



# The Coca-Cola Company (KO)

Updated November 1<sup>st</sup>, 2018 by Josh Arnold

## Key Metrics

|                             |      |  |       |                                 |       |
|-----------------------------|------|--|-------|---------------------------------|-------|
| <b>Current Price:</b>       | \$48 | <b>5 Year CAGR Estimate:</b>               | 5.4%  | <b>Volatility Percentile:</b>   | 0.4%  |
| <b>Fair Value Price:</b>    | \$38 | <b>5 Year Growth Estimate:</b>             | 6.7%  | <b>Momentum Percentile:</b>     | 62.0% |
| <b>% Fair Value:</b>        | 127% | <b>5 Year Valuation Multiple Estimate:</b> | -4.6% | <b>Growth Percentile:</b>       | 60.6% |
| <b>Dividend Yield:</b>      | 3.3% | <b>5 Year Price Target</b>                 | \$52  | <b>Valuation Percentile:</b>    | 16.6% |
| <b>Dividend Risk Score:</b> | A    | <b>Retirement Suitability Score:</b>       | A     | <b>Total Return Percentile:</b> | 23.1% |

## 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 \$204 billion and its brands account for more than 1.9 billion servings of beverages worldwide every day. Coca-Cola reported Q3 earnings on 10/30/18 and results beat expectations. Organic revenue grew 6% on growth in non-core brands like Fuze and smartwater as Coca-Cola's constant focus on product diversification is paying off. Latin America led the way with 19% growth while the bottling business was up 10% as well. Total volume was up 2% while operating margin increased a staggering 575bps as the company's productivity efforts continue to pay dividends. Management reiterated guidance. We are reaffirming our earnings-per-share estimate at \$2.10 for 2018.

## Growth on a Per-Share Basis

| Year          | 2008   | 2009   | 2010                | 2011   | 2012   | 2013   | 2014   | 2015   | 2016   | 2017   | 2018          | 2023          |
|---------------|--------|--------|---------------------|--------|--------|--------|--------|--------|--------|--------|---------------|---------------|
| <b>EPS</b>    | \$1.25 | \$1.46 | \$2.53 <sup>1</sup> | \$1.85 | \$1.97 | \$1.90 | \$1.60 | \$1.67 | \$1.49 | \$1.91 | <b>\$2.10</b> | <b>\$2.90</b> |
| <b>DPS</b>    | \$0.76 | \$0.82 | \$0.88              | \$0.94 | \$1.02 | \$1.12 | \$1.22 | \$1.32 | \$1.40 | \$1.48 | <b>\$1.56</b> | <b>\$1.96</b> |
| <b>Shares</b> | 4,624  | 4,606  | 4,584               | 4,526  | 4,469  | 4,402  | 4,366  | 4,324  | 4,288  | 4,259  | <b>4,220</b>  | <b>4,000</b>  |

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 bottling refranchising initiative, Coca-Cola's earnings growth should pick up materially beginning this year.

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 should 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 earnings-per-share growth moving forward. To summarize, Coca-Cola's efforts to boost organic revenue and profitability are working well.

## Valuation Analysis

| Year             | 2008 | 2009 | 2010 | 2011 | 2012 | 2013 | 2014 | 2015 | 2016 | 2017 | Now         | 2023        |
|------------------|------|------|------|------|------|------|------|------|------|------|-------------|-------------|
| <b>Avg. P/E</b>  | 15.4 | 14.6 | 10.7 | 11.7 | 16.6 | 18.2 | 21.0 | 23.1 | 25.7 | 23.0 | <b>22.8</b> | <b>18.0</b> |
| <b>Avg. Yld.</b> | 2.7% | 3.3% | 3.0% | 2.7% | 2.7% | 2.7% | 2.9% | 3.2% | 3.1% | 3.2% | <b>3.3%</b> | <b>3.8%</b> |

Coca-Cola's price-to-earnings ratio has been rather volatile in the past decade and today, it stands at 22.8. This compares unfavorably to what we see as fair value at 18 times earnings, implying a 4.6% 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 so the yield should move up gradually over time to 3.8% from today's 3.3%.

<sup>1</sup> 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.



