

Should Warren Buffett sell Coca Cola after 34 years?



Valuation Master Class



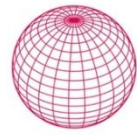
What's interesting
about Coca Cola is
that **Warren Buffett**
owns more than **9%**
of the company



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Should Warren Buffett sell Coca Cola after 34 years?



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Sector: Industrials



American beverage giant that conquered the world with an estimated brand value of US\$90bn

Our estimate:

US\$50

(Downside 20%)

SELL



3 things to know about this company

- ★ Centralized portfolio to maintain superior profitability
- ★ Leveraging revenue through organic growth and acquisitions
- ★ A cash cow with stable and growing dividends

Key statistics

Analyst consensus (28)

US\$70

(Upside 12%)

BUY

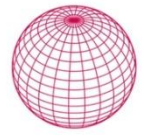
PE ratio (21A)

28x

Dividend yield

2.7%

Do you want to hear a fun fact about Warren Buffett?

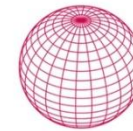


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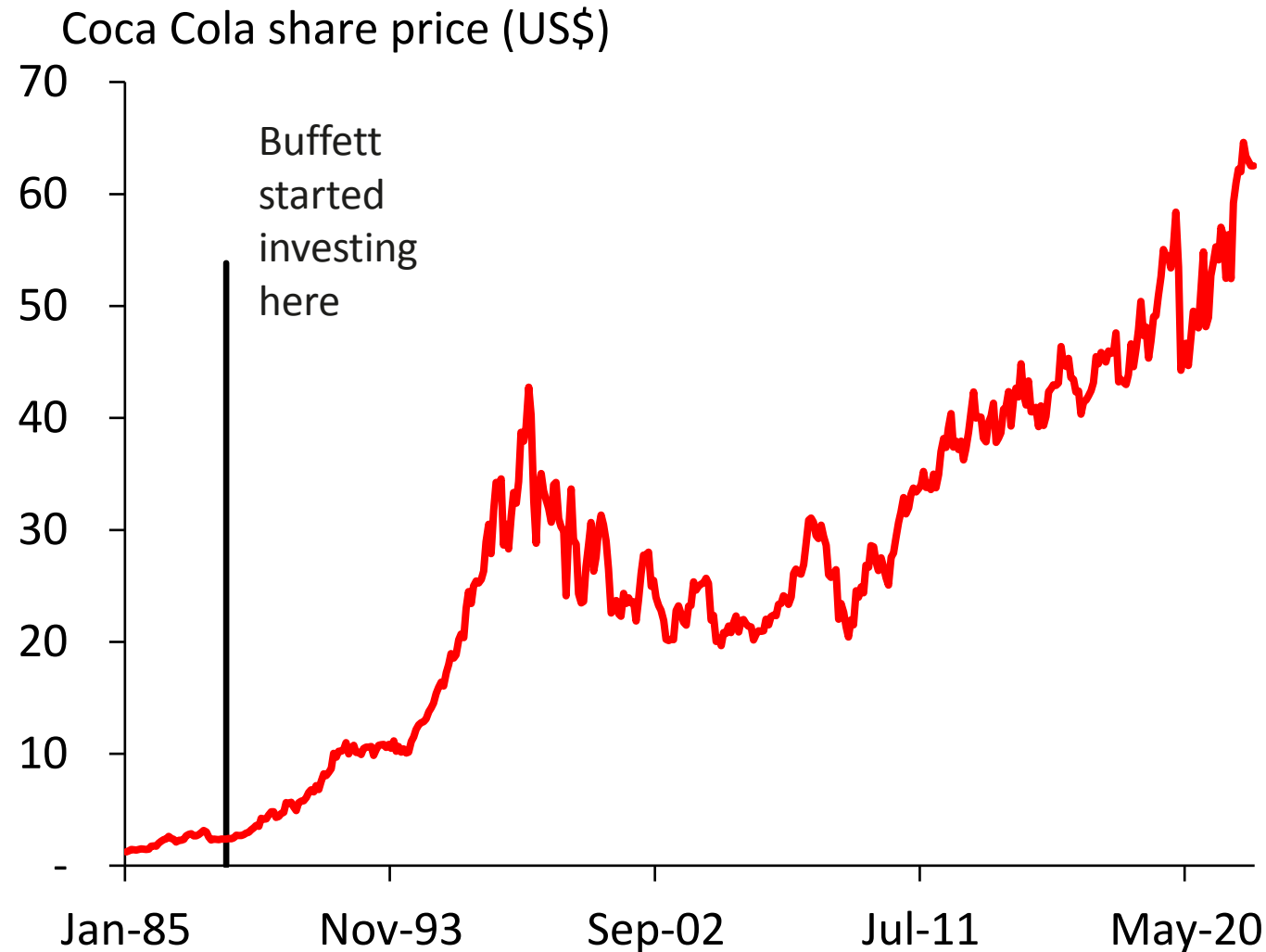
"If I eat 2,700 calories a day, a quarter of that is Coca-Cola. I drink at least five 12-ounce servings. I do it every day."

