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J.P.Morgan

North America Equity Research
21 March 2017

Coca-Cola

Waiting on a Sunny Day; Initiating at Neutral

Initiation

Neutral

KO, KO US

Price: $42.18

Price Target: $43.00

Beverage, Household & Personal Care Products

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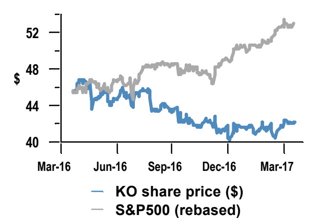
J.P. Morgan Securities LLC

We are initiating coverage of The Coca Cola Company (KO) with a Neutral rating and a Dec-17 price target of $43, implying +2% upside from here. KO has undergone a significant and positive transformation over the past couple of years, by investing in key companies and non-carbonated categories; refranchising and consolidating bottling assets globally; setting up new systems and procurement in the U.S., shifting focus from volume to price and transitioning its CEO. We believe Coke's ongoing deep transformation will allow it to become asset light, increase margins and returns, but investors will likely have to wait until 2019 to see a re-acceleration in earnings. With lack of earnings growth since 2012, potential downside risk to estimates and solid growth still two years away, we think investors can be patient until there is greater visibility on earnings growth going forward.

- **Total beverage portfolio makes sense, but portfolio still skews towards sparkling**. For stills, KO is focused on delivering through local innovation, taking current brands and moving them across the globe, and additional M&A. For sparkling, the priorities are: reduce sugar content, reformulate products, drive sales and margin growth through smaller pack sizes and downsize certain single-serve packs. KO's goal is to combat the secular trends, as carbonated soft drinks are expected to grow below the total liquid refreshment beverage (LRB) globally. Coke will likely continue to take advantage of significant geographic breadth and a vast bottling network. In the end, its current revenue mix is structurally disadvantaged and driving outsized category growth long term may prove to be difficult without larger M&A down the road.
- **Limited upside to current valuation; we rate KO Neutral**. Over the past three years, KO has underperformed both the market and the XLP by 26% respectively. We believe the stock's underperformance has largely been driven by negative earnings revisions as the multiple did not contract and the stock is not as cheap as the underperformance would indicate (currently trading at c.22.5x consensus NTM estimates). Although the steps the company is taking should improve its business model, we think investors need to see a return to earnings growth to become more positive. Our Dec-17 price target is $43, based on 22.5x our '18 estimate, in line with the current multiple. We see limited upside to the current multiple and think any stock price appreciation will likely come as a result of earnings growth.

Price Performance



	YTD	1m	3m	12m
Abs	0.9%	2.3%	1.2%	-7.6%
Rel	-5.3%	1.1%	-3.9%	-23.5%

The Coca-Cola Company (KO;KO US)

FYE Dec	2015A	2016A	2017E	2018E
EPS Reported ($)				
Q1 (Mar)	0.48	0.45	0.44	0.45
Q2 (Jun)	0.63	0.60	0.57	0.59
Q3 (Sep)	0.51	0.49	0.47	0.49
Q4 (Dec)	0.38	0.37	0.38	0.39
FY	2.00	1.91	1.86	1.92
Bloomberg EPS FY ($)	1.99	1.91	1.87	1.95
Adjusted P/E FY	21.1	22.1	22.7	21.9

Source: Company data, Bloomberg, J.P. Morgan estimates.

Company Data	
Price ($)	42.18
Date Of Price	20-Mar-17
52-week Range ($)	47.13-39.88
Market Cap ($ mn)	184,200.10
Fiscal Year End	Dec
Shares O/S (mn)	4,367
Price Target ($)	43.00
Price Target End Date	31-Dec-17

See page 37 for analyst certification and important disclosures.

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Table of Contents

Pricing and valuation on cover as of March 20, 2017’s close; all other pricing and valuation as of March 17, 2017’s close.

Investment Thesis

Coca-Cola Company (KO)

Neutral

In the Right Direction

We believe that the steps Coke is taking should help turn their business around longer term, but we expect earnings to remain somewhat underwhelming over the next two years. We expect KO to resume growth only in 2019, and as a result, we believe the stock will continue to trade sideways. We think investors can be patient at this point in time.

Sometimes Change Takes Longer to Show in Results

In our view, when Coke acquired CCE's North American bottling assets in 2010 it was clear that the company had a long-term vision as to what their optimal business structure would look like. Over the past four years, the company has been through several iterations of refranchising both in the US and internationally, with the long process expected to come to an end this year. The refranchising should create a leaner, more nimble structure and should result in higher margins and greater returns, but it has taken longer to show in the company's actual results, which we believe has disappointed investors. We recognize that the company has faced a number of headwinds that are not specific to Coke (FX, weak macros, etc.) and some that are more one time in nature (bottling divestitures), but the lack of earnings growth has kept the stock range bound over the past several years.

Total Beverage Focus Makes Sense, but Portfolio Still Skews Towards CSDs

During the recent CAGNY 2017 conference, management provided a more detailed plan on how they expect to deliver outsized beverage category growth in the coming years through growth in both stills and sparkling portfolios. Although Coke has always been a total beverage company, the primary focus had been on its largest segment: CSDs (70% of total company revenues) until most recently. In our view, there was a much greater sense of urgency to not only capture growth from the faster growing stills categories, but also re-package (smaller pack sizes) and reformulate some of their current CSD offerings to meet consumer preferences. This focus on CSDs, in our view, will make it more challenging for the company to deliver on their long-term organic revenue growth target of +4-6%.

Earnings Growth Challenged Through 2018…

We think investors have become increasingly disappointed with the lack of earnings growth over the past few years. In reality, the company has not delivered earnings growth since 2013 and we believe that 2017 EPS will likely end up being below the $1.92 number the company delivered in 2011. With structural changes and currency headwinds still expected to adversely affect earnings over the next two years, it is tough for us to see how KO will be able to deliver outsized earnings growth vs. other large-cap multi-national peers until 2019.

… With Signs of Greener Pastures Ahead, but Not Until 2019

We see Coke's stock as still expensive despite the underperformance (see below) and expect earnings growth to be at the low end of the peer range. However, we do think that as we exit 2017 and move through 2018 and the company's path to earnings acceleration becomes clearer, investors will begin to see how the company's changes are beginning to bear fruit and drive outsized growth for the future. We would also not rule out the potential for new CEO James Quincey to announce a large cost savings program (which he hinted at during CAGNY), which we think would be a significant catalyst to get the stock moving higher.

Stock Still Does Not Look Cheap

Over the past three years, KO has underperformed both the market and the XLP by 26%, respectively. The stock's underperformance has largely been driven by negative earnings revisions and the stock is not as cheap as the underperformance may indicate, in our view. KO is trading at roughly 22x our NTM estimate, which is generally in line with where the stock has traded historically. We see limited upside to the current multiple and think any stock price appreciation will likely come as a result of earnings growth.

Risks to Rating and Price Target

Concerns Around Health and Wellness

As the US and global consumer becomes more focused on health and wellness, this may negatively impact the company's revenue growth, particularly the higher calorie sugar offerings. We do think the company will be able to offset some of the negative impact from a more health conscious consumer through product innovation, smaller pack sizes, reformulating certain products to lower the sugar content, and using more natural ingredients.

Potential Taxes on Sugary Beverages

On top of the consumer concerns, we have seen a number of countries as well as local municipalities in the United States enact a tax on sugary beverages. We believe that each separate tax on the company's business will be determined on a case by case basis, but that on average, as these taxes are passed on to the consumer, this could impact demand. We would also point out that with a greater number of these taxes being implemented (United Kingdom coming in 2018 and recently implemented in Philadelphia in January 2017), we think there is an increased threat that more cities and or countries look to implement these taxes to help curb the obesity epidemic or raise funding.

Fx Volatility

Approximately 53% of The Coca-Cola Company's 2016 revenues came from outside the United States. Similar to other companies in our coverage universe, currency has been a significant headwind for both revenue and earnings growth over the past few years. Given the volatility we continue to see around the globe, we think currency volatility will likely remain an issue. Any strengthening or weakening in the dollar could result in downside or upside to our forecasts

Emerging and Developed Markets

KO has significant exposure to a number of emerging and developing markets around the globe. Over the years the company has had a number of tailwinds and headwinds as related to the performance of these markets. We believe that if emerging market trends were to improve, this could lead to upside to company results. On the contrary, if emerging market trends were to deteriorate further, this could add pressure to the company's revenue and earnings performance.

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Company Description

The Coca-Cola Company (KO, Coke) owns or licenses and markets over 500 nonalcoholic beverage brands, 3,800 beverage products of which 1,100 have low or no calories (as of FY15). Among top brands, 20 generate $1 billion in revenues or above, including 14 still brands. Of the total revenues in 2016, 40% is concentrate, and 60% is finished product. Trademark Coca-Cola represented 42%/45% of volumes in US/globally, respectively, in FY16. The U.S. represented 19% of the total volumes in 2016, but 48% of total revenues. Of U.S. beverage volumes, 66% was sparkling and 34% was still. Mexico, Brazil, China and Japan combined represented 31% of volumes in 2016. Of the international volumes, 73% was sparkling beverages. KO is undertaking a re-franchising of the US bottling system, which aims to reach 100% of U.S. volumes by the end of 2017.

Figure 1: Coca-Cola Main Products. Some Are Through Partnerships or Minority Stakes

Source: Company reports.

It Takes a Village, a Global One

Bottler Refranchising Has Taken Longer to Bear Fruit

Reducing complexity and investing in the core business has been one of the major themes that have emerged in the CPG space over the past several years. Typically, we think investors appreciate these turnaround stories, as we believe that focusing on cost cutting and reinvesting back into the business to generate top line growth have allowed companies to generate greater value to shareholders over time.

However, in the case of the Coca-Cola Company, this process has taken longer than its peers to show in actual results, as the company has had to deal with numerous (~250) bottling partners across the globe, some family owned, that have different incentives. In comparison, it took P&G about five fiscal years to show results, while KO has already clocked seven years, and we believe will likely take 8-9 years (2018 or 2019) to show financial results. The transformation started about 8 years ago, when the 2020 plan was announced in 2009. The acquisition in 2010 of the U.S. bottling territories was the first real step in that process. KO acquired the U.S. bottling business of Coca Cola Enterprises (CCE), which is now known as Coca-Cola Refreshments (CCR), to better align incentives of perpetual agreements, some of which did not have performance clauses. Three years later (2013), The Coca-Cola Company announced the initial stages of the re-franchising, which didn't begin until 2014. Management guided that this process will be finalized by the end of 2017, which would mark a total of seven years of transition.

Table 1: Financial Impact of The Coca-Cola Company Transformation - Guidance

In US$ Billions, Unless Otherwise Noted

	2016	Post Transformation
Net Revenues	$41.9B	$28.4B
Gross Margin	60%	68%
Operating Margin	24%	33%
Capex	$2.6B	$1.3B
FCF Margin	16%	+700 bps

Source: Company Reports

Nearly Half of Global Volumes Will Be Refranchised

KO initially acquired the majority of U.S. territories as some contracts were perpetual and there was limited accountability for performance. Since then, KO has realized that bottling was distracting the company from its core business (concentrate), which offers a much higher margin and return.

Anchor Bottlers Facilitate Refranchising and Strengthen Trade Execution

In addition, there has been a wave of bottling partners consolidating worldwide, which tends to create large bottlers that are more capitalized to invest more back into the business and provide better trade execution. As such, KO can count on partners that have proven track records of operating these businesses, and therefore can continue to foster combinations where there is fit. 2016 marked a very strong year for KO's refranchising efforts, not only in the U.S., but globally. **By the end of this process in 4Q17, about 40% of the business will have changed leadership, at least partially.**

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Figure 2: Refranchising Timetable

Source: Company reports, reprint with The Coca-Cola Company permission

Global Concentration of Bottlers Is Net Positive to KO

Eighty-one percent of Coke's volumes are sold outside the United States. Bottling partners that are financially strong and have aligned interests are therefore crucial to grow and improve profitability of the system. Following the consolidation of bottlers in Germany in 2008, in Latin America over the past decade, and most recently in Japan and China, we should continue to see more concentration of volumes in the hands of fewer partners. The top 5 bottlers by volume as of 2015 were (in order of size): Coca Cola Femsa, Coca Cola HBC, Arca Continental (AC), CCEP, Coca Cola Icecek. These five bottlers contributed 39% of the total unit case volume in 2016, up from 34% in 2015, and we believe this number will continue to expand, as both KOF and AC have announced additional deals in Latin America and the United States (in the case of AC Bebidas). Having covered bottling partners in the past, our experience is that having higher scale and contiguous territories are both crucial for profitability and marketing reinvestment in the business.

