BARCLAYS

Equity Research
Consumer | U.S. CHPC & Beverages
22 July 2020

The Coca-Cola Company

A Different Time and P(l)ace

With the trajectory of the COVID-19 outbreak still unpredictable, KO did well, in our view, to shift the focus of yesterday's earnings call away from near-term hypotheticals to a more holistic discussion of its go-forward strategy. In particular, CEO James Quincey outlined a new set of 5 strategic priorities, three of which we highlight below:

With the next three years presenting a very different reality than anticipated just a few months ago, KO is accelerating efforts to optimize its portfolio…While KO has made progress on eliminating "zombie" SKUs over the past 3 years, we learned that >50% of KO's 400 master brands today are still single-country brands that in aggregate contribute a mere 2% to revenues. With the crisis highlighting the benefits of a more focused portfolio across the CPG industry, KO aims to be more deliberate in prioritizing fewer but bigger brands. The recent decision to discontinue Odwalla is case in point.

…whilst introducing greater discipline into innovation and marketing decisions to ensure the company can support its growth ambitions more efficiently… Again, scale is taking precedence with management highlighting both a shift to bigger, more targeted innovation bets in new growth avenues as well as long-term opportunities to improve marketing effectiveness and efficiency through scalable programs eg. a new "Together Tastes Better" campaign pairing Coke with meals that will kick off in the U.S. but be rolled out globally and tailored by market. While recent conversations on marketing have involved tactical changes to offset near-term volume deleverage, we believe this new perspective could drive more lasting P&L benefits.

…and strengthening RGM and in-market execution capabilities to foster stronger customer and consumer relationships as traffic recovers. KO aims to capitalize on changing channel dynamics (on-premise capacity, increased online penetration) with examples discussed including new partnerships in the on-premise channel to support a recovery, digital investments, partnerships with 3PP food aggregators and e-commerce platforms and accelerating owned B2B & DTC platforms.

KO: Quarterly and Annual EPS (USD)

	2019	2020			2021			Change y/y	
FY Dec	Actual	Old	New	Cons	Old	New	Cons	2020	2021
Q1	0.48A	0.51A	0.51A	0.51A	0.50E	0.47E	0.52E	6%	-8%
Q2	0.63A	0.37E	0.42A	0.40E	0.52E	0.55E	0.51E	-33%	31%
Q3	0.56A	0.50E	0.48E	0.47E	0.52E	0.55E	0.55E	-14%	15%
Q4	0.44A	0.48E	0.38E	0.44E	0.46E	0.44E	0.49E	-14%	16%
Year	2.11A	1.86E	1.79E	1.84E	2.00E	2.01E	2.06E	-15%	12%
P/E	22.4		26.4			23.5			

Source: Barclays Research.
Consensus numbers are from Bloomberg received on 21-Jul-2020; 12:50 GMT

Stock Rating	OVERWEIGHT
	Unchanged
Industry View	NEUTRAL
	Unchanged
Price Target	USD 56.00
	Unchanged

Price (21-Jul-2020)	USD 47.20
Potential Upside/Downside	+18.6%
Tickers	KO

Market Cap (USD mn)	202719
Shares Outstanding (mn)	4294.89
Free Float (%)	89.68
52 Wk Avg Daily Volume (mn)	15.6
Dividend Yield (%)	3.47
Return on Equity TTM (%)	51.53
Current BVPS (USD)	4.07

Source: Bloomberg

Price Performance	Exchange-NYSE
52 Week range	USD 60.13-36.27

Source: IDC; Link to Barclays Live for interactive charting

U.S. CHPC & Beverages
Lauren R. Lieberman
+1 212 526 3112
lauren.lieberman@barclays.com
BCI, US

Shirley C. Serrao, CFA
+1 212 526 7518
shirley.serrao@barclays.com
BCI, US

Kate Grafstein
+1 212 526 5755
kate.grafstein@barclays.com
BCI, US

Samira Somany
+1 212 526 4602
samira.somany@barclays.com
BCI, US

U.S. CHPC & Beverages — **Industry View: NEUTRAL**

The Coca-Cola Company (KO)

Stock Rating: OVERWEIGHT

Income statement ($mn)	2019A	2020E	2021E	2022E	CAGR
Revenue	37,280	32,451	35,633	37,774	0.4%
EBITDA (adj)	11,774	10,553	11,707	12,469	1.9%
EBIT (adj)	10,409	9,158	10,317	10,996	1.8%
Pre-tax income (adj)	11,310	9,619	10,822	11,629	0.9%
Net income (adj)	9,104	7,724	8,657	9,303	0.7%
EPS (adj) ($)	2.11	1.79	2.01	2.16	0.7%
Diluted shares (mn)	4,314.0	4,318.3	4,316.0	4,316.0	0.0%
DPS ($)	1.60	1.66	1.73	1.80	4.0%

