

COMPANY PROFILE

PepsiCo Inc

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COMPANY OVERVIEW

PepsiCo Inc (PepsiCo) is a manufacturer of a wide range of beverages, foods and snacks. It sells products under various brands including Pepsi, Pepsi Max, Mountain Dew, Diet Pepsi, Lay's, Frito-Lay, Doritos, 7-Up, Tropicana, Aquafina, Mirinda, Gatorade and Quaker, V Water, Ya, Tostitos, Simba and Trop 50. PepsiCo distributes its products through direct-store-delivery, customer warehouse and foodservice, and vending distribution networks. Its customers include grocery stores, drug stores, convenience stores, discount/dollar stores, mass merchandisers, membership stores, wholesale and other distributors, e-commerce retailers and authorized independent bottlers. It has business operations across North America, South America, Europe, Asia-Pacific, the Middle East and Africa. PepsiCo is headquartered in Purchase, New York, the US.

The company reported revenues of (US Dollars) US\$63,525 million for the fiscal year ended December 2017 (FY2017), an increase of 1.2% over FY2016. In FY2017, the company's operating margin was 16.5%, compared to an operating margin of 15.6% in FY2016. In FY2017, the company recorded a net margin of 7.6%, compared to a net margin of 10.1% in FY2016.

KEY FACTS

Head Office	PepsiCo Inc 700 Anderson Hill Road Purchase New York Purchase New York USA
Phone	1 914 2532000
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Web Address	www.pepsico.com
Revenue / turnover (USD Mn)	63,525.0
Financial Year End	December
Employees	263,000
New York Stock Exchange Ticker	PEP

SWOT ANALYSIS

PepsiCo Inc (PepsiCo) is a food and beverage company. Strong market position, focused R&D activities, reinvestment to generate strong financial results, and strong customer base are the company's major strengths, even as, product recalls and allegations remain areas of concern. In the future, competitive pressures, volatile raw material prices, and obesity and water concerns could affect its business operations. However, growing global growth in soft drinks consumption, global savory snacks market, focus on refranchising internationally, and tax reform in the US are likely to provide growth opportunities to the company.

<p>Strength</p> <p>Market Position R&D Activities Reinvestment to Generate Strong Financial Results Connecting with Consumers</p>	<p>Weakness</p> <p>Lawsuits Product Recalls</p>
<p>Opportunity</p> <p>Global Soft Drinks Consumption Focus on Refranchising Global Savory Snacks Market Tax Reform in the US</p>	<p>Threat</p> <p>Obesity and Water Concerns Competitive Pressures Volatile Raw Material Prices</p>

Strength

Market Position

The company enjoys a prominent market position that helps in attracting and serving a diverse customer base. PepsiCo is the second-largest food and beverage company in the world. It manufactures, markets and sells a range of convenient, enjoyable and wholesome foods and beverages. Its portfolio comprises oat, rice snacks and grain-based foods, carbonated and non-carbonated beverages. The company's products are sold in more than 200 countries. PepsiCo has 25 brands generating retail sales of over US\$1 billion annually. As of December 2017, the company held over 20% market share in the total US liquid refreshment beverage category. PepsiCo was the largest driver of growth for its food and beverage retail partners in the US in FY2017, contributing 19% of total food and beverage retail sales growth, which is more than the next 15 largest F&B manufacturers combined.

R&D Activities

Strong R&D activities improve the company's competitiveness in the marketplace and also enhance its portfolio of offerings. PepsiCo is involved in several R&D activities to offer innovative products to its customers. Its activities comprise development of new ingredients and products; improvement and

modernization of manufacturing processes; reformulation and improvement in the quality and appeal of existing products; and improvements in product quality. It operates research centers in Brazil, China, India, Germany, Russia, Mexico, the U AE, the UK and the US. In FY2017, the company invested US\$737 million on its R&D activities. The company introduced several products in beverage, food and snack portfolio during the review year. In FY2017, PepsiCo focused on refining beverage, food and snack portfolio to meet changing consumer demands by reducing added sugars in beverages and sodium and saturated fat in foods and snacks; developed a wide portfolio of product choices, including beverage options that contain no high-fructose corn syrup and that are made with natural flavors; expanded food and beverage healthy vending initiative to increase the availability of convenient, affordable and enjoyable nutrition, and further expanded portfolio of nutritious products.

