3.2%	6.7%	11.5%	5.9%	7.1%	12.7%	4.9%	3.7%	6.6%	3.4%	3.9%	4.2%	4.3%	4.0%	4.3%
Gross Profit	1.9%	3.8%	3.6%	5.9%	6.1%	5.0%	7.1%	-3.0%	4.1%	6.5%	3.9%	3.2%	11.8%	6.6%	5.8%	6.9%	5.0%	5.6%	5.5%	5.5%	5.6%	5.1%
Selling, general and administrative expenses	2.1%	2.3%	7.9%	7.8%	9.3%	7.2%	9.0%	2.1%	4.7%	7.2%	5.7%	4.2%	11.2%	5.6%	4.5%	6.2%	4.1%	4.5%	4.1%	4.6%	4.3%	4.4%
Amortization of intangible assets	1.2%	6.4%	-4.3%	1.8%	-1.2%	0.1%	6.6%	-10.6%	3.3%	3.9%	0.4%	3.7%	12.8%	9.1%	9.5%	9.0%	6.9%	7.7%	7.7%	7.6%	7.5%	6.8%
Total Operating Profits	1.2%	8.0%	-4.6%	1.8%	-2.7%	-0.2%	6.5%	-13.7%	2.8%	4.3%	-0.7%	0.7%	13.4%	8.9%	9.7%	8.5%	7.7%	8.5%	8.4%	8.6%	8.3%	6.8%
Operating Profit (Ex-Currency)	2.0%	10.0%	-2.5%	3.0%	-3.0%	1.0%	6.0%	-11.0%	5.0%	6.0%	1.0%	1.3%	11.6%	7.6%	9.0%	7.7%	7.7%	8.5%	8.4%	8.6%	8.3%	6.8%
Income before Income Taxes	1.1%	8.8%	-5.9%	0.6%	-3.2%	-0.9%	3.6%	-14.1%	3.2%	3.2%	-1.5%	2.4%	12.9%	9.3%	13.5%	10.0%	8.6%	9.2%	9.1%	9.3%	9.1%	7.4%
Net Income	7.1%	-0.4%	-5.4%	-3.3%	-3.9%	-3.6%	9.3%	-15.4%	5.7%	0.3%	-0.9%	2.5%	14.1%	6.4%	13.3%	9.3%	8.6%	9.2%	9.1%	9.3%	9.1%	7.4%
EPS	8.2%	0.8%	-3.8%	-1.9%	-2.6%	-2.4%	10.4%	-14.5%	6.6%	1.1%	0.0%	3.0%	14.0%	6.1%	12.7%	9.1%	8.4%	9.1%	9.0%	9.3%	9.1%	7.4%
EPS (Ex-Currency)	9.0%	3.0%	-2.0%	-1.0%	-2.5%	-1.0%	10.0%	-11.0%	9.0%	3.0%	2.0%	3.5%	12.3%	4.8%	12.0%	8.3%	8.4%	9.1%	9.0%	9.3%	9.1%	7.4%
Shares Outstanding - Diluted	-0.9%	-1.2%	-1.2%	-1.3%	-1.3%	-1.3%	-1.2%	-1.1%	-1.1%	-0.9%	-1.1%	-0.3%	0.0%	0.3%	0.5%	0.2%	0.2%	0.1%	0.0%	0.0%	0.0%	0.0%
Interest (Expense) Income	6.5%	-9.3%	6.2%	1.4%	-8.4%	-3.2%	42.2%	5.4%	17.9%	19.4%	20.6%	-3.1%	19.2%	5.7%	-18.0%	-0.9%	-1.4%	-1.4%	-1.4%	-1.4%	-1.4%	-1.4%

Margins	2018	1Q19	2Q19	3Q19	4Q19	2019	1Q20	2Q20	3Q20	4Q20	2020	1Q21E	2Q21E	3Q21E	4Q21E	2021E	1Q22E	2Q22E	3Q22E	4Q22E	2022E	2023E
Gross Margin	54.7%	55.9%	55.5%	55.4%	54.6%	55.3%	56.1%	55.6%	54.8%	53.5%	54.8%	55.2%	55.4%	55.2%	54.0%	54.9%	55.6%	55.8%	55.5%	54.3%	55.2%	55.4%
EBITDA Margin	20.1%	19.3%	21.1%	20.6%	17.1%	19.4%	18.1%	19.5%	20.2%	16.3%	18.6%	18.9%	19.8%	20.8%	17.1%	19.0%	19.4%					

Price Target Basis and Risk

Price Target for PEP: \$147.00 from \$157.00

Our \$147 price target is based on a 22.5x P/E multiple to our CY22E EPS estimate.

