



The Coca-Cola Company (KO)

Updated August 4th, 2018 by Josh Arnold

Key Metrics

Current Price: \$47	5 Year CAGR Estimate: 6.1%	Volatility Percentile: 0.5%
Fair Value Price: \$38	5 Year Growth Estimate: 6.7%	Momentum Percentile: 36.7%
% Fair Value: 123%	5 Year Valuation Multiple Estimate: -3.9%	Valuation Percentile: 27.4%
Dividend Yield: 3.3%	5 Year Price Target \$52	Total Return Percentile: 38.1%

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 capitalization of \$198 billion and its brands account for more than 1.9 billion servings of beverages worldwide every day. Coca-Cola reported Q2 earnings on 7/25/18 and results were very strong. Organic revenue was up 5% as the company saw 2% unit case volume and a similar gain from pricing and mix. Growth was led by the flagship Coca-Cola brand, helping the sparkling beverage category to produce a 2% volume increase, supplemented by a 4% gain in the water/sports drink category. Comparable operating margins rose 300bps as well as Coca-Cola continues to work through the divestitures of its bottling operations, in addition to its cost-saving measures. Guidance was reiterated at 8% to 10% earnings-per-share expansion for this year, so our estimate is unchanged after the very nice Q2 report.

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, which declined from \$1.97 in 2012 and have not 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 earnings-per-share growth should be closer to 10%, per guidance, 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 this is continuing 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 earnings-per-share growth moving forward, with 2018 higher because of tax reform. Coca-Cola's efforts to boost organic revenue and profitability are working well.

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	22.2	18.0
Avg. Yld.	2.7%	3.3%	3.0%	2.7%	2.7%	2.7%	2.9%	3.2%	3.1%	3.2%	3.3%	3.8%

Coca-Cola's price-to-earnings ratio has been rather volatile in the past decade and today, it stands at 22.0. This compares unfavorably to what we see as fair value at 18 times earnings, implying a 3.9% annualized headwind to total returns moving forward as the valuation normalizes.

In addition, Coca-Cola's dividend yield is currently at 3.3% and the payout rises each year, offering a meaningful boost to total returns. We see the dividend rising more quickly than the stock price – partly because we forecast a slightly lower valuation in the coming years – so the yield should move up gradually over time to 3.8% from today's 3.3%.

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

Disclosure: This analyst has no position in the security discussed in this research report, and no plans to initiate one in the next 72 hours.

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	11.0	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. Its 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.

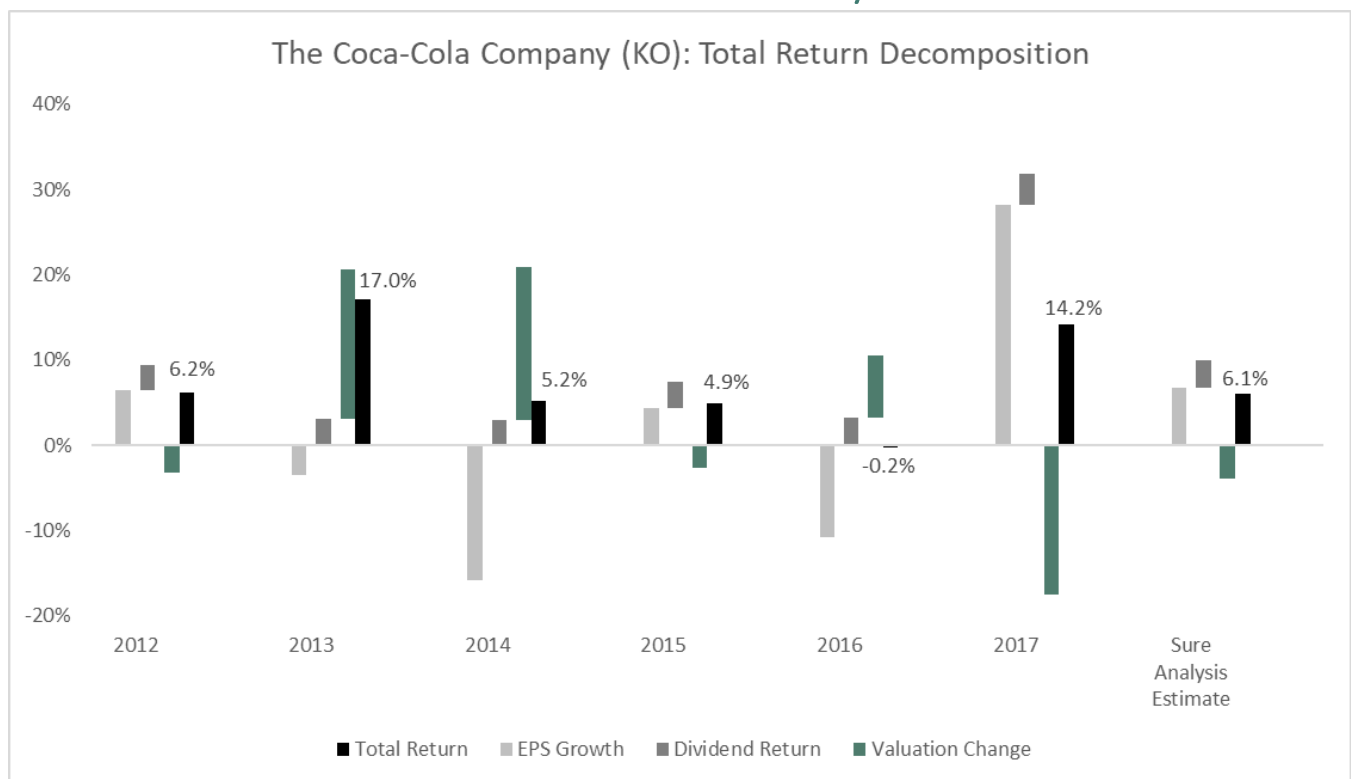
These quality metrics should improve for the rest of 2018 as tax reform will allow for a higher level of earnings and repatriation of overseas cash will afford Coca-Cola the opportunity to reduce debt. Earnings growth should slightly exceed dividend growth, allowing the payout ratio to come back down 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 mid-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 3.9% annualized valuation headwind combined with the company's 3.3% dividend yield give expected total returns of 6.1% per year over the next five years. Coca-Cola should work for investors that are seeking a recession-resistant, high-yielding consumer staple, but shares are trading well in excess of fair value today. Thus, we rate Coca-Cola a hold and suggest investors wait for a better entry price.

Total Return Breakdown by Year



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