Reinvestment to Generate Strong Financial Results

PepsiCo's focus on refining its business model on reducing management layers and implementing technologies resulted in higher manufacturing throughput, reduction in logistics costs and increasing go-to-market efficiency and effectiveness. It resulted in annual productivity savings of US\$1 billion equivalent to 10% of annual EBIT or 1.6% of total sales. It also helped in better utilizing the company's resources and making investments to record financial growth. PepsiCo recorded total revenue of US\$63,525 million in FY2017, a growth of 1.2% over the previous year. It delivered organic revenue growth of 2.3% in FY2017 compared to FY2016. During the review year, its core operating margin improved by 45 basis points. Its core constant currency earnings per share (EPS) improved by 9%, exceeding the 8% goal set at the beginning of FY2017. The company generated free cash flow of US\$7.3 billion in FY2017, which exceeded the goal of US\$7 billion set at the beginning of the review period. The core net return on invested capital (ROIC) improved by 140 basis points and stood at 22.9% at the end of FY2017. The company also achieved its target of returning US\$6.5 billion in cash to shareholders in the form of dividends and share repurchases. Over the past five years, organic revenue grew at a CAGR of 4%, the core operating margin improved by 220 basis points, and constant currency annual EPS growth averaged 9%. The core net ROIC increased by over 750 basis points, whereas annualized dividend per share increased by 50% during the same period. Through dividends and share repurchases, the company returned US\$38 billion to shareholders over the past five years.

Connecting with Consumers

PepsiCo's products are used by consumers over one billion times a day in more than 200 countries. The company's focus on managing customer relationships in retail and foodservice enabled it to create competitive advantage in the marketplace. Focus on strengthening its capabilities in (R&D, e-commerce, social and digital marketing helped it to connect with consumers. PepsiCo partners with retail customers through its e-commerce business to create a point of differentiation. In FY2017, its e-commerce business generated annual retail sales of US\$1 billion. The company's better control of its distribution systems help to develop an aligned system on snacks and beverages that serves the retailers well and reach higher number of consumers. The company leverages big data and predictive analytics to better understand consumers' requirements and design its campaign to deliver real-time marketing messages and tailored offers. The strength of its customer relationships enabled it to secure higher ranks in recent Kantar Retail PowerRanking survey, in which, the company's retail partners named PepsiCo as the best-in-class manufacturer. It also received the top ranking in several functional categories, including clear company strategy, most important consumer brands, growth and profitability, sales force and customer teams,

insights and category management, supply chain management and use of digital platforms. Similarly, PepsiCo was highly ranked in service by advantage in markets outside the US, including major markets comprising China, Russia, the UK and Mexico.

Weakness

Lawsuits

The company was involved in various law suits, affecting its brand image and cost structure. In October 2016, PepsiCo was sued in the federal court of New York by the Center for Science in the Public Interest (CSPI) on behalf of three shoppers over misleading advertisements. In the suit, the company was accused of providing wrong and fabricated information on the labels of Naked juices and smoothies. CSPI alleged that PepsiCo misleadingly markets Naked juices as predominantly containing high-value ingredients, but originally the main ingredient is often cheaper, less nutritious apple or orange juice. CSPI also claimed that PepsiCo embellishes No Sugar Added tag on Naked labels, whereas these products contain roughly as much sugar as in the company's other carbonated soft drinks. Though PepsiCo denied these allegations but later (Feb 2017) it agreed to update the labels for its Naked Juice brand within eight months. In June 2016, PepsiCo reached a settlement in carcinogen class action lawsuit, where the company was accused of selling products containing chemical 4-Methylimidazole (4-Mel) that violates consumer protection law and common law in California.

