

## Coca-Cola

### 3Q22 Preview: Expecting Strong 3Q with Potential Top-Line Raise; 2023 Outlook Dampened by FX

The Coca-Cola Company (KO, Overweight rated) is scheduled to report 3Q22 earnings on Tuesday, October 25, before the open. We have adjusted a few of our estimates, mostly around incremental FX headwinds and gross margins, and net-net our 3Q22 EPS estimate remains unchanged at \$0.64 while our 2022 EPS estimate move down a penny to \$2.46 and our 2023 EPS estimate moves down \$0.13 to \$2.51 (vs. current Bloomberg consensus for 3Q22, 2022, and 2023 of \$0.64, \$2.46, and \$2.56). We don't think there's much concern around underlying trends in the quarter or for FY22 as 2H22 guidance appeared relatively conservative with the three-year CAGR implied by guidance decelerating to +4.5% in 2H vs. +6.5% in 1H despite strong pricing actions and what appears to be largely resilient consumption trends. [PEP's 3Q22 results likely gave investors comfort around the top line with accelerating three-year CAGR and resilient volume performance despite +17% pricing overall \(albeit more driven by snacks\), but also raised the bar for KO. Net-net, we think there could be a lift to 2022 organic growth guidance of +12-13%, but we are not expecting a raise to EPS guidance given FX headwinds.](#)

Looking ahead, we think the bigger question is how away-from-home (historically ~50% of sales) evolves if the consumer environment deteriorates and given the magnitude of FX headwinds to 2023 EPS growth given multiplier effect from the top to the bottom line. We think post-pandemic KO is better able to navigate a potential consumer pullback in the away-from-home and also flex its RGM capabilities. FX appears set to be another significant headwind to sales/EPS growth in 2023, but we think the strong underlying momentum should be better appreciated relative to historical. Net-net, we think KO should continue to work as a core defensive holding with upside given strong underlying momentum, although we acknowledge that FX will likely continue to dampen EPS growth. We are establishing a Dec 2023 target price of \$63 based on 23.2x P/E (five-year historical average) off our 2024 EPS estimate of \$2.73.

## Overweight

KO, KO US  
Price (20 Oct 22):\$55.08

▼ **Price Target (Dec-23):\$63.00**  
Prior (Dec-22):\$70.00

### Beverage, Household & Personal Care Products

**Andrea Teixeira, CFA** <sup>AC</sup>

(1-212) 622-6735  
andrea.f.teixeira@jpmorgan.com  
**Bloomberg** JPMA TEIXEIRA <GO>

**Drew Levine, CFA**

(1-212) 622-0374  
drew.levine@jpmorgan.com

**Shovana Chowdhury**

(1-212) 270-2184  
shovana.chowdhury@jpmorgan.com  
J.P. Morgan Securities LLC

### Key Changes (FYE Dec)

|                       | Prev   | Cur    |
|-----------------------|--------|--------|
| Revenue - 22E (\$ mn) | 42,210 | 42,097 |
| Revenue - 23E (\$ mn) | 43,514 | 42,732 |
| Adj. EPS - 22E (\$)   | 2.47   | 2.46   |
| Adj. EPS - 23E (\$)   | 2.64   | 2.51   |

### Quarterly Forecasts (FYE Dec)

| Adj. EPS (\$) | 2021A | 2022E | 2023E |
|---------------|-------|-------|-------|
| Q1            | 0.55  | 0.64A | 0.62  |
| Q2            | 0.68  | 0.70A | 0.70  |
| Q3            | 0.65  | 0.64  | 0.68  |
| Q4            | 0.45  | 0.48  | 0.52  |
| FY            | 2.32  | 2.46  | 2.51  |

### Style Exposure

| Quant Factors | Current | Hist %Rank (1=Top) |    |    |    |
|---------------|---------|--------------------|----|----|----|
|               | %Rank   | 6M                 | 1Y | 3Y | 5Y |
| Value         | 78      | 82                 | 79 | 90 | 85 |
| Growth        | 47      | 11                 | 12 | 30 | 64 |
| Momentum      | 45      | 30                 | 40 | 29 | 33 |
| Quality       | 19      | 8                  | 35 | 28 | 40 |
| Low Vol       | 1       | 5                  | 12 | 3  | 2  |
| ESGQ          | 4       | 40                 | 18 | 21 | 14 |

Sources for: Style Exposure – J.P. Morgan Quantitative and Derivatives Strategy; all other tables are company data and J.P. Morgan estimates.

### See page 11 for analyst certification and important disclosures.

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## Price Performance



|     | YTD   | 1m    | 3m     | 12m   |
|-----|-------|-------|--------|-------|
| Abs | -7.1% | -8.0% | -10.4% | 0.8%  |
| Rel | 16.0% | -3.1% | -3.0%  | 20.0% |

## Company Data

|                            |             |
|----------------------------|-------------|
| Shares O/S (mn)            | 4,321       |
| 52-week range (\$)         | 67.20-52.28 |
| Market cap (\$ mn)         | 238,000.70  |
| Exchange rate              | 1.00        |
| Free float(%)              | 89.6%       |
| 3M - Avg daily vol (mn)    | 12.84       |
| 3M - Avg daily val (\$ mn) | 773.2       |
| Volatility (90 Day)        | 18          |
| Index                      | S&P 500     |
| BBG BUY HOLD SELL          | 22 7 1      |

