The Henry Fund
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THE COCA-COLA COMPANY (KO)

September 19, 2022

Consumer Staples – Soft Drinks

Stock Rating **BUY**

Investment Thesis

We have a **BUY** rating on the Coca-Cola Company (KO). KO shares are currently traded at $59, which is below our target range of $64 to $68 with an upside of 10.44%. We understand the abundance of unpredictabilities regarding KO aptness to control its vast market share due to the ever-so changing preferences and health of its consumers. We believe that because of Coke's extensive portfolio of over 500 brands and deep core customer base, it is relatively an institutional fixation within the domestic and global markets. Despite having lower upside than other potential holdings, we believe KO is an integral addition to the Henry Fund because the stable growth, it will bring in the near and long-term.[1]

Drivers of Thesis

- KO serves 1.9 billion servings per day, with marginal increases to its products' prices, it will see little elasticity in sales volume. As consumers tend to make spending cuts on the "big-ticket" items in an economic hard ship over "small-ticket" items.[24]
- Over the forecasted period of 2022-2026, the Soft Drink Industry is expected to grow at a CAGR of 5.47%. This signifies an increasing demand for high grade thirst quenchers.[14]
- In 2022, the Coca-Cola company has begun collaborating with major alcohol beverage firms to cobrand its biggest brands to the alcohol beverage market, which offers high margins in its products.

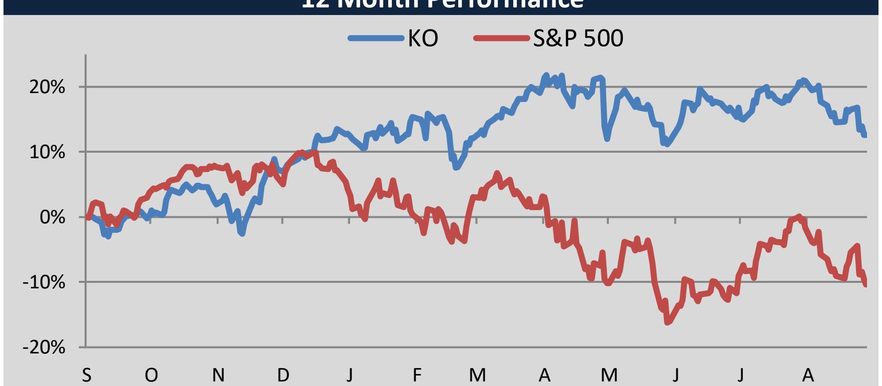
Risks to Thesis

- KO has a major risk of losing its massive market share of 44.9% of the carbonated soft drink (CSD) market due to quantity of competition.[14]
- Coca-Cola is currently dealing with a major ligation due to allegedly tax aversion due to accounting practices.[14]
- International currency exchange could largely nullify marginal profit gained in emerging markets.

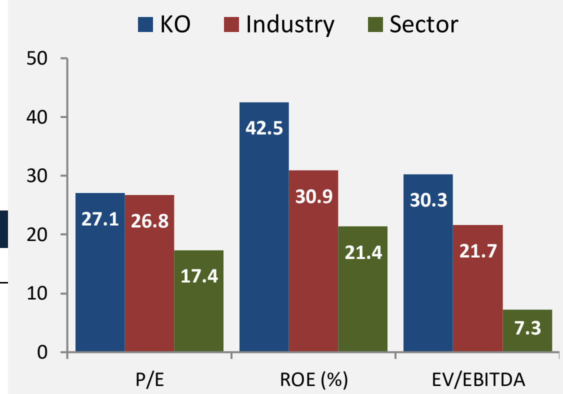
Earnings Estimates

Year	2019	2020	2021	2022E	2023E	2024E
EPS	$2.07	$1.79	$2.25	$2.18	$2.48	$2.59
HF est.				$2.18	$2.61	$2.90
Growth	*31.85%*	*-13.53%*	*25.70%*	*-3.11%*	*19.72%*	*11.11%*

12 Month Performance



Target Price	$66-70
Henry Fund DCF	$68
Henry Fund DDM	$65
Relative Multiple	$64
Price Data	
Current Price	$59
52wk Range	$52 – 67
Consensus 1yr Target	$69
Key Statistics	
Market Cap (B)	$257.5
Shares Outstanding (M)	$432.5
Institutional Ownership	71.0%
Beta	0.81
Dividend Yield	3.0%
Est. 5yr Growth	5.9%
Price/Earnings (TTM)	23.9
Price/Earnings (FY1)	24.3
Price/Sales (TTM)	6.6
Price/Sales (FY1)	6.1
Profitability	
Operating Margin	60.0%
Profit Margin	27.6%
Return on Assets (TTM)	10.5%
Return on Equity (TTM)	44.6%

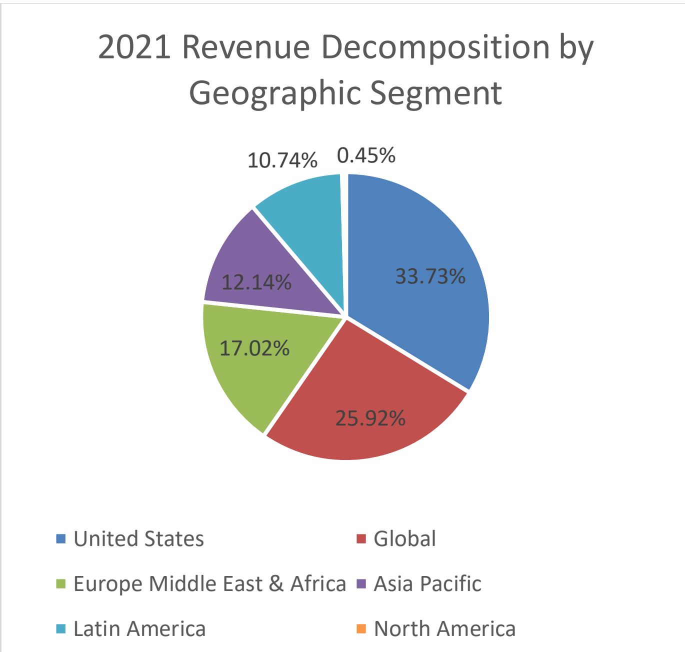


Company Description

The Coca-Cola Company focuses on the creation, distribution, and marketing of nonalcoholic beverages. KO was founded in 1886 and is headquartered in Atlanta, Georgia. Its' business segments include Concentrate and Finished Product. KO is the largest nonalcoholic beverage company in the world. Its products are sold in over 200 countries worldwide. Coca-Cola owns the rights to over 500 brands. Notable brands include Coca-Cola, Sprite, Minute Maid, Powerade, Vitaminwater, Glaceau, and Fanta.[1]

COMPANY DESCRIPTION

The Coca-Cola Company focuses on the creation, distribution, and marketing of nonalcoholic beverages. These beverages include soft drinks, juice, energy drinks, water, enhanced water, coffee, dairy drinks, planted-based drink, teas, and more. KO was founded in 1886 and is headquartered in Atlanta, Georgia. Its' business segments include North America; Latin America; Europe; Middle East, & Africa; and Asia Pacific. KO employs around 79,000 people with about 12% of them located in the United States. Roughly 6,000 of Coca-Cola employees are covered by a collective bargaining agreement.[2]

