COLEGIO UNIVERSITARIO DE ESTUDIOS FINANCIEROS

Trabajo de Fin de Grado

Financial Analysis of the Financial Statements and Industry Comparison:

THE COCA-COLA COMPANY and PEPSICO

Bilingual Degree in Business and Management

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Madrid, April 25th, 2019

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1. INTRODUCTION

1.1 TFG Justification and Objective

This world improves with competition. Competing allows individuals and organizations to be better, more efficient, and smarter. When one company competes with another for market share and profit, they both learn from each other and improve together. This is the basis of the choice to analyze the financial statements of The Coca-Cola company, commonly known as “Coca-Cola”, and PepsiCo, known as “Pepsi”. Both companies have some similarities, starting from the time they were created and going on to their unique way of selling their drinks. Both companies have grown together, but they have also used different strategies to expand. By comparing their balance sheets and income statements, it is expected to find be many differences, on which will be commented and studied. These differences will show how their growth model is working, their stability, their future expectations, and their inefficiencies —as it is expected to find inefficiencies in both companies.

1.2 Company Histories

The Coca-Cola company and PepsiCo have been huge rivals throughout the years. This rivalry started seven years after the creation of Coca-Cola, which took place in 1886 by pharmacist John S. Pemberton, when Pepsi was created by another pharmacist, Caleb Bradham.

At first Pepsi was sold in drugstores as a drink for aiding digestion but, as the years went by, it began being sold as a drink for people to enjoy (Bellis 2018) (Bhasin 2013). Pepsi went bankrupt in 1923 for “gambling on sugar prices” (they believed that prices were going to rise, so they purchased an excessive amount of sugar). In 1931 Pepsi was sold to Loft Candy Co, but it was still not selling enough, and it was even offered to Coca-Cola during the Great Depression. Loft Candy’s president, Guth, reformulated the soda and the sales strategy and suddenly Pepsi was being sold again. In the 1960’s Pepsi reformulated their strategy and acquired Mountain Dew. Later that decade, Pepsi merged with Frito-Lay to become what is now known today as PepsiCo. Since then, Pepsi has been launching new products and has grown to be a bigger and more stable company than Coca-Cola through their market diversification (Tikkanen, Enciclopaedia Britannica s.f.).

On the other hand, Coca-Cola was first sold in a soda fountain — a very popular place for social gatherings at that time, usually close to an apothecary — as a drink to cure ailments. In 1888 its creator, Pemberton, died, but not before selling the company to Asa Griggs Candler who, by 1892, acquired the company and incorporated it as The Coca-Cola Company. In 1919, Coca-Cola was sold to a group of investors that began selling the beverages for home consumption. The post-World War II years saw diversification in the packaging of Coca-Cola and the development and acquisition of new products. The trademark “Coke,” first used in advertising in 1941, was registered in 1945. In 1946 the company purchased rights to Fanta, a soft drink previously developed in Germany, and to the lemon-lime drink, Sprite, in 1961. Since then, Coca-Cola has acquired various different beverages from the same sector — non-alcoholic beverages. In 1981, Roberto C. Goizueta became chairman of the board of directors and CEO of Coca-Cola. Goizueta organized the various U.S. Coca-Cola bottling operations into a new public company, Coca-Cola Enterprises Inc. Coca-Cola has become one of the most recognizable brands and trademarks in the world. With over 1.7 billion servings of Coca-Cola products being served each day, Coca-Cola continues to be one of the world’s most ubiquitous beverages (Tikkanen, Enciclopaedia Britannica s.f.) (Yafai 2016).

The beginnings of the Coca-Cola company and Pepsi have not differed too greatly, one of the many reasons why nowadays, the companies still fight for a position in the marketplace.

1.3 Non-Alcoholic Beverages Sector Analysis and Trends

The non-alcoholic beverages sector includes mainly soft drinks and hot drinks, such as water, carbonated drinks, juices, tea, coffee, etc. Companies in the soft drink industry reach the end market in two ways. One way is by selling finished products, made at company-owned bottling facilities, to distributors and retailers. Another way is by selling beverage concentrates and syrups to authorized bottling partners, who then make the final product by combining the concentrates with still or carbonated water, sweeteners, and other ingredients. Coca-Cola and Pepsi use both ways to reach the final costumer. These two companies particularly have an incredible pricing power and can also produce and distribute third-party brands.

