



# The Coca-Cola Company (KO)

Updated February 17<sup>th</sup>, 2019 by Josh Arnold

## Key Metrics

<b>Current Price:</b>	\$45	<b>5 Year CAGR Estimate:</b>	5.4%	<b>Volatility Percentile:</b>	1.2%
<b>Fair Value Price:</b>	\$37	<b>5 Year Growth Estimate:</b>	6.0%	<b>Momentum Percentile:</b>	55.7%
<b>% Fair Value:</b>	123%	<b>5 Year Valuation Multiple Estimate:</b>	-4.0%	<b>Growth Percentile:</b>	51.8%
<b>Dividend Yield:</b>	3.4%	<b>5 Year Price Target</b>	\$49	<b>Valuation Percentile:</b>	21.0%
<b>Dividend Risk Score:</b>	B	<b>Retirement Suitability Score:</b>	A	<b>Total Return Percentile:</b>	25.8%

## 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 \$193 billion and its brands account for about 2 billion servings of beverages worldwide every day.

Coca-Cola reported Q4 earnings on 2/14/19 and while results were strong in Q4, guidance for 2019 spooked investors. Total revenue declined 6% during the quarter, but that was due to currency headwinds as well as the company's bottler refranchising efforts. Coca-Cola has seen revenue decline for years at this point as it continues its bottler refranchising journey, but on an organic basis, revenue was up an impressive 5% in Q4. This was thanks to a 1% gain from concentrate sales and a 4% increase from more favorable price/mix. Volume was flat in Q4. While the flat volume number is not ideal and reflects the company's ongoing pressure on sparkling demand, Q4's organic revenue number beat our expectations.

Operating income was up a very strong 21% in Q4 thanks to the company's ongoing productivity efforts as well as higher margins from the divestitures of the company's bottling operations. Indeed, a material reason Coca-Cola is refranchising its bottlers is because that business has very low margins and does not fit the company's long-term goals. Fourth quarter earnings-per-share rose 9% on an adjusted basis and was negatively impacted by a 10% headwind from currency exchange. Coca-Cola's enormous non-US presence means it is particularly susceptible to currency movements, and it continues to impact results.

Management guided for organic revenue growth of 4% in 2019, but earnings-per-share that will be essentially flat to 2018. The company cited declining economic growth outlooks in certain parts of the world, currency swings, and rising transportation costs. As a result of this somewhat weak guidance, our initial estimate for 2019 earnings-per-share is \$2.05, which would represent a ~1% decline from 2018.

## Growth on a Per-Share Basis

Year	2009	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019	2024
<b>EPS</b>	\$1.46	\$2.53 <sup>1</sup>	\$1.85	\$1.97	\$1.90	\$1.60	\$1.67	\$1.49	\$1.91	\$2.08	<b>\$2.05</b>	<b>\$2.74</b>
<b>DPS</b>	\$0.82	\$0.88	\$0.94	\$1.02	\$1.12	\$1.22	\$1.32	\$1.40	\$1.48	\$1.56	<b>\$1.56</b>	<b>\$1.92</b>
<b>Shares</b>	4,606	4,584	4,526	4,469	4,402	4,366	4,324	4,288	4,259	4,250	<b>4,230</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 only reclaimed that high in 2018. However, now that the bulk of revenue declines have been absorbed from the bottling refranchising initiative, Coca-Cola's earnings growth should pick up in the coming years, 2019 notwithstanding.

Moving forward, we are forecasting 6% annual earnings-per-share growth. 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 2018, and we see this as a long-term tailwind. Finally, Coca-Cola remains committed to buying back its own stock and all of this combined should produce 6% annual earnings-per-

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

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share growth moving forward. We also see the dividend rising at roughly the rate of earnings, producing a payout near \$2 per share by 2024, up from the current \$1.56.

## Valuation Analysis

Year	2009	2010	2011	2012	2013	2014	2015	2016	2017	2018	Now	2024
Avg. P/E	14.6	10.7	11.7	16.6	18.2	21.0	23.1	25.7	23.0	21.8	22.1	18.0
Avg. Yld.	3.3%	3.0%	2.7%	2.7%	2.7%	2.9%	3.2%	3.1%	3.2%	3.4%	3.4%	3.9%

Coca-Cola's price-to-earnings ratio has been rather volatile in the past decade and today, it stands at 22.1. This compares unfavorably to what we see as fair value at 18 times earnings, implying a 4% annualized headwind to total returns moving forward if the valuation normalizes over a 5-year holding period. In addition, Coca-Cola's dividend yield is currently at 3.4% 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 3.9% from today's 3.4%.

## Safety, Quality, Competitive Advantage, & Recession Resiliency

Year	2009	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019	2024
Payout	56%	35%	51%	52%	59%	76%	79%	94%	77%	75%	76%	70%