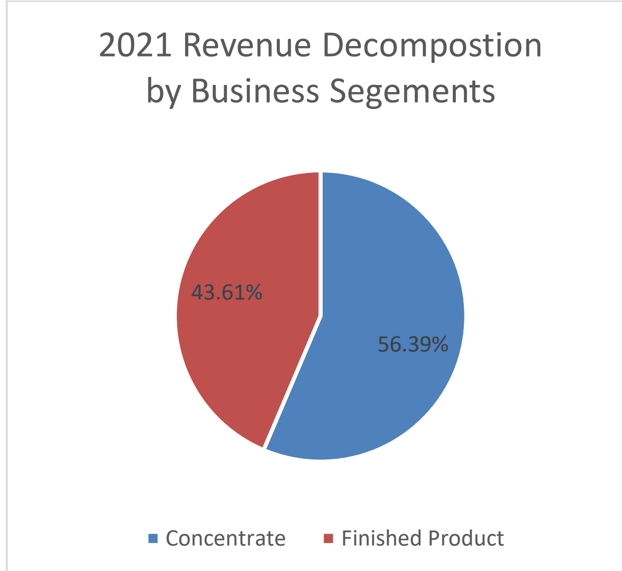


Source: KO 2021 10K

KO is an international firm with sales in over 200 countries. Listed above is the sales allocation from the 2021 10K.

Coca-Cola owns the intellectual rights to over 500 brands. Some of the notable brands include Coca-Cola, Sprite, Minute Maid, Powerade, and Vitaminwater. KO is the largest nonalcoholic beverage company in the world. Its products are sold in over 200 countries worldwide.

KO's products are available to consumers throughout the world by leveraging a network of independent bottling wholesalers, partners, distributors, etc. KO works with nearly 225 independent bottling partners in a strategic partnership to sell products to consumers at a rate of 1.9 billion servings per day.



Source: KO 2021 10K

Coca-Cola has two different product sale segments, concentrate and finished product. The Concentrate Segment sells either the right to use the intellectual or selling the concentrated soda syrups. The finished products segments sell, as named finished bottled or cans products to end markets.

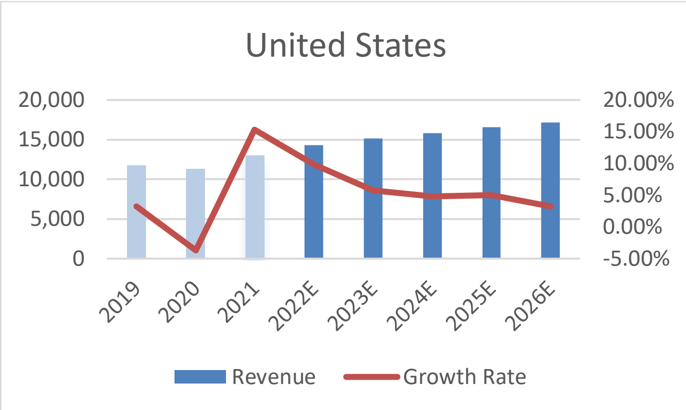
United States & North America

The North America and United States segments have consolidated to improve their forecasted and reporting we decided to keep these isolated. The North America Segment is the firm's flagship market, with approximately 320 million consumers. [19]

Major FY 2021 highlights include:

- Competed full acquisition of high growth sports drink, BodyArmor
- Coca-Cola zero sugar growth was main driver in Diets and zero-sugar sparkling beverages major growth volume in 2021
- Away-from-home channels saw double digit point growth, which led to pre-pandemic figures despite macro-economic disruptors
- Captured the fifth highest hard seltzers with Topo Chico Hard Seltzer

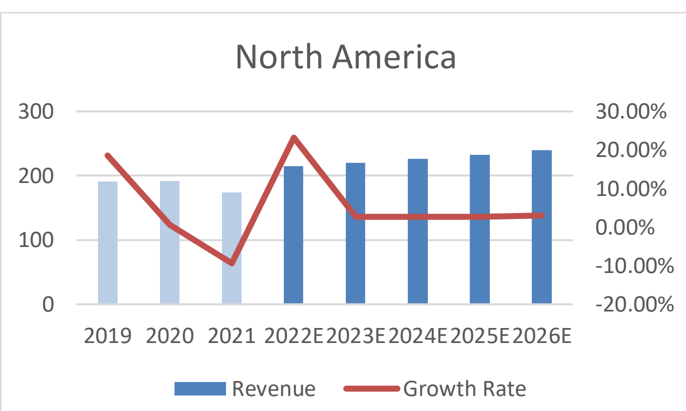
- Saw strong performance from sparkling water portfolio primarily from Topo Chico)



Source: Henry Fund Model & FactSet

We used quarter-over-quarter growth to forecast the revenue more accurately for all of KO's business segments. The growth assumptions were calculated using a combination of historical growth averages and survey data. Our assumptions are for the United States to grow at nearly 10% for the first year and then for growth to slow down to a little over 3% into perpetuity. The cool-down in growth is baking in the expectation that inflation will cool down to traditional levels (2-3% annually). We expect price increases to offset inflation in the near-term.

A major driver in the organic growth of the United States segment is alcohol products as KO is still in the emerging stages of this new entered market. We believe cobranded products between KO's established brands and alcohol brands could result in lucrative gains. In addition, this segment also added BodyArmor to its arsenal of brands with that comes expected organic growth, as BodyArmor is one of the fastest growing sports drinks in the world.



Source: Henry Fund Model & FactSet

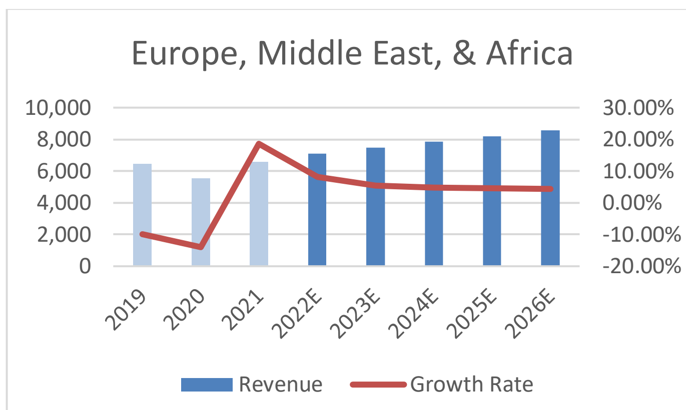
We used the same quarter-over-quarter growth methodology to forecast the revenue more accurately for this segment. This segment has holdings for production and distribution centers, which we expect to get more work. The growth is expecting the segment to get back to pre-Covid figures and then a steady growth of inflation into perpetuity.