Do you want to hear a fun fact about Warren Buffett?

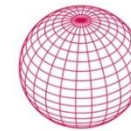


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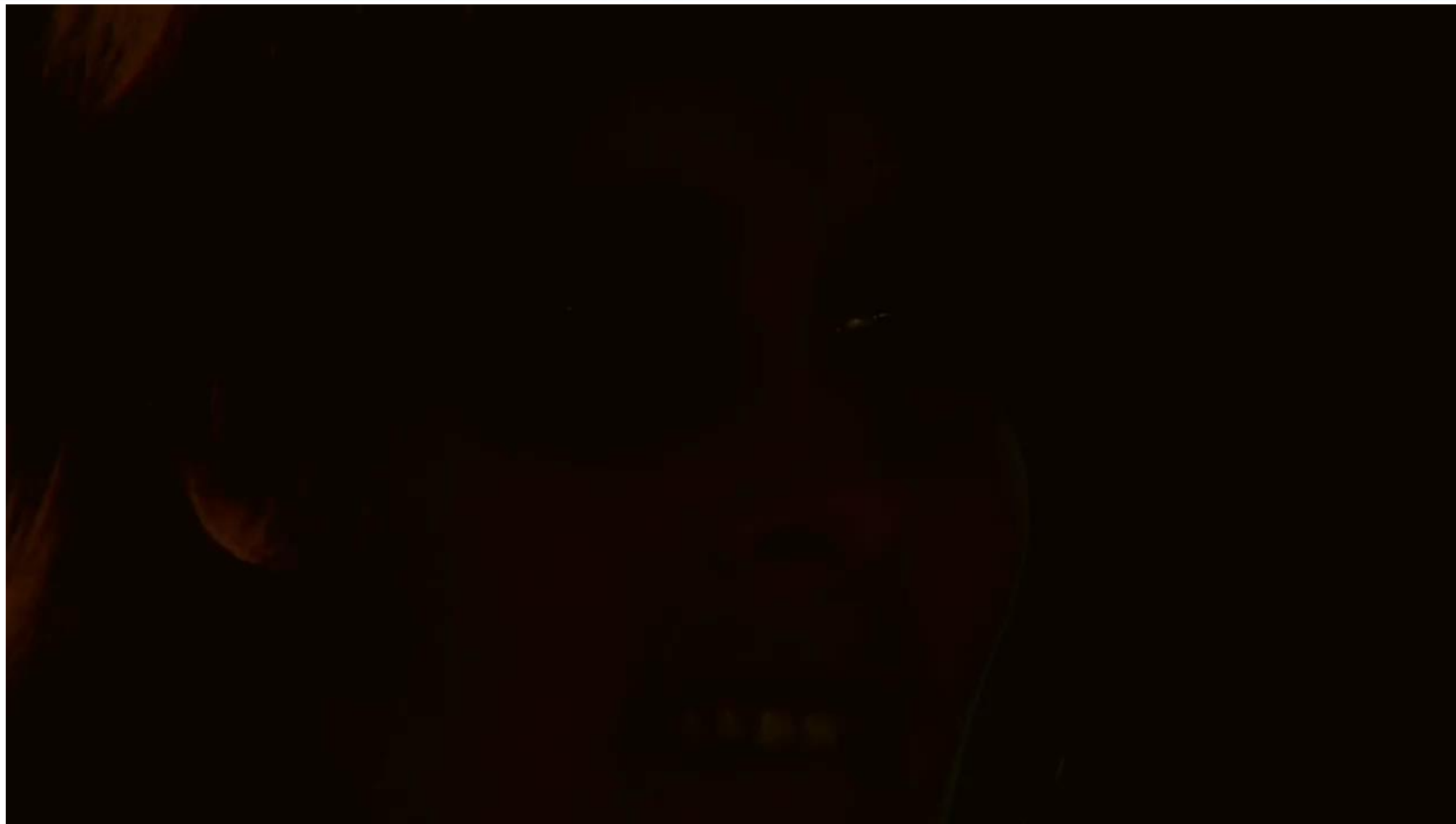
- ★ Warren Buffett bought Coca Cola shares for the first time in January 1988
 - Since then, the share price has increased by more than 2400%
 - Also, he never sold a single share of it
- ★ Here is the reason why
 - "No business ever failed with happy customers. [Coca Cola is] selling happiness."