AC's Mexico Execution Is a Good Proxy for South U.S. Trends

Going forward, we believe that Arca's experience in further expanding sales in Northern Mexico (which already had a high consumption per capita of KO products) will be instrumental in growing revenues in the new U.S. territories, according to the M.O.U. signed on May 25, 2016, which included Texas, parts of Oklahoma, New Mexico and Arkansas. Also, The Coca-Cola Company and KOF signed a new concentrate agreement post the 10-year anniversary of the past contract. Both the joint venture with AC* for the refranchising in the U.S., and the new concentrate agreement with KOF will be effective beginning July 2017. AC Bebidas's experience with complex 1 million POS throughout LatAm should be instrumental to its ability to drive value per UC in Texas and adjacent new territories, as it executes the acquisition in the U.S.

U.S. Refranchising Is c70% Arranged and Should Be Finalized by End of 2017

So far, 70% of U.S volumes are already under new agreements (either definite agreements or signed letters of intent to refranchise bottling territories). The company-owned operations handled 82% of the U.S. unit case volume as of FY15. CCR accounts for about 70% of KO's volumes in the U. KO still controls CCR, the largest bottler in the U.S. after the acquisition in 2010 from CCE. Most of CCR assets are booked under assets for sale. In terms of divisional results, they are booked under Bottling Investments Group (BIG).

Bottler Consolidation in the U.S. Has Occurred Over Time

Historically, KO fostered consolidation of bottlers both in the U.S. and abroad. In the U.S., this consolidation has accelerated in the last three decades. As a result, the large multi-franchise operations (MFOs) eventually grew to control most of the U.S. geography, while a number of single franchise operations (SFOs) declined. The first modern Coke Territory map published by Beverage Digest in September 1983 showed 60 MFOs and more than 100 SFOs. The latest Coke territory map published by Beverage Digest in September 2016 shows 17 MFOs (including CCR) and 48 SFOs. Besides owning 100% of CCR, KO also owns 30% of Coke Consolidated, the second largest U.S. bottler. Together, CCR and Consolidated accounted for more than 70% of U.S. unit case volumes, as of late.

Table 2: Top 10 KO Bottlers in the U.S. Account for 94% of U.S. Volumes

% of Volumes

Ranking	Bottler	% Volumes
1	CCR	59.6%
2	Coke Consolidated	13.3%
3	Coke United	6.6%
4	Swire USA	4.9%
5	Great Lakes	4.5%
6	Coca-Cola Beverages Florida	2.0%
7	Coke Northern New England	1.2%
8	Coke Clark	0.8%
9	Coke Chesterman	0.8%
10	Coke Abarta	0.7%
	Total	**94.4%**

Source: Beverage Digest

Refranchising Payments to KO Typically Based on Gross Profit

As part of the new beverage partnership model for North America, KO has entered into the so-called "comprehensive beverage agreements - or CBAs" with certain bottling partners, in which KO granted to these bottlers certain exclusive territory rights for the distribution, promotion, marketing, and sale of the company-owned and licensed products as defined by the CBA. If a bottler has not entered into a specific manufacturing agreement, CCR retains the right to produce these products, and the bottlers will purchase from CCR or other company-authorized bottlers. Each CBA generally has a term of 10 years. Under the CBA, each bottler will make ongoing quarterly payments to CCR based on its gross profit in the refranchised territories throughout the term of the CBA, including renewals, in exchange for the grant of the exclusive territory rights.

Latin America Powerhouse Bottlers KOF and AC Continue to Consolidate

In Latin America, KO signed a new concentrate agreement with KOF, and also signed a letter of intent (link) for a Joint Venture with Arca Continental. This contract is different from other bottler refranchising agreements in which KO will actually retain a stake in the company, rather than just fully refranchise. KO will own a 20% stake in AC Beverages, a new company to be formed, that will include both the LatAm and U.S. operations. As a reminder, AC is one of the top 5 bottlers in the KO system, and KO did not have a direct ownership, contrary to the other four, all of which KO has a minority stake, ranging from 20% in Icecek, 24% in Hellenic, and 28% in KOF. We believe this will better align KO's interests with AC, which is one of the five largest KO bottlers worldwide, in particular after AC bought Peruvian bottler Lindley, in which KO had a minority stake.

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In Europe, Middle East and Africa, ABI-SABM Merger Triggered More M&A

Two major deals were announced in the newly created Europe, Middle East and Africa division (combining Western Europe and EMEA). Most recently, on December 21, 2016, KO decided to exercise its right of first refusal for Coca-Cola Beverages Africa. KO and ABI have reached an agreement regarding the transition of AB InBev's 54.5% equity stake in Coca-Cola Beverages Africa ("CCBA") for $3.15bn after customary adjustments. CCBA includes the countries of South Africa, Namibia, Kenya, Uganda, Tanzania, Ethiopia, Mozambique, Ghana, Mayotte and Comoros. In addition, the companies have reached an agreement in principle for Coke to acquire ABI's interest in bottling operations in Zambia, Zimbabwe, Botswana, Swaziland, Lesotho, El Salvador and Honduras for an undisclosed amount. The transactions are subject to the relevant regulatory and minority approvals and are expected to close by the end of 2017. This deal was preceded by the negotiation, in November 2014, among three parties, including The Coca-Cola Company, SAB Miller plc, and Gutsche Family Investments. The three entities entered into an agreement to combine the bottling operations of each of the parties' nonalcoholic ready-to-drink beverage businesses in Southern and East Africa. Upon the completion of these two deals, KO will have an ownership of 68% of the bottler, which will be called Coca-Cola Beverages Africa Limited. KO plans to hold all of these territories temporarily until they can be refranchised to other partners. The company's intent is to account for the acquired stakes as a discontinued operation for reporting purposes.

CCEP – Emergence of One of the Largest Bottlers in the System Worldwide

The other main deal happened in August 2015, when the company entered into an agreement to merge its German bottling operations with Coca-Cola Enterprises, Inc. (CCE) and Coca-Cola Iberian Partners SA (CCIP) to create Coca-Cola European Partners (CCEP). At closing, KO will own 18% of CCEP, which the company expects to account for as an equity method investment based on the company's equity ownership percentage, its representation on CCEP's board of directors and other governance rights. The boards of directors of the company, CCE and CCIP have approved the transaction. The proposed merger is subject to approval by CCE's shareowners, receipt of regulatory clearances and other customary conditions. The merger is expected to close in the second quarter of 2016. As a result of this agreement, the company's German bottling operations met the criteria to be classified as held for sale as of December 31, 2015. The company was not required to record the related assets and liabilities at fair value less any costs to sell because their fair value exceeded the company's carrying value.

In Asia Pacific, Both Japan and China Bottlers Are Consolidating

The company also announced that it has entered into a non-binding letter of intent to refranchise company-owned bottling operations in China to two of its existing bottling partners – COFCO and Swire. In July 2016, the company-owned bottling operations in China and a related cost method investment met the criteria to be classified as held for sale. KO has not been required to record these assets and liabilities at fair value less any costs to sell because their fair value approximates the carrying value. Management guided for the closing of this merger by end of 2017.

In Japan, Coca Cola West and Coca Cola East Japan also agreed to merge and the deal is expected to close by 1Q17. KO has an equity investment in Coca Cola East Japan booked at $562mn value but estimated at a fair value of $845mn.

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Impact to Numbers

In the earnings section of this initiation, we discuss the impact of the refranchising in more detail. There, we detail our estimates over the course of 2017 and 2018. There are a number of moving parts as it relates to the refranchising, but we estimate that the company's revenue base will drop by roughly 18-19% over the next two years, with gross and operating margins moving up nicely. Although some refranchising has occurred already, we believe that most of the benefit on the margin lines will start showing up over the course of the next two years.

In the diagram below, KO provides a framework to understand the impact on main accounts if the refranchising of the announced deals had happened in full in 2016, on a pro-forma basis. As we can see below, the main positive impact would be an increase in FCF margin, a 900bps boost to operating margin (driven by 800bps of gross margin) and a $1bn reduction in capex. The actual impact should differ as more deals will likely be announced by then and normal course of business (growth, FX, price/mix, inflation, etc.) will play a role in actual results.

Figure 3: Updated Refranchising Impact on Numbers – Company Guidance

	2016		ADJUSTED
Net Revenues**	$41.9B	↓	$28.4B
Gross Margin**	60%	↑	68%
Operating Margin**	24%	↑	33%
Capex***	$2.3B	↓	$1.3B
FCF Margin****	16%	↑	~+700bps

Source: Company reports. Note: Republished with permission from the Coca-Cola Company. Add footnotes

Top Line Algorithm

Total Beverage Focus Doesn't Fix CSD Mix Issue

With the CSD category facing a number of evolving headwinds both from category fragmentation and increased health and wellness concerns in developed markets, we have seen The Coca-Cola Company transform their approach to how they think about revenue growth as well as their overall beverage portfolio. For historical context, the company was previously heavily volume focused and given their portfolio mix (which over-indexes towards CSDs), we believe was overly concerned about driving volume growth within CSDs. Given the category headwinds, to drive volume growth, KO (as well as other major players) became very competitive on the pricing front, which ultimately ended up hurting the profit pool.

During the second quarter of 2014, we believe there was clearly a shift in the mindset of a number of large CSD manufacturers in the United States. While the category continued to face a number of changes from a consumer standpoint (namely artificial sweeteners and health/wellness), lower pricing was no longer driving the incremental volume growth the category had seen in years past. Therefore, to improve the overall profitability of the category the large manufacturers became more focused on using price to drive an improvement in revenue and profitability trends.

At the CAGNY conference last month, new CEO James Quincey talked about the company's new strategy to become a total beverage company, highlighting that this would be the last time investors would hear him say the words “sparkling and stills”. In our view, we think focusing on the total portfolio makes sense and was encouraged hearing a greater emphasis (and urgency, in our view) outside of the core CSD franchise. The company plans to capture continued growth through at-home innovation, expanding successful brands to international markets, and through potential small tuck-in M&A, which they hope to create into much larger brands down the road. On the sparkling side, the company hopes to continue to grow with their core through solid marketing. Also, thoughtful innovation around their core CSD brands both inside (reduced sugar intake, product reformulations) and outside (drive smaller pack sizes and downsize select single-serve packs) will be crucial to delivering this plan. Our concern regarding the company’s top line algorithm (which calls for +4-6% organic revenue growth longer-term) is that while the company has limited direct exposure to some of these smaller, faster growing categories both in the U.S. and globally, the company's portfolio mix still skews too far in the direction, in our view, towards CSDs. Said another way, if the global Beverage category is expected to grow +4% in the coming years (according to KO's CAGNY presentation), and roughly 70% of the company's revenue mix comes from the slower growing CSDs, it is tough to see how the high end of the company's LT revenue algorithm is sustainable.

We believe the company’s geographic breadth (65% of revenues outside the US when refranchising is complete) and global bottling network will likely allow the company to continue to gain share of the categories in which it competes. However, we remain concerned that the company's current portfolio mix may be disadvantaged longer term and as these emerging markets begin to mature and the beverage category continues to fragment, delivering organic revenue within the long-term algorithm may prove to be more difficult as we believe CSDs are inherently going to grow below the NARTD category average.

As we look ahead, we think it is clear that management is being thoughtful about the company’s portfolio and there has been a greater sense of urgency to accelerate the diversification both within sparkling and in additional categories. That said, we think the company has been somewhat hesitant to undertake large scale M&A and although it has made strategic equity investments, which provide some benefit to the P&L on an earnings basis, they have not provided the coveted top line growth that has become harder to come by within CPG.

Putting this all together, we believe that KO's organic revenue growth will likely remain at the low end (or potentially below, which the company guided to in ‘17) of their long-term organic revenue target of +4-6% in the coming years.

Growth in Non-CSDs

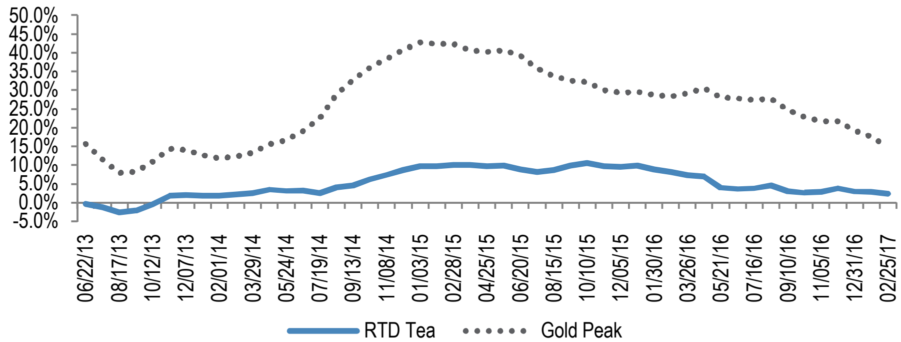
As mentioned above, the company is focusing on driving growth and capturing their share of the non-carbonated beverage categories that are growing above the category average. The company highlighted a number of key categories in which they currently have 10-15% market shares and are looking to not only benefit from strong category growth, but hope to gain greater share of these categories, particularly at the high end. Management stated that they hope to drive growth and gain share through: at home innovation, accelerated scaling of the ones that are working, and make investments/smaller acquisitions to produce more opportunities down the road.

