KILLIK & Co

20 January 2012

Global Equity

.Company:	Epic:	Market Cap:	Recommendation:	Risk Rating:	Price:
PepsiCo	PEP.N	$103.0bn	Neutral Previously Buy	6 CATEGORY: UNRESTRICTED (see bottom of note for risk categories)	$65.91

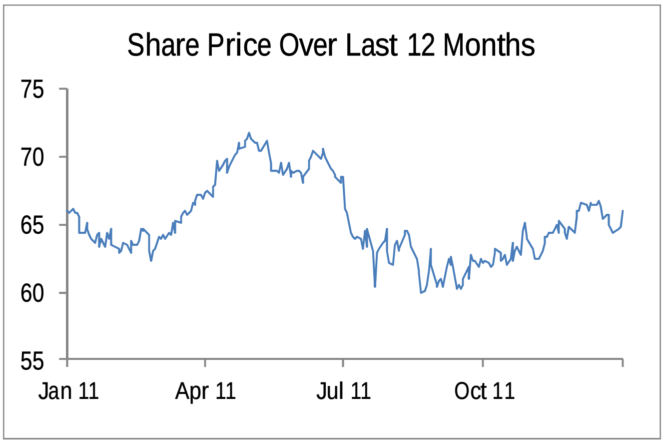
PepsiCo is the second largest food and beverage (F&B) business in the world and the largest in North America. Revenues are split 48% snacks/foods and 52% beverages, and 18% of the overall portfolio are good-for-you nutrition products. The global macrosnacks category is worth $200bn, with PepsiCo operating in the savoury segment which is a $60bn business. Beverages are a $400bn category with $100bn in North America and Pepsico has products across the whole beverage segment. Pepsico has both a strong operating culture and strong consumer brand culture.

52 Week High	$71.89
52 Week Low	$58.50
Price to Book Value	4.9x
Dividend Yield	3.1%
Free Cash Flow Yield	8.9%
Dividend Cover	4.4x
Net Debt	$18.9bn
Interest Cover	9.2x
Emerging markets sales	30%
Next announcement	9 February 2012

Source: Company Data and Bloomberg Consensus

Investment Case

- Leading brand portfolio with 19 $1bn+ brands, including Pepsi, 7up, Doritos, Walkers, Lipton, Tropicana and Gatorade.
- Localised supply chains allows customisation to local tastes.
- Developed market growth to come from move to healthier snacks.
- Emerging markets growth will come from higher income levels and increased urbanisation.
- Nutrition business to meet need for convenient, highly nutritious products.



While we continue to like the long-term investment case for PepsiCo, we are concerned that the investor update next month may involve the rebasing of 2012 EPS guidance and hence result in short-term underperformance. While we are moving our recommendation to Neutral, investors with a shorter-term time horizon may wish to reduce their holdings with a view to re-investing at a lower level post the investor update.

Note: UK investors may be subject to a withholding tax of 30% on dividends from US companies. Dividend yields are stated gross of this withholding tax. We do not automatically reclaim the withholding tax on investments held with us. This will reduce the amount of dividend income that you receive.

Year End	Sales ($m)	PBT ($m)	EPS ($)	PE (x)	DPS ($)	Yield (%)
Dec 2010	57,838	8,232	3.97	16.6	1.9	2.9
Dec 2011	66,385	9,562	4.39	15.0	2.0	3.1
Dec 2012	68,303	9,741	4.56	14.5	2.2	3.3
Dec 2013	71,288	10,328	4.91	13.4	2.4	3.6