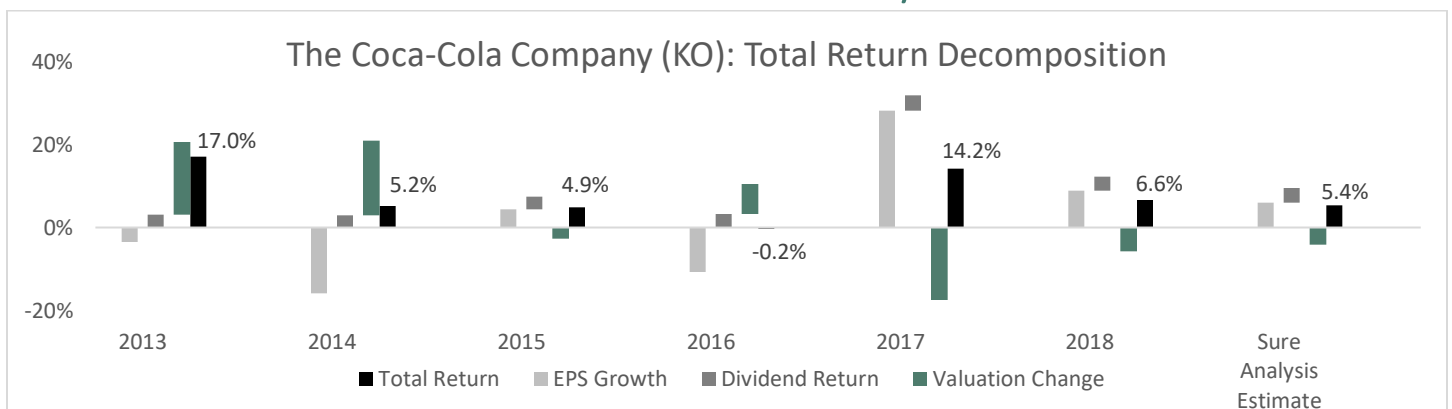
The payout ratio has been in the mid-70% range for the past few years and we believe it will remain around there or slightly lower in the coming years. Dividend growth will remain a priority for management and we see the payout as safe, with room to grow in the coming years.

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. Continued margin expansion is key to earnings growth and the company is well on its way on that front. Our estimates of 6% earnings growth and a 4% annualized valuation headwind combined with the company's 3.4% 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, Coca-Cola earns a hold recommendation from Sure Dividend at current prices. We suggest patient investors wait for a better entry price.

## Total Return Breakdown by Year



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## Income Statement Metrics

Year	2009	2010	2011	2012	2013	2014	2015	2016	2017	2018
<b>Revenue</b>	30990	35119	46542	48017	46854	45998	44294	41863	35410	31856
<b>Gross Profit</b>	19902	22426	28327	28964	28433	28109	26812	25398	22154	20086
<b>Gross Margin</b>	64.2%	63.9%	60.9%	60.3%	60.7%	61.1%	60.5%	60.7%	62.6%	63.1%
<b>SG&amp;A Exp.</b>	11358	13194	17422	17738	17310	17218	16427	15262	12496	10307
<b>D&amp;A Exp.</b>	1236	1443	1954	1982	1977	1976	1970	1787	1260	1086
<b>Operating Profit</b>	8231	8413	10173	10779	10228	9708	10240	9750	9427	8700
<b>Op. Margin</b>	26.6%	24.0%	21.9%	22.4%	21.8%	21.1%	23.1%	23.3%	26.6%	27.3%
<b>Net Profit</b>	6824	11787	8584	9019	8584	7098	7351	6527	1248	6434
<b>Net Margin</b>	22.0%	33.6%	18.4%	18.8%	18.3%	15.4%	16.6%	15.6%	3.5%	20.2%
<b>Free Cash Flow</b>	6193	7317	6554	7865	7992	8209	7975	6534	5431	6280
<b>Income Tax</b>	2040	2370	2812	2723	2851	2201	2239	1586	5560	1623

## Balance Sheet Metrics

Year	2009	2010	2011	2012	2013	2014	2015	2016	2017	2018
<b>Total Assets</b>	48671	72921	79974	86174	90055	92023	89996	87270	87896	83216
<b>Cash &amp; Equivalents</b>	7021	8517	12803	8442	10414	8958	7309	8555	6006	8926
<b>Acc. Receivable</b>	3758	4430	4920	4759	4873	4466	3941	3856	3667	3396
<b>Inventories</b>	2354	2650	3092	3264	3277	3100	2902	2675	2655	2766
<b>Goodwill &amp; Int.</b>	12828	26909	27669	27337	27611	26372	24132	21128	16636	17270
<b>Total Liabilities</b>	23325	41604	48053	53006	56615	61462	64232	64050	68919	64158
<b>Accounts Payable</b>	1410	1887	2172	1969	1933	2089	2795	2682	2288	8932
<b>Long-Term Debt</b>	11859	23417	28568	32610	37079	41745	44116	45709	47685	43555
<b>Total Equity</b>	24799	31003	31635	32790	33173	30320	25554	23062	17072	16981
<b>D/E Ratio</b>	0.48	0.76	0.90	0.99	1.12	1.38	1.73	1.98	2.79	2.56

## Profitability & Per Share Metrics

Year	2009	2010	2011	2012	2013	2014	2015	2016	2017	2018
<b>Return on Assets</b>	15.3%	19.4%	11.2%	10.9%	9.7%	7.8%	8.1%	7.4%	1.4%	7.5%
<b>Return on Equity</b>	30.1%	42.2%	27.4%	28.0%	26.0%	22.4%	26.3%	26.9%	6.2%	37.8%
<b>ROIC</b>	20.3%	25.6%	14.9%	14.3%	12.6%	9.9%	10.3%	9.4%	1.8%	10.0%
<b>Shares Out.</b>	4,606	4,584	4,526	4,469	4,402	4,366	4,324	4,288	4,259	4,250
<b>Revenue/Share</b>	6.65	7.53	10.02	10.47	10.39	10.34	10.06	9.59	8.19	7.41
<b>FCF/Share</b>	1.33	1.57	1.41	1.72	1.77	1.84	1.81	1.50	1.26	1.46

Note: All figures in millions of U.S. Dollars unless per share or indicated otherwise.

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