The global soft drink market is led by carbonated soft drinks (or CSDs), which had a market size of $337.8 billion in 2013. In the same year, CSDs were followed by bottled water, with a market size of $189.1 billion, and juice, with a market size of $146.2 billion. In this market there are different companies competing, the main competitors are: The Coca-Cola company, PepsiCo, Dr Pepper Snapple Group, Monster Beverage Corporation, and Cott Corporation. Coca-Cola and Pepsi are part of the consumer staple sector, which is essentially composed of products that people are unlikely to stop buying regardless of their financial situation, such as beverages, tobacco, producers of non-durable goods, and personal products. Products like this are considered to be less sensitive to economic cycles. (Fidelity s.f.) (Bailey, Market Realist 2014) (Bailey, Market Realist 2014)

The term soft drink originated to distinguish the flavored drinks from hard liquor or distilled spirits. Soft drinks were recommended as a substitute in the effort to change the hard-drinking habits of early Americans. In fact, health concerns of modern consumers led to new categories of soft drinks emphasizing low calorie count, low sodium content, no caffeine, and “all natural” ingredients.

The regular consumption of soft drinks has been associated with multiple chronic health conditions. These increased risks are largely due to the added ingredients in soft drinks, especially sugar. Indeed, some sugar-sweetened soft drinks contain 40 grams of sugar or more per 12-ounce serving, which exceeds the recommended daily sugar intake for adults. Long-term consumption of soft drinks is linked to weight gain, obesity, and tooth decay. Sugar-free soft drinks also have been associated with dental erosion. Concerns about the negative health effects of soft drinks have given rise to debate about legally restricting their consumption through soda bans, increased soda taxes, and other regulatory measures. In January 2014 Mexico became one of the first countries to impose a nationwide revenue-raising tax on soft drinks containing added sugar. Later that year Berkeley, California, became the first city in the United States in which voters unanimously approved a tax on sugary drinks. In 2015, a ban on the sale of caffeinated soft drinks to children went into effect in the Vologda region of Russia. That same year authorities in San Francisco approved a measure that would require soft drink manufacturers to add health warnings to soft drink labels, similar to the health warnings displayed on labels for alcohol and tobacco products. As it can be seen, governments form different countries are realizing of the health issues that CSDs bring and acting toward this, but is not only the governmental institutions realizing this, people have started to realize this too and carbonated drinks consumption has been decreasing. On the other hand, bottled water, ready-to-drink coffee, and energy drinks are increasing their volume sales. (Pietka 2019) (Beverage Marketing Corporation 2015) (Beverage Marketing Corporation 2017)

U.S volume decade comparison from 2007-2017		
Category	Millions of gallons	CAGR
Bottled Water	4898	4.50%
RTD Tea	514	3.60%
Energy Drinks	350	7.50%
Sport Drinks	183	1.30%
Bvalue-Added Water	100	1.80%
RTD Coffee	94	11.20%
Fruit Beverages	-759	-2.20%
CSD	-2382	-1.80%
Total	2998	0.90%

Table 1- U.S volume decade comparison from 2007-2017

As it can be seen in this graph, from the Beverage Marketing Corporation about volume sales from 2007 to 2017 in U.S (the largest CSD consumer country), CSDs have decreased greatly in the last 10 years, giving rise to bottled water, which have increased their sales the most, expanding to 4898 more gallons sold in 2017 than in 2007.

Lastly, in general, overall revenues in the non-alcoholic beverages sector have been decreasing as well.