Product Recalls

Frequent product recalls could increase the company's operational costs. In July 2017, PepsiCo recalled two pack sizes of Doritos Chilli Heatwave over presence of milk that was not mentioned on the label that could potentially cause health risk for customers with an allergy or intolerance to milk or milk constituents. In January 2017, PepsiCo and the Food Standards Agency recalled few batches of Doritos lightly salted corn chips over presence of soya and wheat (gluten) that were not mentioned on the label. The recalled product could cause a possible health risk for individuals with an allergy or intolerance to wheat or gluten, and/or an allergy to soya. Though the product recalls portray the company's focus towards safety, frequent recalls could have a negative impact on company's reputation in the market.

Opportunity

Global Soft Drinks Consumption

The company stands to benefit from the growing global demand for soft drinks. According to in-house research report, the global consumption of soft drinks in terms of value stood at US\$841,600.2 million in 2016 and is expected to grow at a CAGR of 5.8% during 2016-21 to reach US\$1,113,926.6 million by 2021. Major factors driving the growth include growing global middle class population, increasing disposable income, rapid urbanization, improving buying power of customers' worldwide, introduction of new flavors and changing customer needs. Usage of natural colors and sweeteners such as corn syrup, aspartame and similar ingredients, apart from improvement of quality in manufacturing process of beverages also contribute to the growth of the industry by attracting health conscious people. Carbonates

and packaged water are the largest segments of the global soft drinks market, accounting for 33.1% and 20.6% of the market's total value, respectively. Asia-Pacific accounts for about 32.9% of the total global soft drinks market value, followed by the US (28.9%), Europe (22.5%), the Middle East (1.7%) and the rest of the world (14.1%).

PepsiCo stands to benefit from the growth as it markets products in more than 200 countries worldwide. The company took several initiatives to strengthen its beverages market. In February 2018, PepsiCo launched a new sparkling water, bubly, that combines refreshing and delicious flavors. In January 2018, the company's Mountain Dew introduced MTN DEW ICE, a crisp, clear, carbonated soft drink made with a splash of real juice.

Focus on Refranchising

PepsiCo repurposed its refranchising strategy, which focuses on extracting the productivity, driving the top line growth and also to check whether innovation sticks in the marketplace. In August 2017, Varun Beverages Ltd acquired PepsiCo India's previously franchised territories in Odisha and parts of Madhya Pradesh along with three manufacturing units. PepsiCo signed an agreement with Varun Beverages to distribute its Tropicana juices, Gatorade sports drink and Quaker oats. During the review year, the company refranchised its beverage business in Jordan by selling a controlling interest in its bottling operations. PepsiCo recorded a pre-tax gain of US\$140 million in selling, general and administrative expenses in AMENA segment. During the review year, the company entered into an agreement to refranchise its beverage business in Thailand by selling a controlling interest in its bottling operations. The transaction is expected to be completed in 2018. In FY2017, the company entered into an agreement to refranchise its entire beverage bottling operations and snack distribution operations in Czech Republic, Hungary, and Slovakia (CHS). The transaction is expected to be completed in 2018.

Global Savory Snacks Market

The growth in the global savory snacks market is likely to increase the company's business in the future. Increasing population, higher per capita consumption, urbanization, growing middle class, improving technological standards, and increasing number of snacking occasions drive the savory snacks market worldwide. According to in-house research report, the global savory snacks market was valued at US\$96,425.9 million in 2016, where processed snacks accounted for 36.4% of the total market value, followed by potato chips (25.8%), nuts and seeds (15.3%), ethnic or traditional snacks (11.6%), popcorn (4.9%), meat snacks (3.1%) and others (2.9%). The market is projected to grow at a CAGR of 6% during 2016-21 to reach US\$129,158.5 million by the end of 2021. In terms of volume, the market is expected to grow at a CAGR of 3.2% during the period to reach 11,929.5 million kg by 2021. Increasing population in Asia-Pacific, coupled with a healthy economic outlook, presents a significant opportunity for the growth of the savory snacks market.

PepsiCo's snacks business is handled by Frito-Lay North America (FLNA) division, which is one of the largest contributors in its total revenue. FLNA contributed 24.9% of the total sales and 41% of EBIT in FY2017. Its total revenue increased by 1.6% in FY2017 over the previous year. It achieved an organic revenue growth of 3% during the review year, which could be attributed to higher growth in variety packs, Ruffles, Tostitos, Doritos and dips. FLNA has taken several initiatives to strengthen its portfolio and maintain its growth momentum. In January 2018, it introduced Doritos Blaze, a hot and spicy snack. In

FY2017, FLNA launched Doritos Crunch Nuts and Doritos Crunch Mix Poppables, a light-textured potato snack in various flavors, including white cheddar and sea salt.