## Key Metrics (FYE Dec)

| \$ in millions                 | FY21A  | FY22E  | FY23E  | FY24E  |
|--------------------------------|--------|--------|--------|--------|
| <b>Financial Estimates</b>     |        |        |        |        |
| Revenue                        | 38,658 | 42,097 | 42,732 | 45,223 |
| Adj. EBITDA                    | 12,561 | 13,404 | 13,599 | 14,687 |
| Adj. EBIT                      | 11,109 | 12,084 | 12,177 | 13,101 |
| Adj. net income                | 10,086 | 10,710 | 10,913 | 11,826 |
| Adj. EPS                       | 2.32   | 2.46   | 2.51   | 2.73   |
| BBG EPS                        | 2.28   | 2.46   | 2.56   | 2.73   |
| Cashflow from operations       | 12,625 | 11,302 | 12,588 | 13,659 |
| FCFF                           | 11,258 | 9,941  | 10,451 | 11,398 |
| <b>Margins and Growth</b>      |        |        |        |        |
| Revenue growth                 | 17.1%  | 8.9%   | 1.5%   | 5.8%   |
| Total Organic Sales Growth (%) | -      | -      | -      | -      |
| Gross margin                   | 60.1%  | 58.9%  | 59.0%  | 59.3%  |
| EBITDA margin                  | 32.5%  | 31.8%  | 31.8%  | 32.5%  |
| EBITDA growth                  | 11.1%  | 6.7%   | 1.5%   | 8.0%   |
| EBIT margin                    | 28.7%  | 28.7%  | 28.5%  | 29.0%  |
| Net margin                     | 26.1%  | 25.4%  | 25.5%  | 26.1%  |
| Adj. EPS growth                | 19.1%  | 5.8%   | 2.1%   | 8.6%   |
| <b>Ratios</b>                  |        |        |        |        |
| Net debt/EBITDA                | 2.5    | 2.2    | 2.0    | 1.7    |
| ROIC                           | -      | -      | -      | -      |
| ROE                            | 47.7%  | 45.3%  | 42.6%  | 41.5%  |
| <b>Valuation</b>               |        |        |        |        |
| FCFF yield                     | 4.7%   | 4.1%   | 4.4%   | 4.8%   |
| Dividend yield                 | 3.0%   | 3.2%   | 3.4%   | 3.6%   |
| EV/Revenue                     | 6.6    | 6.0    | 5.9    | 5.5    |
| EV/EBITDA                      | 20.4   | 19.0   | 18.6   | 17.0   |
| Adj. P/E                       | 23.7   | 22.4   | 21.9   | 20.2   |

## Summary Investment Thesis and Valuation

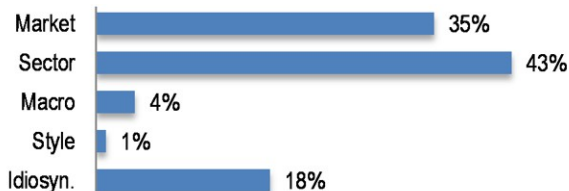
### Investment Thesis

We have an Overweight rating on KO shares. We think Coca-Cola will benefit from economies re-opening and is well positioned to reaccelerate organic growth toward the top-end of its long-term 4-6% range. KO has undergone a deep positive transformation over the past few years by improving its sales portfolio, refranchising, and consolidating bottling assets globally, setting up new systems and procurement in the US, shifting focus from volume to value growth, and transitioning senior management. While the multi-billion dollar dispute with the IRS and FX are overhangs, we think it is already reflected in the share price.

### Valuation

We are establishing a Dec 2023 price target of \$63 based on 23.2x P/E (five-year historical average multiple) applied to our 2024 estimates as top-line momentum, better ability to pass through cost inflation, and defensive nature in an uncertain macro backdrop are mitigated by ongoing unfavorable FX outlook. Our \$63 price target implies ~12% upside in the next ~14 months plus a ~3.3% dividend yield. While the IRS tax dispute and FX headwinds are overhangs, we think these are contemplated in current valuation, creating favourable risk/reward.

## Performance Drivers



| Factors                 | 6M Corr | 1Y Corr |
|-------------------------|---------|---------|
| Market: MSCI US         | 0.65    | 0.59    |
| Sect: Cons Staples      | 0.87    | 0.81    |
| Ind: Food Bev & Tobacco | 0.94    | 0.89    |
| <b>Macro:</b>           |         |         |
| US 10yr Breakeven       | -0.21   | -0.20   |
| Crude Oil               | 0.08    | 0.13    |
| US 10yr yield           | -0.17   | -0.10   |
| <b>Quant Styles:</b>    |         |         |
| DivYld                  | 0.34    | 0.36    |
| LowVol                  | 0.39    | 0.35    |
| Size                    | 0.33    | 0.28    |

Source: J.P. Morgan Quantitative and Derivatives Strategy for Performance Drivers; company data, Bloomberg Finance L.P. and J.P. Morgan estimates for all other tables. Note: Price history may not be complete or exact.

