



The Coca-Cola Company (KO)

Updated May 5th, 2020 by Josh Arnold

Key Metrics

Current Price:	\$45	5 Year CAGR Estimate:	7.8%	Market Cap:	\$194 B
Fair Value Price:	\$40	5 Year Growth Estimate:	7.0%	Ex-Dividend Date:	06/12/20
% Fair Value:	113%	5 Year Valuation Multiple Estimate:	-2.4%	Dividend Payment Date:	07/01/20
Dividend Yield:	3.6%	5 Year Price Target	\$56	Years Of Dividend Growth:	58
Dividend Risk Score:	B	Retirement Suitability Score:	B	Last Dividend Increase:	2.5%

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 \$194 billion and its brands account for about 2 billion servings of beverages worldwide every day, producing roughly \$33 billion in annual revenue.

Coca-Cola reported first quarter earnings on April 21st, with revenue and earnings beating subdued expectations. Total revenue declined -1%, while organic revenue was flat year-over-year, at \$8.6 billion. North America posted a 4% gain in organic sales, driven by pantry-stocking ahead of and during stay-at-home orders due to COVID-19. However, this only offset a decline in organic sales in Asia-Pacific, driven primarily by China. Pricing and mix were flat during the quarter, while Q1 of 2020 contained one less selling day, resulting in a small volume headwind.

Coca-Cola didn't issue guidance on the rest of the year but did warn investors that away-from-home volume would likely continue to suffer as sports arenas, restaurants, and other spots where it sells its products experience large traffic declines.

Operating cash flow was \$556 million in Q1, down -29% year-over-year. Free cash flow declined -43% to \$229 million, due to working capital changes and currency headwinds.

Operating margins were 30.7% on an adjusted basis in the first quarter, up from 28.2% in the year-ago period. Earnings-per-share were up 8% on an adjusted basis to \$0.51 from the year-ago period. However, we've cut our estimate for earnings-per-share for this year from \$2.25 to \$1.90 on what we see as significant weakness in the second quarter.

Growth on a Per-Share Basis

Year	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019	2020	2025
EPS	\$2.53 ¹	\$1.85	\$1.97	\$1.90	\$1.60	\$1.67	\$1.49	\$1.91	\$2.08	\$2.11	\$1.90	\$2.66
DPS	\$0.88	\$0.94	\$1.02	\$1.12	\$1.22	\$1.32	\$1.40	\$1.48	\$1.56	\$1.60	\$1.64	\$2.19
Shares²	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, 2020 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 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 \$2.19 per share by 2025, up from the current \$1.64.

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

² Share count in millions

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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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	23.8	21.0
Avg. Yld.	3.0%	2.7%	2.7%	2.7%	2.9%	3.2%	3.1%	3.2%	3.4%	3.1%	3.6%	3.9%

Coca-Cola's price-to-earnings ratio has been rather volatile in the past decade and today, it stands at 23.8. This compares unfavorably to what we see as fair value at 21 times earnings, implying a small 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 3.6% 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 3.9%.

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%	86%	82%

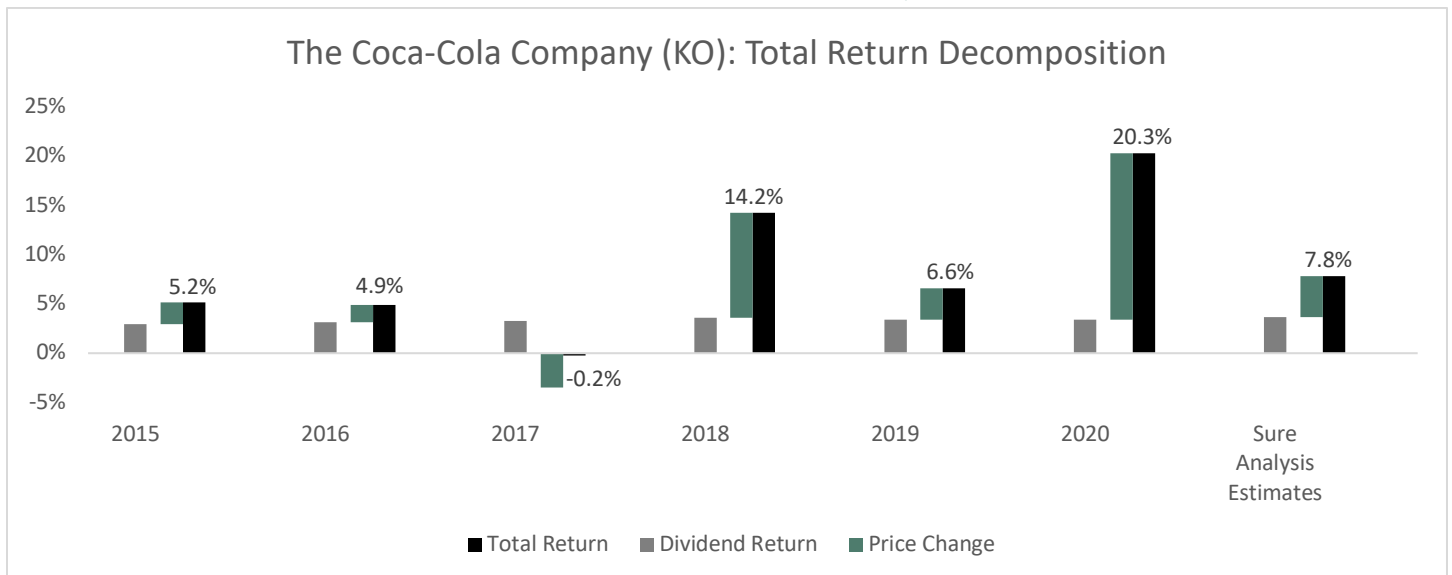
The payout ratio has been in the mid-70% range for the past few years and we believe it will remain around there in the coming years. Dividend growth will remain a priority for management and we see the payout as safe, with room to grow, particularly with generally improving free cash flow generation.

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 high single-digits, driven mostly by projected earnings growth and an ample dividend. Our estimates of 7% earnings growth and a small valuation headwind, combined with the company's dividend yield give expected total returns of 7.8% 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 still in excess of our estimate of fair value today. We're reiterating Coca-Cola at a hold rating on an 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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