At Home Innovation

The company highlighted that in order to benefit from these faster growing categories they will continue to innovate locally. Of the 21 billion dollar brands that the company owns, management highlighted that roughly 75% of these brands were home grown. Some primary examples include: Gold Peak Tea, Fuze Tea, Simply, and Ice Dew (water in China).

Figure 4: Gold Peak Continues to Deliver Outsized Growth vs. RTD Tea Category

Rolling 12-Week Y/Y % Change in $ Takeaway



Source: The Nielsen Company

After launching roughly 500+ new products in 2016, another 500+ new products are currently in the pipeline and planned for launch in 2017. As we look at the different ways that the company is planning to capture growth, we think this would likely be the preferred route of investors as it is the cheapest of the three options, but, in our view, has the greatest room for error. It typically takes significant time for new brands to get to a point where they are big enough to move the needle for the overall company, which management highlighted recently saying that it can take up to 10 years to build a billion dollar brand (which we think would be something that would be big enough to move the needle).

Accelerating Scale of Successful Brands

In addition to at-home innovation, the company is looking to accelerate the pace at which they take brands that are very successful in their home market and launch them in different markets. One of the more recent successful launches was Smartwater into Great Britain in 2014, which has seen rapid success in the market.

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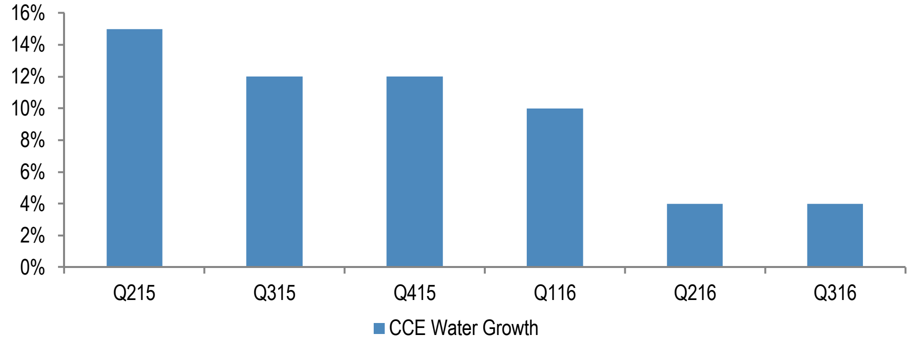
Figure 5: Launch of Smartwater in GB Had Solid Results

Quarterly Y/Y % Change in CCE's Water Portfolio



Source: Company Reports Note: Q116 Growth Was "Double-Digits", which we assume to be +10% in this chart

Looking ahead, the company is looking to build on the success of Smartwater in the U.S. and in GB by taking the brand into 20 new markets in 2017, as well as taking the Honest brand to additional markets internationally.

M&A: Both through Investments and Small Tuck-Ins

The company has made some small strategic tuck-in acquisitions as well as equity investments in recent years. We believe that the company has been somewhat skeptical about large-scale M&A and prefers to make equity investments to benefit from the growth. It started in early 2014, when it took a 20% stake in Green Mountain Coffee Roaster (this has since been exited as a result of JBH's acquisition of GMCR), and this was followed by an equity stake in Monster Beverage.

Although these investments do provide a boost to earnings, they do not provide the incremental top line growth that we believe has become coveted by investors. One of the key reasons why Coke says that taking equity investments is the right choice is often times large-scale M&A fails as the smaller brand gets lost in a larger company's vast network. Investing in these specific companies allows these brands to maintain the focus that has made them successful in the first place.

Looking ahead, we think that KO will likely continue to do small tuck-in acquisitions with the potential for additional M&A down the road. The company has highlighted that they are taking their Venture Emerging Brands (VEB) concept and moving it into international markets. As it relates to M&A, we do think any potential deals will likely remain smaller in size, particularly given the company's commentary at CAGNY, stating, "*Of course, we're going to continue to look for small bolt-on M&As. M&A is like everything else in life: the bigger it gets, the fewer there are and the much more episodic those things become. So the most likely outlook is similar to what it has been in the past in the sense that we will do the majority of transactions we do will be small bolt-on ones that we will aim to grow in their home country or region and through global expansion*."

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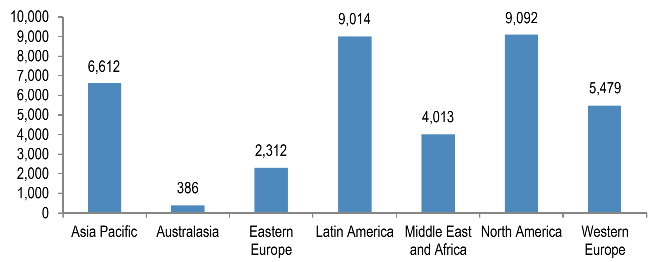
How Is Coke Thinking about CSDs Going Forward?

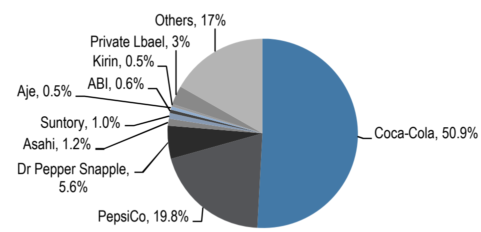
It comes as no surprise to us that CSDs have been challenged in developed markets due to secular reasons, but the category is still showing increased penetration in developing markets, such as India and South Africa, where per capita consumption is low. Globally, Coca Cola has about 51% market share of global CSDs, more than double PepsiCo's share of 20%.

Figure 6: Global CSD Volume by Region in 2016
mm cases of 192oz



Source: Euromonitor

Figure 7: Global CSD Value Share in 2016
% Value Share



Source: Euromonitor

Although there has been a greater sense of urgency to transform the total company portfolio towards the faster growing stills categories, as of 2016, 72% of total company volume was carbonated soft drinks (which we estimate means that roughly 75% of '16 total company revenues came from sparkling beverages; we note that post refranchising in North America, the company's segment mix will shift more towards stills as KO will be selling full revenue non-carb cases vs. simply CSD concentrates). At the end of the day, in order to hit the company's long-term organic revenue target of +4-6%, the company needs to drive some growth from their CSD business. As we look ahead we think KO's performance in the sparkling segment will be driven by the following factors:

1.) **Shifting the equation as it relates to price/mix and volume**. Greater price/mix vs. volume in developed markets vs. more volume in emerging markets.

2.) **Package innovation**: Driving Smaller pack sizes and downsizing select single-serve packs.

3.) **Product reformulation** and focusing on reducing sugar within products.

Shifting the equation: Emerging Markets Growth Expected to Continue

Although carbonated soft drinks should remain challenged in key developed markets such as the United States, the global CSD category is still expected to grow in the LSD range as a result of growth in emerging markets. Over the next few years, carbonated soft drink volume is expected to grow in the +2-3% per year through 2020, while volume in developed markets should remain under pressure. Volatility in a number of key emerging markets should remain an issue, but generally speaking, we believe that exposure to emerging markets will be an important driver of organic growth for the CSD category in the coming years.

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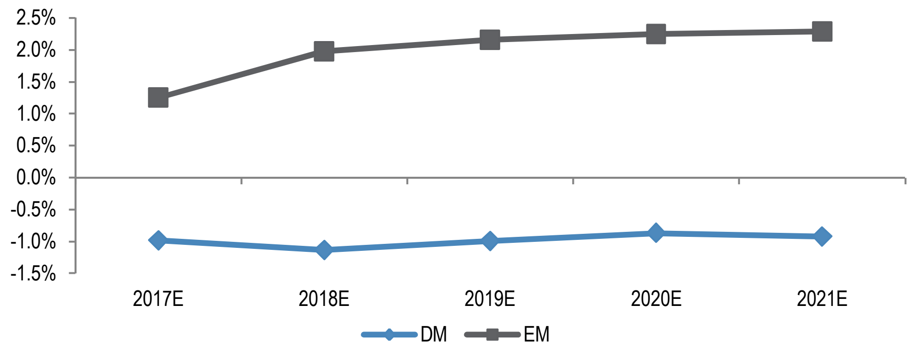
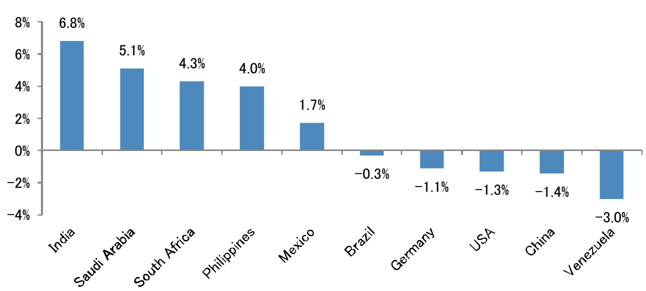
Figure 8: CSD Growth in Emerging Markets Expected to Continue to Outpace Developed Markets
YOY % Change in Carbonate Volume (Developed vs. Emerging Markets)



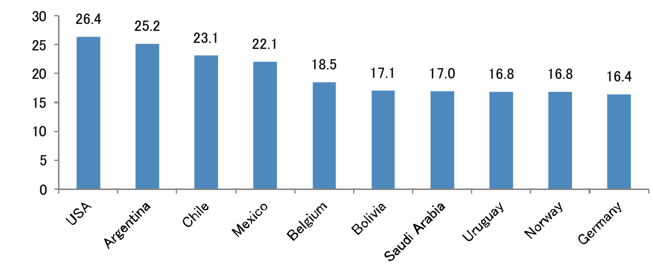
Source: Euromonitor

Figure 9: Top 5 and Bottom 5 Countries by Expected Volume Growth
2016-21 CAGR Growth % (Total Volume Cases of 192oz)



Source: Euromonitor

Figure 10: Top 10 Countries by Consumption per Capita in 2016
192 ounce case equivalents



Source: Euromonitor

Shifting the Equation: Developed Markets

One of the more welcomed changes that have occurred in the CSD category, particularly in the US, over the past couple of years has been the industry's rational pricing environment. During the second quarter of 2014, we believe there was clearly a shift in the mindset of a number of large CSD manufacturers in the United States. Historically, the category was generally more focused on volume growth/share vs. total revenue growth/share. While there were a number of changes going on from a consumer standpoint in the CSD category (namely, artificial sweeteners and health/wellness), lower pricing was no longer driving the incremental volume growth the category had seen in years past. Therefore, to improve the overall profitability of the category the large manufacturers became more focused on using price to drive an improvement in revenue trends. In addition to being rational on pricing, the category has benefited from package innovation, as the companies are now offering smaller pack sizes and on-the-go offerings, which provide mix benefits as they typically sell at higher prices per ounce (more detail below).

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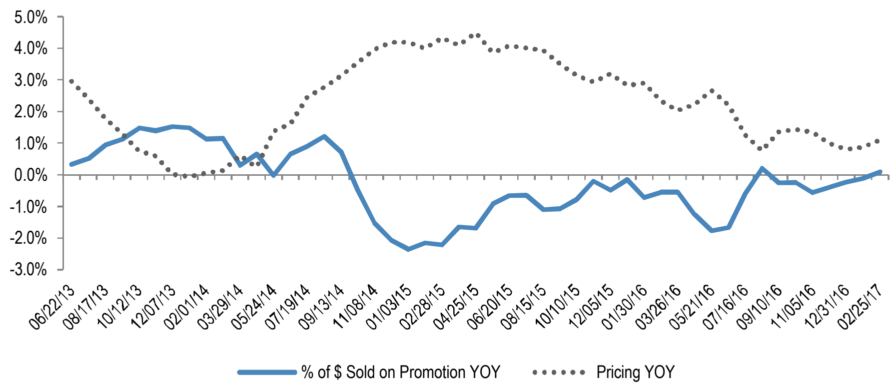
Figure 11: CSD Pricing Has Generally Stayed Rational Since Early 2014

YOY % Change in Pricing and YOY % Change in $ Sold on Promotion



Source: The Nielsen Company

Package Innovation

As mentioned above, the company's mindset within CSDs has shifted towards total revenue growth over the past few years. Although we believe rational pricing has led to improvement on the pricing front, the company has used package innovation to help benefit the on-the-go occasion as well as provide consumers with a greater focus on portion control, less sugar, natural ingredients, and alternative choices. To that end, KO has been launching smaller packages and more on-the-occasion, which have become a much larger piece of the portfolio in recent years.