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- **3Q22 Expectations.** We are forecasting 3Q22 EPS of \$0.64 (unchanged), which is in line with Bloomberg consensus estimates. We expect another strong underlying top-line result and think there could be upside as 1) KO cycles another relatively easy comparison (3Q21 organic +14% against a -7% comparison); 2) benefits from pricing actions flow through; and 3) further global away-from-home reopening benefit and resilient at-home consumption. There are headwinds such as China lockdowns, exit of Russia, and lapping of bottler inventory stock-up, although we think guidance was set relatively conservatively and think the high end of +12-13% organic growth for FY22 is achievable, even baking in 3Y CAGR deceleration implied by guidance. For 3Q22, we forecast organic revenue growth +10.8% (unit case volume +3.6%, price/mix +7.2%) versus apples-to-apples Consensus Metrix forecast +11.3% (unit case volume +3.7%, price/mix +7.6%), although our concentrate shipment forecast is a bit lower than consensus (JPMe +1.6% vs. consensus +2.4%) as we model for more of a give-back of prior-year stock-up. We are slightly below Street gross margins (59.2%, or -190 bps YOY, vs. consensus 59.4%) and slightly higher on SG&A (30.6% of sales, or 52 bps favorable YOY, vs. consensus 30.4%).

### 3Q22 Earnings Outlook

**Date:** Tuesday, October 25

**Estimated Release Time:** 6:55 AM ET

#### Conference Call Details:

Time: 8:30 AM ET

Dial-in: +1-888-415-4465 Pin: COKE IR

The Coca-Cola Company (KO, Overweight rated) is scheduled to report 3Q22 earnings on Tuesday, October 25, before the market open. We slightly adjusted a couple of our underlying assumptions for 3Q (lowering gross margin offset by more favorable SG&A), although our \$0.64 EPS estimate remains unchanged and is in line with Bloomberg consensus. For 4Q22 our EPS moves down a penny to \$0.48 (from \$0.49) largely due to incremental FX headwinds and a slightly less favorable gross margin – also in line with consensus. For 2023, we lowered our EPS estimate to \$2.51 from \$2.64 after layering in additional FX headwinds and multiplier to the bottom line vs. Bloomberg consensus \$2.56.

We don't think there's much concern around underlying trends within the quarter or for FY22 as 2H22 guidance appeared relatively conservative with the 3Y CAGR implied by guidance decelerating to +4.5% in 2H vs. +6.5% in 1H despite strong pricing actions and what appear to be largely resilient consumption trends. Moreover, strong results from PEP's 3Q22, which featured an accelerating 3Y organic growth CAGR and resilient volumes (-1%) against +17% pricing, including +13% organic growth in PBNA, should give investors confidence ahead of KO's results. We think the bigger question is looking ahead to how away-from-home (historically ~50% of sales) evolves if the consumer environment deteriorates and given the magnitude of FX headwinds to 2023 EPS growth. We think KO can apply its learnings from the pandemic to better navigate a potential consumer pullback in away-from-home and also flex its RGM capabilities to maintain affordability where needed and premiumize where able. FX

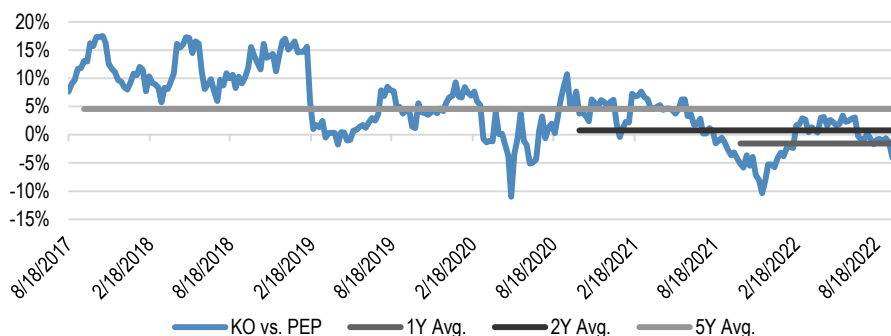
appears set to be another significant headwind to sales/EPS growth in 2023, but we think the strong underlying momentum should be better appreciated relative to historical, which could still allow KO to drive some USD EPS growth ahead, although we lowered our 2023 EPS estimate to +2.1% YOY.

**Net-net, we think there could be a lift to 2022 organic growth guidance of +12-13%, but we are not expecting a raise to EPS guidance given FX headwinds.**

From a stock perspective, KO shares have underperformed meaningfully over the last three months (-8.4%) vs. staples index XLP (-4.0%) and particularly against peers PEP (+4.3%) and KDP (+5.8%) as we think investors have rotated to more domestic-focused names with less on-premise exposure. That said, we think the relative share price weakness represents a buying opportunity with KO shares now trading at a roughly -9% NTM P/E discount to PEP (vs. five-year average +4.6% premium) and +4.8% NTM P/E premium to KDP (vs. five-year average +13.4% premium).

**Figure 1: KO Shares Now Trading at Nearly -DD% Discount to PEP on NTM P/E**

KO NTM P/E Relative Premium/Discount vs. PEP



Source: Bloomberg Finance L.P.

### **We Are Relatively in Line on the Top Line but Slightly below on Margins**

On the top line, our +5.0% estimate (including +8.8% organic on concentrate shipment basis, -7.7% FX, and +3.1% M&A) is ahead of consensus (+4.6%), although we are slightly below the Street on gross margins (59.2%, or -190 bps YOY, vs. consensus 59.4%, or -170 bps YOY) and slightly ahead of the Street on SG&A (30.6% of sales, or 52 bps favorable YOY, vs. consensus 30.4%, or 70 bps favorable YOY). All in, our 3Q22 and 2022 EPS estimates of \$0.64 and \$2.46 are both in line with consensus.