Europe, Middle East, & Africa

The Coca-Cola Company's Europe, Middle East & Africa segment includes 130 markets and roughly 2 billion consumers. [19]

Major FY 2021 highlights include:

- Increased effort of premiumization focus on key African markets to drive YoY growth
- Successful relaunch of Coca-Cola Zero Sugar
- Middle East and Eurasia recorded successful economic recovery and gained shares in sparkling soft drinks
- The KO system delivered highest additive retail value in Europe



Source: Henry Fund Model & FactSet

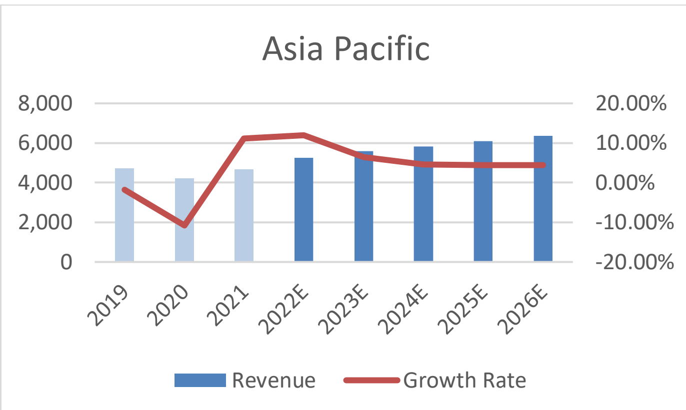
Despite the Ukraine-Russia situation, our assumptions are for Europe, Middle East & Africa segment to have two relatively high growth years, as the world recovers from the world lockdown and prices adjust for inflation as it cools-down. The vast supply of emerging and developing markets are within this segment (mostly in Africa). Then we expect a relatedly high growth in its final forecast year (4.29%) as we expect the US Dollar to weaken versus foreign currencies.

Asia Pacific

The Coca-Cola Company's Asia Pacific segment includes 37 markets and roughly 3.3 billion consumers.[19]

Major FY 2021 highlights include:

- Had growth in Japan despite government-imposed state of emergency for 80% of the year by meaningfully placing vending machines
- Alcohol revenue growth in Japan because Topo Chico Hard Seltzer was well received
- Sparkling flavors exploded as Sparkling flavors increased sales to $1 billion, double digit growth



Source: Henry Fund Model & FactSet

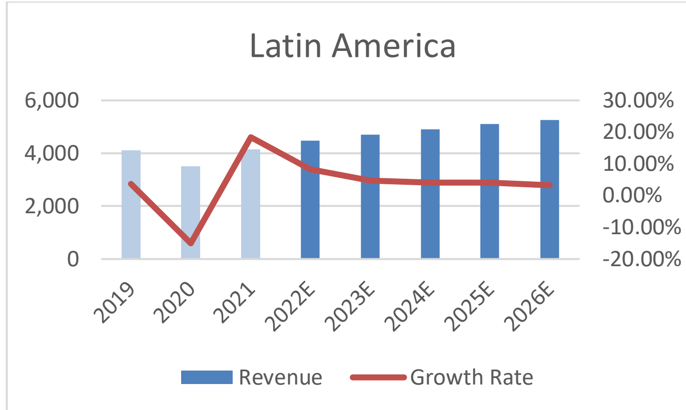
Our assumptions are for the Asia Pacific segment to have a relatedly high growth into perpetuity. This market holds a great amount of potential due to the population located within it. We expect great growth over the near-term due to KO's focus and recent success created innovate products specially for this market, such as Ayataka Matcha Latte and Lemon-Dou (alcoholic beverage). As these foreign nations' economies develop, the organic growth will be realized.

Latin America

The Latin America Segment is primarily in emerging and developing market stages. There are 39 markets with about 520 million consumers.[19]

Major FY 2021 highlights include:

- For all quarters of 2021, reached the same volumes as pre-Covid-19
- Juice refillables were up 50% YoY
- Digital execution with B2B was up 300% YoY
- Gathered more than 45,000 kg for recycling efforts across the geographic segment



Source: Henry Fund Model & FactSet

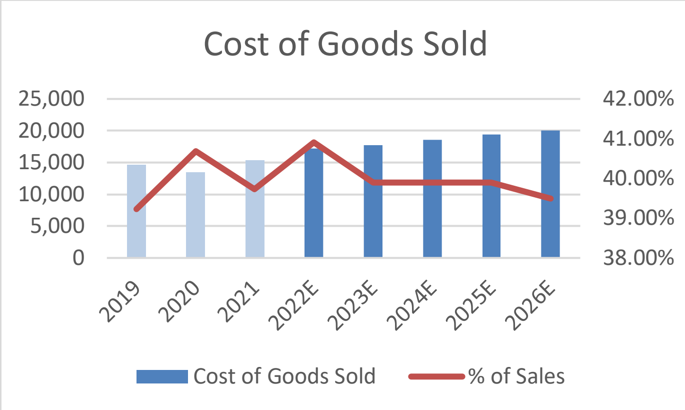
Our assumptions are for the Latin America segment to have a high growth year. Then we expect modest 3% growth from 2024E into perpetuity. This is with the assumption that we expect the US Dollar to weaken versus foreign currencies within these markets and the markets to growth due to population growth. Coca-Cola has tremendous footing to-date being first place for market share in sparkling soft drinks, juice; dairy; & plant, and hydration. We believe KO will control its market share for the foreseeable future within this market.

Cost Structure Analysis

Coca-Cola Company has two major operating expenses, Cost of Goods Sold and Selling; general and administrative.

Cost of Goods Sold

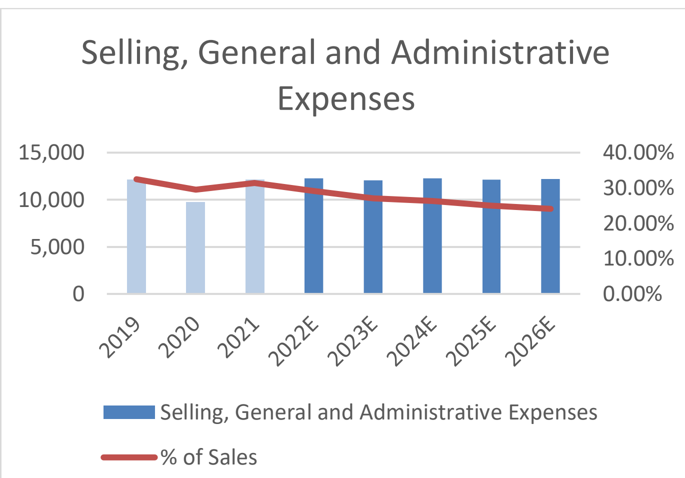
Cost of Sold is largely determined by commodity markets for inputs and the nearby labor. We see input costs rising to keep up with inflation. We used the average Cost of Goods Sold by quarter adjusted to inflation, using the HF consensus inflation rate of 3.60%, to overstate the effects of current inflation for producers, as a rate time each fiscal year's sale. This is nearly identical to consensus estimates for KO's COGS.



Source: Henry Fund Model & FactSet

Selling, General, and Administrative & Other Cost and Expense Operating

Selling, General and Administrative includes marketing expenses, professional fees, technology related costs, etc. We see project these costs to stay within historical averages in the first forecasted year and then to decline relative to revenue for the foreseeable future. We believe there are opportunities to trim down staffing to be closer to industry standards.



Source: Henry Fund Model & FactSet

We believe that corporate and technology jobs will be cut and is the main driver in SG&A expenses lower despite inflation. Our forecast for SG&A expenses are lower than the consensus estimates because we believe main players in their respected industries will conduct layoffs and hiring freezes before their margins tighten and it is necessary.