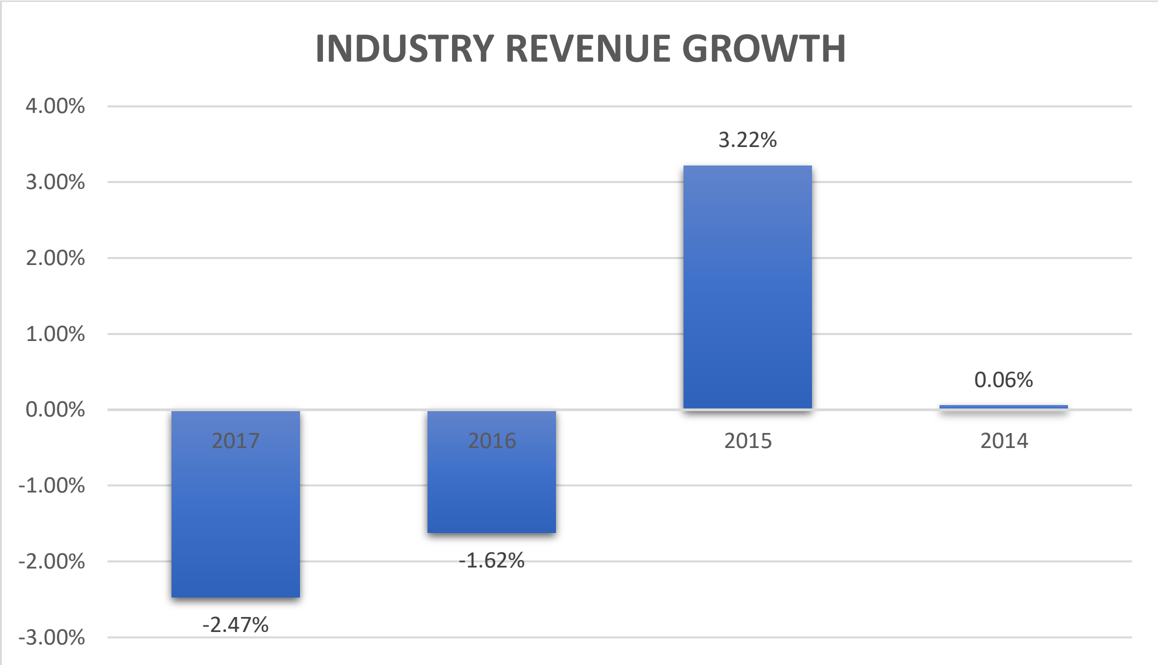

Table 2- Industry revenue growth from 2014-2017

As it can be seen in this graph, for the last two years analyzed in this paper, 2016 and 2017, the non-alcoholic beverages industry has been decreasing, and for the last four years, from 2014-2017, there has been no growth in the industry.

1.4 Tax Reform Act

The tax cuts and jobs act, or TCJ, is a regulatory reform that was imposed by the new Republican government at the end of 2017 and affected most international American companies. The TCJ act made several significant changes not only to companies, but also to households. As it also affected the results of Coca-Cola and Pepsi for 2017, it is this these aspects that are going to be analyzed. Essentially, the U.S government made profit repatriation more attractive for companies by establishing a tax of 15.5% for a onetime repatriation of cash, while the tax for other non-cash assets was also reduced to 8%. Before, the tax rate for profits returned to U.S was at 35%, which led many companies to keep the money that the country generated for a future reinvestment in that country or in any other one. This meant that U.S didn't get back some of the money from profits out of the country. According to The Coca-Cola Company, in their income statement: *"The tax reform act includes net tax expense of $3,610 million primarily related to our reasonable estimate of the one-time transition tax resulting from the Tax Reform Act that was signed into law on December 22,* *2017, partially offset by the impact of the lower rate introduced by the Tax Reform Act on our existing deferred tax balances."* While for Pepsi: *"During the fourth quarter of 2017, the TCJ Act was enacted in the United States. Among its many provisions, the TCJ Act imposed a mandatory one-time transition tax on undistributed international earnings and reduced the U.S. corporate income tax rate from 35% to 21%, effective January 1, 2018. As a result of the enactment of the TCJ Act, we recognized a provisional net tax expense of $2.5 billion in the fourth quarter of 2017."* (Bartash 2018) (PepsiCo Inc 2017) (The Coca-Cola Company 2017).