Table 1: JPMe 3Q22 and 2022 vs. Bloomberg Consensus

\$ m, except per share values

|                         | 3Q22     |           | Y/Y     | JPMe     | 2022     |           | Y/Y   | JPMe     |
|-------------------------|----------|-----------|---------|----------|----------|-----------|-------|----------|
| Income Statement        | JPMe     | Consensus | %       | vs. cons | JPMe     | Consensus | %     | vs. cons |
| Net Sales               | 10,547.1 | 10,510.1  | 5.0%    | 0.4%     | 42,097.4 | 42,145.3  | 8.9%  | -0.1%    |
| Gross Profit            | 6,242.9  | 6,246.7   | 1.7%    | -0.1%    | 24,785.8 | 24,859.4  | 6.6%  | -0.3%    |
| Operating Income        | 3,019.1  | 3,052.4   | 0.2%    | -1.1%    | 12,084.0 | 12,195.8  | 8.8%  | -0.9%    |
| Interest, Net           | 132.9    |           |         |          | 469.2    |           |       |          |
| Net Income              | 2,777.7  | 2,767.2   | -1.4%   | 0.4%     | 10,709.5 | 10,697.0  | 6.2%  | 0.1%     |
| Shares Outstanding      | 4,353.0  |           | 0.2%    |          | 4,354.0  |           | 0.3%  |          |
| EPS                     | \$0.64   | \$0.64    | -1.6%   | 0.3%     | \$2.46   | \$2.46    | 5.8%  | 0.1%     |
|                         | 3Q22     |           | bps     | JPMe     | 2022     |           | Y/Y   | JPMe     |
| Growth/Margins          | JPMe     | Consensus | bps     | vs. cons | JPMe     | Consensus | bps   | vs. cons |
| Sales Growth            | 5.0%     | 4.6%      | (1,113) | 37       | 8.9%     | 9.0%      | (825) | (12)     |
| Gross Margin            | 59.2%    | 59.4%     | (190)   | (24)     | 58.9%    | 59.0%     | (126) | (11)     |
| SG&A Margin             | 30.6%    | 30.4%     | (52)    | 17       | 30.2%    | 30.0%     | (123) | 13       |
| Operating Profit Margin | 28.6%    | 29.0%     | (138)   | (42)     | 28.7%    | 28.9%     | (3)   | (23)     |
| Tax Rate                | 19.5%    |           |         |          | 19.5%    |           |       |          |

Source: Company reports, Bloomberg Finance L.P., and J.P. Morgan estimates.

### Organic Revenue Growth

KO is lapping another quarter of relatively easier comparisons (3Q21 organic growth +14% came against a -7% comparison) with the company continuing to benefit from global reopening and resilient at-home consumption, although there continue to be headwinds in the form of lockdowns in China and the exit of the Russia business, in addition to lapping of distributor stocking in the prior year to insulate from volatility (3Q21 concentrate shipments ran 2 points ahead of unit case sales). Moreover, positive segment/channel mix likely becomes less of a benefit to price/mix as KO laps initial reopening.

Notwithstanding, we think the high end of KO's guidance is very doable as the company seemed to be building in a deceleration in the 3Y CAGR trends to +4.5% in 2H vs. +6.5% in 1H, although all indications are that there hasn't been much deterioration in consumer demand trends sequentially and peer PEP saw sequential acceleration in 3Y CAGR trends during its recent 3Q22.

All in, we are forecasting 3Q22 organic revenue growth of +10.8% (unit case volume +3.6%, price/mix +7.2%) versus the apples-to-apples Consensus Metrix forecast of +11.3% (unit case volume +3.7%, price/mix +7.6%). Consensus and the company utilize concentrate shipments to derive organic growth, and on that basis the Street is currently modeling for +9.8% organic growth (shipments +2.4%, price/mix +7.6%), and on an apples-to-apples basis our model calls for organic growth of +8.8% (shipments +1.6%, price/mix +7.2%) as we model for a larger impact from lapping of distributor inventory stocking last year. On a regional basis, our organic sales forecasts are as follows: +8.0% in EMEA (unit case volume -2.0%, price/mix +10.0%), +13.0% in Latin America (unit case volume +5.0%, price/mix +8.0%), +12.5% in North America (unit case volume +2.5%, price/mix +10.0%), +12.0% in Asia Pacific (unit case volume +8.0%, price/mix +4.0%), +13.0% in Global Ventures (unit case volume +10.0%, price/mix +3.0%), and +10.0% in BIG (unit case volume +9.0%, price/mix +1.0%).

Our estimates for +3.6% unit case volume growth in 3Q imply a deceleration in the 3Y CAGR to +1.8% from +2.3% in 2Q (and +2.3% in 1Q) as we think it's prudent to model more cautiously given potential elasticities and pressure on low-end consumers and European exposure, although tracked channel data in the U.S. and commentary from KO's key bottler in Europe (CCEP, covered by Jared Dinges) seem constructive for the quarter. From a price/mix perspective, our +7.2% estimate implies a deceleration in the 3Y CAGR to +3.3% from +6.1% in 2Q, but closer to 1Q +2.6%, which we think makes sense given less segment/channel mix benefit.

The regional breakdown of our organic revenue growth estimates vs. consensus (measured by Consensus Metrix) is below.