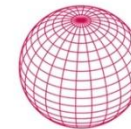


Coca Cola has created one of the most memorable commercials ever



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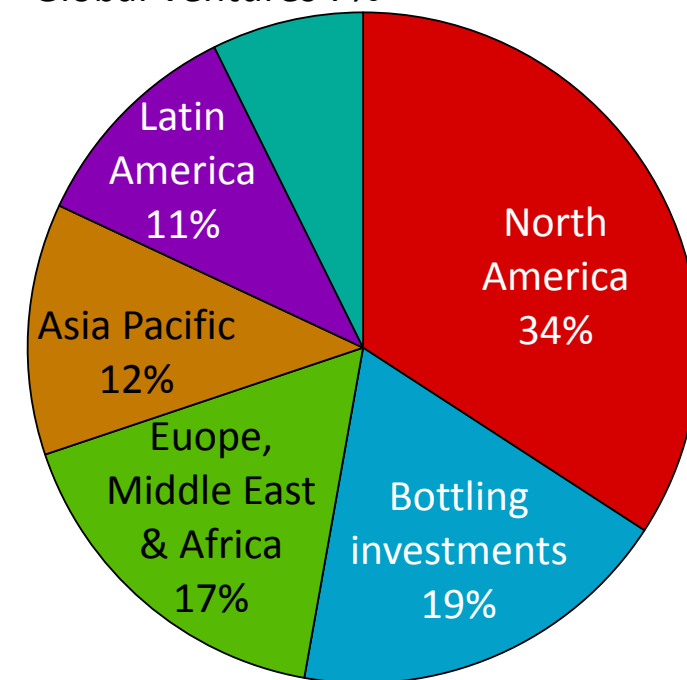
Risks

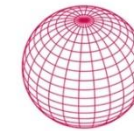
A beverage empire



Breakdown by segment

Global Ventures 7%





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P&L (US\$m)	2019	2020	2021
Revenue	37,270	33,014	38,655
COGS	(14,597)	(13,433)	(15,357)
Gross profit	22,673	19,581	23,298
Operating (exp.)/inc.	(12,161)	(9,757)	(12,144)
EBIT	10,512	9,824	11,154
Other items	(1,592)	(2,077)	(1,383)
Net profit	8,920	7,747	9,771

	2019	2020	2021
Revenue	67,161	70,372	79,474
COGS	(30,132)	(31,797)	(37,075)
Gross profit	37,029	38,575	42,399
Operating (exp.)/inc.	(26,738)	(28,495)	(31,237)
EBIT	10,291	10,080	11,162
Other items	(2,977)	(2,960)	(3,544)
Net profit	7,314	7,120	7,618

- ★ PepsiCo and Coca Cola are fierce competitors
 - Interestingly, their strategy to expand market share differs significantly
- ★ PepsiCo has diversified its product portfolio and encompasses food and snacks
 - It is also considered a price setter in the market
- ★ Coca Cola stayed centralized on beverages and is rather considered as a price follower

Higher net profit despite having much less revenue



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Risks



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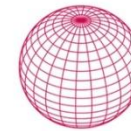
Common size (%)	2019	2020	2021
Revenue	100	100	100
COGS	(39.2)	(40.7)	(39.7)
Gross profit	60.8	59.3	60.3
Operating (exp.)/inc.	(32.6)	(29.6)	(31.4)
EBIT	28.2	29.8	28.9
Other items	(4.3)	(6.3)	(3.6)
Net profit	23.9	23.5	25.3

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	2019	2020	2021
Revenue	100	100	100
COGS	(44.9)	(45.2)	(46.7)
Gross profit	55.1	54.8	53.3
Operating (exp.)/inc.	(39.8)	(40.5)	(39.3)
EBIT	15.3	14.3	14.0
Other items	(4.4)	(4.2)	(4.5)
Net profit	10.9	10.1	9.6

