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July 12, 2018 | www.btnresearch.com

# PepsiCo (PEP) EQ Update- 6/18 Quarter

| Current EQ Rating* | Previous EQ Rating |
|---|---|
| 4- | NA |

*For an explanation of the *EQ Review Rating* scale, please refer to the end of this report

**We initiate coverage of PepsiCo (PEP) with an EQ Rating of 4- (Acceptable).**

We note the following observations regarding PEP's 6/18 quarterly earnings. We saw no material erosion in the company's earnings quality during the quarter.

- PEP recorded a $144 million ($0.09 per share) gain from the refranchising of its Thai bottling operations during the quarter. However, following its recent practice, PEP did not exclude the gain from its adjusted "core earnings" figure. PEP reported $1.61 in core EPS, $0.10 ahead of the Zack's consensus estimate. Almost all the upside came from the non-operational gain.

- The company does not disclose accounts payable on a quarterly basis, but rather lumps it in with other accrued expense items such as accrued marketing, accrued dividend payable and accrued marketplace spending in the "accounts payable and other current liabilities" account. On a days-of-cost-of-sales basis, this account jumped by almost 5 days over the year-ago quarter which may be an indication that PEP is continuing to stretch payables on its suppliers.

- PEP took another $32 million in restructuring charges in the quarter related to its 2014 plan. As of the end of the second quarter, the company expects the plan to be wrapped up by the end of the year.

# Explanation of EQ Review Rating Scale

| | |
|---|---|
| 6- "Exceptionally Strong" | Indicates uncommonly conservative accounting policies to the point that revenue and earnings are essentially understated relative to the company's peers. Higher possibility of reporting positive earnings surprises |
| 5- "Strong" | Indicates the company has no areas of concern with its reported results and we see very little risk of the company disappointing due to recent results being overstated from aggressive reporting in recent periods. |
| 4- "Acceptable" | Indicates the company may have exhibited a minor "red flag", but the severity of the issue is not yet a concern. Minimal risk of an earnings disappointment resulting from previous earnings or cash flow overstatement |
| 3- "Minor Concern" | Indicates the company has exhibited either a larger number of or more serious warning signs than companies receiving a 4. The likelihood of an immediate earnings or cash flow disappointment is not considered to be high, but the signs mentioned deserve a higher degree of attention in the future. |
| 2- "Weak" | Indicates the company's recent reported results have benefitted materially from aggressive accounting. Follow up work should be performed to determine the nature and extent of the problem as there is a possibility that upcoming results could disappoint as the impact of unsustainable benefits disappears |
| 1- "Strong Concerns" | Indicates that the company's recent results are significantly overstated and that we view a disappointment in upcoming quarters is highly likely. |

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