Tax Reform in the US

Impact of tax reform in the US is expected to give a fresh boost to the company's business. The tax reform law is likely to allow business entities in the country for more flexibility in terms of managing resources, and particularly cash resources around the world and lower the cost of capital in the US. This new scenario could attract more investments on business in the country in coming years. In December 2017, the Government of the US passed The Tax Cuts and Jobs Act (Tax Reform Act). The new law slashed the corporate tax to a flat rate of 21%, a drastic fall from its previous maximum corporate tax rate of 35%. Furthermore, the new law eliminates the special corporate tax rate on personal service corporations (PSCs). It also lowers the 80% dividends received deduction (for dividends from 20% owned corporations) to 65% and the 70% dividends received deduction (for dividends from less than 20% owned corporations) to 50%. The new rate is effective from January 2018. The new law also repeals the alternative corporate tax on net capital gain. According to the Joint Committee on Taxation's (JCT's) estimates, the new law reflects a net tax cut of approximately US\$1.456 trillion over the ten-year budget window. The reform is likely to enhance profitability of companies such as PepsiCo, which expects 9% increase in its core earnings per share in 2018 compared to 2017 due to the lower tax rate.

Threat

Obesity and Water Concerns

Health consequences resulting from obesity, and water scarcity are primary areas of concern for beverage companies. Researchers, health advocates and dietary guidelines have advocated a reduction in consumption of sweetened beverages in order to avoid obesity. Various governments plan to increase taxes on sugar-sweetened beverages to reduce consumption of such beverages and increase revenue. For instance, the Sugar-Sweetened Beverages Tax (SWEET) Act, institutes a tax of one cent per teaspoon of caloric sweetener such as sugar or high-fructose corn syrup. Increased consumer awareness towards obesity and probable new or increased taxes on sugar-sweetened beverages by governments could reduce the company's product sales. To overcome from the above concerns, in March 2017, the company introduced Pepsi Max Ginger, a new sugar-free addition to the Max line-up. In the same month, PepsiCo introduced low-calorie Lemon Lemon and IZZE Fusions. Moreover, increased water scarcity and availability of quality water is deteriorating day by day. Water being a major ingredient for beverage manufacturers, increasing demand could result in higher production costs in coming years.

Competitive Pressures

PepsiCo and Coca-Cola are the two big soft drink giants that battle fiercely over the consumer attention and attachment. As they are present across most categories, the two adversaries have been very active in marketing. PepsiCo and The Coca-Cola Company represent over 40% of the US liquid refreshment beverage category. Apart from Coca-Cola, PepsiCo also competes with international beverage, food and snack companies operating in multiple geographies such as Nestle S.A., Kellogg Company, DPSG, International, Inc., Kraft Foods Group, Inc., Monster Beverage Corporation, Red Bull GmbH, and

Snyder's-Lance, Inc.

Volatile Raw Material Prices

The company's performance is sensitive to raw material price movements. According to the Food and Agriculture Organization of the United Nations' (FAO), Food Price Index averaged 174.6 points in 2017 as compared to 161.5 points in 2016, up 8.2%. Its Cereal Price Index averaged 151.6 points in 2017 as compared to 146.9 points in 2016, up 3.2%. Similarly, Dairy Price Index averaged 202.2 points in 2017 in comparison with 153.8 points in 2016, up 31.5%. The continuous supply of raw materials could be affected by adverse weather conditions, national emergencies, strikes, governmental controls, natural disasters, supply shortages or any other unexpected events. PepsiCo uses various agriculture related products in the production of carbonated and non-carbonated beverages. It also uses aspartame, cocoa, corn, corn sweeteners, flavorings, flour, grapefruits and other fruits, juice and juice concentrates oats, oranges, potatoes, rice, seasonings, sucralose, sugar, vegetable and essential oils, and wheat. Fluctuations in the prices of raw materials could increase product costs and affect the operations of the company.

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