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## 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% | <b>63.0%</b> | <b>64.5%</b> |
| Int. Cov. | 13.3  | 19.2  | 16.1  | 20.7  | 22.9  | 18.6  | 14.7  | 8.6   | 8.9   | 10.4  | <b>11.0</b>  | <b>12.0</b>  |
| Payout    | 61%   | 56%   | 35%   | 51%   | 52%   | 59%   | 76%   | 79%   | 94%   | 77%   | <b>74%</b>   | <b>68%</b>   |
| Std. Dev. | 36.1% | 22.8% | 15.4% | 17.7% | 13.1% | 15.7% | 15.1% | 14.5% | 14.3% | 9.1%  | <b>12%</b>   | <b>14%</b>   |
| Debt/A    | 49%   | 49%   | 57%   | 60%   | 62%   | 63%   | 67%   | 72%   | 74%   | 81%   | <b>80%</b>   | <b>75%</b>   |

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

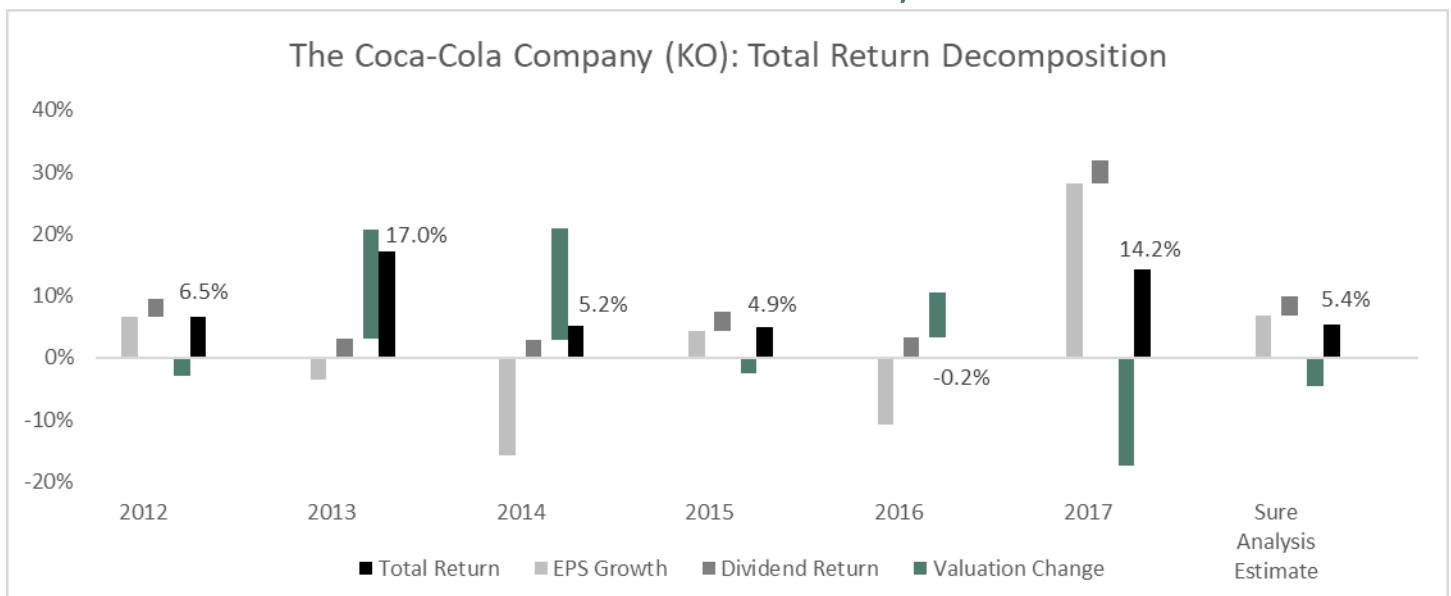
These quality metrics should improve for the rest of 2018 as tax reform will allow for a higher level of earnings and repatriation of overseas cash will afford Coca-Cola the opportunity to reduce debt. Earnings growth should slightly exceed dividend growth, allowing the payout ratio to come back down 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 concern 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 5.4% earnings growth and a 4.6% annualized valuation headwind combined with the company's 3.3% dividend yield give expected total returns of 5.4% 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 patient investors wait for a better entry price.

## Total Return Breakdown by Year



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