PepsiCo in Q1 of 2025: Price Discovery or Overreaction

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PepsiCo is one of the most consistent public companies in terms of capital return to shareholders, paying consecutive quarterly cash dividends since 1965 and increasing its annual dividend for 53 consecutive years. However, it faces a challenging narrative amongst investors given its reliance on an international supply chain in sourcing its raw materials (aluminum, agricultural commodities…) and thus its exposure to the recently implemented tariffs on U.S. imports.

We analyze the underlying value of the business using a pro-forma discounted cash flow model and the recently filed 2024 10K annual report. Our forecast extends from 2025 to 2028 and is based on driving ratios calculated based on the 3 financial statements. The weighted average cost of capital was calculated based on an assumed corporate tax rate of 20% (currently at 21%, but tax cuts appear to be on the horizon) and a current cost of equity of 7.57% (CAPM yields an unrealistically low value). The resulting WACC of 6.61% indicates a balanced capital structure but more weighted to equity. The company's cost of debt (2.08%) is lower than its cost of equity due to investment-grade credit rating and stable projected cash flows (around $10 B). Its cost of equity reveals a low-risk premium vis-à-vis the market (NASDAQ) due to its size ($50 B profit), but in spite of its high debt-to-equity ratio (5) which can only be explained by its reliable dividend history (5.69$ per share announced for 2025). The company also operates in the consumer goods sector which provides predictable revenues due to controlled product distribution, minimizing business risk. Also, its vast portfolio amongst different segments of the market limits the volatility of the business as it acts similarly to a holding company.

By discounting its projected free cash flows, PepsiCo's equity issue is valued at $195.7 using a long-term GDP growth rate of 2%. Even an exit multiple of 18.9 (projected 2025 EV/EBITDA) results in a share value of $176.3. Both valuations are higher than the current share price of $134.31 (as of 4/29/2025). Thus, there appears to be a disconnect between the stock price trajectory in Q1 of 2025 and the expectation of strong future growth as reflected in the enterprise multiple. The company also displays strong working capital efficiency, with a cash conversion cycle of -126 days, which reflects a fast-moving inventory and strong bargaining power with suppliers. Finally, PepsiCo benefits from its solid margins and low equity base (leverage and share buybacks) to deliver attractive 50% net income returns on shareholder capital,

In summary, there appears to be 2 divergent narratives amongst institutional and retails investors alike concerning the beverage and snack giant. On the one hand, the stock is underpriced given its fundamentals and the legacy of investor-friendly policies; and on the other hand, the company is at risk of failure at different nodes of its supply chain and U.S. tariffs will stress test these potential failure points. The latter scenario is plausible given the excessive leverage revealed by the debt-to-capital ratio (80%) and the aggressive working capital management as revealed in days payable outstanding (214 days) that may break overextended supplier relationships. Nonetheless, PepsiCo stock remains an attractive opportunity for the value investor given the $40 to 60$ differential especially if the market continues to overprice tariff updates and any potential negative headline. For instance, both Bank of America and Barclays have downgraded the stock primarily due to the North America Foods division performance which has contributed to the 6.24% drop in price over the last week and part of the broader 10.42% decrease for the month of April, which has seen it reach its 1 year low (see figure 1). Our analysis alone shows that the noise might have overpowered the signal in consumer sentiment around PepsiCo's equity offering but the company is well positioned for a sizeable rebound once the correction is over. In my opinion (unrelated to the analysis), Ramon Laguarta (CEO since 2018) has steered the company through a global pandemic and can surely navigate a changing world order by focusing on local supply in each region and decoupling the interconnected nodes across geographic markets. The task will likely take time, but our model shows that he can afford to undertake the risk (for at least the next 3 years).

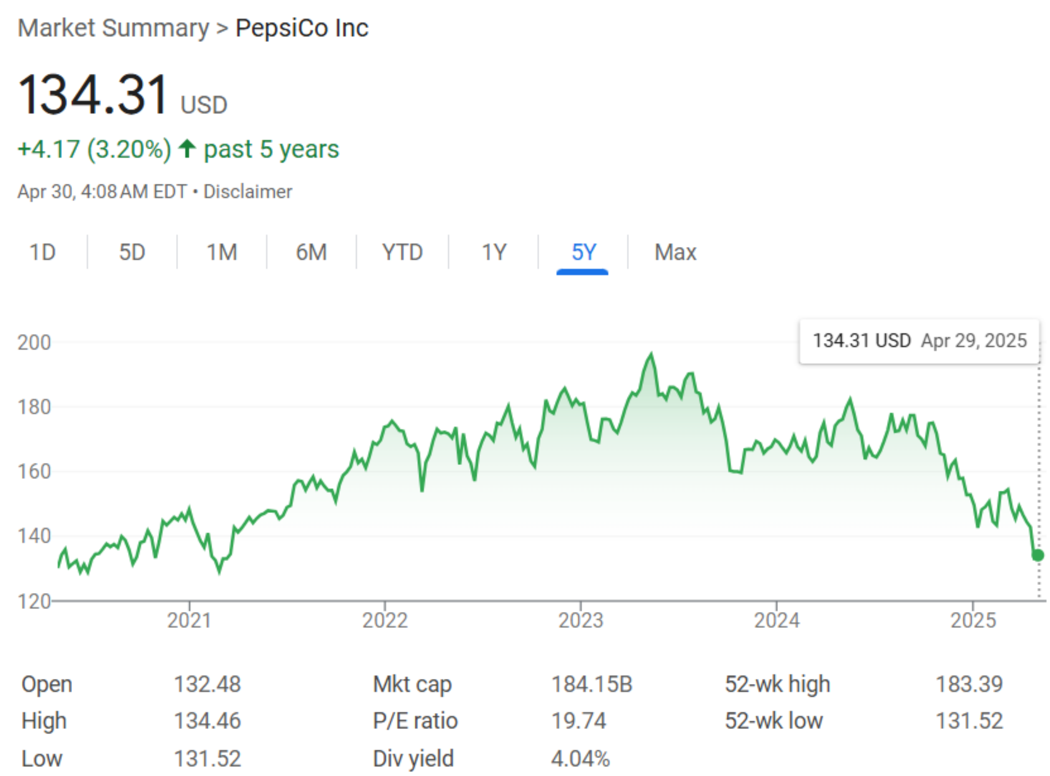

Figure 1. NASDAQ: PEP in the current decade

Sources:

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