- ★ The expansion of product lines has led to a rise in Pepsi's revenue, which is now 2 higher than Coca Cola
- ★ However, Coca Cola has superior profitability leading to a similar bottom line

2 Leveraging revenue through organic growth and acquisitions



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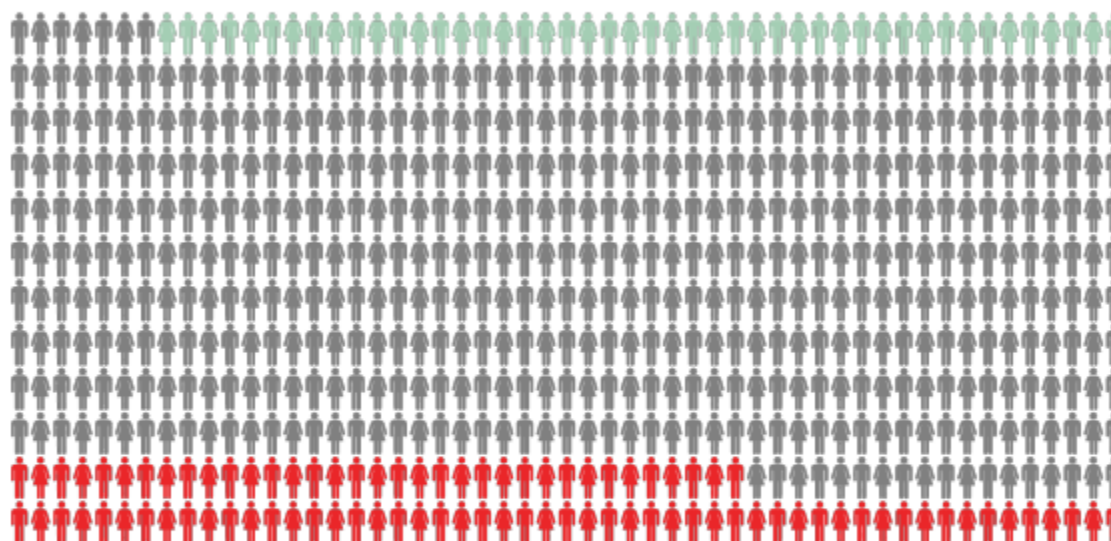
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On a Global Scale



TCCC Consumer



Non-TCCC Consumer



2030 Population Increase

TCCC = The Coca Cola Company

★ Despite Coca-Cola being such a big brand, there are still many people who haven't consumed a product from it yet (The grey portion of the graphic)

- To grow in emerging markets, it bets on offering affordable products
- In developed countries, it increasingly focuses on premiumization

Acquisitions are key to reaching new consumers



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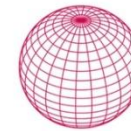
Year Ended December 31,	2021	2020	2019
Operating Activities			
Consolidated net income	\$ 9,804	\$ 7,768	\$ 8,985
Depreciation and amortization	1,452	1,536	1,365
Stock-based compensation expense	337	126	201
Deferred income taxes	894	(18)	(280)
Equity (income) loss — net of dividends	(615)	(511)	(421)
Foreign currency adjustments	86	(88)	91
Significant (gains) losses — net	(1,365)	(914)	(467)
Other operating charges	506	556	127
Other items	201	699	504
Net change in operating assets and liabilities	1,325	690	366
Net Cash Provided by Operating Activities	12,625	9,844	10,471
Investing Activities			
Purchases of investments	(6,030)	(13,583)	(4,704)
Proceeds from disposals of investments	7,059	13,835	6,973
Acquisitions of businesses, equity method investments and nonmarketat	(4,766)	(1,052)	(5,542)
Proceeds from disposals of businesses, equity method investments and r	2,180	189	429
Purchases of property, plant and equipment	(1,367)	(1,177)	(2,054)
Proceeds from disposals of property, plant and equipment	108	189	978
Other investing activities	51	122	(56)
Net Cash Provided by (Used in) Investing Activities	(2,765)	(1,477)	(3,976)

★ Acquisitions allow Coca Cola to stay up to date with markets trends

- For example, in 2021, it acquired Body Armor to gain market share in the sport drinks industry

★ Both organic growth and acquisitions provide a good foundation for further growth