Margin and return data					Average
Gross margin (%)	60.7	59.4	61.0	61.4	60.6
EBITDA (adj) margin (%)	31.6	32.5	32.9	N/A	32.3
EBIT (adj) margin (%)	27.9	28.2	29.0	29.1	28.6
Pre-tax (adj) margin (%)	30.3	29.6	30.4	30.8	30.3
Net (adj) margin (%)	24.4	23.8	24.3	24.6	24.3
ROIC (%)	18.9	25.4	23.0	22.3	22.4
ROA (%)	9.7	9.3	9.5	N/A	9.5
ROE (%)	43.2	141.1	67.8	N/A	84.0

Balance sheet and cash flow ($mn)					CAGR
Cash and equivalents	6,480	15,506	15,787	17,193	38.4%
Total assets	86,381	79,149	86,909	92,133	2.2%
Short and long-term debt	42,763	52,234	52,234	52,234	6.9%
Total liabilities	65,283	73,674	74,131	74,147	4.3%
Net debt/(funds)	34,816	35,261	34,980	N/A	N/A
Shareholders' equity	21,098	5,476	12,778	17,986	-5.2%
Change in working capital	366	423	548	123	-30.4%
Cash flow from operations	10,471	7,900	9,705	9,987	-1.6%
Capital expenditure	-2,054	-974	-1,710	-1,813	N/A
Free cash flow	8,417	6,927	7,994	8,174	-1.0%

Valuation and leverage metrics					Average
P/E (adj) (x)	22.4	26.4	23.5	21.9	23.5
EV/sales (x)	5.9	6.8	6.2	N/A	6.3
EV/EBITDA (adj) (x)	18.6	20.8	18.8	N/A	19.4
EV/EBIT (adj) (x)	21.1	24.0	21.3	N/A	22.1
Equity FCF yield (%)	4.1	3.4	3.9	N/A	3.8
P/BV (x)	9.7	37.2	15.9	N/A	20.9
Dividend yield (%)	3.4	3.5	3.7	3.8	3.6
Total debt/capital (%)	67.0	90.5	80.3	74.4	78.1
Net debt/EBITDA (adj) (x)	3.0	3.3	3.0	N/A	3.1

Selected operating metrics					Average
Organic sales growth (%)	6.0	-10.7	10.0	N/A	1.8
Volume growth (%)	1.0	-9.6	8.2	N/A	-0.1
Price growth (%)	5.0	-2.8	2.9	N/A	1.7

Price (21-Jul-2020)	USD 47.20
Price Target	USD 56.00

Why Overweight? We expect KO's comprehensive transformation to re-accelerate the top and bottom line. As the company demonstrates an ability to sustainably deliver its algorithm, we expect more valuation credit to be given.

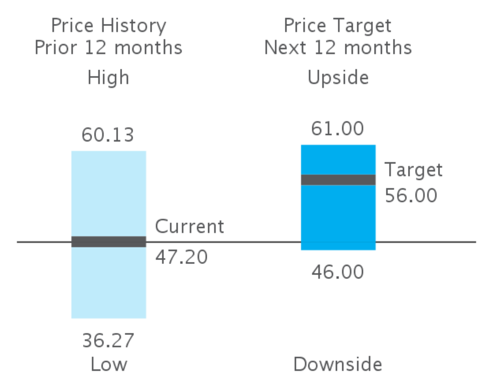
Upside case — **USD 61.00**

Our upside case assumes that KO trades at a +30% premium to Large-Cap Staples on upside 2021 EPS of $2.10.

Downside case — **USD 46.00**

Our downside case assumes that KO trades at a +15% premium to Large-Cap Staples on downside 2020 EPS of $1.80.

Upside/Downside scenarios



Source: Company data, Bloomberg, Barclays Research
Note: FY End Dec

Yesterday, KO reported 2Q20 Comparable EPS of $0.42, which compares to Consensus $0.40 and Barclays Research $0.37. Below-the-line items were a 1c drag to earnings.

What to do with the stock. To be sure, there is still significant uncertainty ahead with regard to the course of the COVID-19 outbreak and extent/timeline of its impact on away-from-home consumption. That said, with headwinds likely to prove temporary over time and much of the market arguably already trading on "post-COVID" CY21 earnings power, we find it difficult to reconcile KO's underperformance versus its peer set (down -15% YTD vs. XLP -2.5%).

