



The Coca-Cola Company

It Had to be Good to Get Where It Is

While this had been a contested perspective, we have long viewed KO as one of the most compelling fundamental stories in Staples. It's been a long and bumpy road for the KO investment case as the company has struggled to marry what an impressive top-line turnaround with commensurate earnings growth and cash flow generation. Beyond the face value challenge of this dynamic, the lack of flow-through furthered the Consensus concern that the pursuit of becoming a "total beverage company" would be untenably dilutive to profitability. Our view has been that the company has a well-architected plan for working through this mix shift, not to mention that it is concurrently increasing the profitability of the legacy CSD portfolio (05/17/18: *Upgrade to OW - A Sparkling Transformation*). Likewise, our deep dive into the factors that have limited KO's free cash conversion rate has highlighted progress on this front as being critical to further share price outperformance (05/16/19 - *Go With the Free Cash Flow*), with yesterday's move in the stock (KO +3% vs. XLP +1%) bearing this out.

With the 2020 outlook calling for the first year in almost a decade where KO should see a trifecta of solid top-line growth, earnings growth and free cash flow conversion, we expect investor enthusiasm for the transformation under way at KO to grow to match ours from here. Importantly, while guidance calls for +5% organic growth, we find ourselves comfortably rounding up to yet another year of +6% growth in our model. To be sure, 2020 is not devoid of macroeconomic pressure. That said, we see room for innovation and better execution to offset headwinds to growth. On the cash flow side, we would highlight that work to address this issue is yielding results earlier than expected with free cash flow for the year up +40% YoY to \$8.4 billion, ~\$4 billion higher than management's initial forecasts and reflecting a conversion rate of 96% (vs. just 67% at the end of 2018). Last year's cash flow did benefit from a special dividend and a transition tax payment, so the company has suggested that the true run-rate is more in mid-to-high 80% range, matching the ~85% guidance for 2020.

KO: Quarterly and Annual EPS (USD)

	2019		2020		2021		Change y/y	
FY Dec	Actual	Old	New	Cons	Old	New	2020	2021
Q1	0.48A	0.51E	0.50E	0.51E	N/A	0.54E	0.59E	8%
Q2	0.63A	0.66E	0.66E	0.67E	N/A	0.71E	0.73E	8%
Q3	0.56A	0.60E	0.60E	0.61E	N/A	0.65E	0.68E	8%
Q4	0.44A	0.48E	0.49E	0.47E	N/A	0.55E	0.54E	12%
Year	2.11A	2.26E	2.26E	2.26E	N/A	2.45E	2.44E	8%
P/E	27.9		26.1			24.0		

Source: Barclays Research.

Consensus numbers are from Bloomberg received on 30-Jan-2020; 15:50 GMT

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PLEASE SEE ANALYST CERTIFICATION(S) AND IMPORTANT DISCLOSURES BEGINNING ON PAGE 5.

Equity Research

Consumer | U.S. CHPC & Beverages

31 January 2020

Stock Rating **OVERWEIGHT**
Unchanged

Industry View **NEUTRAL**
Unchanged

Price Target **USD 63.00**
raised 9% from USD 58.00

Price (30-Jan-2020) USD 58.86
Potential Upside/Downside +7.0%
Tickers KO

Market Cap (USD mn) 252185
Shares Outstanding (mn) 4284.49
Free Float (%) 89.66
52 Wk Avg Daily Volume (mn) 12.9
Dividend Yield (%) 2.72
Return on Equity TTM (%) 49.61
Current BVPS (USD) 4.44

Source: Bloomberg

Price Performance Exchange-NYSE
52 Week range USD 58.98-44.42



Source: IDC; Link to Barclays Live for interactive charting

U.S. CHPC & Beverages

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U.S. CHPC & Beverages	Industry View: NEUTRAL
The Coca-Cola Company (KO)	Stock Rating: OVERWEIGHT