3 A cash cow with stable and growing dividends



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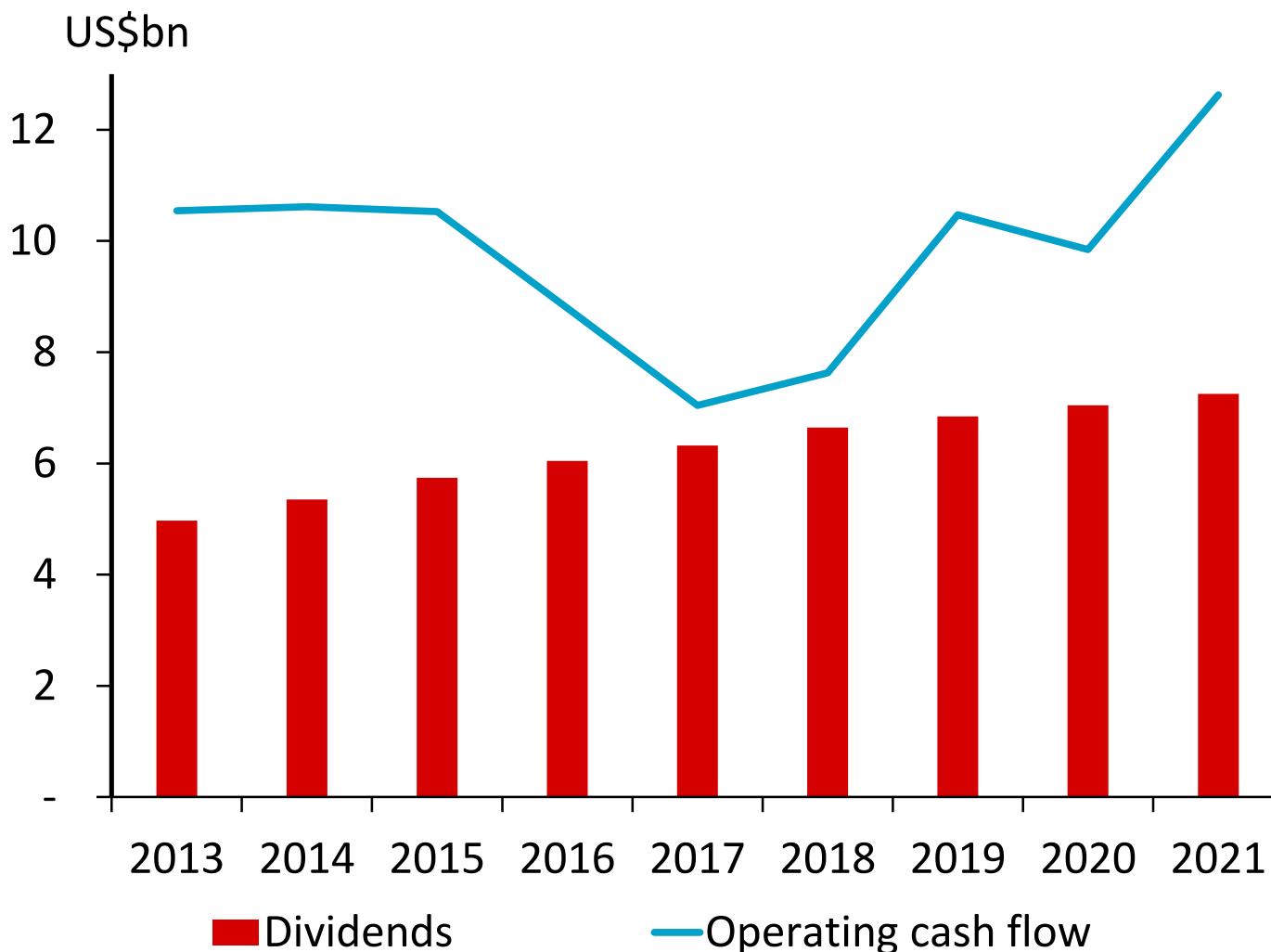
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- ★ Coca Cola delivered a solid annual dividend yield of 3 – 3.5% over the past few years
 - **Given the strong cash flow generation, we don't see a risk that it can't continue growing its dividends over time**
- ★ The company even has massive share buyback programs to return excess cash to shareholders

Consensus is bullish



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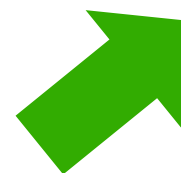
Risks

Analyst consensus valuation

Recommendation	Apr-22	May-22	Jun-22	Current
Strong buy	5	4	4	3
Buy	16	17	17	17
Hold	7	8	8	8
Sell	-	-	-	-
Strong sell	-	-	-	-
Average score	2.1	2.1	2.1	2.2