Debt Maturity Analysis

Coca-Cola has a S&P credit rating of A+ with a stable outlook. Using the Standard & Poor's credit rating scale bonds, those who have a rating of BBB- or better are considered "investment grade." This is ideal because having a better rating allows more asset managers' charters to allow for trading on the market. [1]

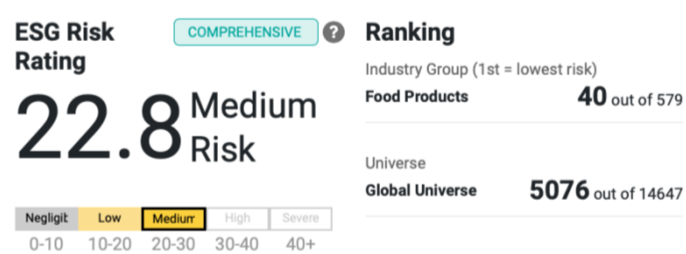
A large percentage of KO's total debt is due after 2027, approximately 55% of its debt outstanding. We believe that because of this large amount of debt due in a longer time horizon. KO is less likely to run into liquidity issues and can focus its resources toward expanding its markets.[24]

Fiscal Year	Payment ($mil)
2022	0
2023-2024	2,192
2025-2026	1,732
Thereafter	33,922
Total	37,846

Source: KO 2021 10K

ESG Analysis

ESG stands for environmental (E), social (S), and corporate governance (G). The Risk Rating below was rated by Morningstar's Sustainalytics.



Source: Sustainalytics

Sustainalytics calculates firms' ESG Risk Ratings by measuring firms' exposure and management risk, as well as its controversy rating. Coca-Cola had medium exposure risk, strong management of material risk, and three out of five controversy rating. We believe KO had medium ESG exposure, largely due to large water and plastic usage and labor relations issues.

KO's management had strong ESG material risk. Which is referring to how well Coca-Cola has managed its relevant ESG issues. KO had its highest controversy rating of three out of five because of a large tax dispute over 2010-2021 fiscal years.

The aggregate incremental tax liability could be worth up to $13 billion, this liability is high disputed by KO. We see this legal procedure as having a low likelihood of following through, as a result, we do not expect to see this affected Coca-Cola's bottom line in the long-term. Other underlining ESG controversies include issues with the social impact of its products (plastic waste).

RECENT DEVELOPMENTS

Russia Exposure

In March 2022, Coca-Cola announced suspension of all business in Russia, which accounts for between 1-2% of total revenue in FY2021. Coca-Cola HBC, is a Swiss bottling firm that manufactures products within Russia took a one-time hit of 190 million euros ($195.4 million) in the FY2022. KO owns 20% stake in Coca-Cola HBC. However, Russia Multon Partners is selling KO products despite the suspension. There are currently ongoing legal battles, in Coca-Cola's attempt to stop third-party firms from importing its sodas and to ultimately protect its brand. We believe KO will return to Russia when the Russia-Ukraine situation ends.[21 & 23]

BodyArmor Acquisition

In 2018, KO acquired a 15% stake in BodyArmor with a pathway for potential full ownership. In November 2022, KO purchased the residual 85% stake of BodyArmror for $5.6 billion in cash. The executive team at BodyArmor will maintain roles to continue the firm's successful momentum. [1]

Coca-Cola Q2 Earnings

Coca-Cola beat Q2 street estimates on July 26th, 2022, but Q2 profit decreased. KO increased their expectations for revenue growth of 13% for the FY2022, with previous guidance at 7%. Coke said that its Q2 revenue had increased by 12% from the previous year. The Q2 net income was $1.91 billion, 44 cents per share. Last year the Q2 net income was $2.62 billion, 61 cents per share. KO raised prices over the quarter to deal with higher input costs such as aluminum and high fructose corn syrup supplies and higher freight costs. The firm said they had not seen spending pullbacks, as most consumers cut back on "big ticket items" before "small ticket items." The firm has raised prices to offset inflation, which was a driver in revenue gains.[20 & 26]

KO's guidance released steeped as they now expect organic growth to be 12-13% for the full fiscal year, up from previous expectation of 7-8%. Our FY 2023 forecasts are mostly like guidance for sales. We believe that commodities, such as aluminum will be a threat in the near-term for tightening margins in congruence with guidance. As previously mentioned, we believe SG&A can be and will be lowered in the near-term. KO has not mentioned this as the media could perceive many negative things if KO mentioned layoffs or hiring freezes.

INDUSTRY TRENDS

Hard Drink Collaborations

As hard drinks become a larger social phenomenon, there became a clear and obvious market for larger, established drink firms to fill the void. For decades, bartenders have been taking Coca-Cola and Pepsi branded products and mixing them with liquor to create hard drinks.

In early 2022, Boston Beer (SAM) and Pepsi released Hard Mountain Dew. Hard Mountain Dew reached 34% of flavored malt beverage category in Iowa in Q1 2022.

In early 2022, Coca-Cola announced a collaboration with Jack Daniel's distiller Brown-Forman to create a cocktail called "Jack-and-Coke". This is considered a long-time staple for bar-goers, so it was a natural fit for the firms. Another early 2022, collaboration Coca-Cola announced was a partnership with Molson Coors (TAP) to create Spiked Simply Juices. Simply Juices is America's number chilled juice brand. Simply is KO's second largest brand, it was an easy decision to leverage this brands quality and appeal as a growth opportunity. Both Coca-Cola ventures are expected to be released later in 2022.[1]

Creators Establishing Micro Brands

Prime Hydration (Energy Drink)

YouTube Creators, Jake Paul and KSI, have collaborated on an intriguing product within the Energy Drink Subindustry called Prime Hydration. Prime Hydration aims to bring both great taste and low calorie, high nutritional function to consumers. This product uses a simplistic and bold color scheme for its packaging to attach customer appeal. This brand is sold exclusively online within the United States, for now. Marketed by two of YouTube's biggest stars, this brand has garnered instant success as most of its flavors have been sold out upon release in early 2022.[28]

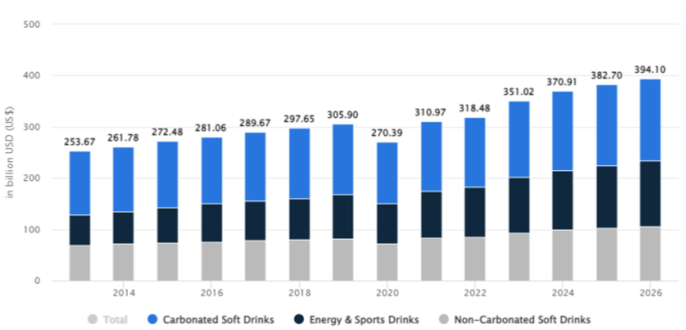
Happy Dad (Hard Selzer)

On a larger scale, superstar content creation group known as the Nelk Boys created the hard seltzer brand, Happy Dad. Which was added to their up-incoming apparel brand, Full Send. Happy Dad is already sold in over 8 states of the US and across Canada after its launch in 2021. Happy Dad aims to bring the best simple flavored hard seltzers with low carbonation. It is simple vintage packaging and brand appeal are eye catching. Happy Dad brings additional appeal with casual clothing donning its red and blue logo. This brand is exclusively marketed by the Nelk Boys, which have interviewed major guest such as Elon Musk and Mark Cuban in recent months on its Full Send Podcast.[29]

Shift In Consumer Preferences?