A Different Time and P(l)ace

As expected, global unit case volume for KO improved markedly over the course of 2Q (down mid-single digits in July MTD vs. -10% in June and -25% in April). That said, with the COVID-19 crisis yet to find its peak in certain regions and others still in the process of re-opening their economies and testing new thresholds for social interaction, the trajectory of the COVID-19 outbreak remains unpredictable. Against this backdrop, KO did well, in our view, to shift the focus of yesterday's earnings call away from guess work around how the next six months could hypothetically play out and to a more holistic conversation around enhancements to its go-forward strategy intended to help restore the business to pre-COVID levels over time. Leveraging key learnings through the crisis, CEO James Quincey outlined a new set of 5 strategic priorities (replacing the ones introduced at CAGNY in February), three of which we highlight below:

With the next three years presenting a very different reality than what would have been anticipated just a few months ago, KO is accelerating existing efforts to optimize its portfolio…It's been nearly 3 years since Mr. Quincey first discussed the concept of eliminating "zombies" with the Street – shutting down sub-scale, underperforming brands/SKUs soaking up critical resources that could be better allocated towards brands with building momentum. While there has been progress on the SKU front (eg. eliminating 700 SKUs in 2018 and 600 in 2019), with >50% of KO's 400 current master brands highlighted as single-country brands that in aggregate contribute a mere 2% to annual revenues, it would appear that brand work has lagged at best. In this regard, it would seem KO isn't going to let the current crisis go to waste and is redoubling efforts to streamline the portfolio. Recall, KO and other CPGs have tactically narrowed assortment through the peak of the lockdown periods in order to ease pressure on supply chains and minimize out of stocks for key SKUs. We'd think the background work enabling these moves similarly yielded the realization of just how fat the tail had become, with the recent decision to discontinue Odwalla being case in point.

…whilst introducing greater discipline into innovation and marketing such that the company can support its growth ambitions more efficiently…To improve the odds of success for "explorer" and "challenger" brands, KO is raising the bar on its innovation pipeline, shifting focus to bigger, more targeted bets in new growth avenues (eg. AHA sparkling which has achieved double-digit value share in the U.S. in its first 18 weeks on the market). Additionally, while the conversation on marketing in recent months has been more in the way of near-term tactical cuts or delays in spend to offset volume deleverage, Mr. Quincey discussed longer-term opportunities to improve marketing effectiveness and efficiency that we believe could drive more lasting benefits to the P&L. In particular, Mr Quincey highlighted the importance of scalable initiatives eg. a new "Together Tastes Better" campaign pairing Coke with meals that will kick off in the U.S. but be rolled out globally and tailored by market.

…and strengthening RGM and in-market execution capabilities to foster stronger customer and consumer relationships as traffic recovers. To be sure, price-pack architecture is the most widely discussed component of KO's Revenue Growth Management strategy, with yesterday's call highlighting refillable offerings in Latin America to address affordability and expanding package assortment in Japan to cater to bifurcating demand at the high and low-end of the pricing spectrum. That said, with the crisis breeding opportunity to collaborate more closely with struggling food-service/restaurant operators and accelerating e-commerce adoption in the industry, KO also discussed efforts to capitalize on changing channel dynamics. To this point, we heard several examples of new partnerships in the on-premise channel to support a recovery in its customer base (eg. a new "Open Like Never Before" campaign behind re-openings in Europe, a rapid response resource for food-service outlets in the U.S., touchless FreeStyle machines). Additionally, KO is also emphasizing investments in digital strategies to drive sales, efficiencies and data analytics across the business, including partnering with 3PP food aggregators and e-commerce platforms and accelerating proprietary B2B and DTC platforms. As we reflect on these developments, we are reminded of the Rubik's cube analogy first shared at CAGNY in February and, in particular, the role that data and analytics as well as healthy bottler relationships are playing in identifying and segmenting new growth opportunities.

Changes to the model. We are taking down our organic sales outlook for 2020 slightly to -11% (vs. -10% prior), driven by weaker concentrate shipments this quarter, offset by a more favorable outlook for 3Q given unit case volume exit rates and trends month-to-date in July. Including a ~300 bps headwind from currency and a +50bps contribution from M&A, we model net sales down ~15%. We look for gross margins to be down -120 bps reflecting volume deleverage in the P&L and currency pressure, offset by mix benefits from lower margin businesses growing more slowly than the balance of the portfolio eg. BIG, Costa. We look for SG&A to be up +70 bps including a -35% cut to currency-neutral marketing spend vs. our original estimates at the start of the year and a -15% cut to currency-neutral non-marketing opex leaving our operating margins up +30 bps for the year. Including higher interest expense from new debt issuances this quarter, we are taking down our estimates for full-year EPS by 7c to $1.79.