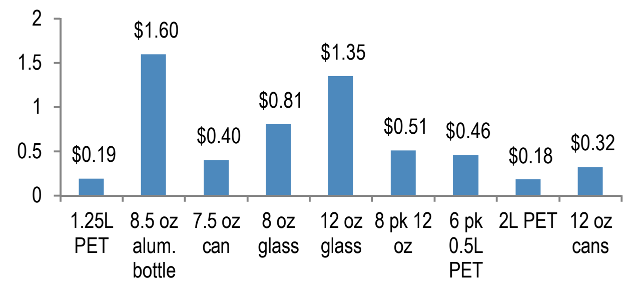
Figure 12: Prices per ounces of products presentation

$ unless otherwise noted

	Coca-Cola $/occasion	Price	Ounces	Price/ Oz
1.25L PET	0.19	1.25	42.27	0.03
8.5 oz alum. bottle	1.60	1.74	8.50	0.20
7.5 oz can	0.40	0.38	7.50	0.05
8 oz glass	0.81	0.78	8.00	0.10
12 oz glass	1.35	0.64	12.00	0.05
8 pk 12 oz	0.51	4.18	96.00	0.04
6 pk 0.5L PET	0.46	1.11	101.44	0.01
2L PET	0.18	2.29	67.63	0.03
12 oz cans	0.32	0.64	12.00	0.05

Source: Company reports, Nielsen, JPMorgan estimates

Figure 13: $ per occasion



Source: Company reports, Nielsen

Although about 2/3 of carbonated soft drink volumes in the U.S. are either in multi-serve presentations (i.e. 2L PET bottle) or larger pack of cans (12-pack of 12oz cans), a large piece of the growth in the CSD category has been coming from these smaller pack occasions. As you can see from the chart below, smaller package options (which we define at this point in time as 1.25L PET, 8.5 ounce aluminum bottle, 7.5 ounce cans, 8 ounce bottles, 12 ounce glass bottles, and 0.5 L PET) have significantly outpaced the growth of the overall CSD category in the Nielsen xAOC + C store channel.

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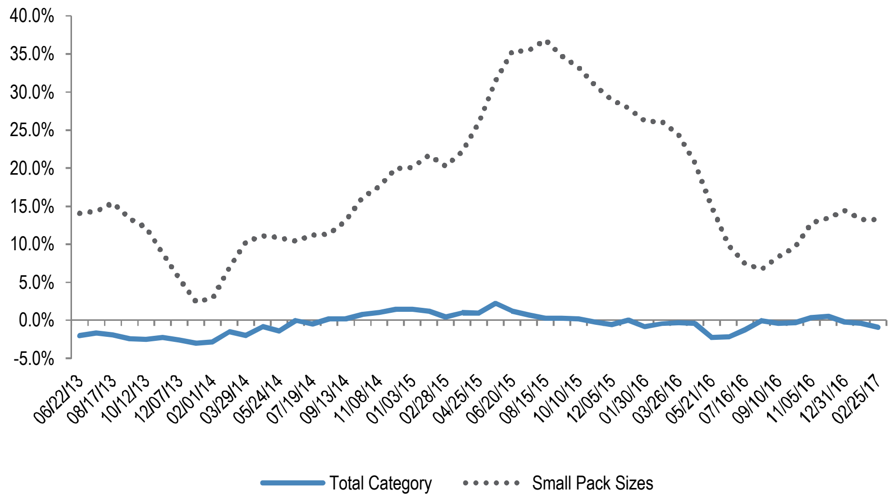
Figure 14: Smaller Pack Sizes Continue to Outperform Category

Rolling 12-Week Y/Y % Change in $ Takeaway

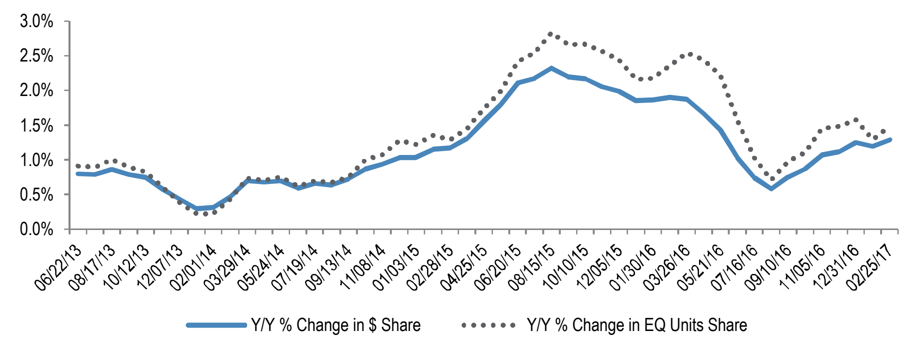


Source: The Nielsen Company and J.P. Morgan estimates Note: Small Pack Size definition includes 1.25L PET, 8.5 oz aluminum bottle, 7.5 oz can, 8 oz glass bottle, 12 oz glass bottle, 0.5L PET

Although these packages are still a small piece of the total CSD category, they have grown over the past few years. In 2012, these small pack sizes (as defined above) made up around 4-5% of the total CSD category $ takeaway and EQ volumes. However, for the latest 12-week period ending February 25, 2017, small pack sizes made up nearly 10% of both category takeaway and EQ volume.

Figure 15: Small Pack Sizes Gaining Share of Category

Y/Y % Change in $ Share and EQ Unit Share of Small Pack Sizes



Source: The Nielsen Company and J.P. Morgan estimates

KO has historically been at the forefront of the package innovation and therefore has significantly higher share vs. peers. Although the company has lost some share as key competitors have increased their presence in some of these smaller occasions, the company is still benefiting from the outsized growth.

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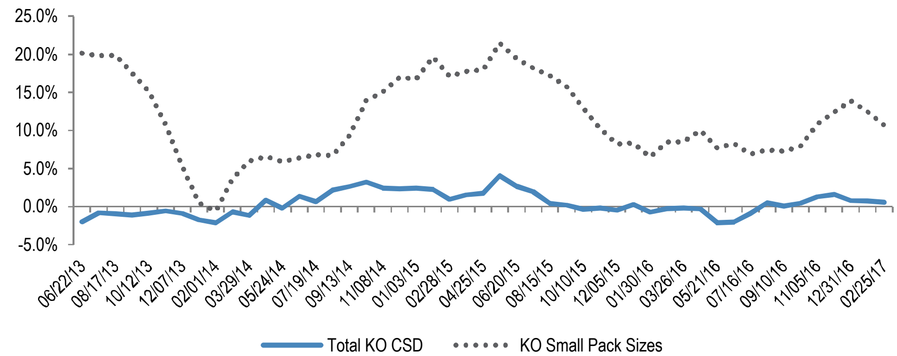
Figure 16: Smaller Pack Sizes Driving Growth for KO as well
Rolling 12-Week Y/Y % Change in $ Takeaway

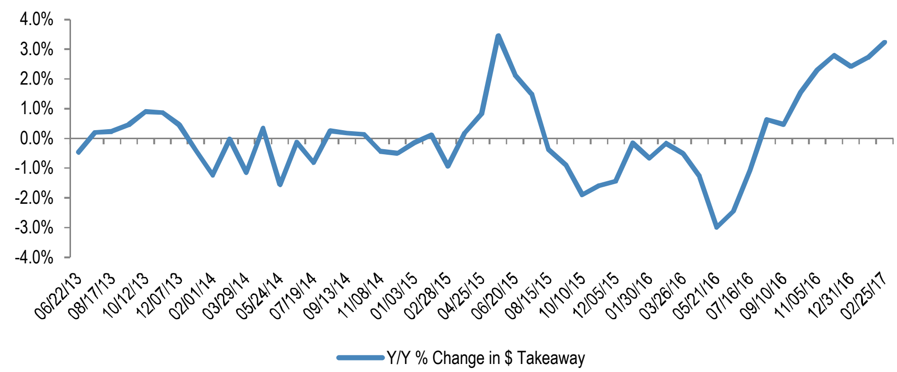


Source: The Nielsen Company and J.P. Morgan estimates

Product Innovation: Reducing Sugar and Product Reformulation

Outside of package innovation, Coke made it clear that they are looking to reformulate certain beverages and are looking to reduce the sugar content across the board. The company is currently relaunching and expanding Coca-Cola Zero Sugar internationally. KO has a number of programs and projects aimed at reducing the amount of sugar in the core formulas while maintaining taste. Management stated that this process is still in the early innings and there will likely be a few iterations that will not work, but over time they believe that they will get to a point where they will be able to provide consumers with a beverage that offers reduced sugar content and great taste.

Figure 17: Coke Zero Showing Improvement as Messaging Around Zero Sugar Paying Off
Rolling 12-Week Y/Y % Change in $ Takeaway



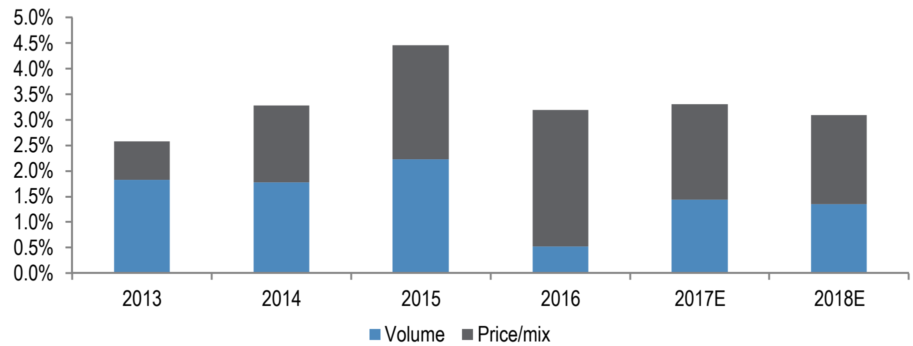
Source: The Nielsen Company

Top Line Growth in the +3-4% Range in ’17 and ‘18

As highlighted earlier, we do think that Coke is taking steps that should help turn its business around in regards to both their still and sparkling portfolios and have been thoughtful about how to drive growth given their current portfolio mix. We will provide more detail in the earnings section regarding our top line assumptions for '17 and '18, but at this stage we think that given KO's category mix (as well as continued pressure from emerging markets), we think organic revenue growth will likely remain below the company's long-term growth algorithm of +4-6%.

Figure 18: Organic Revenue Growth in the +3% Range in '17E and '18E

Annual % Change in Organic Volume and Price/Mix



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

Earnings Outlook

2017 Shaping Up to Be Another Challenging Year for KO

As we have mentioned, the company's bottling refranchising both in the US and internationally should have a significant impact on the company's reported numbers over the next two years. Management provided detailed guidance and hosted a modeling call to go over **the specific impacts of the bottler refranchising, particularly as it relates to impact on the top line growth**. The company is currently forecasting 2017 EPS to be down -1% to -4% y/y, which implies an earnings range of $1.84-$1.89 vs. consensus of $1.87 currently. Below we discuss the headwinds and tailwinds in more detail. Coke's EPS guidance is mainly predicated on LSD organic revenue growth and HSD currency neutral income before taxes (structurally adjusted) growth that will be offset by: 1) LSD headwind from FX on revenue growth and -3-4% headwind on PBT. 2) Structural impacts of -18-19% on revenue and -5-6% impact on PBT, and 3) higher tax rate (which will be partially offset by $2B of share repurchase).

KO's guidance is detailed below.

Table 3: KO's 2017 Guidance

As of February 9th, 2017

Item	Prior	Last Updated	Commentary
FY17			
Sales Growth			
Organic Growth	+3%	Q416 Earnings	Price/mix > Volume
Currency Impact	-1% to -2%	Q416 Earnings	
Structural Impact	-18% to -19%	Q416 Earnings	
Implied Total	**-16% to -18%**	Q416 Earnings	
Income Before Tax			
Organic Growth	7-8%	Q416 Earnings	Includes 2 pts of removing overhead
Currency Impact	-3% to -4%	Q416 Earnings	
Structural Impact	-5% to -6%	Q416 Earnings	
Implied Total	**-3% to Flat**	Q4 16 Earnings	
Other Items			
Net Interest Expense	Increasing Rate Environment		
Underlying Tax Rate	24%	Q416 Earnings	
Net Share Repurchases	~$2B	Q416 Earnings	
Net Capex	~$2B to $2.5B	Q416 Earnings	

Source: Company reports.

Organic Top Line Growth in the LSD Range

Management expects 2017 organic revenue growth of +3%, although the company did seem to imply that their core business (which excludes the Bottling Investment Group) will grow slightly faster than that and likely be at the low end of their long-term organic sales growth range of +4-6%. Below are management's main puts and takes as it relates to organic sales growth:

1.) Price/mix will be a larger contributor to organic sales growth vs. volume

2.) Global environment similar to '16, with continued challenges in emerging and developing economies and continued growth in the developed world.

3.) Timing of Easter shifts into Q2 in '17 vs. Q1 in '16

We are currently forecasting organic revenue growth to be up roughly +3.3% year over year, with total company volume up +1% and price/mix up roughly +2%.

Structural Impact on Top Line

Before discussing in more detail our gross profit and operating margin assumptions, we think it is prudent to understand all the different moving pieces of what management refers to as structural headwinds. As we discussed in more detail above, the company's bottling refranchising in North America, Europe, Africa, and Asia is going to have a significant impact on both revenues and profits before tax in 2017.