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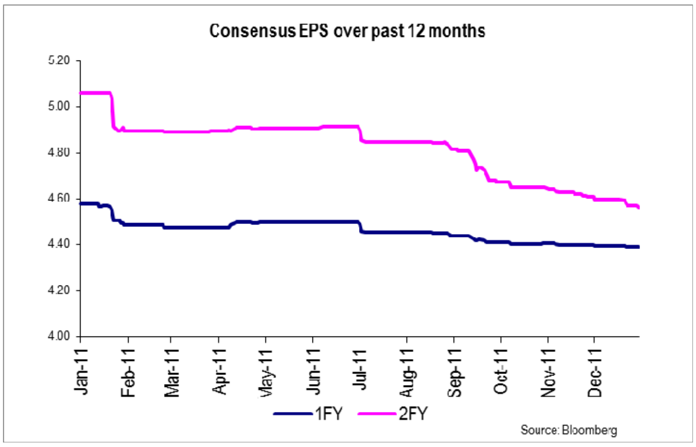
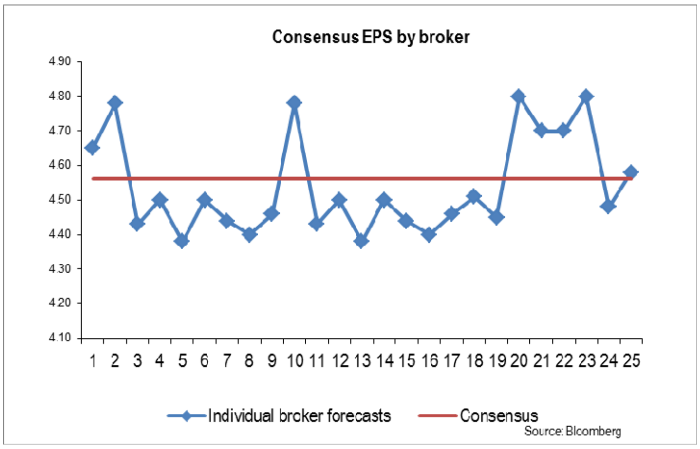
PepsiCo is due to announce its full year 2011 results on 9 February, and is also going to update investors on the results of the review of the company's business plan for 2012 and beyond. There have been various press reports regarding the likely outcome and what will be announced. We believe that it is likely that PepsiCo is going to announce a significant step up in investment spending on its brands (primarily through advertising and promotion), partially offset by some cost-cutting, but involving a re-basing of the EPS guidance before resuming the low double-digit growth rate of the past decade. This is certainly a view shared by some parts of the market as can be seen by the decline in consensus EPS growth rate for 2012 over the past four months. However, there is still a fairly wide dispersion in brokers' 2012 EPS estimates and with our view that the guidance is likely to be at the bottom of this range, there is potential for downgrades and the consensus number to decline by 4-5%.





There are two more positive scenarios for the investor update, but we believe these are less likely. Firstly, it is possible that the investment in brands is announced but will be fully offset by cost-savings. Due to the size of the investment likely to be made, we don't believe this can easily be offset by cost savings without impacting the business and hence the market is unlikely to give PepsiCo credit for the cost savings, and will mark earnings down regardless. Secondly, it has been rumoured that PepsiCo is going to announce a break-up into three separate companies: beverages, snacks and nutrition. While this would probably be taken positively by the market, we believe it is unlikely at this stage given the recent focus on the 'Power of One' strategy, designed to leverage the combined scale of its complementary snacks and beverage businesses. In addition, the nutrition group does not seem large or developed enough to be standalone, and it seems unlikely given the recent acquisitions in this space.

We continue to like the long-term investment case for PepsiCo, with its portfolio of leading snack and beverage brands with large-scale reach into both developed and emerging markets. The business is a combination of global brands, with localised supply chains allowing local customisation and innovation of products. The growth potential in developed markets will come from a move to healthier snack options and PepsiCo is well positioned to take advantage of this trend, both in shifting traditional snack brands and offering more nutritional brands. In emerging markets, growth will be driven by increased per capita consumption from higher incomes and increased urbanisation, and PepsiCo has both the brands and the strong distribution networks necessary to capture this growth. However, we believe that over the short term, there is a risk of under-performance if the EPS for 2012 is rebased lower. While we are moving our recommendation to Neutral, investors with a shorter-term time horizon may wish to consider reducing their holdings with a view to re-investing at a lower level post the investor update.

Risks to this recommendation

- EPS is not rebased and there are upgrades to consensus.
- A break-up of PepsiCo into three separate businesses.

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KILLIK & Co RESEARCH RECOMMENDATIONS					
Equity Research			*Fund Research*		
Large Cap	*Mid Cap*	*Global*	*Absolute Return*	*Income*	*Growth*
Investment ideas in the FTSE 100 which we believe will generate returns ahead of the All-Share index.	*Investment ideas in the FTSE 250 which we believe will generate returns ahead of the All-Share index.*	*Global investment ideas which we believe will generate returns ahead of the FTSE World (ex UK) index over the long term.*	*Funds that aim to generate an absolute return over the medium to long term, i.e. a positive return irrespective of equity or bond market direction.*	*Income producing funds, which are attractive in the context of the yield available from cash, gilts and UK equities.*	*Funds which we believe have the potential to generate a high level of capital growth over the long term.*

KILLIK & Co RESEARCH PERIODIC PUBLICATIONS		
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