Price target	Apr-22	May-22	Jun-22	Current
Median	68	70	70	70
Mean	68	70	70	70

28
analysts



Upside: 12%

Analyst consensus 3-year forecast

(%)	19	20	21	22E	23E	24E
Revenue growth	8.7	(11.4)	17.1	8.1	5.1	5.7
Gross margin	60.8	59.3	60.3	59.9	59.9	60.4
EBIT margin	28.2	29.8	28.9	30.5	30.1	30.2
Net margin	23.9	23.5	25.3	25.6	25.9	26.3

- ★ Most analyst have a BUY recommendation on the company, but the upside is rather small
- ★ Analysts predict stable revenue growth an a net margin expansion

Profit & loss statement



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(YE Dec, US\$ m)	2020A	2021A	2022E	2023E
Revenue	33,014	38,655	41,361	43,429
Cost of goods & services	(13,433)	(15,357)	(16,338)	(17,154)
Gross profit	19,581	23,298	25,023	26,274
SG&A	(9,731)	(12,144)	(12,408)	(13,246)
Other operating (exp)/inc	(26)	-	-	-
EBIT	9,824	11,154	12,615	13,029
Interest expense (net)	(1,067)	(671)	(486)	(489)
Other non-operating inc/(exp)	166	334	351	368
Earnings before taxes (EBT)	8,923	10,817	12,479	12,907
Income tax	(1,981)	(2,621)	(2,870)	(2,969)
Earnings after taxes (EAT)	6,942	8,196	9,609	9,939
Equity income/Minority interest	957	1,405	1,024	1,086
Earnings from cont. operations	7,899	9,601	10,633	11,025
Forex/Exceptionals before tax	(152)	170	-	-
Net profit	7,747	9,771	10,633	11,025

★ Coca Cola has a one-of-a-kind profitability, leading to a super strong bottom-line



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(YE Dec, US\$ m)	2020A	2021A	2022E	2023E
Cash & short-term investments	10,914	12,625	10,531	11,901
Accounts receivable	3,144	3,512	3,791	4,102
Inventories	3,266	3,414	3,721	3,907
Other current assets	1,916	2,994	3,226	3,387
Total current assets	19,240	22,545	21,269	23,297
Long-term investments	19,273	17,598	18,654	19,773
Net fixed assets	12,325	11,338	10,182	9,411
Intangible assets	11,044	15,250	15,557	15,874
Goodwill	17,506	19,363	20,138	20,943
Other long-term assets	7,908	8,260	8,838	9,457
Total assets	87,296	94,354	94,638	98,755

- ★ Acquisitions are an integral part of the business to drive revenue growth

Balance sheet - liabilities



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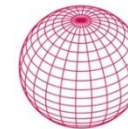
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(YE Dec, US\$ m)	2020A	2021A	2022E	2023E
Overdrafts & short-term loans	2,668	4,645	1,207	1,231
Accounts payable	9,686	13,191	13,615	14,295
Other current liabilities	2,247	2,114	2,068	2,171
Total current liabilities	14,601	19,950	16,890	17,698
Long-term debt	40,125	38,116	39,036	39,817
Other long-term liabilities	11,286	11,428	11,657	11,890
Total liabilities	66,012	69,494	67,582	69,404
Minority interest	1,985	1,861	1,893	1,926
Paid-up capital - Common shares	19,361	19,876	19,876	19,876
Paid-up capital - Preferred shares	-	-	-	-
Retained earnings	66,555	69,094	71,801	74,608
Revaluation/Forex/Others	(66,617)	(65,971)	(66,514)	(67,060)
Total equity	19,299	22,999	25,163	27,424
Total liab & shareholders' equity	87,296	94,354	94,638	98,755

- ★ The company uses excess cash to buyback shares, providing additional return for shareholders