This industry has an expected CAGR of 5.47%, over the forecasted period of 2022-2026. The chart below is illustrating a change in consumer preference indicated by revenue allocation changes.

US Soft Drinks Sub-Industry Revenue 2013-2026



Source: Statista

In 2016, carbonated soft drinks accounted for 46.7%, energy and sports drinks accounted for 26.3%, and non-carbonated soft drinks accounted for the remaining 27%. The revenue allocations shift over 2013 to 2026 suggestions that more consumers' preferences are moving from carbonated soft drinks to energy drinks. In 2026, the revenue allocation is carbonated soft drinks 40.7%, energy drinks 32.6%, and 26.7%. The largest differences carbonated beverages loses 6% revenue share and energy drinks gaining 6.3% revenue share. The industry as a whole's revenue is expected to grow 40.2% from 2016 ($281 billion) to the forecasted 2026 ($394 billion).[14]

MARKETS AND COMPETITION

Threat of New Entrants

The threat of new entrants in the Soft Drink Industry has shifted in the most recent decade from **low** to **moderate**. Historically, economies-of-scale and brand recognition has provided larger, established brands like Coca-Cola, Pepsi the inside track to dominate the market share in this space. However, younger generation consumers (Gen Z and Millennial) have less brand loyalty and have different brand preferences. These brand preferences include social impact (purpose), quality (larger premium preference), higher price threshold, etc.

The rise of e-commerce has in some sense, leveled the playing field for smaller producers. We expect larger, established brands to continue their dominance in the long-term. There are still several high barrier factors, such as a high capital requirement for manufacturing and distribution. In the near-term, smaller brands pose a threat to collect market share. There are growing opportunities for M&A transactions as more small brands continue to succeed. [11]

Threat of Substitutes

The threat of substitutes is **high**. Within the Drinks Industry, as there is an endless supply of substitutes. Different generations have different preferred staple drink preferences. We believe the most positive cash-flow companies within this industry over the long-term will have a diversified portfolio. As a larger percentage of United States citizens become obese, low-calorie drinks could become a larger preference. We see this market already as saturated, but a larger market could allow for more products. [11]

Intensity of Competitor Rivalry

The intensity of competitor is **high**. The drink industry is highly competitive, with innumerable manufactures of major branded products. In developed markets, the industry is mature with opportunities dependent on generational trends and preferences. The "Cola Wars" between Pepsi and Coca-Cola have been going on since the later 1800s. These firms have been aggressively competing for market share as consumer proclivity shifts. Outside competitions is brought by "pure play" firms, companies with one established product, as well as by developing "micro" brands. The micro brands tend to have a small geographic presence. [11]

Bargaining Powers of Customers

The bargaining power of customers is **high**. The Drinks Industry's end markets are mostly grocery retailers, event concessions, and chain restaurants. Although, three companies drink sales accounted for over 91% of all sales in 2021. Switching producers is an easy and cheap option as the larger, establish firms have vast distribution geographic networks to reach across the United States and larger international markets. Almost all products within this industry are affordable to all economic classes, which allows entire populations the option to spend capital on products. [11]

Bargaining Powers of Suppliers

The bargaining power of customers is **low**. The bargaining power of the suppliers in this industry is low. Each product is unique and different, on factors such as flavor, color, formula, etc. No two products are the same. The large, established firms have comparable substitutes for consumer preferences. Most grocery retailers, event concessions, and chain restaurants have long established relationships with suppliers. For most event concessions and chain restaurants there is an exclusive partnership to only sale one firm's product line. [11]

Porter's Five Forces Summary

Overall, we have a positive outlook on the Soft Drinks Sub-Industry. In 2021, the sub-industry posted strong growth and rebounded to better nominal revenue than before COVID-19 ($305.9 billion vs. $310.1 billion). The main driver this growth was domestic carbonated soft drink volume growth of 3.1%, which had experiences secular decline for several years prior. In addition, Soft Drink firms were successfully able to pass on rising cost to its consumers, as United States price realizations were 8.0% YoY. This reflects the strong brand values that firms within this industry possesses.

We view this sub-industry's bountiful dividends and defensive characteristics as a positive for the current economic climate. We see Coca-Cola and Pepsi as the leaders of this sub-industry. We believe they can set the price because of their aforementioned strong brand value. Due to KO and PEP's diversified product mix in soft drinks and committed to adapting to consumer preferences, we believe they have a great capacity to be major players in this sub-industry for the foreseeable future.

PEER COMPARISONS

PepsiCo, Inc. (PEP)

PepsiCo, Inc. is a conglomerate consumption firm with focuses on the creating, marketing, and distribution snacks, food, and beverages. Its business segments operations are the following: PepsiCo Beverages North America (31.8%); Frito-Lay North America (24.7%); Europe (16.4%); Latin America (10.2%); Africa, Middle East, & South Asia (7.6%); APAC (5.8%); and Quaker Foods North America (3.5%).

Pepsi was founded 1965 and is headquartered in Purchase, New York. This firm manufactures and markets a vast variety of carbonated and non-carbonated beverages, snacks, and food. PEP operates under a mass quantity of brand, most notably Pepsi, Gatorade, Mountain Dew, Lay's, Doritos, Cheetos, Cap'n Crunch, and many more. At FYE 2021, PEP had over 291 thousand employees (about 94% under a collective bargaining agreement), with rough 42% of them located in the United States. The United States makes up approximately 56% of its net sales.[5]

Keurig Dr. Pepper, Inc. (KDP)

Keurig Dr. Pepper, Inc. focuses on the creation and marketing of flavored beverages. Its business segments operations are the following: Packaged Beverages (46.4%), Coffee Systems (37.2%), Beverage Concentrates (11.7%), and Latin America Beverages (4.7%).

KDP was founded 2018 and is headquartered in Burlington, Massachusetts. This was firm was formed in 2018 when Keurig Green Mountain and Dr Pepper Snapple Group. The allocation of ownership upon the merger was roughly 87% Keurig Green Mountain shareholders and 13% Dr Pepper Snapple Group shareholders. The Keurig Dr Pepper operates over 125 brands, most notably Keurig, Dr Pepper, Canada Dry, Snapple, and Margaritaville. At the FYE 2020, KDP had over 27 thousand employees (29% are under a collective bargaining agreements).4

Monster Beverage Corporation (MNST)

Monster Beverage Corp. focuses on the creation, marketing, and distribution of energy drink concentrates and beverages. Its business segments operations are the following: Monster Energy Drinks (94.2%), Strategic Brands (5.3%), and Other (0.5%).

