**PepsiCo Inc. (NYSE: PEP)**

**COMPANY OVERVIEW**

PepsiCo Inc. recently acquired Quaker Oats. In 1997 Pepsi spun off its restaurant businesses to shareholders. A couple years later in 1999 bottling operations in the form of Pepsi Bottling Co. The company now exists as producer and distributor of concentrate product to licensed bottlers as well as a top seller of snack foods. In August of 2001 PepsiCo acquired Quaker Oats, strengthening its revenue and profit stream and resulting in a more positive outlook for the company and its stock.

**INVESTMENT CONCLUSION**

- Buy 300 shares of Pepsi-Cola Inc. at $49.

**SUMMARY**

- Recent business reorganization lead to spin-offs of restaurant businesses and bottling operations.
- Acquired Quaker Oats to gain ownership of popular Gatorade brand.
- EPS growth target of 13-14%. Earnings forecast of $1.66 per share for FY '01.
- Main source of growth and stability is the Frito-Lay snack foods division.
- Pepsi is performing well in harsh conditions, unlike Coke which is struggling due to international exposure.
- Used a Discounted Free Cash Flow model and dividend discount model.
- The fund will be slightly overweight, however all companies in the consumer staples sector tend to be stable companies.

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**INDUSTRY INSIGHT**

**News & Trends**

Soft drinks have under-performed the market this past year, falling 15.3% v. an 11.8% decline in the S&P 500 Index.

Investors have been questioning whether drink volumes and earnings would continue their historical growth rates. Coca-Cola’s under-performance in the past couple years has contributed to these worries.

Current investments in the Wright Fund include Anheuser Busch and Philip Morris for the consumer staples sector.
**Company Strategy or Company Discussion**

The industry in which it operates is dominated by Coca-Cola and Pepsi. The company successfully reduced the capital intensiveness of its business with the spin-off of its restaurant businesses (now listed as “YUM” on the NYSE) and its bottling operations.

Pepsi is experiencing strong growth in all of its core products. The business focuses on three product areas: soft drinks, snack foods, and non-carbonated drinks (strengthened by acquisition of Quaker Oats). Soft drinks represent 25% of sales and 28% of operating profits. Non-carbonated drinks are represented mainly by Tropicana and represent 12% of sales and 6% of profits. The snack foods division represents 63% of sales and 66% of operating profits.

**Investment Risks**

Currently, market exposure to international markets is low. This is working in Pepsi’s favor since it limits foreign currency exposure, especially considering a strong dollar. However when markets overseas recover, the impact on competitors like Coca-Cola will be less. Pepsi has benefited from weakness in Coke, as investors have taken positions in Pepsi. Over the long-term, growth in international markets is key to growth in profitability. Interest rate risk and the effect of changes in the cost of fuel are also risks.

**Recent Results**

Pepsi has guided investors to expect earnings of $1.66 per share for the FY ‘01, closing a year of high growth for the company. Pepsi expects growth of 13-14% for FY ‘02.

In the most recent quarter Pepsi’s EPS increased 13% to 48 cents per share. Net sales increased 8% to $6.9 billion, marking the third consecutive quarter of double digit growth for the company.

Earnings will be released on February 6th. Expectations is for overall EPS to be $1.66 for the year. At that time a conference call write-up will be submitted to further detail Pepsi’s position and performance to date.
Recent Results

Quarterly results came in at 13% EPS increase. Expectations are for earnings of $1.66 per share with earnings on February 6th.

<table>
<thead>
<tr>
<th>Cumulative For Period Ended:</th>
<th>9/2/00</th>
<th>12/30/00</th>
<th>3/24/01</th>
<th>6/16/01</th>
<th>9/8/01</th>
</tr>
</thead>
<tbody>
<tr>
<td>Net Income</td>
<td>1,845,000</td>
<td>2,183,000</td>
<td>498,000</td>
<td>1,150,000</td>
<td>1,995,000</td>
</tr>
<tr>
<td>Depreciation</td>
<td>711,000</td>
<td>960,000</td>
<td>208,000</td>
<td>425,000</td>
<td>737,000</td>
</tr>
<tr>
<td>Deferred Taxes</td>
<td>138,000</td>
<td>63,000</td>
<td>-12,000</td>
<td>-3,000</td>
<td>-4,000</td>
</tr>
<tr>
<td>Non Cash Charges</td>
<td>219,000</td>
<td>317,000</td>
<td>32,000</td>
<td>65,000</td>
<td>154,000</td>
</tr>
<tr>
<td>Change in Operating</td>
<td>-388,000</td>
<td>—</td>
<td>-648,000</td>
<td>-997,000</td>
<td>-390,000</td>
</tr>
<tr>
<td>Non-Cash Items</td>
<td>194,000</td>
<td>—</td>
<td>—</td>
<td>—</td>
<td>145,000</td>
</tr>
<tr>
<td>Bottling Equity Inc.</td>
<td>-135,000</td>
<td>-130,000</td>
<td>-5,000</td>
<td>-68,000</td>
<td>-153,000</td>
</tr>
</tbody>
</table>

Financial Outlook

![Earnings Estimates Chart](chart.png)
Using a ten-year Discounted Cash Flow Model, the valuation for Pepsi came to $49.94. However, the valuation was conducted using the lowest estimates of future earnings. I believe there is still room for appreciation in shares of Pepsi and limited downside to the company’s shares.

**Summary of Model**

<p>| | |</p>
<table>
<thead>
<tr>
<th></th>
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</thead>
<tbody>
<tr>
<td>Current Price</td>
<td>$49.41</td>
</tr>
<tr>
<td>Target Price</td>
<td>$49.94</td>
</tr>
<tr>
<td>Stop Price</td>
<td>$44</td>
</tr>
<tr>
<td>Growth Rate</td>
<td>13-14%</td>
</tr>
<tr>
<td>WACC</td>
<td>10.18%</td>
</tr>
</tbody>
</table>

**INVESTMENT HIGHLIGHTS**

**CHARTS / TECHNICAL**

![Graph of PepsiCo Inc. stock prices from January 2002 to January 2003](https://finance.yahoo.com/)