The company currently expects 2017 revenue to be negatively impacted by roughly -18-19% due to structural items. This headwind is comprised of four key moving parts. **First**, the largest component is the expected **reduced revenues in the Bottling**

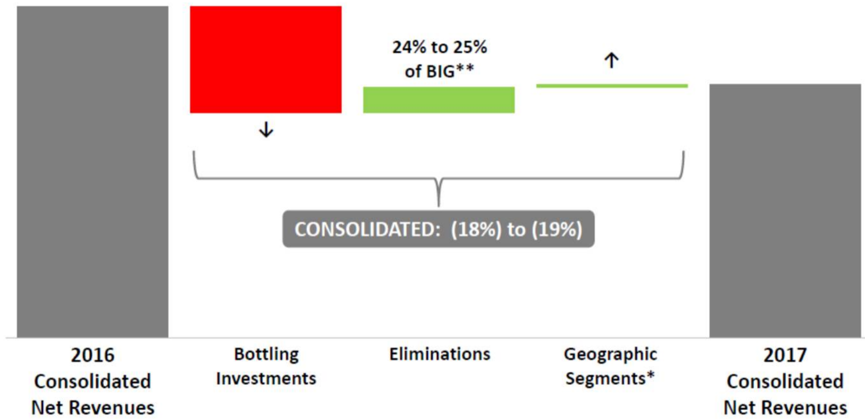
Investment Group (BIG). This headwind should be partially offset by a reduction in eliminations (which works as a boost to sales), intercompany profit eliminations that will flow through as a benefit in several geographic segments in year one, and sub-bottling payments that will benefit North America.

Second, the **sub-bottling payments** are a result of how the Coca-Cola Company is refranchising their North American territories. As a result of these transactions, the company has entered into sub-bottling payment arrangements for the intangible assets associated with the refranchised territories. These payments are initially flowing through the North America segment at an even split between net revenue and interest income.

Third, in addition to the sub-bottling payments, the geographic regions will also have a benefit from **intercompany profit eliminations** at the consolidated basis. This occurs when the company sells concentrate to the company owned bottlers, they are not able to recognize that concentrate revenue or profit until the bottling partner has sold the finished products manufactured from concentrate to third party, which essentially means that the concentrate profit in bottler inventory must be eliminated when consolidated. As these bottlers are refranchised, the elimination is no longer needed and is reversed during the period in which the transaction closes. This results in a one-time profit increase that flows from revenue down to OI in the relevant geographic segments. Given the number of transactions that are expected to occur, this should be roughly a +2% benefit on the consolidated level, with a much larger benefit coming in North America. At this point, we think the biggest structural benefit will likely come through the write-up of inventory vs. the sub-bottling payments.

The **fourth** and final moving piece relates to a reduction of **intercompany sales eliminations**. These occur when Coke sells concentrate to the bottlers, this is booked in the relevant geographic segments, but then removed in the consolidated numbers through eliminations. Therefore, as the revenue in BIG moves lower, so will the eliminations. Historically, the revenue offset from eliminations was around roughly 24-25% of BIG net revenues. We do want to highlight that the eliminations piece will not be part of the company's reported structural impact, but just works as an offset to the headwind. Ultimately, the net impact of the structural items net of the eliminations should be a -18-19% headwind for the year.

Figure 19: Structural Items Should Be a -18-19% Headwind to '17 Revenues



Source: Company reports. Note: Reprinted with permission from The Coca-Cola Company.

Total Revenue Growth for '17

With organic revenue growth of around +3%, structural headwinds of -18-19%, and layering in -1-2% of FX headwinds in '17, total company revenue growth is expected to be down -16-18%. We are currently forecasting total revenue growth to be down -16.7%, which is slightly ahead of Bloomberg consensus of -17.5%.

Table 4: 2017 Revenue Estimates vs. Guidance

	JPMe	Guidance
Volume	1%	Organic Sales ~3% (Volume < Price/Mix)
Currency	-2%	-1% to -2%
Price/Mix	2%	*See Above*
Structural	-23%	Net of eliminations: -18% to -19%
Eliminations	5%	*See Above*
Total	**-17%**	**-16% to -18%**

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

Gross Margin, Operating Income, and Profit Before Taxes Outlook

One of the more difficult things to model over the course of the past year has been KO's consolidated gross margin given the number of moving parts related to the bottler refranchising. At the company's 2016 CAGNY presentation, management highlighted that they would expect total company gross margin to improve by roughly 700 bps as a result of the bottler refranchising as the Bottling businesses the company is divesting typically have gross margin between 35-40% (which is well below the consolidated gross margin of around 61%). In '16, the company did not see this incremental benefit flow through the gross margin line due to the phasing of the transactions in terms of distribution rights vs. production plants in North America. As we look out to '17 (and 2018 for that matter), the company expects to see much more of a structural benefit to gross margins as the plants in North America should transfer at the same time as the distribution rights. In our view, it is still going to be difficult to model consolidated gross profit on a quarterly basis **as the timing of the refranchising on a quarterly basis is still yet to be determined,** but we think that **once we exit '17, the company will have recouped roughly half of the 700**

bps GM expansion, with the remaining coming in '18. Said another way, we believe that when **we exit 2018, total company gross margins will be closer to the pro-forma 68% that the company outlined during the past two CAGNY presentations.**

As it relates to PBT, before the impact of structural items and currency, management expects +7-8% underlying growth driven by strong operating performance partially offset by an increasing interest rate environment. Structural items are anticipated to be a -5-6% headwind to PBT: The Company expects the divested operating profit and Canners operation in South Africa to have a negative impact on PBT, but this should be offset by increased equity investments, and favorability in the geographic segments that would result from the intercompany profit eliminations and sub-bottling payments. In addition to the moving pieces at PBT related to structural items, the company expects Fx to be a -3-4% headwind based on current spot rates and hedged positions. All in, this implies a change in total company PBT in the range of flat to -3%.

We point out that although the company did not explicitly give operating profit guidance, they did highlight that they believe there will be 2 points of negative leverage between the operating income and profit before tax line.

We are currently forecasting total company operating profit to be down -1% on a dollar basis, although total company OPM will increase by roughly 450 bps YOY to 28.3% (vs. consensus of 28.2%). We expect PBT to be down -2%, which is towards the mid-point of the company's guidance range.

EPS Forecasted to be Down -1-4% Y/Y

We are currently forecasting 2017 EPS to be $1.86, which is towards the low end of the company's implied guidance range of $1.84-$1.89. Aside from all the moving pieces discussed above, we are forecasting a 2017 tax rate of 24% (up from 22.5% in '16 and in line with guidance), with share repurchases of approximately $2B (down from $3B in '16 and also in line with guidance).

Table 5: 2017 JPM Estimates vs. Consensus

$ in millions (unless otherwise noted)

	FY16	FY17	FY17	Y/Y	JPMe
Income Statement	**Actual**	**JPMe**	**Consensus**	**%**	**vs. cons**
Net Sales	$41,854	$34,851	$34,535	-16.7%	0.9%
Gross Profit	25,241	21,953	21,662	-13.0%	1.3%
Operating Income	9,958	9,879	9,738	-0.8%	1.4%
Interest, Net	91	219			N/A
Net Income	8,348	8,047	8,078	-3.6%	-0.4%
Shares Outstanding	4,367	4,338		-0.7%	N/A
EPS	**$1.91**	**$1.86**	**$1.87**	-3.0%	-0.8%
EBITDA	11,745	11,379	11,395	-3.1%	-0.1%
Growth/Margins				**bps**	**vs. cons**
Sales Growth	-5.4%	-16.7%	-17.5%	-1130	76
Organic Sales	3.2%	3.3%		11	N/A
Gross Margin	60.3%	63.0%	62.7%	268	26
SG&A Margin	36.5%	34.6%	34.5%	-187	12
Operating Profit	23.8%	28.3%	28.2%	455	15
Tax Rate	22.5%	24.0%	23.8%	150	24

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

1Q17 Outlook

Although the company did not provide any underlying targets for 1Q17, they did provide a few modeling items during their 4Q16 earnings call as it relates to timing. Management highlighted that 1Q17 will have 2 fewer days vs. 1Q16 (which will likely be a 200 bps headwind to revenue) as well as Easter shifting into 2Q17 vs. 1Q16 last year. In terms of structural items and FX, KO expects a -12-13% and -1-2% headwind, respectively. All in, we believe 1Q17 organic revenue growth will likely be below the company's full year guidance and with fewer selling days, FX, and structural impacts, we expect total company revenue to be down nearly -15% vs. consensus of -14%.

On a PBT basis, the company expects currency to be a -3-4% headwind, while structural items will be a -1-2% impact. Although there are a number of moving parts, we are currently forecasting 1Q17 EPS of $0.44, which is in line with Bloomberg consensus.

Table 6: 1Q17 JPM Estimates vs. Consensus

$ in millions (unless otherwise noted)

	1Q16	1Q17	1Q17	Y/Y	JPMe
Income Statement	**Actual**	**JPMe**	**Consensus**	**%**	**vs. cons**
Net Sales	$10,329	$8,790	$8,892	-14.9%	-1.2%
Gross Profit	6,212	5,480	5,508	-11.8%	-0.5%
Operating Income	2,447	2,394	2,382	-2.1%	0.5%
Interest, Net	(3)	45			N/A
Net Income	1,992	1,902	1,885	-4.5%	0.9%
Shares Outstanding	4,382	4,355		-0.6%	N/A
EPS	**$0.45**	**$0.44**	**$0.44**	-4.0%	-0.1%
EBITDA	2,905	2,841	2,814	-2.2%	1.0%
Growth/Margins				**bps**	**vs. cons**
Sales Growth	-3.5%	-14.9%	-13.9%	-1141	-99
Organic Sales	3.0%	2.4%		-60	N/A
Gross Margin	60.1%	62.3%	61.9%	220	40
SG&A Margin	36.5%	35.1%	35.2%	-135	-6
Operating Profit	23.7%	27.2%	26.8%	355	46
Tax Rate	22.5%	24.0%	24.3%	151	-25

Source: Company reports, J.P. estimates, and Bloomberg

Earnings Should Begin to Turn in ’18, But Are Numbers Done Going Down?

During their earnings call, management provided some color on their best estimate at this point in time in regards to how structural items and FX will have an impact on revenues and PBT. The company is currently forecasting structural items to have another negative impact of -16 to -17% to top line and another -1 to -2% to PBT. In addition, the company expects FX to be an LSD headwind and the 2018 tax rate to move up another 200 bps Y/Y to 26%.

Table 7: KO's 2018 Guidance

As of February 9th, 2017

Item	Guidance	Last Updated
FY18		
Sales Growth		
Structural Impact	-16% to -17%	Q416 Earnings
Income Before Tax		
Currency Impact	LSD Headwind	Q416 Earnings
Structural Impact	-1% to -2%	Q416 Earnings
Other Items		
Underlying Tax Rate	26%	Q416 Earnings

Source: Company reports.

Although the company did not provide an outlook for underlying results, we think it is tough to see a scenario in which we would see a meaningful improvement in underlying trends given the global backdrop and current beverage trends. The one caveat would be a potential large cost savings initiative, which management alluded to at the CAGNY conference. Assuming similar underlying PBT growth (+7-8% growth) this implies 2018 EPS growth in the LSD range, which is an obvious inflection point, but still well below other large-cap peers.

Table 8: FY18 Earnings Bridge

Earnings Bridge	Assumption
FY18	
Underlying PBT Growth	+7-8%
Less:	
Structural Impacts	-1% to -2%
FX	-1% to -3%
Tax Rate (26%; 200 bps increase)	-2% to -3%
Total EPS Growth	**-1% to +4%**
2017 Mid-Point	$1.87
Implied 2018 EPS	**$1.85-$1.95**
2018 Consensus	$1.95
Potential Downside vs. Consensus	**Flat to -5%**

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

If FY18 guidance materializes, it would be a step in the right direction, and a **potential inflection point, in our view, as it implies a 1.5% growth in EPS in FY18, at the middle of the range. At this point,** there is **limited visibility** as we are still in the first quarter of 2017 and there are a number of moving pieces in Coke's P&L, including timing of refranchising of additional territories. That said, if we look at consensus right now for 2018, earnings are expected to grow +4.6% vs. the mid-point of the company's guidance, which seems somewhat optimistic given what we know at this point in time. We recognize that Coke has become more difficult to model due to structural changes arising from mainly the intercompany profit eliminations and sub-bottling payments. We view management's intention to provide color on 2018 this early as a way to level the playing field, with the hope of eliminating some (not all) of the uncertainties. A lot of the negative revisions we see

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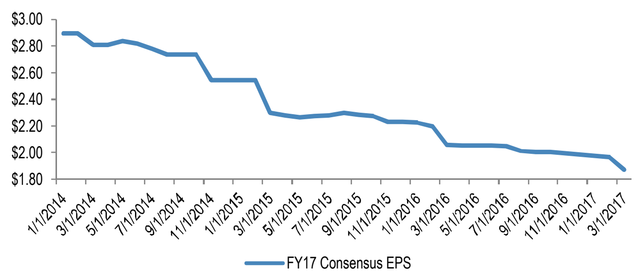
below in Figure 20 and Figure 21 are a result of the acceleration of the refranchising, but even after that was announced in early '16, consensus estimates have continued to move down. Looking at just the last year alone, before the accelerated refranchising was announced, consensus estimates came down by 9% (for '17) and 11% (for '18). Assuming our implied range is a good proxy, we think consensus of $1.95 for '18 may need to move down further.

