

90504

Date	Activity	Number of Shares	Price	Held to maturity	Available for sale	Trading	Equity
2007							
05-Jan-07	Purchased	120,000	\$32.00	3,840,000	3,840,000	3,840,000	3,840,000
	Earnings for equity method	120,000	x \$0.50				60,000
	Dividends for equity method	120,000	x (\$0.20)				(24,000)
	Unrealized gain	120,000	x [\$31.00 - \$32.00]		(120,000)	(120,000)	
<u>A</u> 31-Dec-07	Carrying value	120,000	\$32.00 <<Plug	3,840,000	3,720,000	3,720,000	3,876,000
		120,000	\$31.00 <<Plug				
		120,000	\$32.30 <<Plug				
<u>B</u> 31-Dec-08	Other Comprehensive income				(120,000)		
<u>C</u>				3,840,000	3,840,000	3,720,000	3,876,000
	Earnings for equity method	120,000	x \$0.50				60,000
	Dividends	120,000	x \$0.20	24,000	24,000	24,000	
	Unrealized gain	120,000	x [\$31.00 - \$32.00]			(120,000)	
<u>D</u> 2007	Investment Income			24,000	24,000	(96,000)	60,000
2008							
17-Jan-08	Sold	(25,000)	x \$30.00	(750,000)	(750,000)	(750,000)	(750,000)
<u>E</u> 31-Dec-08	Realized gain	25,000	x [\$30.00 - \$32.00]	(50,000)	(50,000)	<u>F</u>	
<u>G</u>		25,000	x [\$30.00 - \$31.00]			(25,000)	<u>G</u>
		25,000	x [\$30.00 - \$32.30]				(57,500)
	Earnings for equity method	95,000	x \$0.60				57,000
	Dividends for equity method	95,000	x (\$0.20)				(19,000)
	Unrealized gain	95,000	x [\$28.00 - \$31.00]		(285,000)	(285,000)	
	Other Comprehensive income				25,000	<u>F-G</u>	
<u>H</u> 31-Dec-08	Carrying value	95,000		3,040,000	2,660,000	2,660,000	3,106,500
<u>I</u>	Other Comprehensive income				(380,000)		
<u>J</u>				3,040,000	3,040,000	2,660,000	3,106,500
	Earnings for equity method	95,000	x \$0.60				57,000
	Dividends	95,000	x \$0.20	19,000	19,000	19,000	
	Realized gain		From <u>F</u>	<u>F</u> (\$50,000)	(50,000)	(25,000)	(57,500)
	Unrealized gain	95,000	x [\$28.00 - \$31.00]			(285,000)	
<u>K</u> 2008	Investment Income			(31,000)	(31,000)	(291,000)	(500)
	<u>J-K-D</u>			3,047,000	3,047,000	3,047,000	3,047,000

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The income statement numbers should be for the last four quarters.

So after the third quarter 2006, last four quarter results can be obtained from:

	First Nine Months 2006	+	Twelve months 2005	-	First Nine Months 2005	=	Twelve months ending 09/30/06
Total sales and revenues	119,805	+	177,089	-	130,571	=	166,323
Income/(loss) before income taxes	(9,363)	+	1,996	-	1,337	=	(8,704)
Interest expense	6,330	+	7,643	-	6,287	=	7,686
Earnings Before Interest and Taxes	(3,033)	+	9,639	-	7,624	=	(1,018)

