



PepsiCo's Chairman and CEO Indra Nooyi feels that the board's action reflects continued confidence in the growth of PepsiCo's business and its commitment to providing strong cash returns to its shareholders

PEPSICO: SHARE BUYBACK

Sweeter away from sugar

PepsiCo is slowly but surely making some of the biggest ever changes in its financial and corporate strategy. But will the move really pay off in the long run? Questions ANCHAL GUPTA

With hoards of political and economic lobbies attributing the sugar price debacle to a nefarious nexus between politicians, sugar producers and big MNCs, the barrage of criticism accused food & beverage companies of massive sugar hoarding and beverage giant PepsiCo was included in the tainted list. But, it wasn't the first time in its 112 year history that the company was involved in kickboxing bouts with sugar prices.

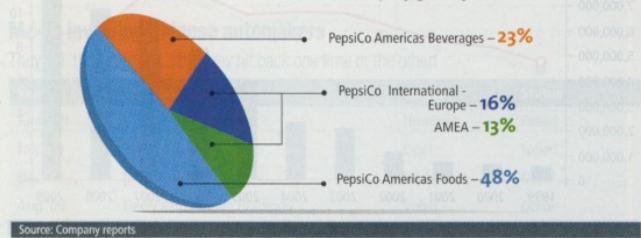
Immediately post World War I, sugar prices scaled stratospheric highs of 28 cents per pound, more than nine times the 3 cent per pound level during the pre war days. Severe uncertainty regarding supply and massive demand led Caleb Bradham, founder owner of PepsiCo to buy tonnes of sugar at the same high price (*Pepsi Cola was the sole product of the company known for its sweetness*). But,

by 1923, sugar prices crashed, thanks to bumper production and return to normalcy in demand. PepsiCo went bankrupt and Bradham sold it to Craven Holding Company for \$35,000. It was a boon in disguise. Since then, the company has withstood every blow and stood

tall as the sole rival to Coca Cola, the world leader in beverages. But, to avoid tracing the path of 'Big Tobacco' especially with obesity becoming the single biggest health threat in US in recent times, PepsiCo is slowly but surely making the biggest ever changes in its finan-

PepsiCo's revenue breakup by geography and business units

Foods form over 50% of the total revenues for the company globally with 48% from US alone



BUSINESS & ECONOMY



(Above): This 27-acre site at Plano, an affluent northern suburb of Dallas, Texas is the home of PepsiCo's Information Technology Division and the Frito-Lay international management team. This modern 284,000 square feet building houses 1,100 employees

cial and corporate strategy. The recent declaration to buy back \$15 billion worth of its shares from market by 2013 and a 7% dividend increase is only a quadrant of the new pie being baked.

Regarding the dynamics of the share buyback *vis-à-vis* the dividend, PepsiCo had 1.58 billion diluted shares outstanding at the end of 2009. But, the recently completed merger with two of its biggest bottlers will add around 61 million shares, making the new total to 1.64 billion outstanding. If the number of shares outstanding and the annual dividend (considering the 7% increase) were to remain the same for the next three years, PepsiCo would pay out \$3.15 billion annually to shareholders. However, if we put the share buyback into the next three years picture, things tend to vary a bit.

PepsiCo's stock gave an annualised return of 12% over the period 2005-2009. Considering a similar return till 2013, the average share price of PepsiCo over the next three years stands at around \$78. Dividing \$15 billion by \$78 gives an esti-

mated number of shares repurchased at around 190 million. Now, if the company pays the dividend for 190 million shares less even with a 7% increase, it might actually end up paying around \$350 million less in dividend in 2013 to that what it paid in 2009.

In fact, it is not the first time that PepsiCo has gone for a buyback. Between 2006 and 2008 (no repurchases in 2009), it bought back 181 million of its shares at an average price of \$66.41. Regarding the share buyback, Indra Nooyi stated (in a press release), "From 2005 to 2009, we distributed over \$26 billion to our shareholders through dividends & buybacks. The Board's action reflects continued confidence in the growth of our business and our commitment to providing strong cash returns to our shareholders."

With regards to corporate strategy, PepsiCo's changing portfolio with its host of "good for you" products to date accounts for \$10 billion in revenues, nearly one sixth of the total global revenues.

The company estimates the figure to grow to \$30 billion within 10 years. The firm has hired a battalion of experts on health and nutrition in its research and development business to drive innovation and portray credibility to its claim that it is application of solid science to create better products for its customers. In fact, its re-

PEPSICO'S SHARE BUYBACK

Coca Cola vs. PepsiCo's share price*

Prices of the two have trailed each other closely but PepsiCo took over Coca Cola only recently



cent acquisition – Quaker Oats (PepsiCo initially aimed at acquiring Gatorade, the iconic sports drink brand also owned by Quaker Oats), now happens to be a critical part of its product portfolio and has certainly gelled in well with PepsiCo's plans to become a healthy food maker.

Another move to hit home the message, especially with shareholders, has been PepsiCo's decision last year to acquire two of its independent bottling firms. The deal earlier received lukewarm reception, courtesy Coca-Cola which had always insisted that keeping syrup-making and bottling separate was the right business strategy. Ironically, Coca-Cola has taken Pepsi's line and recently acquired its main bottler.

The core objective behind the move is that it will bring greater control over an ever expanding and complex drinks portfolio, while simultaneously initiating cross-marketing between the food and drink divisions. Eventually, the company would be saved the hassles and costs associated with negotiating a division of the spoils for every big deal and can also set the conditions for joint promotion of products with other companies during events like the Super Bowl.

Whether the moves are to prevent going the way Big Tobacco went or to morph into the world's biggest foods and beverages conglomerate, PepsiCo's recent steps are all in the right direction. Hope the move away from sugar turns out to be much sweeter for all. **B+E**