Table 2: 3Q22 JPM Organic Revenue Estimates vs. Consensus

| Revenue Build            | 3Q22         |              | JPMe           |
|--------------------------|--------------|--------------|----------------|
|                          | JPMe         | Consensus    | vs. cons (bps) |
| <b>Organic Revenue</b>   | <b>10.8%</b> | <b>9.8%</b>  | <b>100</b>     |
| EMEA                     | 8.0%         | 10.0%        | (200)          |
| Latin America            | 13.0%        | 6.0%         | 700            |
| North America            | 12.5%        | 10.4%        | 210            |
| Asia-Pacific             | 12.0%        | 10.7%        | 130            |
| Global Ventures          | 13.0%        | 11.4%        | 160            |
| BIG                      | 10.0%        | 12.2%        | (220)          |
| <b>Unit Case Volume</b>  | <b>3.6%</b>  | <b>3.7%</b>  | <b>(11)</b>    |
| EMEA                     | -2.0%        | 0.0%         | (200)          |
| Latin America            | 5.0%         | 3.9%         | 110            |
| North America            | 2.5%         | 2.1%         | 40             |
| Asia-Pacific             | 8.0%         | 6.6%         | 140            |
| Global Ventures          | 10.0%        | 9.6%         | 40             |
| BIG                      | 9.0%         | 10.3%        | (130)          |
| <b>Concentrate Sales</b> | <b>1.6%</b>  | <b>2.4%</b>  | <b>(84)</b>    |
| EMEA                     | -2.0%        | -0.7%        | (130)          |
| Latin America            | 2.0%         | 1.0%         | 100            |
| North America            | -0.5%        | 1.2%         | (170)          |
| Asia-Pacific             | 6.0%         | 5.4%         | 60             |
| Global Ventures          | 5.0%         | 8.6%         | (360)          |
| BIG                      | 9.0%         | 8.4%         | 60             |
| <b>Price/Mix</b>         | <b>7.2%</b>  | <b>7.6%</b>  | <b>(39)</b>    |
| EMEA                     | 10.0%        | 10.6%        | (60)           |
| Latin America            | 8.0%         | 5.4%         | 260            |
| North America            | 10.0%        | 9.3%         | 70             |
| Asia-Pacific             | 4.0%         | 5.1%         | (110)          |
| Global Ventures          | 3.0%         | 2.8%         | 20             |
| BIG                      | 1.0%         | 2.6%         | (160)          |
| <b>FX</b>                | <b>-7.7%</b> | <b>-7.6%</b> | <b>(14)</b>    |
| <b>M&amp;A/Other</b>     | <b>3.1%</b>  | <b>2.8%</b>  | <b>31</b>      |

Source: Consensus Metrix and J.P. Morgan estimates.



### US Tracked Channel Trends +DD% in 3Q22 Driven by Pricing, Flat Sequentially YOY

Within the tracked channels during the period roughly corresponding to 3Q22 (L13W 10/1/22), KO's overall dollar takeaway trends were flat sequentially from L13W 7/2/22 and remained solid at +DD% with a deceleration in unit sales trends (-4.5% L13W 10/1/22 vs. -3.7% L13W 7/2/22) offset by an acceleration in price per unit (+14.6% L13W 10/1/22 vs. +13.8% L13W 7/2/22) as the company likely layered on additional pricing as it lapped pricing actions last August. Overall, though, we think unit declines continue to be relatively modest in the context of sustained +DD% pricing, which we think continues to signal limited price elasticity despite pervasive inflationary cost pressures throughout the store. All in, dollar sales growth of +10.1% L13W 10/1/22 accelerated a slight +5 bps from prior L13W 7/2/22.

### 3Y CAGR Accelerated Sequentially to +DD% While 2Y Stack Also Accelerated

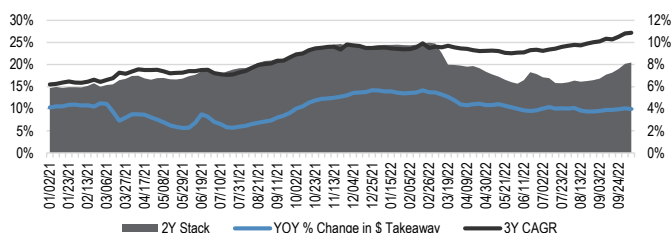
On a two-year stack basis KO dollar takeaway L13W 10/1/22 accelerated to +20.1% from +17.1% L13W 7/2/22 with roughly 300 bps tougher comparisons. That said, looking at a 3Y CAGR, KO's dollar takeaway of +10.8% L13W 10/1/22 accelerated roughly +160 bps from prior L13W 7/2/22 of +9.2% and +9.5% in L13W 4/2/22.

### CSD Trends Accelerate Slightly Sequentially to +High-Teens% and Continue to Outpace Peers

In CSDs, tracked channel trends for KO were accelerated modestly sequentially in L13W 10/1/22 to +17.4% (vs. category +14.6%) from +16.5% L13W 7/2/22 (vs. category +13.0%) with both EQ volumes (+1.2%) and price per EQ (+16.0%) improving slightly sequentially (EQ volumes +20 bps and price per EQ by +60 bps). KO's outperformance vs. the category of 280 bps narrowed modestly L13W 10/1/22 (from 350 bps outperformance L13W 7/2/22), and the company gained roughly +100 bps of value share of CSDs in the L13W 10/1/22. Value share gains for KO narrowed sequentially from +128 bps YOY L13W 7/2/22, although on a 2Y basis KO share gains accelerated sequentially to +110 bps (vs. +62 bps L13W 7/2/22). Dollar takeaway for both KO and the category also accelerated sequentially on a 3Y CAGR basis to +12.3% and +11.6%, respectively, L13W 10/1/22 from +9.5% and +9.3% L13W 7/2/22. We continue to be impressed by resilience in consumption despite +DD% pricing in tracked channels as we think KO and most peers have been taking a conservative stance on volumes when providing guidance.

