



The Coca-Cola Company (KO)

Updated April 2nd, 2018 by Josh Arnold

Key Metrics

Current Price: \$43	5 Year CAGR Estimate: 7.9%	Quality Percentile: N/A
Fair Value Price: \$38	5 Year Growth Estimate: 6.7%	Momentum Percentile: N/A
% Fair Value: 113%	5 Year Valuation Multiple Estimate: -2.4%	Total Return Percentile: N/A
Dividend Yield: 3.6%	5 Year Price Target \$52	Valuation Percentile: N/A

Overview & Current Events

Coca-Cola is the world's largest beverage company. It owns or licenses more than 500 unique non-alcoholic brands. Since the company's founding in 1886, it has spread to more than 200 countries worldwide. It currently has a market cap of \$185B and its brands account for more than 1.9B servings of beverages worldwide every day.

Total revenue declined 15% in 2017 but that was due to a 17% headwind from the company's refranchising of bottling operations. Pricing provided a 2% tailwind to revenue while volume was flat. Comparable operating margins grew 350bps in 2017 due to the bottling refranchising and ongoing productivity efforts. Reported earnings included a \$3.6B one-time net charge due to tax reform, but excluding this, EPS was up 28% in 2017.

Growth on a Per-Share Basis

Year	2008	2009	2010	2011	2012	2013	2014	2015	2016	2017	2018	2023
EPS	\$1.25	\$1.46	\$2.53 ¹	\$1.85	\$1.97	\$1.90	\$1.60	\$1.67	\$1.49	\$1.91	\$2.10	\$2.90
DPS	\$0.76	\$0.82	\$0.88	\$0.94	\$1.02	\$1.12	\$1.22	\$1.32	\$1.40	\$1.48	\$1.56	\$1.96

Coca-Cola has experienced some years of stagnation in earnings-per-share. EPS declined from \$1.97 in 2012 and hasn't yet reclaimed that high five years later. However, now that the bulk of revenue declines have been absorbed from the refranchising initiative, Coca-Cola's earnings growth should pick up materially beginning in 2018.

This year's results will be aided by a lower tax rate so EPS growth should be closer to 10% but moving forward, we are forecasting 6.7% annually. Volume has been improving and pricing has remained strong, which should mean low single digit revenue growth. In addition, job cuts and other productivity measures produced very strong margin growth in 2017 and that will continue in 2018 and beyond. Finally, Coca-Cola remains committed to buying back its own stock and all of this combined should produce 6.7% annual EPS growth moving forward, with 2018 higher because of tax reform.

Valuation Analysis

Year	2008	2009	2010 ¹	2011	2012	2013	2014	2015	2016	2017	Now	2023
Avg. P/E	15.4	14.6	10.7	11.7	16.6	18.2	21.0	23.1	25.7	23.0	20.3	18.0
Avg. Yld.	2.7%	3.3%	3.0%	2.7%	2.7%	2.7%	2.9%	3.2%	3.1%	3.2%	3.6%	3.8%

Coca-Cola's adjusted EPS for 2017 was \$1.91 after excluding the one-time tax reform charge. That puts the price-to-earnings ratio using 2017 earnings at 20.3, which is slightly above where it has been at in the past decade. The company's earnings multiple has risen significantly since the Great Recession. The increase in the multiple has been largely due to record-low interest rates around the globe; when this occurs, dividend growth stocks like Coca-Cola tend to see the value of their dividend rise relative to the risk-free rate.

With interest rates now firmly on the rise, Coca-Cola's earnings multiple has come off of the highs set in 2016. We expect that as earnings-per-share growth stabilizes and as rates continue to rise that the company's earnings multiple will decline slightly in the coming years. Earnings growth – powered by higher margins – should provide the bulk of total returns going forward and more than overcome the small headwind from the lower earnings multiple. In addition, Coca-Cola's dividend yield is currently at 3.6% and the payout rises each year, offering a meaningful boost to total returns. In

¹ Large one-time gain due to sale of Norwegian and Swedish bottling operations.

total, we expect to see total returns of 7.9% annually when earnings growth, share repurchases, the dividend and multiple revaluation are taken into account.

Safety, Quality, Competitive Advantage, & Recession Resiliency

Year	2008	2009	2010	2011	2012	2013	2014	2015	2016	2017	2018	2023
GP/A	64.4%	64.2%	63.9%	60.9%	60.3%	60.7%	61.1%	60.5%	60.7%	62.6%	63.0%	64.5%
Int. Cov.	13.3	19.2	16.1	20.7	22.9	18.6	14.7	8.6	8.9	10.4	10.9	12.0
Payout	61%	56%	35%	51%	52%	59%	76%	79%	94%	77%	74%	68%
Std. Dev.	36.1%	22.8%	15.4%	17.7%	13.1%	15.7%	15.1%	14.5%	14.3%	9.1%	12%	14%
Debt/A	49%	49%	57%	60%	62%	63%	67%	72%	74%	81%	80%	75%

Coca-Cola has experienced some deterioration in its quality metrics in recent years. Interest coverage and debt-to-asset ratio have declined, owed to taking on debt to fund share repurchases and other needs. The payout ratio has also moved higher as the company's earnings stagnated for several years while the dividend continued to increase.

These quality metrics should improve beginning in 2018 as tax reform will allow for a higher level of earnings and repatriation of overseas cash will afford Coca-Cola the opportunity to reduce debt. Earnings growth should exceed dividend growth, allowing the payout ratio to come back down to more normalized levels.

Coca-Cola's competitive advantages include its unparalleled suite of beverage brands as well as its efficient global distribution network. Coca-Cola is also extremely resistant to recessionary environments, having increased its earnings-per-share during and after the financial crisis.

Final Thoughts & Recommendation

Coca-Cola's expected total returns are in the high-single digits, driven mostly by projected earnings growth and an ample dividend. The deterioration of its quality metrics should be a thing of the past as several factors look to improve the company's financial position. Continued margin expansion is key to earnings growth and the company is well on its way on that front. Our estimates of 6.7% earnings growth and a 2.4% annualized valuation headwind combined with the company's 3.6% dividend yield give expected total returns of 7.9% per year over the next five years. Coca-Cola should work for investors that are seeking a recession-resistant, high-yielding consumer staple.

Total Return Breakdown by Year