Figure 20: 2017 Consensus Estimates Have Moved Down by 35% Since Early 2014

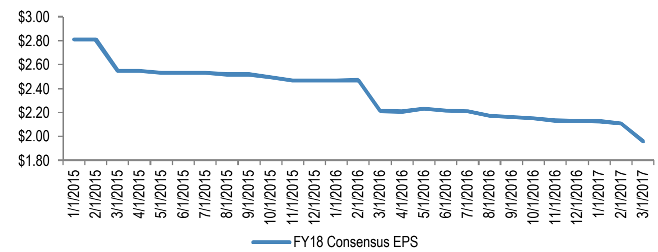
FY17E Consensus EPS



Source: Bloomberg estimates.

Figure 21: 2018 Consensus Estimates Have Moved Down by 30% Since Early '15

FY18 Consensus EPS



Source: Bloomberg estimates.

We are currently forecasting 2018 EPS of $1.92, which implies 3.5% growth Y/Y and is below Bloomberg consensus of $1.95.

Table 9: FY18 JPM Estimates vs. Consensus

$ in millions (unless otherwise noted)

	FY18	FY18	Y/Y	JPMe
Income Statement	**JPMe**	**Consensus**	**%**	**vs. cons**
Net Sales	$30,601	$30,267	-12.2%	1.1%
Gross Profit	20,408	19,787	-7.0%	3.1%
Operating Income	10,242	10,364	3.7%	-1.2%
Interest, Net	188			N/A
Net Income	8,310	8,289	3.3%	0.3%
Shares Outstanding	4,323		-0.3%	N/A
EPS	**$1.92**	**$1.95**	3.6%	-1.4%
Growth/Margins			**bps**	**vs. cons**
Sales Growth	-12.2%	-12.4%	454	513
Organic Sales	3.1%			
Gross Margin	66.7%	65.4%	370	265
SG&A Margin	33.2%	31.1%	-142	-340
Operating Profit	33.5%	34.2%	512	604
Tax Rate	26.0%	24.6%		

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

Tax Reform Scenarios

While there are still many uncertainties on the potential border tax adjustment (BAT) as proposed by the Trump administration and Speaker Paul Ryan's blueprint from June 24, 2016, and its potential side effects, we ran a sensitivity analysis to FY18 estimates. We also base our analysis on some of the extensive studies JPM's U.S. economist Mike Feroli wrote about the tax reform, in particular the report about the potential FX impact of BAT. Our model is flexible to different assumptions, and available upon request. We based the assumptions below on consensus view of the following key potential changes:

1. 20% border tax
2. 20% marginal corporate tax rate in the U.S.
3. Non-deductibility of imported products and raw materials from the federal taxable income. Of the US operations, we assume 0% of cost of goods sold are imported.
4. Non-deductibility interest expense from taxable income, albeit the most common assumption is that it would be applicable only to new debt. For the purpose of this exercise, we are assuming 0% of interest expense is deductible from taxable income (in line with Paul Ryan's proposal).
5. Tax holiday for cash overseas - repatriation rate of 9%. As of December 31, 2016, roughly 91% of Coke's cash is held overseas.

Table 10: Tax Reform Assumption

Policy	Assumption
Federal Corporate Tax Rate	**20%**
% Imported COGS Taxed	**100%**
% Border Adj. Tax	**20%**
% Interest Expense Deductible	**0%**
One-Time Repatriation Tax Rate	**9%**
Appreciation of USD % of Border Tax	**50%**

Source: J.P. Morgan estimates.

Tax Reform Would Likely Be Positive for KO Assuming No $ Appreciation

We believe the potential tax reform will have an LDD positive impact on KO's EPS FY18E if we assume that the USD will not appreciate relative to the basket of currencies of its international operations. Many economists, however, including our U.S. economic team, believe that the border tax (if implemented) will be followed by an appreciation of the U.S. dollar, which would hurt the translation of Coca-Cola's international results into USD.

Like Other Multi-Nationals, $ Appreciation Remains Biggest Unknown

When we add in a layer of potential impact of U.S. dollar appreciation against other currencies as a result of the potential reform, the economic theory is that currencies will adjust to the impact on trade. This is particularly relevant for Coke given that approximately 65% of KO's sales (JPMe post bottler refranchising) is international and is translated into U.S. dollars. We assume that the USD will appreciate at a beta of 50% of the proposed border tax (so 50% of a 20% border tax implies a 10% appreciation of the dollar), as highlighted in the table above. We also adjust our equity income assumptions to account for this dollar appreciation (we assume roughly 85% of the company's equity income is international after excluding MNST and COKE). Under this scenario, KO's we estimate that EPS would still increase roughly 5% primarily as a result of the share buybacks (see below).

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U.S. Impact of Potential Border Tax Likely Would Be Low for KO

We believe that there would be little to no impact on KO from a potential border tax. Coca-Cola sells concentrate that is produced in U.S. territories for their U.S. business and does not source any material part of their cost of goods sold (mostly concentrate) from international markets and they do not export any material portion of their sales.

Cash Repatriation Would Work

With roughly $20.2B of cash sitting overseas (according to KO's latest 10-K filed last month), we believe that one of the biggest offsets to any dollar appreciation as it relates to tax reform would come from cash repatriation. For the purpose of this exercise, we are assuming that some of the cash will remain overseas (roughly 50%) and that the cash that is brought back will be used to repurchase shares. We would also point out that given the company's gross debt balance ($42.2B), this could be used to pay down debt. If we were to exclude the benefit of share repurchases in this exercise, then we estimate earnings would be down slightly.

Table 11: Potential Tax Reform Could Be a Slight Potential Positive for KO

	2018E	
Income Statement	**Current**	**Proposed**
Sales	**30,601**	**28,737**
COGS	10,193	9,572
Gross Profit	**20,408**	**19,165**
Operating Expenses	10,166	9,547
EBIT	**10,242**	**9,618**
Interest Income	614	614
Deductible Interest Expense	801	321
Equity Earnings, Other	1,204	1,111
Non-Deductible Costs	0	0
Taxable Income	**11,258**	**11,022**
Tax Expense	2,927	2,095
Tax Rate	*26.0%*	*19.0%*
Post-Tax Income	8,331	8,927
Non-Deductible COGS	0	0
Non-Deductible Interest Expense	0	481
Non-Controlling & Other	21	21
Net Income	**8,310**	**8,425**
Shares Outstanding	4,323	4,104
EPS	**$1.92**	**$2.05**
% Change		6.8%

Source: J.P. Morgan estimates, Company data.

Valuation

We are introducing our December 2017 price target of $43, which is based on 22.5x our 2018 EPS estimate of $1.92, which represents limited upside from current levels. We think using a 22.5x is justified as it is roughly in line with the company's current multiple, which we think reflects the top and bottom line earnings growth outlook for the company. The 22.5x times is also anchored by the similar P/E18E for non-alcoholic peers, as we see in the table below. The premium/discount relative to large-

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cap multi-national peers (which we define as an average of KO, PEP, CL, PG, and KMB) is slightly ahead of the company's 2-year and 5-year averages.

We believe until earnings growth shows a re-acceleration or is more in line with other LC peers, we think investors can afford to be patient. In our view, there is limited upside to the company's current multiple and any price appreciation in the stock would come from better-than-anticipated earnings performance.

Table 12: Price Target of $43 Offers Limited Upside Potential from Current Levels

Prices as of close of March 17, 2017

	2017E
JPM 2018 EPS Estimate	$1.92
Multiple	22.5x
Fair Value - Dec .17	**$43.00**
Current Price	$42.03
Implied Upside/Downside	**2.3%**
Dividend Yield - Dec. 16	**3.5%**
Expected TSR	**5.8%**

Source: J.P. Morgan estimates.

Although it seems that many investors understand that Coke has had its fair share of issues over the years, we think it still comes as a surprise that Coke has underperformed both the market and XLP by -26%, respectively, since the end of 2013, which is the worst performance of any stock in our coverage universe. We believe the issue currently is that most of the stock's underperformance has been driven by negative earnings revisions (see above), and the stock is ultimately not as cheap as the underperformance would indicate.

Table 13: Beverage Comp Sheet

Prices as of close of March 17, 2017

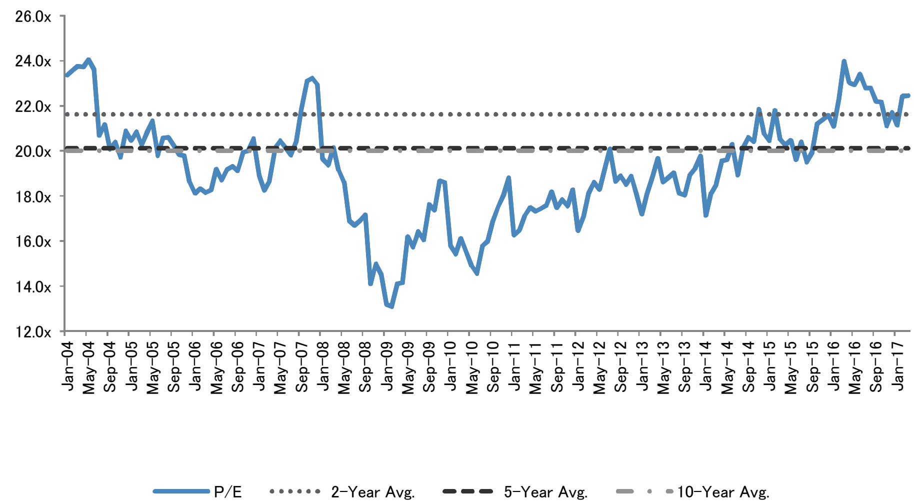
	EV / EBITDA			P / E			PEG	Div.	FCF Yield			ROIC		
Company	'16	'17E	'18E	'16	'17E	'18E	Ratio	Yield	'16	'17E	'18E	'16	'17E	'18E
Beverages														
BF/B	18.7x	17.9x	16.9x	26.9x	26.1x	24.2x	5.0x	1.6%	2.4%	3.7%	3.8%	41.4%	38.2%	39.9%
COT	10.1x	8.4x	7.9x	51.0x	54.3x	25.1x	1.2x	2.0%	7.7%	9.9%	12.6%	10.9%	5.1%	6.4%
CUERVO* MM	19.9x	13.9x	11.6x	32.4x	24.9x	21.2x	1.4x	N/A	2.0%	3.4%	3.8%	11.8%	13.1%	14.9%
DPS	12.5x	12.1x	11.5x	21.7x	20.9x	19.1x	3.4x	2.4%	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%
KO	**17.4x**	**17.9x**	**18.1x**	**22.0x**	**22.7x**	**21.9x**	**NM**	**3.5%**	**6.1%**	**6.1%**	**6.0%**	**12.7%**	**13.4%**	**14.0%**
MNST	21.3x	18.8x	16.7x	36.2x	31.1x	26.8x	2.2x	N/A	3.0%	3.5%	3.9%	29.1%	27.7%	31.6%
PEP	14.1x	13.6x	12.8x	23.0x	21.7x	20.1x	3.3x	2.7%	8.5%	8.0%	8.6%	17.9%	18.6%	19.6%
SAM	10.3x	11.3x	11.0x	23.6x	26.8x	25.2x	-7.4x	N/A	4.4%	4.0%	3.7%	0.0%	0.0%	0.0%
SODA	13.4x	13.4x	12.6x	23.6x	20.3x	18.9x	2.0x	N/A	5.4%	2.9%	3.1%	14.0%	15.7%	15.9%
STZ	16.9x	15.4x	13.4x	25.0x	22.2x	19.5x	1.9x	1.0%	2.4%	2.6%	3.8%	9.9%	10.2%	11.3%
TAP	16.2x	13.0x	12.3x	17.0x	15.6x	14.4x	2.0x	1.7%	3.7%	4.7%	6.7%	6.0%	4.5%	4.7%
Total Beverage Avg.	15.6x	14.5x	13.5x	27.5x	26.0x	21.5x	1.5x	2.1%	4.1%	4.4%	5.1%	14.0%	13.3%	14.4%
Non-Alcohol Avg.	14.8x	14.1x	13.3x	29.6x	28.5x	22.0x	2.4x	2.7%	5.1%	5.1%	5.7%	14.1%	13.4%	14.6%
Non-Alcohol Avg. (excl. KO)	14.3x	13.3x	12.3x	31.1x	29.7x	22.0x	2.4x	2.4%	4.9%	4.9%	5.7%	14.4%	13.4%	14.7%
Premium/Discount	**22%**	**35%**	**47%**	**-29%**	**-24%**	**-1%**		**115**	**121**	**123**	**32**	**(170)**	**(5)**	**(70)**

Source: J.P. Morgan estimates, Bloomberg.