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(YE Dec)	2020A	2021A	2022E	2023E
Internal liquidity (x)				
Current ratio	1.3	1.1	1.3	1.3
Quick, or acid test ratio	1.1	1.0	1.0	1.1
Working cap. mgmt (Days)				
Inventory conversion period	89	78	79	80
Receivables collection period	39	31	32	33
Days from raw mat to coll	128	109	110	113
Payables deferral period	276	268	295	293
Cash conversion cycle	(149)	(159)	(185)	(180)
Profitability ratios (%)				
Gross profit margin	59.3	60.3	60.5	60.5
EBIT margin	29.8	28.9	30.5	30.0
EBIT return on avg assets	11.3	12.3	13.3	13.5
Return on average assets	8.9	10.8	11.3	11.4
Financial risk (x)				
Liabilities-to-assets (%)	75.6	73.7	71.4	70.3
Debt-to-equity	2.2	1.9	1.6	1.5
Net debt-to-equity	1.7	1.3	1.2	1.1
Times-interest-earned	7.9	13.3	18.2	19.9
Effective interest rate (%)	3.4	2.2	1.9	1.8

- ★ High payables outstanding illustrates the bargaining power it has over its suppliers



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(YE Dec)	2020A	2021A	2022E	2023E
General growth (YoY, %)				
Revenue	(11.4)	17.1	7.0	5.0
Assets	1.1	8.1	0.3	4.3
Gross profit	(13.6)	19.0	7.4	5.0
Operating profit	(6.5)	13.5	13.1	3.3
Attributable profit	(13.2)	26.1	8.8	3.7
EPS	(13.5)	25.5	8.7	4.0
Recurring EPS	(20.7)	22.1	10.2	4.0
Du Pont analysis (%)				
Net profit margin	23.5	25.3	25.7	25.4
Revenue per US\$100 of assets	38.0	42.6	43.8	44.9
Assets/equity (x)	4.5	4.3	3.9	3.7
Return on equity	40.5	46.2	44.2	41.9
Others (%)				
Effective tax rate	22.6	23.9	23.0	23.0
Dividend payout ratio	89.6	75.2	75.1	74.9

★ Strong dividend payout ratio contributed to a solid annual 3 - 3.5% dividend yield over the past few years



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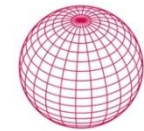
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(YE Dec, US\$ m)	2020A	2021A	2022E	2023E
EBIT	9,824	11,154	12,615	13,029
<i>Est tax rate (%)</i>	23	24	23	23
NOPAT	7,605	8,493	9,714	10,032
Add: Depre & amort	1,536	1,452	1,516	1,548
Less: CAPEX	(988)	(1,259)	(1,442)	(1,898)
Chg in A/R	827	(368)	(279)	(310)
Chg in inventory	113	(148)	(307)	(186)
Chg in oth curr assets	(30)	(1,078)	(232)	(161)
Chg in A/P	(1,253)	3,505	424	681
Chg in oth curr liabs	1,460	(133)	(46)	103
Less: Chg in working cap	1,117	1,778	(441)	127
Less: Chg in invest cap				
Free cash flow to firm	9,270	10,464	9,347	9,808

- ★ Coca Cola is a cash flow machine and there is no reason to assume differently for the future



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Forecast assumptions

3-year average	Consensus	My assumptions
Revenue growth (CAGR)	6.3	5.7
Gross margin	60.0	60.5
EBIT margin	30.3	30.2
Net margin	25.9	25.5

My valuation method

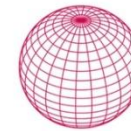
Market: United States

Market risk-free rate	2.5
Market equity risk premium	8.0
Market return	10.5
Company beta (x)	0.8
COE	8.5

WACC	7.2
Terminal growth rate	3.0

Valuation Method:
FCFF

- ★ Deglobalization trend could result in lower-than-expected revenue
 - However, I agree with the consensus that Coca-Cola can defend its massive margin over time
- ★ I value the company by using FCFF and a terminal growth rate of 3%



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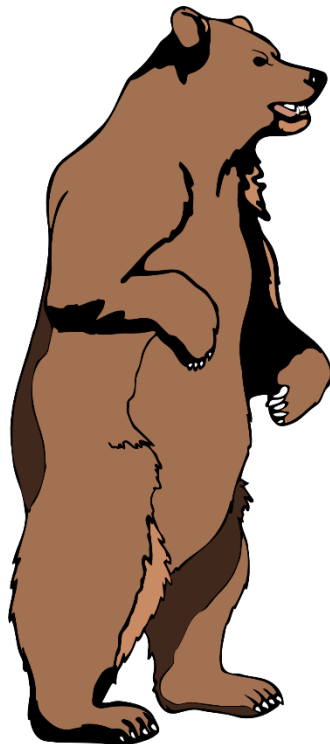
Ratios

Value

Risks

Bear
US\$46

(Downside 26%)