MNST was founded in 1990 and is headquartered in Corona, California. At the FYE 2020, Monster Beverage had about 4,100 employees in 69 different countries. MNST sells "alternative drinks" ready-to-drinks such as energy drinks, iced teas, lemonades, juice cocktails, natural sodas, and more. The Strategic Brands segment sells beverage and concentration bases to beverage distributors and bottlers. [6]

Celsius Holding, Inc. (CELH)

Celsius Holdings, Inc. focuses on the creation and marketing of calorie-burning beverages. Its business segment is Calorie-Burning Functional Energy Drinks & Liquid Supplements (100%).

CELH was founded in 2004 and is headquartered in Boca Raton, Florida. Celsius Holdings, Inc. changed its name in 2007 from Vector Ventures, Inc. Celsius Holdings offers an assortment of carbonated and non-carbonated energy functional drinks under the Celsius brands. In addition, CELH creates and distributes CELSIUS On-the-Go, a powder individual packet or mass container with active agreement for consumers to mix with water at their convenience. CELH has about 280 employees in FYE 21.[3]

National Beverage Corp. (FIZZ)

National Beverage Corp. focuses on the creation and marketing of flavored beverage products. Its business segment is Flavored Beverage (100%). FIZZ was founded in 1991 and is headquartered in Fort Lauderdale, Florida. National Beverage has a deep portfolio of brands it operates under such as LaCroix, Rip It energy drinks, Shasta Sparkling Water products, Shasta, Faygo, Mr. Pure 100% juice, and many more. These beverage brands are engineered for active and health-conscious consumers with all of its sales occurring in the United States and Canada. At the FYE 2022 FIZZ had roughly 1,580 employees (23% under a collective bargaining agreement). FIZZ only has about 29% of its market cap on the public due to holdings by the business insiders.[7]

Primo Water Corporation (PRMW)

Primo Water Corp. focuses on the creating, processing, and distribution of beverages. Its business segments operations are the following: North America (75.4%) and Rest of World (24.6%). PRMW was founded in 1955 and is headquartered in Tampa, Florida. Primo Water Corporation, which changed its name in 2020 from Cott Corporation, offers consumers a wide range of purified water products and coffee services. Its Rest of World segment operates across Europe and Israel and offers, like the North America segment, an array of purified water products and coffee services. In addition, PRMW manufactures; markets; and distributes self-service refill drinking water, filtration equipment, and water dispensers. Primo Water operates under many brands such as Primo, Mountain Valley, Deep Rock, Alhambra, Crystal Rock, and many more.[8]

Soft Drinks Industry Debt Comparison

TCKR	LT Debt/Assets	EBITDA/Interest Expense	Debt Rating
PEP	40.7	8.1	A+
KDP	26.6	6.8	B+
MNST	0.2	-	-
CELH	0.4	-376.6	-
FIZZ	10.8	-	-
PRMW	39.5	5.0	B
KO	41.6	16.3	A+

Source: FactSet

The chart above compares the Soft Drinks Sub-Industry firms' debt and credit. We believe it is likely that interest rates rise significantly in the near-term. If there is a demand shock, firms with less levered positions will have drastically more flexibility in these terms.

MNST and FIZZ are the least levered positions. MNST, CELH, and FIZZ are debt averse companies to the point, where their debt rating is not posted by a major credit agency. In terms of the large Soft Drink firms, KDP is least levered versus their total assets. However, KO has the best coverage ratio, meaning they have the best ability to pay off their current debt. KO and PEP have been major players in M&A in this industry. We believe they will continue to due to their magnitude.

Although MNST and CELH have little debt, they cannot compete in deals with massive firms. PRMW seems to have the worst debt situation because of their high debt to asset ratio, poor coverage ratio, and worst debt rating of all considered within the industry. [1]

Soft Drinks Margin Comparison (%)

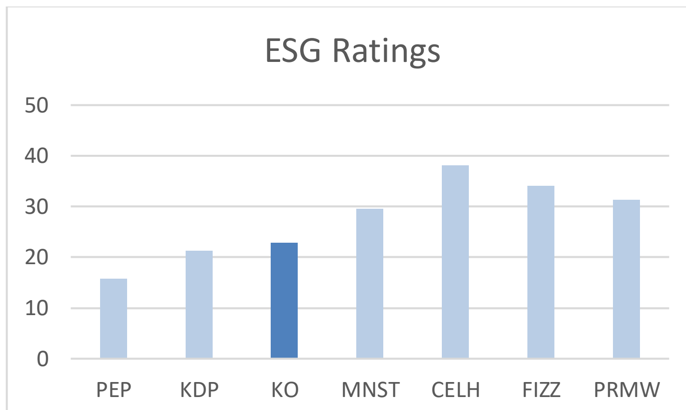
TCKR	Operating	Net	Gross
PEP	14.4	9.6	53.5
KDP	22.6	16.9	50.4
MNST	32.5	24.9	56.1
CELH	-1.3	1.3	40.4
FIZZ	17.4	13.9	35.8
PRMW	6.1	-0.2	55.8
KO	27.6	23.5	60.0

Source: FactSet

The chart above compares the Soft Drinks Sub-Industry firms' operating, net, and gross margins. Across the board KO and MNST standout, this is because MNST does not own any bottling centers and KO owns a very few (all located in Asia). KO and MNST, both have extremely strong brands that consumers will buy despite marginally higher prices compared to store brands. PRMW and CELH had the worst margins over the FY 2021, these are the smallest firms and operating bottling centers, which lead to poor figures. PEP only has 32% of their revenue stemming from their beverage segment, so their margins are not a perfect indicator of their relative operations. [1]

Soft Drinks ESG Comparison

ESG stands for environmental (E), social (S), and corporate governance (G). The Risk Ratings below were rated by Morningstar's Sustainalytics.

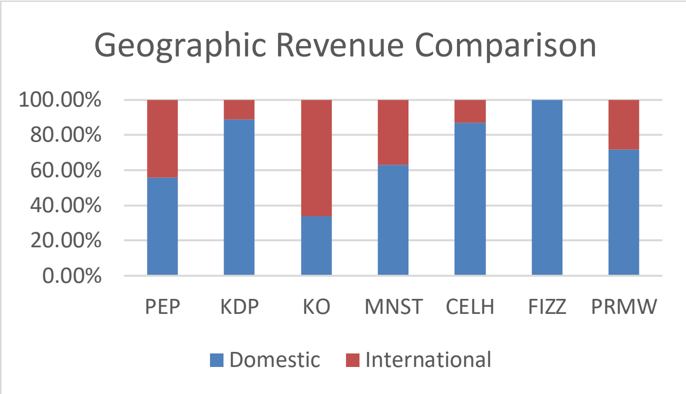


Source: Sustainalytics

The chart above compares each Soft Drinks sub-Industry firms' ESG Rating. The lower the score the better, rating are between 0 and 50.