	09/30/06	12/31/05	Coefficient
Total Current Assets	92,644	89,865	
Total Current Liabilities	55,223	59,247	
Working capital	37,421	30,618	
Total Assets	267,465	269,459	
Working capital / Total assets	0.1399	0.1136	1.2
Retained Earnings	5,608	13,064	
Total Assets	267,465	269,459	
Retained Earnings / Total assets	0.0210	0.0485	1.4
Income/(loss) before income taxes	(8,704)	1,996	
Interest Expense	7,686	7,643	
EBIT	(1,018)	9,639	
EBIT / Total assets	(0.0038)	0.0358	3.3
Stock price	\$ 8.00	\$ 7.90	
Average number of shares of Common Stock, billiions	1,846.00	1,846.00	
Market value of equity	14,768	14,583	
Debt - Due In One Year	978	977	
Long-Term Debt - Total	153,432	152,301	
Total debt	154,410	153,278	
Market value of equity / Book value of debt	0.096	0.095	0.6
Sales	166,323	177,089	
Sales / Total assets	0.622	0.657	1.0
Working capital / Total assets	0.168	0.136	
Retained Earnings / Total assets	0.029	0.068	
EBIT / Total assets	(0.013)	0.118	
Market value of equity / Book value of debt	0.057	0.057	
Sales / Total assets	0.622	0.657	
Z score	0.864	1.037	
	09/30/06	12/31/05	

As the Z-score is less than 2.90, the probability of bankruptcy is high. But the Z-score is going down

and the company should be under watch.

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The Z-score has changed mainly due to the ROA.

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EBIT	(1,018)	9,639
Interest Expense	7,686	7,643
EBIT interest coverage	(0.132)	1.261
Predicted rating	Junk	B+

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Cut dividends.

Increase margins and profitability.

1a	Current ratio.	Total Current Assets	6,513		81201	
		÷ Total Current Liabilities	6,052	÷		= 1.076
b	Debt to equity.	Short-term obligations	562			
		Long-Term Debt Obligations	2,187			
		Total debt	2,749			
		÷ Total Common Shareholders' Equity	9,298	÷		= 0.296
c	Operating income to sales.	Income before Income Taxes	4,730			
		÷ Net Sales	25,112	÷		= 18.84%
d	Return on assets (After tax).	Income before Income Taxes	4,868			
		Interest expense	178			
		EBIT	5,046			
	Tax rate	1,555	÷ 4,868	=	31.94%	
		EBIT	x (1 - tax rate)			
		5,046	x(100.00% - 31.94%)	=	3,434	
		Net Income + Interest expense	x (1 - tax rate)			
		3,313 + 178	x(100.00% - 31.94%)	=	3,434	
			EBIT ÷ Total Assets			
			3,434 ÷ 23,474	=	14.63%	
e	Times interest Earned	EBIT ÷ Interest expense				
		5,046 ÷ 178				= 28.348
f	Return on Equity	Net Income ÷ Common Shareholders' Equity				
		3,313 ÷ 9,298				= 35.63%

2	PBG	Equity	=	Total assets - Liabilities		
				10,027 - 8,203	=	1,824 Note 8
		Pepsico's share of PBG equity		42.00% x 1,824	=	766
		Pepsico's reported value of PBG holding				884 Note 8
<u>B</u>		Excess valuation		884 - 766	=	118
<u>C</u>		Minority interest in PBG		1,824 - 766	=	1,058
<u>D</u>		Pepsico's share of PBG net income		42.00% x 428	=	180
<u>E</u>		Minority interest net income for PBG		428 - 180	=	248
<u>F</u>		Interest rate =	178 ÷ 2,749	=	6.48%	