For the non-alcoholic beverage sector in the fourth quarter of 2017 the effective industry tax rate was 76% due to this measure, while the average for the past years had been 25.6%. (CSI market s.f.).

By reading this it can be concluded that the cause of a lower net income in the year 2017 for Coca-Cola and Pepsi is due to an increase in taxes that year and that year's tax increase in both companies was, in particular, due to the TCJ act that gave an incentive to both companies to repatriate their profits held in other countries. For Coca-Cola, the TCJ act supposed 53.5% of the total profit before taxes, while for Pepsi it supposed a net 25.5%. These numbers added to the other taxes that Coca-Cola and Pepsi had to pay added to total tax rate of 82.5% and 48.9% respectively.

2. METHODOLOGY

This project is going to be based on the analysis of the financial statements of Coca-Cola and Pepsi. The initial step was to find the income statements and balance sheets of both companies from the year 2014 to the year 2017. Using this information, a horizontal and vertical analysis will be conducted to analyze these statements. After this first analysis the balance sheet and income statement information together with the sector information will be used to calculate different types of ratios that will help to understand both companies' financial statements. In particular, four types of ratios: Activity ratios, Profitability ratios, Solvency ratios, and Liquidity ratios. Both companies' ratios by themselves can be compared to each other, but cannot be used to evaluate each company's performance in reality. As a result, these ratios will also be compared to those of the non-alcoholic beverages industry, which will be a measurement benchmark and aid in seeing how the companies are performing compared to their industry. As well, the root of the differences between the companies and the industry will also be discussed. To generate the non-alcoholic beverages industry ratios the following companies where used:

New Age Beverages, Corp.
Attitude Drinks, Inc.
Mojo Data Solutions, Inc.
Healthient, Inc.
Coca-Cola Enterprises, Inc.
Celsius Holdings, Inc.
Coca-Cola Consolidated, Inc.
Cott, Corp.
China Ginseng Holdings, Inc.
Dewmar International Bmc, Inc.
Fbec Worldwide, Inc.
Keuring Dr Pepper, Inc.
Satusa, Corp.
Fbec Worldwide, Inc.
National Beverage, Corp.
Life on earth, Inc.
Right on brands, Inc.
Jammin Java, Corp.
Jones Soda, Co.
Coca Cola, Co.
KonaRed, Corp.
Leading Brands, Inc.
Long Blockchain, Corp.
Mojo Data Solutions, Inc.
Monster Beverage, Corp.
Mojo Organics, Inc.
Musclepharm, Corp.
New Age Beverages, Corp.
Peets Coffee & Tea, Inc.

PepsiCo, Inc.
Pulse Beverage, Corp.
Reddy Ice Holdings, Inc.
Reeds, Inc.
Rocky Mountain High Brands, Inc.
Sport Endurance, Inc.
Skinny Nutritional Corp.
Smartag International, Inc.
High Performance Beverages Co.
True Drinks Holdings, Inc.
Uplift Nutrition, Inc.
Vim Beverage, Inc.
Diageo Plc.
Ambev S.a.

Table 3- Companies used to generate non-alcoholic beverage industry ratios

The next step will be analyzing the cash flow statement of both companies. Once finished, final conclusions will be drawn based on the companies and sector analysis.

3. BALANCE SHEET AND INCOME STATEMENT ANALYSIS

3.1 Horizontal Analysis

The horizontal analysis is used in financial statement analyses to compare historical data over a number of accounting periods. It's done by performing a comparative analysis between the financial statements of every year, comparing them with the year before statements. This way, the increase from year to year in each statement can be obtained. The results will show the relevant tendencies. There are different ways of performing a horizontal analysis, but in this case, the calculation of the percentage variance of each year, using 2014 as a benchmark for the rest of the years, is going to be done. In essence, the changes of every year in respect to 2014 are going to be seen. Therefore, to do the horizontal analysis the years statements needs to be divided by the initial year statement — 2014. (Merchante 2011) (Jerry Weygandt s.f.) (C. William Thomas s.f.) (Kenton 2018)

THE COCA-COLA COMPANY (% change)