The worst amongst this subindustry is CELH, MNST, PRMW, and PRMW. It is due to two reasons; they both make products perceived as unhealthy and do not have established parts of their corporate dedicated to ESG initiatives. Out of the three firms (PEP, KDP, & KO), that have corporate dedicated to initiatives KO is the worst. They are currently having a legal battle with the IRS about income tax. PEP is the best because of their clean record and ESG corporate initiatives. [17]

Soft Drinks Geographic Comparison

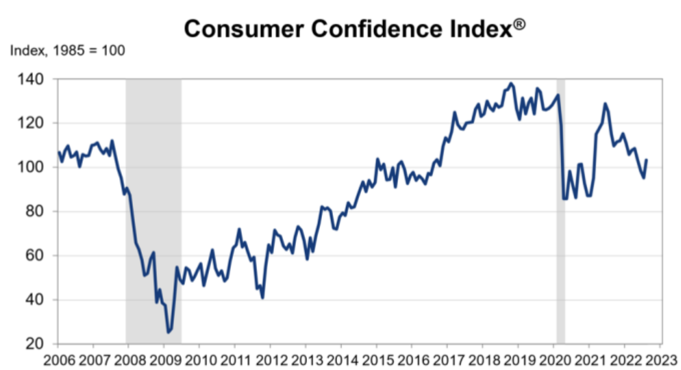


Source: FactSet

KO has by far the most foreign exposure as 66% of their revenue is brought in from foreign markets. This could be a major issue if the dollar continues to strength like it has. We expect the dollar to weaken in the long-term as major conflicts ease. KO does have roughly $100 million in derivatives to hedge some of the foreign currency exposure. PEP has 49% exposure to foreign markets, with over 4% of its 2021 FYE revenue coming from Russia. The other smaller firms will post likely move to foreign markets after further maturity in the United States.

ECONOMIC OUTLOOK

Consumer Confidence Index

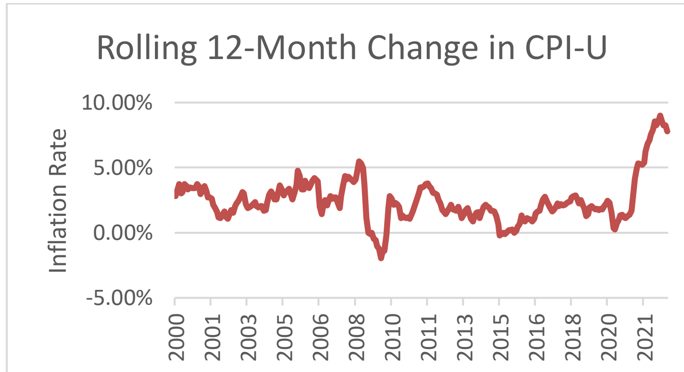


Source: Conference Board

The Consumer Confidence Index (CCI) is a survey, handled by The Conference Board. This is a metric that measures how optimistic or pessimistic individuals are regarding their expected of their financial situation. The Consumer Confidence Index is built on the premise that if survey takers are optimistic, they will spend money creating an expansion on the economy. If survey takers are pessimistic, they will save their money and there could potentially be an economic slowdown or recession.

On the most recent CCI, August CCI, which was on August 30, 2022, the Conference Board's increased from 95.3 to 103.2. This was following a three-month decline. We anticipate the confidence to drop over the next several months as expected interest rate hikes will cool down spending. [18]

Consumer Price Index

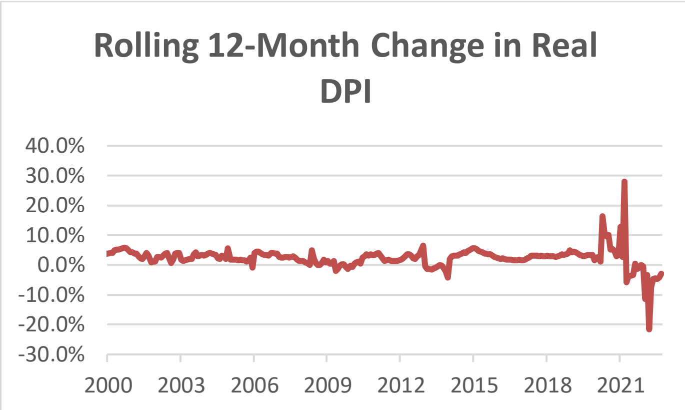


Source: FRED

The August CPI report relieved higher than street expectations. Core inflation rose by 60bps MoM. Headline inflation rose by 10bps MoM, despite plunging gas prices. The initial reaction from equity markets appeared that the streets are baking in at least an interest hike of 75bps. The traditional route to tame inflation is via rate hikes, however we believe that aggressive rate hikes may not be successful versus this current inflation. This inflation is caused by supply shocks from the Russia-Ukraine conflict and underline Covid-19 supply chain issues. [10]

Disposable Personal Income

Disposable income is the amount of money an individual has after taxes, not necessarily after all necessity expenses, which is known as discretionary income. Disposable income is a macroeconomic measure used to gauge the overall economic. If the disposable income lowers, it can be a major indicator of a possible recession.



Source: FRED

As shown in the figure above the Real Disposable Personal Income has declined from LTM high of $19,119 in March 2021 to $15,146 in July 2022. This could be an early indicator of a recession. As consumers have less purchasing power, their spending is lessened. We see the Drink Industry as having much inelastic demand than the economy at large because more products are less than $2. [10]

US Dollar Index

The US dollar Index is a measure of the value of the dollar against a basket of foreign currencies. The foreign currencies it is against is the British pound, Euro, Japanese yen, Canadian dollar, and Swedish krona. The index was established in 1973 by the US Federal Reserve with a base of 100. This is index is a fair indication of the US Dollar's value in global markets.

US Dollar Index

Source: Marketwatch

In the past year, the US Dollar Index has increased from 93.28 in September 2021 to 109.64 in September 2022. We believe the US Dollar will continue to increase as the US dollar strengthens due to the energy crisis in Europe. This negatively effects KO as their profits and uninvested cash from foreign nations are tampered. We believe this is a near-term issue and will be settled over the next year to decade. [16]

VALUATION

Revenue Decomposition

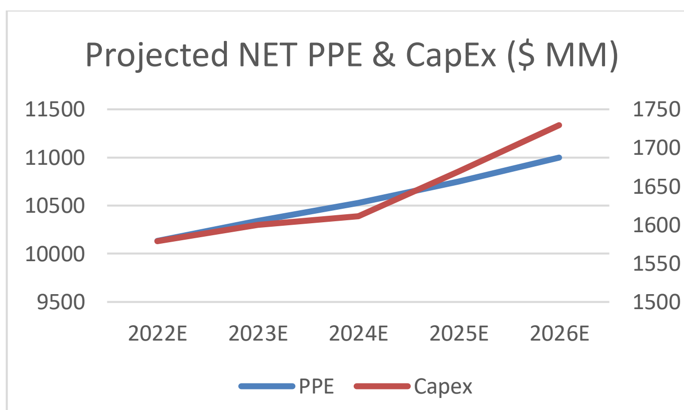
We decomposed the revenue into business segments to mimic how the revenue is displayed in official release documents. The segments are North America; Latin America; Europe; Middle East, & Africa; and Asia Pacific.

Income Statement

We expect the total sales to increase by 8.72% in 2022E to over $42 billion. The cost of goods sold is forecasted to be approximately $17 billion, leaving an operating income of about 10 billion. The EPS is expected to be $2.18, which is equal to the FactSet GAAP Consensus. We are more bullish in future, due to our outlook on SG&A trimming and higher sales growth.

