Seed Weekly

How PepsiCo Delivered Inflation Beating Returns

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All businesses must manage a range of input costs. Right now, these ingredients (from labour to raw materials and cost of capital) are costing a lot more. This is squeezing both margins and the customer, and generally leaving less of the pie for investors.

Central banks are now intent on taming this inflation beast even though they are one of the root causes. Trying to bring it under control, they use a blunt but effective tool – "**raise interest rates until it starts to hurt**".

While more fragile businesses will be hit hard, this environment offers greater opportunity for stronger, less indebted businesses with enduring brands. Not only will these businesses navigate the more treacherous times, but many can pass on their cost pressures, providing a **"natural" hedge** to patient investors.

Fund manager Lindsell Train highlighted one such business – PepsiCo.

The statistics make for interesting reading for this company that owns 23 brands, each generating over $1bn in annual sales.

PepsiCo, in its current form, came about from a 1965 merger of the Pepsi-Cola Company and Frito-Lay. Inflation in the US has averaged 3.9% p.a. since 1965. Over the same period PepsiCo managed to increase the price of their cans by an average of 5.6% p.a. Besides this organic (price increase) growth, it also grew its business through increased distribution and acquisitions – from a $510m turnover to $79 billion in 2021.

The resulting margin expansion allowed profits to grow at 9.8% p.a. All these doing wonders for long term investors.

Valuations of businesses as measured by their prices, however, do not move up in a straight line. Investor patience is required. Fortunately, our two quality fund managers have this in bucketloads as they continue to maintain a relatively high allocation to this long-term compounder.

Kind regards,

Ian De Lange *SA(SA)*
Chief Investment Officer

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