Income statement (\$mn)	2019A	2020E	2021E	2022E	CAGR	Price (30-Jan-2020)	USD 58.86
Revenue	37,280	39,269	41,221	43,278	5.1%	Price Target	USD 63.00
EBITDA (adj)	11,774	12,572	13,606	14,672	7.6%	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.	
EBIT (adj)	10,409	11,080	11,999	12,984	7.6%		
Pre-tax income (adj)	11,310	12,160	13,230	14,376	8.3%		
Net income (adj)	9,104	9,749	10,584	11,501	8.1%		
EPS (adj) (\$)	2.11	2.26	2.45	2.66	8.0%		
Diluted shares (mn)	4,314.0	4,322.0	4,322.0	4,322.0	0.1%		
DPS (\$)	1.60	1.66	1.73	1.80	4.0%		

Margin and return data	Average				
Gross margin (%)	60.7	60.5	60.9	61.3	60.8
EBITDA (adj) margin (%)	31.6	32.0	33.0	N/A	32.2
EBIT (adj) margin (%)	27.9	28.2	29.1	30.0	28.8
Pre-tax (adj) margin (%)	30.3	31.0	32.1	33.2	31.7
Net (adj) margin (%)	24.4	24.8	25.7	26.6	25.4
ROIC (%)	18.9	17.2	17.6	18.6	18.1
ROA (%)	9.7	9.3	9.5	N/A	9.5
ROE (%)	43.2	32.9	31.1	N/A	35.7

Balance sheet and cash flow (\$mn)	CAGR				
Cash and equivalents	6,480	7,289	9,018	12,525	24.6%
Total assets	86,381	95,779	100,540	105,557	6.9%
Short and long-term debt	42,763	42,763	42,763	42,763	0.0%
Total liabilities	65,283	66,188	66,495	66,415	0.6%
Net debt/(funds)	34,816	34,007	32,278	N/A	N/A
Shareholders' equity	21,098	29,591	34,045	39,142	22.9%
Change in working capital	366	212	188	180	-21.0%
Cash flow from operations	10,471	10,165	11,408	12,363	5.7%
Capital expenditure	-2,054	-2,003	-1,979	-2,077	N/A
Free cash flow	8,417	8,163	9,429	10,286	6.9%

Valuation and leverage metrics	Average				
P/E (adj) (x)	27.9	26.1	24.0	22.1	25.0
EV/sales (x)	7.2	6.9	6.5	N/A	6.9
EV/EBITDA (adj) (x)	22.9	21.4	19.7	N/A	21.3
EV/EBIT (adj) (x)	26.0	24.3	22.3	N/A	24.2
Equity FCF yield (%)	3.3	3.2	3.7	N/A	3.4
P/BV (x)	12.0	8.6	7.5	N/A	9.4
Dividend yield (%)	2.7	2.8	2.9	3.1	2.9
Total debt/capital (%)	67.0	59.1	55.7	52.2	58.5
Net debt/EBITDA (adj) (x)	3.0	2.7	2.4	N/A	2.7

Selected operating metrics	Average				
Organic sales growth (%)	6.0	5.8	5.0	N/A	5.6
Volume growth (%)	1.0	3.5	3.0	N/A	2.5
Price growth (%)	5.0	2.3	2.0	N/A	3.1

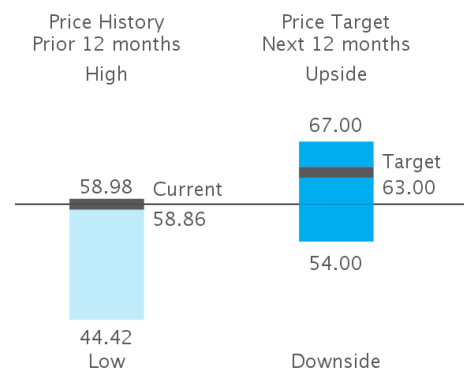
Upside case **USD 67.00**

Our upside case assumes that KO trades at a +30% premium to Large-Cap Staples on upside 2020 EPS of \$2.31.

Downside case **USD 54.00**

Our downside case assumes that KO trades at a +10% premium to Large-Cap Staples on downside 2020 EPS of \$2.23.

Upside/Downside scenarios



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

Yesterday, KO reported 4Q19 Comparable EPS of \$0.44, which compares to Consensus and Barclays Research \$0.44. Below the line items were a 2c drag to EPS, split between minority interest impacts from CCBA and hedging/FX dynamics.