Base
US\$50

(Downside 20%)



Bull
US\$54

(Downside 13%)





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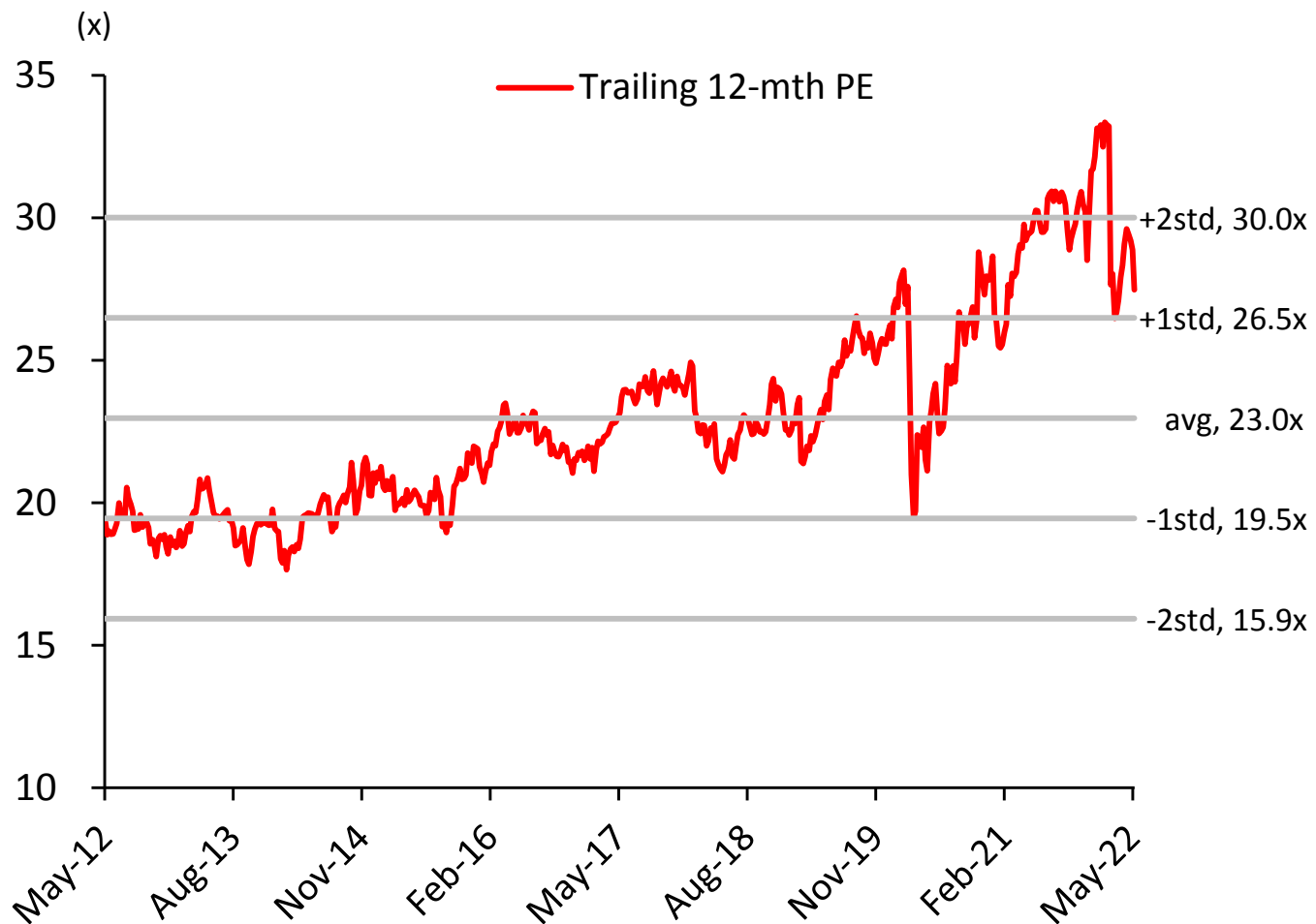
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- ★ Recently, its PE was trading two standard deviations higher than its long-term average



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- ★ Failure to meet changing consumer behavior (e.g., increasing health awareness)
- ★ Lower-than-expected synergies from acquisitions
- ★ Deglobalization trend could benefit local brands

CONCLUSION

- Coca Cola is a fantastic brand with a massive profitability
- Shareholders benefit from high dividends and share buybacks
- Though, valuation might be a bit too high