Consolidated Balance Sheet		Pepsico	PBG	Adjust-ments	Consoli-dated
<u>G</u>	Current assets	6,513	1,737	(126) <u>G</u> (122) <u>G</u>	8,002
	Noncurrent assets		8,290		8,290
	Property, Plant and Equipment, net	7,290			7,290
	Amortizable Intangible Assets, net	801		118 <u>B</u>	919
	Nonamortizable Intangible Assets	4,418			4,418
	Investments in Noncontrolled Affiliates	2,611		(884)	1,727
	Other Assets	1,841			1,841
	Total assets	23,474	10,027	(1,014)	32,487
	Current liabilities	6,052	1,248	(126) <u>G</u> (122) <u>G</u>	7,052
<u>H</u>	Long-Term Debt Obligations	2,187	6,607 <u>H</u>		8,794
	Other Liabilities	4,226			4,226
	Deferred Income Taxes	1,718			1,718
	Minority interest		348	1,058 <u>C</u>	1,406
	Preferred Stock, no par value	41			41
	Repurchased Preferred Stock	(48)			(48)
	Total Common Shareholders' Equity	9,298	1,824	(1,824)	9,298
		23,474	10,027	(1,014)	32,487
Income Statement		Pepsico	PBG	Adjust-ments	Consoli-dated
	Net sales	25,112	9,216	(3,455) <u>G</u> (83) <u>G</u>	30,790
<u>I</u>	Cost of sales	11,497	5,001 <u>I</u>	(3,455) <u>G</u>	13,043
	Gross profit	13,615	4,215	(83)	17,747
<u>J</u>	Selling, general and administrative expenses:	8,523	3,317 <u>J</u>	(83)	11,757
	Amortization of intangible assets	138			138
	Merger-related costs	224			224
	Operating profit	4,730	898	-	5,628
	Equity income	280		(180) <u>D</u>	100
	Interest income	36			36
	Minority income			(248) <u>E</u>	(248)
	Earnings before interest and taxes	5,046	898	(428)	5,516
<u>K</u>	Interest expense	178	428 <u>K</u>		606
	Earnings before taxes	4,868	470	(428)	4,910
	Provision for Income Taxes	1,555	42		1,597
	Net income	3,313	428	(428)	3,313

G from note 8 Related Party Transactions.

H Assume that all noncurrent liabilities of PBG is debt.

I 5,001 = 9,216 - 4,215 Plug

J 3,317 = 4,215 - 898 Plug

K Implicit Interest Expense 6.48% x 6,607 = 428

E x H

Interest rate x Long-Term Debt Obligations

3 and 4

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Consolidated Pepsi

a Current ratio. $\frac{\text{Total Current Assets}}{\div \text{Total Current Liabilities}} = \frac{8,002}{7,052} = \mathbf{1.135}$ 1.076

Ratio improves as PBG has better current ratio.

b Debt to equity.

Short-term obligations	562			
Long-Term Debt Obligations	8,794			
Total debt	9,356			
\div Total Common Shareholders' Equity	\div 9,298	$=$	$\mathbf{1.006}$	0.296

Worsens a lot as Pepsico is able to move debt off-balance sheet. We may also be counting a higher value for PBG's debt as not all noncurrent liabilities are debt.

c Operating income to sales.

Income before Income Taxes	5,628			
\div Net Sales	\div 30,790	$=$	$\mathbf{18.28\%}$	18.84%

Does not worsen much as PBG also has high profit margins.

d Return on assets (After tax).

Tax rate	1,597	\div 4,910	$=$	32.53%
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	EBIT		$\times (1 - \text{tax rate})$	
	5,516	$\times ($	1 - 32.53%	$) = 3,722$
Net Income + Interest expense	3,313 + 606	$\times ($	1 - 32.53%	$) = 3,722$

	EBIT \div Total Assets			
	3,722 \div 32,487	$=$	$\mathbf{11.46\%}$	14.63%

Worsens a lot as PBG has lot of assets but low ROA.

e Times interest Earned $\frac{\text{EBIT} \div \text{Interest expense}}{5,516 \div 606} = \mathbf{9.105}$ 28.348

Worsens as PBG has lot of debt.

f Return on Equity **SAME**

5 Long-Term Contractual Commitments and Off-Balance Sheet Arrangements

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Long-Term Contractual Commitments and Off-Balance Sheet Arrangements will make the risk of Pepsico more

	as reported	Note 9 Off-balance sheet	Revised	
Total Current Assets	8,002	773	8,775	
Total Current Liabilities	7,052	1,034	8,086	
Current ratio	1.135		1.085	WORSE
Total debt	9,356	5,302 $\underline{\quad}$	14,658	
Total Common Shareholders' Equity	9,298		9,298	
Debt to equity.	1.0062		1.5765	BAD
$\underline{\quad}$	6,336 - 1,034 =	5,302	Note 9	

Off-Balance Sheet Arrangements

Pepsico seems to guarantee \$2.3 billion of Bottling Group, LLC's long-term debt through 2012.

This is less than what we assumed in the consolidated statement 6,607

So if we had done proportional consolidation, we would have avoided this.