



The Coca-Cola Company (KO)

Updated February 19th, 2020 by Josh Arnold

Key Metrics

Current Price:	\$60	5 Year CAGR Estimate:	5.0%	Market Cap:	\$257B
Fair Value Price:	\$47	5 Year Growth Estimate:	7.0%	Ex-Dividend Date:	03/13/20 ¹
% Fair Value:	126%	5 Year Valuation Multiple Estimate:	-4.5%	Dividend Payment Date:	04/01/20 ²
Dividend Yield:	2.7%	5 Year Price Target	\$66	Years Of Dividend Growth:	57
Dividend Risk Score:	B	Retirement Suitability Score:	B	Last Dividend Increase:	2.6%

Overview & Current Events

Coca-Cola is the world's largest beverage company, as 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 \$257 billion and its brands account for about 2 billion servings of beverages worldwide every day, producing roughly \$39 billion in annual revenue.

Coca-Cola reported Q4 and full-year earnings on January 30th and results were better than expected on the top and bottom lines, along with strong guidance for 2020. Revenue grew 16% in Q4 to \$9.1 billion and 9% to \$37.3 billion for the year. Organic revenue was up 7% for the quarter and 6% for the year. Concentrate sales growth was up 2% and price-mix grew 5% for the quarter. For the year, concentrate growth was 1% and price/mix growth was 5%.

For Q4, operating margin was 24.8% for both the current and prior Q4 periods. For the year, operating margin was down from 28.8% to 27.9%. The company said underlying margin expansion was more than offset by headwinds from acquisitions and currency translation, the latter of which Coca-Cola has struggled with for years.

The company said cash flow from operations was up 37% year-over-year to \$10.5 billion, and full-year free cash flow was \$8.4 billion, up 38% year-over-year.

Earnings-per-share for the quarter rose 1% to \$0.44 and for the year, earnings-per-share increased 1% to \$2.11, which included an 8% currency headwind.

We see earnings-per-share rising to \$2.25 this year on higher revenue and continued margin improvement, but note that the US dollar continues to weigh on results as roughly 75% of the company's revenue is from outside the US.

Growth on a Per-Share Basis

Year	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019	2020	2025
EPS	\$2.53 ³	\$1.85	\$1.97	\$1.90	\$1.60	\$1.67	\$1.49	\$1.91	\$2.08	\$2.11	\$2.25	\$3.16
DPS	\$0.88	\$0.94	\$1.02	\$1.12	\$1.22	\$1.32	\$1.40	\$1.48	\$1.56	\$1.60	\$1.60	\$2.14
Shares⁴	4,584	4,526	4,469	4,402	4,366	4,324	4,288	4,259	4,250	4,314	4,350	4,500

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 7% annual earnings-per-share growth. Volume has been improving and pricing has remained strong, which could 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. All of this

¹ Estimated date

² Estimated date

³ Large one-time gain due to sale of Norwegian and Swedish bottling operations.

⁴ Share count in millions

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combined could produce 7% annual earnings-per-share growth moving forward. We also see the dividend rising at roughly the rate of earnings, producing a payout of \$2.14 per share by 2025, up from the current \$1.60.

Valuation Analysis

Year	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019	Now	2025
Avg. P/E	10.7	11.7	16.6	18.2	21.0	23.1	25.7	23.0	21.8	24.1	26.5	21.0
Avg. Yld.	3.0%	2.7%	2.7%	2.7%	2.9%	3.2%	3.1%	3.2%	3.4%	3.1%	2.7%	3.2%

Coca-Cola's price-to-earnings ratio has been rather volatile in the past decade and today, it stands at 26.5. This compares very unfavorably to what we see as fair value at 21 times earnings, implying a -4.5% annualized headwind to total returns moving forward if the valuation normalizes over a 5-year holding period. Meanwhile, Coca-Cola's dividend yield is currently 2.7% 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 could move up gradually over time to 3.2%.

Safety, Quality, Competitive Advantage, & Recession Resiliency

Year	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019	2020	2025
Payout	35%	51%	52%	59%	76%	79%	94%	77%	75%	76%	71%	68%