For 3Q specifically, we model organic sales down -9% and net sales down -12% including a ~300 bps headwind from currency and a +70 bps tailwind from M&A. We assume a sequential improvement in trend versus 2Q across all segments with the biggest incremental change coming in EMEA and Global Ventures given mid-late 2Q re-openings in Europe (which would also benefit Costa) and the likelihood of some volatility in the U.S. given case resurgence in certain states in the country. We look for gross margins to be down -200 bps and SG&A to be down -220 bps including a -40% cut to currency-neutral marketing spend vs. our original estimates at the start of the year and a -20% cut to currency-neutral non-marketing opex leaving our operating margins up +20 bps.

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Primary Stocks (Ticker, Date, Price)

The Coca-Cola Company (KO, 21-Jul-2020, USD 47.20), Overweight/Neutral, A/CD/CE/D/J/K/L/M/N

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U.S. CHPC & Beverages

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Constellation Brands (STZ)	Coty Inc. (COTY)	Edgewell Personal Care Company (EPC)
Energizer Holdings, Inc (ENR)	International Flavors & Fragrances (IFF)	Keurig Dr Pepper (KDP)
Kimberly-Clark Corp. (KMB)	Molson Coors Beverage Company (TAP)	Newell Brands Inc. (NWL)
PepsiCo Inc. (PEP)	Procter & Gamble (PG)	Reynolds Consumer Products (REYN)
The Coca-Cola Company (KO)	The Estée Lauder Companies (EL)	

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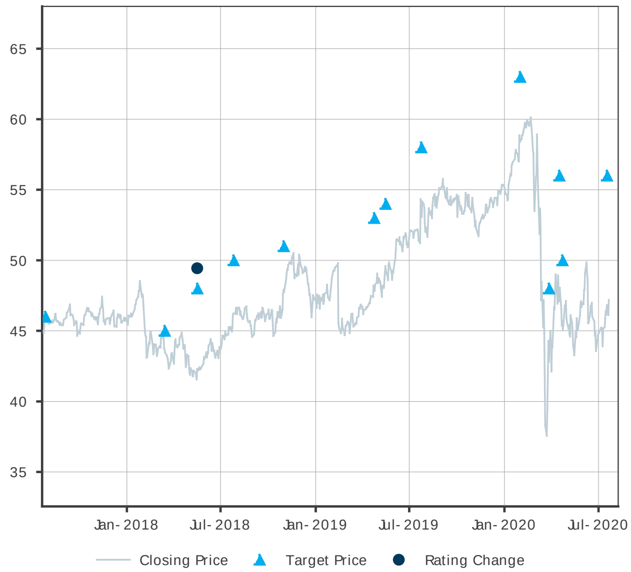
The Coca-Cola Company (KO / KO)

USD 47.20 (21-Jul-2020)

Stock Rating **OVERWEIGHT**

Industry View **NEUTRAL**

Rating and Price Target Chart - USD (as of 21-Jul-2020)



Source: IDC, Barclays Research

Currency=USD

Publication Date	Closing Price	Rating	Adjusted Price Target
17-Jul-2020	46.82		56.00
22-Apr-2020	45.68		50.00
16-Apr-2020	47.10		56.00
27-Mar-2020	42.81		48.00
31-Jan-2020	58.40		63.00
24-Jul-2019	53.78		58.00
16-May-2019	49.58		54.00
24-Apr-2019	47.98		53.00
31-Oct-2018	47.88		51.00
26-Jul-2018	46.24		50.00
17-May-2018	42.30	Overweight	48.00
15-Mar-2018	43.67		45.00
27-Jul-2017	46.12		46.00

On 21-Jul-2017, prior to any intra-day change that may have been published, the rating for this security was Equal Weight, and the adjusted price target was 45.00.

Source: Bloomberg, Barclays Research

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Valuation Methodology: Our price target of $56 is based on a 28x P/E reflecting a +25% premium to Large-Cap Staples peers on our CY21 EPS estimate of $2.01.

Risks which May Impede the Achievement of the Barclays Research Valuation and Price Target: 1) FX headwinds force downward revision of estimates, 2) Slowdown in CSD category growth, 3) More sugar taxes cloud the dialogue, 4) Deterioration in North American pricing environment would hurt results

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