KO Generally in Line with Recent Valuation on a P/E Basis

On a P/E basis, Coke is currently trading at 22.5x NTM consensus estimates, which is a +4.8% premium to the company's two-year average, and a +13.0% premium and 15.1% premium to the company's 5 and 10-year historical averages.

Figure 22: KO Is Trading at a Premium to Company's Historical Average
NTM P/E Valuation for KO



Source: Bloomberg estimates.

As mentioned above, we believe that other large (or mega-cap) U.S. listed Staples names with large international exposure, such as Pepsi, Procter & Gamble, Colgate Palmolive, Estee Lauder, and Kimberly-Clark are the best comps for The Coca-Cola Company. These companies typically have similar underlying revenue growth and have diverse geographic mix that can help provide stability to top line growth, but as we have seen over the past few years, it can also drive significant currency headwinds. Relative to the large-cap multi-national average, KO is currently trading at an LSD discount to peers, which is slightly ahead of the company's historical averages.

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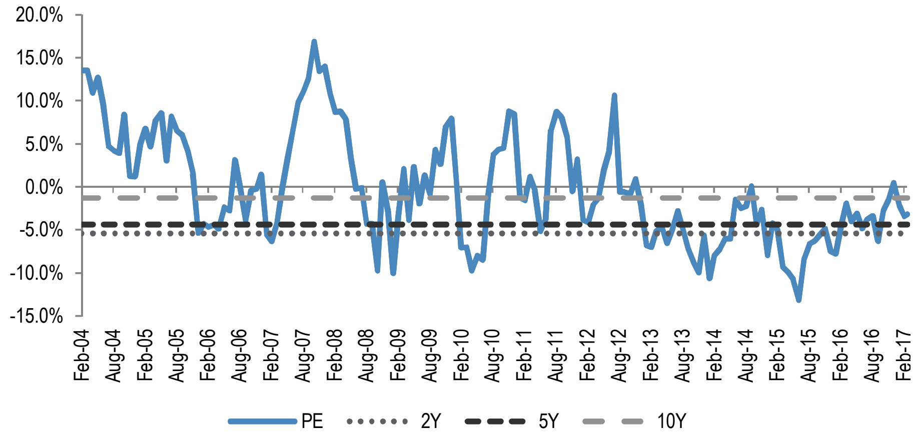
Figure 23: KO Is Trading at a Discount to Large-Cap Multinational Peers 10-year Average

% Premium/Discount vs. PEP, CL, PG, KMB, and EL Avg. NTM PE



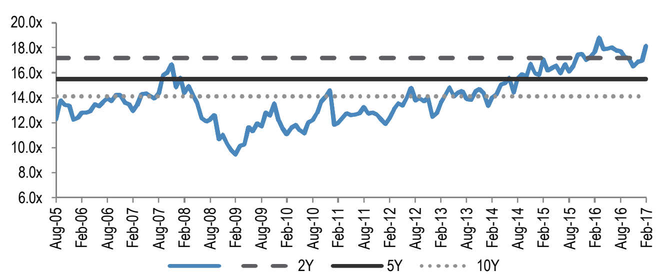
Source: J.P. Morgan estimates, Bloomberg.

EV/EBITDA Looks More Expensive

On an absolute basis, KO does not look cheap relative to peers on an EV/EBITDA basis. Coke is currently trading at 17.9x our '17 EBITDA forecast, which is a 27% premium to other large-cap multinational peers. We believe this discrepancy is due to two factors: (1) KO's historically low tax rate. (2) Coke has had net interest income/low interest expense, despite having $24bn in net debt as of 4Q16. The only stocks that look more expensive in our coverage universe on EV/EBITDA are Brown-Forman, Monster, and e.l.f.

Figure 24: KO is Trading at a Premium vs. Historical Average...

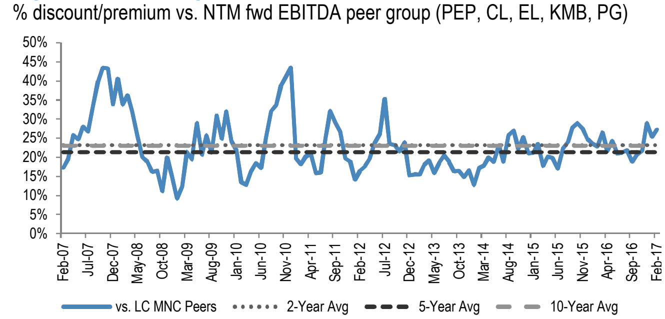
NTM fwd EBITDA



Source: Bloomberg.

Figure 25: ... And Against LC Bevs/HPC Peer Group

% discount/premium vs. NTM fwd EBITDA peer group (PEP, CL, EL, KMB, PG)



Source: J.P. Morgan estimates, Bloomberg.

Relative to PEP

Relative to the company's largest global competitor, Coke is currently trading at a LSD premium to Pepsi. Although this is ahead of both the 2-year and 5-year average, it is slightly below the long-term average of an MSD premium.

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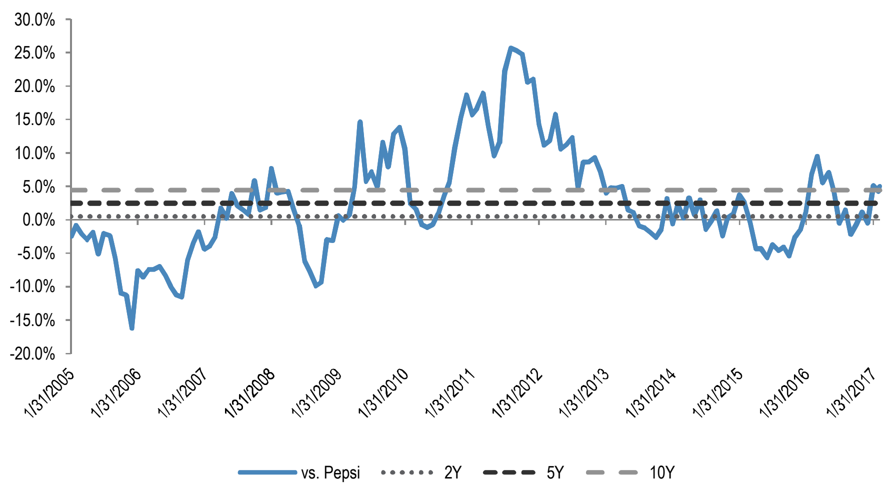
Figure 26: KO Trading at a 3% Premium to Pepsi

% discount/premium vs. NTM fwd PE of PEP



Source: Bloomberg estimates.

Management

On December 9, 2016, KO announced that James Quincey, President and COO, was promoted to CEO effective May 1, 2017. In addition, the company announced that Muhtar Kent, who is current Chairman of the Board of Directors and CEO, will continue as Chairman following Mr. Quincey's succession to the position of CEO. The company also announced that the Board of Directors intends to nominate Mr. Quincey to stand for election as a director at the 2017 Annual Meeting of Shareowners. Mr. Quincey, age 51, was named the company's President and COO in August 2015. Prior to this role, Mr. Quincey served as President of the company's Europe Group. Mr. Quincey served as President of the Northwest Europe & Nordics Business Unit from 2008 to 2012. From 2005 to 2008, Mr. Quincey was President of the Mexico Division. Mr. Quincey joined the company in Atlanta in 1996 as Director, Learning Strategy for the Latin America Group, and went on to serve in a series of operational roles of increasing responsibility in Latin America, leading to his appointment as President of the South Latin Division in 2003, a position he held until his 2005 promotion to President of the Mexico Division. Muhtar had been in the CEO position for the past 8 years.

Other four executives were named by the board on December 8, 2016, and effective immediately. Barry Simpson, who was recently named Chief Information Officer, was elected as a Senior Vice President. In addition, Robert Long, Global Vice President of Research and Development; Bernard McGuinness, Vice President of Science; and Darlene Nicosia, Vice President of Commercial Product Supply were elected as Vice Presidents of the company.

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Financial Statements

Table 14: Annual Income Statement

$ in millions, except per share data

	FY15	FY16	FY17E	FY18E	FY19E
Net Sales	**$44,257**	**$41,854**	**$34,851**	**$30,601**	**$31,536**
% change	*-3.8%*	*-5.4%*	*-16.7%*	*-12.2%*	*3.1%*
Cost of goods sold	17,416.0	16,613.0	12,898.0	10,193.1	10,305.8
as a % of net sales	*39.4%*	*39.7%*	*37.0%*	*33.3%*	*32.7%*
Change as % of net sales (bps)	*44*	*34*	*(268)*	*(370)*	*(63)*
% change	*-2.7%*	*-4.6%*	*-22.4%*	*-21.0%*	*1.1%*
Gross profit	**$26,841**	**$25,241**	**$21,953**	**$20,408**	**$21,230**
as a % of net sales	*60.6%*	*60.3%*	*63.0%*	*66.7%*	*67.3%*
Change as % of net sales (bps)	*(44)*	*(34)*	*268*	*370*	*63*
% change	*-4.5%*	*-6.0%*	*-13.0%*	*-7.0%*	*4.0%*
Selling general & administrative	16,468.0	15,283.0	12,074.6	10,166.1	10,393.7
as a % of net sales	*37.2%*	*36.5%*	*34.6%*	*33.2%*	*33.0%*
Change as % of net sales (bps)	*(8)*	*(69)*	*(187)*	*(142)*	*(26)*
% change	*-4.0%*	*-7.2%*	*-21.0%*	*-15.8%*	*2.2%*
Operating income	**$10,373**	**$9,958**	**$9,879**	**$10,242**	**$10,836**
as a % of net sales	*23.4%*	*23.8%*	*28.3%*	*33.5%*	*34.4%*
Change as % of net sales (bps)	*(37)*	*35*	*455*	*512*	*89*
% change	*-5.3%*	*-4.0%*	*-0.8%*	*3.7%*	*5.8%*
Interest Expense, net	**77.0**	**-91.0**	**-219.5**	**-187.6**	**31.9**
Interest expense	*536.0*	*733.0*	*833.1*	*801.5*	*717.1*
Interest income and other	*613.0*	*642.0*	*613.6*	*613.9*	*749.0*
Bottling Equity Income, net	576.0	896.0	1146.5	1203.8	1264.0
Other income (expense)	344.0	46.0	-185.0	0.0	0.0
Income Before Taxes	**$11,370**	**$10,809**	**$10,621**	**$11,258**	**$12,132**
as a % of net sales	*25.7%*	*25.8%*	*30.5%*	*36.8%*	*38.5%*
Change as % of net sales (bps)	*13*	*13*	*465*	*632*	*168*
% change	*-3.3%*	*-4.9%*	*-1.7%*	*6.0%*	*7.8%*
Tax Rate	*22.5%*	*22.5%*	*24.0%*	*26.0%*	*26.0%*
Provision for Income Taxes	2,558.0	2,432.0	2,548.9	2,927.1	3,154.4
NI from Noncontrolling interests	-9.0	-29.0	-24.1	-21.2	-21.9
Net Income	**$8,803**	**$8,348**	**$8,047**	**$8,310**	**$8,956**
as a % of revenue	*19.9%*	*19.9%*	*23.1%*	*27.2%*	*28.4%*
% change	*-3.5%*	*-5.2%*	*-3.6%*	*3.3%*	*7.8%*
Diluted Earnings Per Share	**$2.00**	**$1.91**	**$1.86**	**$1.92**	**$2.08**
% change	*-2.6%*	*-4.3%*	*-3.0%*	*3.6%*	*8.2%*
Diluted shares outstanding	4,408.5	4,367.0	4,338.0	4,323.0	4,308.0
% change	*-0.9%*	*-0.9%*	*-0.7%*	*-0.3%*	*-0.3%*

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

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Table 15: Annual Balance Sheet