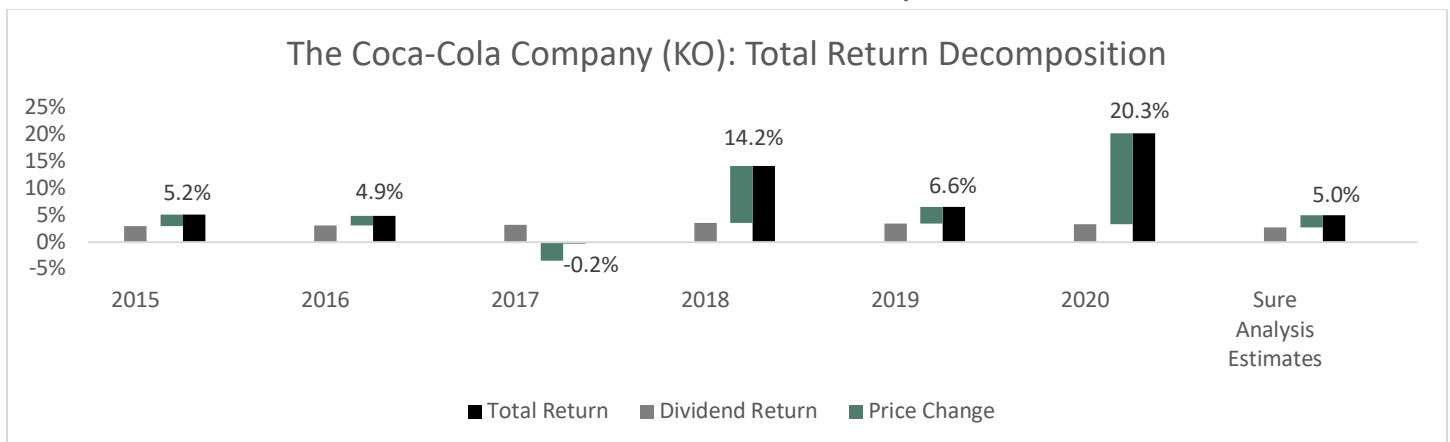
The payout ratio has been in the mid-70% range for the past few years and we believe it will remain around there in the coming years. Dividend growth will remain a priority for management and we see the payout as safe, with room to grow, particularly with improving free cash flow generation.

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 low single-digits, driven mostly by projected earnings growth and an ample dividend. Our estimates of 7% earnings growth and a -4.5% annualized valuation headwind, combined with the company's dividend yield give expected total returns of just 5% per year over the next five years. Coca-Cola could work for investors that are seeking a recession-resistant, higher-yielding consumer staple, but shares are trading well in excess of our estimate of fair value today. We're upgrading Coca-Cola from sell to hold on a slightly improved total return outlook.

Total Return Breakdown by Year



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Income Statement Metrics

Year	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019
Revenue	35119	46542	48017	46854	45998	44294	41863	35410	31856	37,266
Gross Profit	22426	28327	28964	28433	28109	26812	25398	22154	20086	22,647
Gross Margin	63.9%	60.9%	60.3%	60.7%	61.1%	60.5%	60.7%	62.6%	63.1%	60.8%
SG&A Exp.	13194	17422	17738	17310	17218	16427	15262	12496	10307	12,103
D&A Exp.	1443	1954	1982	1977	1976	1970	1787	1260	1086	1,365
Operating Profit	8413	10173	10779	10228	9708	10240	9750	9427	8700	10,086
Op. Margin	24.0%	21.9%	22.4%	21.8%	21.1%	23.1%	23.3%	26.6%	27.3%	27.1%
Net Profit	11787	8584	9019	8584	7098	7351	6527	1248	6434	8,920
Net Margin	33.6%	18.4%	18.8%	18.3%	15.4%	16.6%	15.6%	3.5%	20.2%	23.9%
Free Cash Flow	7317	6554	7865	7992	8209	7975	6534	5431	6280	8,417
Income Tax	2370	2812	2723	2851	2201	2239	1586	5560	1623	1,801

Balance Sheet Metrics

Year	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019
Total Assets	72921	79974	86174	90055	92023	89996	87270	87896	83216	86,381
Cash & Equivalents	8517	12803	8442	10414	8958	7309	8555	6006	8926	6,480
Acc. Receivable	4430	4920	4759	4873	4466	3941	3856	3667	3396	3,971
Inventories	2650	3092	3264	3277	3100	2902	2675	2655	2766	3,379
Goodwill & Int.	26909	27669	27337	27611	26372	24132	21128	16636	17270	26,766
Total Liabilities	41604	48053	53006	56615	61462	64232	64050	68919	64158	65,283
Accounts Payable	1887	2172	1969	1933	2089	2795	2682	2288	8932	11,312
Long-Term Debt	23417	28568	32610	37079	41745	44116	45709	47685	43555	42,763
Total Equity	31003	31635	32790	33173	30320	25554	23062	17072	16981	18,981
D/E Ratio	0.76	0.90	0.99	1.12	1.38	1.73	1.98	2.79	2.56	2.25

Profitability & Per Share Metrics

Year	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019
Return on Assets	19.4%	11.2%	10.9%	9.7%	7.8%	8.1%	7.4%	1.4%	7.5%	10.5%
Return on Equity	42.2%	27.4%	28.0%	26.0%	22.4%	26.3%	26.9%	6.2%	37.8%	49.6%
ROIC	25.6%	14.9%	14.3%	12.6%	9.9%	10.3%	9.4%	1.8%	10.0%	14.1%
Shares Out.	4,584	4,526	4,469	4,402	4,366	4,324	4,288	4,259	4,250	4,314
Revenue/Share	7.53	10.02	10.47	10.39	10.34	10.06	9.59	8.19	7.41	8.64
FCF/Share	1.57	1.41	1.72	1.77	1.84	1.81	1.50	1.26	1.46	1.95

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

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