**Figure 2: KO Trends +DD% in 3Q, Flat Sequentially; 3Y CAGR Accelerates to +DD%**

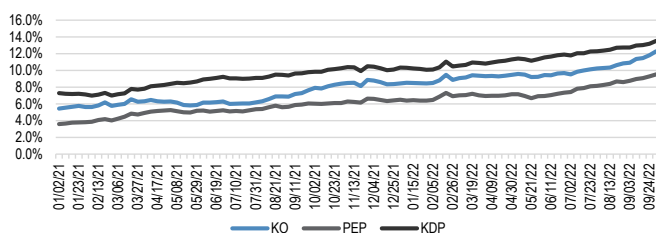
YOY % Change in \$ Takeaway (13-Weeks) vs. 2-Year Stack (left-axis); 3Y CAGR (right-axis)



Source: NielsenIQ.

**Figure 3: KO CSD 3Y CAGR Accelerated More Than PEP/KDP in 3Q**

3Y CAGR Change in CSD \$ Takeaway (13-Weeks)

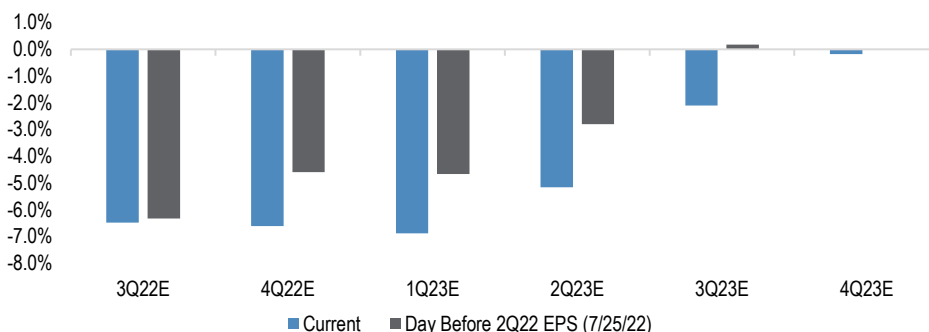


Source: NielsenIQ.

### Updated FX Outlook

With the company's 2Q22 earnings results released on July 26, 2022, management updated its outlook for currency to be a headwind of -6% to the top line (from prior guidance of -2% to -3%) and -9% to the bottom line (from prior guidance of -3% to -4%). Additionally, the company provided expectations for 3Q22 currency impact of -7% to -8% to revenues and -9% to -10% to EPS. Since the day before KO last reported (i.e., 7/25/22), the USD has continued to strengthen with the DXY (U.S. Dollar Index) increasing over +5.5%. KO does hedge G10 currencies, although overall the USD strengthening portends continued pressure on the top and bottom lines. Based on our currency model, it appears that FX could be around -20 bps worse in 3Q vs. prior expectations and -200 bps worse in 4Q vs. prior expectations, and in aggregate for full-year 2022 our currency model suggest an incremental roughly -60 bps headwind. Net-net, we updated our 2022 FX impact to top line to -6.3% from -6.0% previously, but our 3Q estimate of -7.7% remains unchanged. Looking ahead to 2023, currency impact to KO's top line appears to have worsened by at least -230 bps, and we now model for a -3.8% headwind for 2023 thus far, from -2.2% previously. Recall, the impact from currencies from the top to bottom line is generally ~1.5-2.0x, so we would expect another meaningful currency headwind to EPS in 2023. The current Consensus Metrix consensus calls for FX headwind to revenue of -7.6% for 3Q22, -7.1% for 2022, and -3.0% for 2023.

Figure 4: USD Has Strengthened Materially Since KO's 2Q22



Source: Bloomberg Finance L.P. and J.P. Morgan estimates.



## Investment Thesis, Valuation and Risks

### Coca-Cola (*Overweight; Price Target: \$63.00*)

#### Investment Thesis

We have an Overweight rating on KO shares. We think Coca-Cola will benefit from economies re-opening, and it is well positioned to reaccelerate organic growth toward the top end of its long-term 4-6% range. KO has undergone a deep positive transformation over the past few years by improving its sales portfolio, refranchising and consolidating bottling assets globally, setting up new systems and procurement in the US, shifting focus from volume to value growth, and transitioning senior management, all of which give us confidence in the underlying fundamentals of the business. While the multi-billion dollar dispute with the IRS and FX are overhangs, we think it is already reflected in the share price.

#### Valuation

We are establishing a Dec 2023 price target of \$63 based on 23.2x P/E (5-year historical average) applied to our 2024 estimates as top-line momentum, better ability to pass through cost inflation, and defensive nature in an uncertain macro backdrop are mitigated by ongoing unfavorable FX outlook. Our \$63 price target implies ~12% upside in the next ~14 months plus a ~3.3% dividend yield. While the IRS tax dispute and FX headwinds are overhangs, we think these are contemplated in current valuation, creating a favourable risk/reward.

#### Risks to Rating and Price Target

Downside risks to our Overweight rating and price target include (1) negative resolution in the tax dispute with the IRS (not contemplated in our model); (2) the uncertainty around when or if the pandemic is contained and its impact on out-of-home consumption; (3) further margin de-leverage because of inflationary headwinds and/or volume losses; and (4) increasingly unfavorable FX movements—all of which could drive further negative earnings revisions.