	FY15	FY16	FY17E	FY18E	FY19E
Assets					
Cash and cash equivalents	7309	8555	13164	11565	10969
Short term investments	8322	9595	9595	9595	9595
Marketable securities	4269	4051	4051	4051	4051
Accounts receivables	3941	3856	3168	2832	2889
Inventories	2902	2675	2014	1631	1639
Prepaid expenses and other current assets	2752	2481	1868	1513	1520
Assets held for sale	3900	2797	2797	2797	2797
Total current assets	**33395**	**34010**	**36658**	**33984**	**33461**
Non-current Assets					
PP&E, net	12571	10635	5099	5845	6505
Trademarks with indefinite lives	5989	6097	6097	6097	6097
Goodwill	11289	10629	10629	10629	10629
Other intangible assets	6854	4402	4402	4402	4402
Equity method investments	12318	16260	16260	16260	16260
Cost method investments	3470	989	989	989	989
Other assets	4207	4248	4248	4248	4248
Total Assets	**90093**	**87270**	**84382**	**82454**	**82591**
Current Liabilities					
Short-term obligations	13129	12498	12498	12498	12498
Current portion of LT-debt	2677	3527	3527	3527	3527
Accounts payable and other current liabilities	9660	9490	7145	5787	5815
Taxes payable	1464	1017	836	747	762
Total current liabilities	26930	26532	24006	22559	22602
Non-current Liabilities					
LT Debt	28407	29684	29684	29684	29684
Deferred tax liabilities	4691	3753	3753	3753	3753
Other liabilities	4301	4081	4081	4081	4081
Total non-current liabilities	37399	37518	37518	37518	37518
Total Liabilities	64329	64050	61524	60077	60120
Shareholders' Equity					
Common stock	1760	1760	1760	1760	1760
Treasury stock	(45066)	(47988)	(50034)	(52112)	(54189)
Capital in excess of par value	14016	14993	14993	14993	14993
Retained earnings	65018	65502	67186	68783	70953
Accumulated other comprehensive loss	(10174)	(11205)	(11205)	(11205)	(11205)
Non-controlling interests	210	158	158	158	158
Total Equity	**25764**	**23220**	**22858**	**22377**	**22470**
Total liabilities and equity	**90093**	**87270**	**84382**	**82454**	**82591**

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

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Table 16: Annual Cash Flow Statement

$ in millions

	FY15	FY16	FY17E	FY18E	FY19E
Net income	7366	6550	8047	8310	8956
Depreciation and amortization	1970	1787	1501	1049	1190
Stock-based compensation expense	236	258	0	0	0
Deferred income taxes	73	(856)	0	0	0
Equity income or loss, net of dividends	(122)	(449)	0	0	0
Other	1162	1727	(181)	(89)	15
Net change in operating assets and liabilities	(157)	(221)	(383)	(284)	(44)
Net cash provided by operating activities	**10528**	**8796**	**8984**	**8986**	**10117**
Acquisitions and investments (princ. trademarks and bottling cos)	(2491)	(838)	0	0	0
Purchases of investments and other assets	(15831)	(15499)	0	0	0
Proceeds from disposals of investments and other assets	14079	17659	0	0	0
Purchases of property, plant and equipment	(2553)	(2262)	(2015)	(1795)	(1849)
Proceeds from disposals of property, plant and equipment	85	150	6050	0	0
Other investing activities	525	(209)	0	0	0
Net cash from investing activities	**(6186)**	**(999)**	**4035**	**(1795)**	**(1849)**
Issuances of debt	40434	27281	0	0	0
Payments of debt	(37738)	(25615)	0	0	0
Issuances of stock	1496	1434	0	0	0
Purchases of stock for treasury	(3564)	(3681)	(2046)	(2077)	(2077)
Dividends	(5741)	(6043)	(6363)	(6713)	(6786)
Other financing activities	0	79	0	0	0
Net cash used for financing activities	**(5113)**	**(6545)**	**(8410)**	**(8790)**	**(8863)**
Effect of exchange rate changes	(878)	(6)	0	0	0
Net (dec)/increase in cash and equivalents	**(1649)**	**1246**	**4609**	**(1600)**	**(595)**
Cash at beginning of period	8958	7309	8555	13164	11565
Cash at end of period	7309	8555	13164	11565	10969

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

Coca-Cola: Summary of Financials

Income Statement - Annual	FY15A	FY16A	FY17E	FY18E	FY19E
Revenue	**44,257**	**41,854**	**34,851**	**30,601**	**31,536**
COGS	(17,416)	(16,613)	(12,898)	(10,193)	(10,306)
Gross profit	**26,841**	**25,241**	**21,953**	**20,408**	**21,230**
SG&A	(16,468)	(15,283)	(12,075)	(10,166)	(10,394)
Adj. EBITDA	**12,343**	**11,745**	**11,379**	**11,291**	**12,026**
D&A	(1,970)	(1,787)	(1,501)	(1,049)	(1,190)
Adj. EBIT	**10,373**	**9,958**	**9,879**	**10,242**	**10,836**
Net Interest	77	(91)	(219)	(188)	32
Adj. PBT	**11,370**	**10,809**	**10,621**	**11,258**	**12,132**
Tax	(2,558)	(2,432)	(2,549)	(2,927)	(3,154)
Minority Interest	(9)	(29)	(24)	(21)	(22)
Adj. Net Income	**8,803**	**8,348**	**8,047**	**8,310**	**8,956**
Reported EPS	2.00	1.91	1.86	1.92	2.08
Adj. EPS	**2.00**	**1.91**	**1.86**	**1.92**	**2.08**
DPS	**1.30**	**1.38**	**1.47**	**1.55**	**1.58**
Payout ratio	65.2%	72.4%	79.1%	80.8%	75.8%
Shares outstanding	4,409	4,367	4,338	4,323	4,308

Income Statement - Quarterly	1Q17E	2Q17E	3Q17E	4Q17E
Revenue	**8,790**	**9,684**	**8,675**	**7,703**
COGS	(3,310)	(3,584)	(3,135)	(2,869)
Gross profit	**5,480**	**6,100**	**5,539**	**4,834**
SG&A	(3,085)	(3,125)	(3,079)	(2,785)
Adj. EBITDA	**2,841**	**3,380**	**2,789**	**2,369**
D&A	(447)	(405)	(329)	(320)
Adj. EBIT	**2,394**	**2,974**	**2,460**	**2,050**
Net Interest	(45)	(57)	(47)	(71)
Adj. PBT	**2,510**	**3,250**	**2,712**	**2,148**
Tax	(602)	(780)	(651)	(516)
Minority Interest	(6)	(7)	(6)	(5)
Adj. Net Income	**1,902**	**2,463**	**2,055**	**1,627**
Reported EPS	0.44	0.57	0.47	0.38
Adj. EPS	**0.44**	**0.57**	**0.47**	**0.38**
DPS	**0.35**	**0.37**	**0.37**	**0.37**
Payout ratio	80.2%	65.4%	78.2%	98.5%
Shares outstanding	4,355	4,344	4,332	4,321

Balance Sheet & Cash Flow Statement	FY15A	FY16A	FY17E	FY18E	FY19E
Cash and cash equivalents	7,309	8,555	13,164	11,565	10,969
Accounts receivable	3,941	3,856	3,168	2,832	2,889
Inventories	2,902	2,675	2,014	1,631	1,639
Other current assets	10,921	9,329	8,716	8,361	8,368
Current assets	**33,395**	**34,010**	**36,658**	**33,984**	**33,461**
PP&E	12,571	10,635	5,099	5,845	6,505
LT investments	3,470	989	989	989	989
Other non current assets	25,984	27,594	27,594	27,594	27,594
Total assets	**90,093**	**87,270**	**84,382**	**82,454**	**82,591**
Short term borrowings	13,129	12,498	12,498	12,498	12,498
Payables	9,660	9,490	7,145	5,787	5,815
Other short term liabilities	4,141	4,544	4,363	4,274	4,289
Current liabilities	**26,930**	**26,532**	**24,006**	**22,559**	**22,602**
Long-term debt	28,407	29,684	29,684	29,684	29,684
Other long term liabilities	37,399	37,518	37,518	37,518	37,518
Total liabilities	**64,329**	**64,050**	**61,524**	**60,077**	**60,120**
Shareholders' equity	25,554	23,062	22,700	22,219	22,312
Minority interests	210	158	158	158	158
Total liabilities & equity	**90,093**	**87,270**	**84,382**	**82,454**	**82,591**
BVPS	**5.80**	**5.28**	**5.23**	**5.14**	**5.18**
y/y Growth	*(14.9%)*	*(8.9%)*	*(0.9%)*	*(1.8%)*	*0.8%*
Net debt/(cash)	25,905	24,032	19,423	21,022	21,618
Cash flow from operating activities	**10,528**	**8,796**	**8,984**	**8,986**	**10,117**
o/w Depreciation & amortization	1,970	1,787	1,501	1,049	1,190
o/w Changes in working capital	(157)	(221)	(383)	(284)	(44)
Cash flow from investing activities	**(6,186)**	**(999)**	**4,035**	**(1,795)**	**(1,849)**
o/w Capital expenditure	(2,553)	(2,262)	(2,015)	(1,795)	(1,849)
as % of sales	*5.8%*	*5.4%*	*5.8%*	*5.9%*	*5.9%*
Cash flow from financing activities	**(5,113)**	**(6,545)**	**(8,410)**	**(8,790)**	**(8,863)**
o/w Dividends paid	(5,741)	(6,043)	(6,363)	(6,713)	(6,786)
o/w Net debt issued/(repaid)	2,696	1,666	0	0	0
Net change in cash	**(1,649)**	**1,246**	**4,609**	**(1,600)**	**(595)**
Free cash flow to firm	**8,000**	**6,755**	**13,186**	**7,329**	**8,244**
y/y Growth	*(4.1%)*	*(15.6%)*	*95.2%*	*(44.4%)*	*12.5%*

Ratio Analysis	FY15A	FY16A	FY17E	FY18E	FY19E
Gross margin	60.6%	60.3%	63.0%	66.7%	67.3%
EBITDA margin	27.9%	28.1%	32.7%	36.9%	38.1%
EBIT margin	23.4%	23.8%	28.3%	33.5%	34.4%
Net profit margin	19.9%	19.9%	23.1%	27.2%	28.4%
ROE	31.5%	34.3%	35.2%	37.0%	40.2%
ROA	9.7%	9.4%	9.4%	10.0%	10.9%
ROCE	11.9%	11.7%	11.5%	11.7%	12.4%
SG&A/Sales	37.2%	36.5%	34.6%	33.2%	33.0%
Net debt/equity	100.5%	103.5%	85.0%	93.9%	96.2%
P/E (x)	21.1	22.1	22.7	21.9	20.3
P/BV (x)	7.3	8.0	8.1	8.2	8.1
EV/EBITDA (x)	16.0	16.4	16.5	16.7	15.8
Dividend Yield	3.1%	3.3%	3.5%	3.7%	3.7%
Sales/Assets (x)	0.5	0.5	0.4	0.4	0.4
Interest cover (x)	NM	129.1	51.9	60.2	NM
Operating leverage	139.1%	73.7%	4.8%	(30.2%)	190.0%
Revenue y/y Growth	(3.8%)	(5.4%)	(16.7%)	(12.2%)	3.1%
EBITDA y/y Growth	(4.5%)	(4.8%)	(3.1%)	(0.8%)	6.5%
Tax rate	22.5%	22.5%	24.0%	26.0%	26.0%
Adj. Net Income y/y Growth	(3.5%)	(5.2%)	(3.6%)	3.3%	7.8%
EPS y/y Growth	(2.6%)	(4.3%)	(3.0%)	3.6%	8.2%
DPS y/y Growth	8.3%	6.3%	6.0%	5.9%	1.4%

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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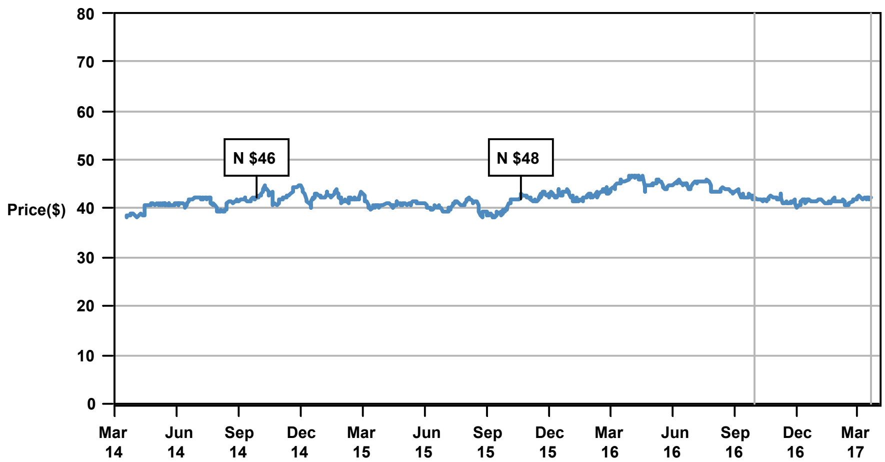

Date	Rating	Share Price ($)	Price Target ($)
26-Sep-14	N	42.20	46.00
20-Oct-15	N	41.99	48.00

Source: Bloomberg and J.P. Morgan; price data adjusted for stock splits and dividends.
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