Risk for PEP

Downside risks: (1) PEP is global and the world faces many risks that could slow its category growth (COVID-related for ex) and thus company revenue/earnings; (2) PBNA margins remaining stagnant would affect our EPS estimates that embed improvement. Upside risks: (1) PBNA margins accelerating could drive upside to earnings. (2) a faster global recovery which would drive PEP's foodservice business.

Investment Thesis

PEP

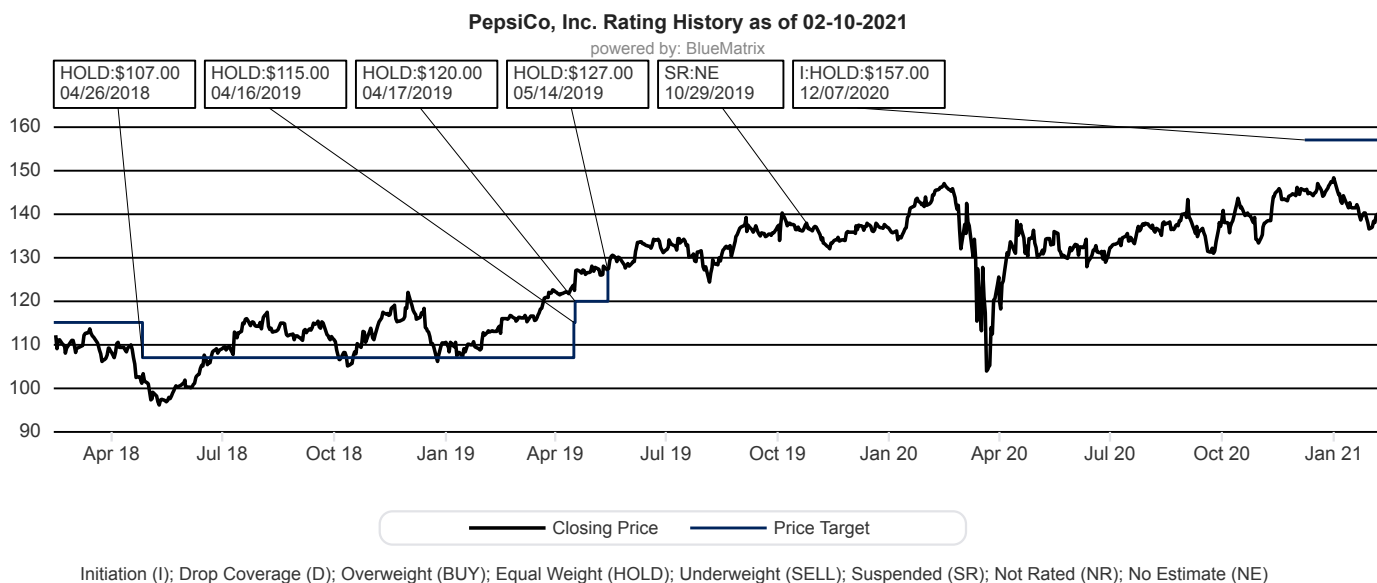
PEP results have been resilient amidst COVID; and with a consistent algorithm and valuation in line with historicals, we expect the stock to track the group. We carry a positive lean and recognize the case that could drive earnings catalysts. We simply need time to assess if these scenarios become reality, namely PBNA, and view EPS expectations as reasonable for now, hence the Equal Weight rating.

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I, Chris Carey, certify that:

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- 2) No part of my compensation was, is, or will be, directly or indirectly, related to the specific recommendations or views expressed by me in this research report.

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PEP:

Downside risks: (1) PEP is global and the world faces many risks that could slow its category growth (COVID-related for ex) and thus company revenue/earnings; (2) PBNA margins remaining stagnant would affect our EPS estimates that embed improvement. Upside risks: (1) PBNA margins accelerating could drive upside to earnings. (2) a faster global recovery which would drive PEP's foodservice business.

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1=Overweight: Total return on stock expected to be 10%+ over the next 12 months. BUY

2=Equal Weight: Total return on stock expected to be 0-10% over the next 12 months. HOLD

3=Underweight: Total return on stock expected to lag the Overweight- and Equal Weight-rated stocks within the analyst's coverage universe over the next 12 months. SELL

As of February 10, 2021

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