## Coca-Cola: Summary of Financials

| Income Statement - Annual           |          |          |          |          |          | Income Statement - Quarterly |          |          |         |         |        |
|-------------------------------------|----------|----------|----------|----------|----------|------------------------------|----------|----------|---------|---------|--------|
|                                     | FY20A    | FY21A    | FY22E    | FY23E    | FY24E    |                              | 1Q22A    | 2Q22A    | 3Q22E   | 4Q22E   |        |
| Revenue                             | 32,999   | 38,658   | 42,097   | 42,732   | 45,223   | Revenue                      | 10,502A  | 11,302A  | 10,547  | 9,746   |        |
| COGS                                | (13,498) | (15,410) | (17,312) | (17,508) | (18,393) | COGS                         | (4,233)A | (4,634)A | (4,304) | (4,140) |        |
| Gross profit                        | 19,501   | 23,248   | 24,786   | 25,224   | 26,830   | Gross profit                 | 6,269A   | 6,668A   | 6,243   | 5,606   |        |
| SG&A                                | (9,731)  | (12,139) | (12,702) | (13,048) | (13,729) | SG&A                         | (2,967)A | (3,203)A | (3,224) | (3,308) |        |
| Adj. EBITDA                         | 11,306   | 12,561   | 13,404   | 13,599   | 14,687   | Adj. EBITDA                  | 3,626A   | 3,787A   | 3,358   | 2,633   |        |
| D&A                                 | (1,536)  | (1,452)  | (1,320)  | (1,422)  | (1,586)  | D&A                          | (324)A   | (322)A   | (339)   | (335)   |        |
| Adj. EBIT                           | 9,770    | 11,109   | 12,084   | 12,177   | 13,101   | Adj. EBIT                    | 3,302A   | 3,465A   | 3,019   | 2,298   |        |
| Net Interest                        | (583)    | (500)    | (469)    | (516)    | (419)    | Net Interest                 | (110)A   | (104)A   | (133)   | (122)   |        |
| Adj. PBT                            | 10,498   | 12,427   | 13,350   | 13,578   | 14,687   | Adj. PBT                     | 3,487A   | 3,800A   | 3,449   | 2,613   |        |
| Tax                                 | (2,042)  | (2,308)  | (2,603)  | (2,648)  | (2,864)  | Tax                          | (680)A   | (741)A   | (673)   | (510)   |        |
| Minority Interest                   | (21)     | (33)     | (37)     | (17)     | 3        | Minority Interest            | (12)A    | 5A       | 1       | (31)    |        |
| Adj. Net Income                     | 8,435    | 10,086   | 10,710   | 10,913   | 11,826   | Adj. Net Income              | 2,795A   | 3,064A   | 2,778   | 2,073   |        |
| Reported EPS                        | 1.95     | 2.32     | 2.46     | 2.51     | 2.73     | Reported EPS                 | 0.64A    | 0.70A    | 0.64    | 0.48    |        |
| Adj. EPS                            | 1.95     | 2.32     | 2.46     | 2.51     | 2.73     | Adj. EPS                     | 0.64A    | 0.70A    | 0.64    | 0.48    |        |
| DPS                                 | 1.63     | 1.67     | 1.75     | 1.86     | 1.97     | DPS                          | 0.44A    | 0.44A    | 0.44    | 0.44    |        |
| Payout ratio                        | 83.5%    | 71.9%    | 71.1%    | 73.9%    | 72.1%    | Payout ratio                 | 68.2%A   | 62.1%A   | 68.5%   | 91.9%   |        |
| Shares outstanding                  | 4,323    | 4,340    | 4,354    | 4,345    | 4,334    | Shares outstanding           | 4,357A   | 4,353A   | 4,353   | 4,353   |        |
| Balance Sheet & Cash Flow Statement |          |          |          |          |          | Ratio Analysis               |          |          |         |         |        |
|                                     | FY20A    | FY21A    | FY22E    | FY23E    | FY24E    |                              | FY20A    | FY21A    | FY22E   | FY23E   | FY24E  |
| Cash and cash equivalents           | 6,795    | 9,684    | 9,299    | 7,507    | 6,198    | Gross margin                 | 59.1%    | 60.1%    | 58.9%   | 59.0%   | 59.3%  |
| Accounts receivable                 | 3,144    | 3,512    | 3,508    | 3,723    | 3,939    | EBITDA margin                | 34.3%    | 32.5%    | 31.8%   | 31.8%   | 32.5%  |
| Inventories                         | 3,266    | 3,414    | 3,361    | 3,542    | 3,721    | EBIT margin                  | 29.6%    | 28.7%    | 28.7%   | 28.5%   | 29.0%  |
| Other current assets                | 6,035    | 5,935    | 6,300    | 6,497    | 6,692    | Net profit margin            | 25.6%    | 26.1%    | 25.4%   | 25.5%   | 26.1%  |
| Current assets                      | 19,240   | 22,545   | 22,467   | 21,269   | 20,550   | ROE                          | 44.1%    | 47.7%    | 45.3%   | 42.6%   | 41.5%  |
| PP&E                                | 10,777   | 9,920    | 9,662    | 10,376   | 11,051   | ROA                          | 9.7%     | 11.1%    | 11.5%   | 11.8%   | 12.8%  |
| LT investments                      | 812      | 818      | 655      | 655      | 655      | ROCE                         | 13.2%    | 14.4%    | 15.2%   | 15.6%   | 17.1%  |