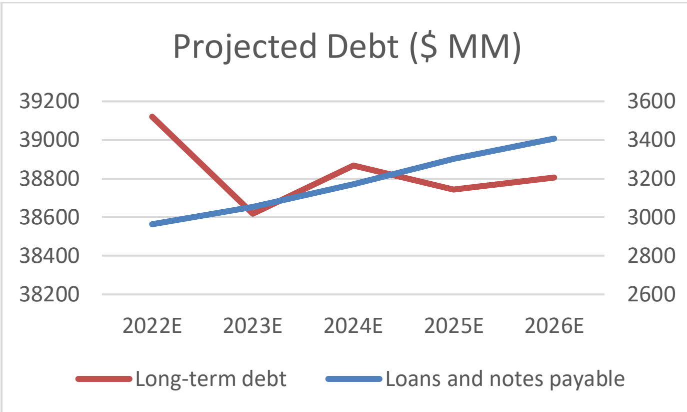
Balance Sheet

Operating assets and liabilities like marketable securities, inventories, accounts payable etc., are projected to grow at the historical average percentage of sales adjusted to inflation. This is largely because we do not expect major changes to shake up the cost of these items in the future.



Source: Henry Fund Model

For capital expenditures, we expect it to rise to 1579 in 2022 within management guidance. From there on out we have than figure rising to keep up with inflation. The inflation figure used was 3.60%, which was the median Henry Fund Analyst estimate the depreciation is a bearish historical average using extreme bullish figures out.



Source: Henry Fund Model

We expect the long-term debt to be paid down to historical figures (Mid $20 billions) for time following multiple M&A deals. We expect the current debt to keep up the ratio with the sales moving forward.

Value Drivers

We calculated the NOPLAT as a needed input to get the free cash flows and ROIC. We got the operating working capital added to the present value of operating leases, intangible assets, and net property plant and equipment to get the invested capital. We then calculated each year's free cash flow by taking that year's NOPLAT less the change in invested capital. We calculated ROIC by taking each year's NOPLAT divided by the beginning invested capital. The economic profit was also calculated on this worksheet by taking each year's beginning invested capital time ROIC less WACC.

WACC

The weighted average cost of capital was calculated using the 10-year Treasury bond as the risk-free rate. The beta used was an average of 2, 3, 3, 4, and 5-year weekly raw betas web scraped off of Bloomberg. The equity risk premium of 5.15% was Henry Fund Analysts' estimate. Using the CAPM, the cost of equity of 8.04% was solved. KO's pre-tax cost of debt is the yield on the firm's 10-year corporate bond. Using the marginal tax rate of 23%, the after-tax cost of debt is 3.23%. KO has $256,915 million in market equity value and $44,169 million in market value of debt. The market value of equity is 77.46% of market value of the firm and the market value of debt is 22.54%. After using the WACC formula, we received an estimated WACC of 5.72%.

Discounted Cash Flows Model

The discounted cash flows model used the free cash flows from the drivers' page. This model aims to discount future cash flows to the present. After we get the present value of operating assets, which was garnered from discounting the free cash flows from 2022 to perpetuity by the WACC, we subtracted the non-operating adjustments to get a value of equity. The value of equity was then divided by the number of shares outstanding to get the intrinsic value at the end of the last fiscal year. We then fractional discounting to get the intrinsic value of the share price today, which was $68. This has an implied return of 15.3%.

Economic Profit Model

The economic profit model used the terminal value growth of NOPLAT assumption of 4% and terminal year ROIC of 32.98. The terminal year ROIC was calculated on the drivers' page using last year's NOPLAT divided by the beginning invested capital. We discounted the economic profit from 2022 to perpetuity by the WACC, we subtracted the non-operating adjustments to get a value of equity. The value of equity was then divided by the number of shares outstanding to get the intrinsic value at the end of the last fiscal year. We then fractional discounting to get the intrinsic value of the share price today, which was $68. This has an implied return of 15.3%.

Relative Valuation Model

The relative valuation uses peers' financial ratios that have similarities to the target company to arrive at an implied relative value. We selected Pepsi Co.; Keurig Dr Pepper Inc.; Monster Beverage Corporation; Celsius Holdings, Inc.; National Beverage Corp.; and Primo Water Corporation as peers with the Soft Drinks Industry. We removed Celsius Holdings, Inc because their financial were an extreme outlier. The financial metrics used were 2022E P/S, and 2023E P/S. After getting the peers' average for each metric it is used as a multiple to arrive at the implied relative value. We multiplied the Coke's financials metrics times the peers' multiples and averaged these out to arrive at an implied relative value of $62.83 per share. This has an implied return of 6.49%.

Dividend Discount Model

The dividend discount model uses the assumption that the earning per share growth will be 4%, to sustain growth with the economy. The terminal year ROE was solved for on the ratios' worksheet. The cost of equity was solved for on the WACC's worksheet. The future EPS and DPS were projected out on the IS worksheet. The dividends per share were discounted for 2022 to perpetuity by the cost of equity to get the intrinsic value at the end of last fiscal year. We then utilized fractional discounting to get the intrinsic value of the share price today, which was 64.85. This has an implied return of 9.92%.

Sensitivity Analysis

We built six sensitivity tables that would help us understand the marginal change by slight differences in the models' assumptions the twelve variables were pre-tax cost of debt, risk-free rate, beta, terminal growth of NOPLAT, marginal tax rate, beta, equity risk premium, depreciation rate, normal cash % of sales, 2026E global revenue growth, potential cost of scandals, and 2023E united states revenue growth.

The variables that are the most intriguing table are the effect of the beta and marginal tax rates could have on KO share prices. The beta is one of the most intriguing aspects of the stock, as this stock is historically a low beta play. Due to being a staple of everyday consumer lives. The marginal tax rate could shift, if KO loses its legal battle with the IRS, so it was important that we did our due diligence. If the betas were to dramatically increase, which is highly unlikely. KO could be having issues because their cost of capital would be expensive, lowering the amount they could bid on an appeal acquisition.

Sanity Check

The For a sanity check we chose three liquidity ratios, asset-management leverage ratios, profitability ratios, and payout ratios. The most notable is the total payout ratio, this ratio is the dividends paid and treasury repurchase cost divided by net income of that year. Over the last five historical years, KO has paid out more their net income. We have forecast 2022E to have an over 100% pay out, thereafter it will decrease to nearly 80% into perpetuity.

KEYS TO MONITOR

We need to keep inflation and the US Dollars exchange rate with foreign nations at the front of our attention. Inflation can cause products to be underpriced and laborers to be underpaid. If inflation is still above 7% and unemployment is over 5%, there will be serious issues for this firm, as well as the market at large. Foreign demand for products and profit can be harshly affected by currency exchange rates; if momentum is continued from issues with the Euro's value there could be an effect seen on KO's bottom line. If the Euro's value continues to decline lower than $0.90 to Euro, KO will lose over 5% of revenue to currency exchange.

RECOMMENDATION

We have a **BUY** rating on the Coca-Cola Company (KO). KO shares are currently traded at $59, which is below our target range of $64 to $68 with an upside of 10.44%. We understand that this firm may have not the largest upside out of all available firms, but due to our downward outlook of the economy at large it is essential to add inflation insensitive firm with a reliable dividend and commitment to stock buybacks. We believe in KO near and long-term growth due to the firm's nature to adapt to what the market demands.

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