| Other non current assets            | 56,467   | 61,071   | 59,911   | 59,911   | 59,911   | SG&A/Sales                   | 29.5%    | 31.4%    | 30.2%   | 30.5%   | 30.4%  |
| Total assets                        | 87,296   | 94,354   | 92,695   | 92,211   | 92,167   | Net debt/equity              | 1.6      | 1.3      | 1.1     | 1.0     | 0.8    |
| Short term borrowings               | 2,183    | 3,307    | 4,358    | 4,358    | 4,358    | P/E (x)                      | 28.2     | 23.7     | 22.4    | 21.9    | 20.2   |
| Payables                            | 11,145   | 14,619   | 15,020   | 15,830   | 16,630   | P/BV (x)                     | 12.3     | 10.4     | 9.9     | 8.9     | 7.9    |
| Other short term liabilities        | 1,273    | 2,024    | 1,387    | 1,424    | 1,461    | EV/EBITDA (x)                | 22.8     | 20.4     | 19.0    | 18.6    | 17.0   |
| Current liabilities                 | 14,601   | 19,950   | 20,766   | 21,612   | 22,449   | Dividend Yield               | 3.0%     | 3.0%     | 3.2%    | 3.4%    | 3.6%   |
| Long-term debt                      | 40,125   | 38,116   | 34,755   | 30,755   | 26,755   | Sales/Assets (x)             | 0.4      | 0.4      | 0.5     | 0.5     | 0.5    |
| Other long term liabilities         | 11,286   | 11,428   | 11,080   | 11,080   | 11,080   | Interest cover (x)           | 19.4     | 25.1     | 28.6    | 26.3    | 35.0   |
| Total liabilities                   | 66,012   | 69,494   | 66,601   | 63,447   | 60,284   | Operating leverage           | 53.5%    | 79.9%    | 98.6%   | 50.8%   | 130.3% |
| Shareholders' equity                | 19,299   | 22,999   | 24,296   | 26,966   | 30,085   | Revenue y/y Growth           | (11.5%)  | 17.1%    | 8.9%    | 1.5%    | 5.8%   |
| Minority interests                  | 1,985    | 1,861    | 1,798    | 1,798    | 1,798    | EBITDA y/y Growth            | (4.0%)   | 11.1%    | 6.7%    | 1.5%    | 8.0%   |
| Total liabilities & equity          | 87,296   | 94,354   | 92,695   | 92,211   | 92,167   | Tax rate                     | 19.5%    | 18.6%    | 19.5%   | 19.5%   | 19.5%  |
| BVPS                                | 4.46     | 5.30     | 5.58     | 6.21     | 6.94     | Adj. Net Income y/y Growth   | (7.3%)   | 19.6%    | 6.2%    | 1.9%    | 8.4%   |
| y/y Growth                          | 1.5%     | 18.7%    | 5.3%     | 11.2%    | 11.8%    | EPS y/y Growth               | (7.5%)   | 19.1%    | 5.8%    | 2.1%    | 8.6%   |
| Net debt/(cash)                     | 34,227   | 31,835   | 29,826   | 27,618   | 24,927   | DPS y/y Growth               | 2.7%     | 2.5%     | 4.7%    | 6.1%    | 6.0%   |
| Cash flow from operating activities | 9,844    | 12,625   | 11,302   | 12,588   | 13,659   |                              |          |          |         |         |        |
| o/w Depreciation & amortization     | 1,536    | 1,452    | 1,320    | 1,422    | 1,586    |                              |          |          |         |         |        |
| o/w Changes in working capital      | 690      | 1,325    | (122)    | 216      | 210      |                              |          |          |         |         |        |
| Cash flow from investing activities | (1,477)  | (2,765)  | (2,019)  | (2,137)  | (2,261)  |                              |          |          |         |         |        |
| o/w Capital expenditure             | (1,177)  | (1,367)  | (1,361)  | (2,137)  | (2,261)  |                              |          |          |         |         |        |
| as % of sales                       | 3.6%     | 3.5%     | 3.2%     | 5.0%     | 5.0%     |                              |          |          |         |         |        |
| Cash flow from financing activities | (8,070)  | (6,786)  | (9,509)  | (12,243) | (12,707) |                              |          |          |         |         |        |
| o/w Dividends paid                  | (7,047)  | (7,252)  | (7,618)  | (8,064)  | (8,527)  |                              |          |          |         |         |        |
| o/w Net debt issued/(repaid)        | (1,862)  | 228      | (560)    | (4,000)  | (4,000)  |                              |          |          |         |         |        |
| Net change in cash                  | 373      | 2,915    | (387)    | (1,792)  | (1,309)  |                              |          |          |         |         |        |
| Adj. Free cash flow to firm         | 8,667    | 11,258   | 9,941    | 10,451   | 11,398   |                              |          |          |         |         |        |
| y/y Growth                          | 3.0%     | 29.9%    | (11.7%)  | 5.1%     | 9.1%     |                              |          |          |         |         |        |

Source: Company reports and J.P. Morgan estimates.

Note: \$ in millions (except per-share data). Fiscal year ends Dec. o/w - out of which

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Coca-Cola (KO, KO US) Price Chart



Source: Bloomberg Finance L.P. and J.P. Morgan; price data adjusted for stock splits and dividends. Initiated coverage Oct 03, 2011. All share prices are as of market close on the previous business day.

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