What to do with the stock. With KO, in our view, positioned to be the breakout story for 2020, we find it apt to consider our valuation methodology in the context of the market's enthusiasm for P&G, the other recent mega-cap Staples turnaround story. Here we would note that KO's estimated organic revenue and earnings growth profile is favorable to that of P&G in C20 and we would argue that "available" top-line growth longer term vis a vis their individual category and geographic footprints also bears the same relationship. As such, while KO is trading at a premium to P&G (+17% premium to Large-Cap Staples vs. P&G and +10%), we see reason for this differential to remain going forward. We are raising our PT to \$63 reflecting a +25% premium to Large-Cap Staples on our C20 EPS estimate of \$2.26. Our prior \$58 PT reflected a +20% premium to Large-Cap Staples on the same EPS estimate.

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With the 2020 outlook calling for the first time in nearly a decade that KO should see a trifecta of solid top-line growth, earnings growth and free cash flow conversion, we expect investor enthusiasm for the transformation underway at KO to grow to match ours from here. Importantly, while guidance calls for +5% organic revenue growth, we find ourselves comfortably rounding up to yet another year of +6% growth in our model. To be sure, 2020 is not devoid of macroeconomic pressure (Argentina is likely to continue to deteriorate, India may or may not be softening and the impact of the Wuhan coronavirus outbreak in China is still unknown). That said, we see room for innovation and better execution to offset headwinds to growth. To this point, we would expect Latin America to continue to benefit from revenue growth management initiatives including price/pack development in Mexico and cooler investments in Brazil through 2020. Additionally, from an innovation standpoint, we understand Coke Plus Coffee to be tracking ahead of expectations and would expect the continued rollout/reformulation of Coke Energy and the launch of AHA Sparkling in the U.S. to be accretive to growth.

On the cash flow side, we would highlight that work to address these line items is yielding results earlier than expected with free cash flow for the year up +40% YoY to \$8.4 billion, ~\$4 billion higher than management's initial forecasts and reflecting a conversion rate of 96% (vs. just 67% at the end of 2018). Last year's cash flow did benefit from a special dividend and a transition tax payment, so the company has suggested that the true run-rate is more in mid-to-high 80% range, matching the ~85% implied guidance for 2020.

Changes to the model. We are taking up our estimates for C20 organic sales growth to +5.8% (vs. +5.2% prior) driven largely by our more favourable expectations for price/mix in

Latin America (organic now +11% vs. +8% prior) as KO cycles through price/pack adjustments. We expect currency to shave ~100 bps off top-line and the Fairlife acquisition to add ~50 bps to top-line growth, bringing our all-in revenue growth outlook to up ~5%. We assume gross margins are down ~20 bps and that operating profit grows +6.5% which we note is above the high end of management guidance for +5-6% operating profit growth given stronger top-line performance (e.g. +8% constant currency, less a 2-3% FX headwind). All in, while we are modeling a YoY a step-up in minority interest (linked to CCBA) we expect this to be offset by other below-the-line items leaving our full-year EPS estimate up +7% to \$2.26.

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Primary Stocks (Ticker, Date, Price)

The Coca-Cola Company (KO, 30-Jan-2020, USD 58.86), Overweight/Neutral, A/CD/CE/D/J/K/L/M/N

Unless otherwise indicated, prices are sourced from Bloomberg and reflect the closing price in the relevant trading market, which may not be the last available price at the time of publication.

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Stock Rating

Overweight - The stock is expected to outperform the unweighted expected total return of the industry coverage universe over a 12-month investment horizon.

Equal Weight - The stock is expected to perform in line with the unweighted expected total return of the industry coverage universe over a 12-month investment horizon.

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Neutral - industry coverage universe fundamentals/valuations are steady, neither improving nor deteriorating.

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U.S. CHPC & Beverages

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Coca-Cola European Partners PLC (CCE.AS)	Coca-Cola European Partners PLC (CCEP)	Colgate-Palmolive (CL)
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 Brewing Company (TAP)	Newell Brands Inc. (NWL)
PepsiCo Inc. (PEP)	Procter & Gamble (PG)	Sundial Growers, Inc. (SNDL)
The Coca-Cola Company (KO)	The Estée Lauder Companies (EL)	

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IMPORTANT DISCLOSURES CONTINUED

The Coca-Cola Company (KO / KO)

USD 58.86 (30-Jan-2020)

Stock Rating

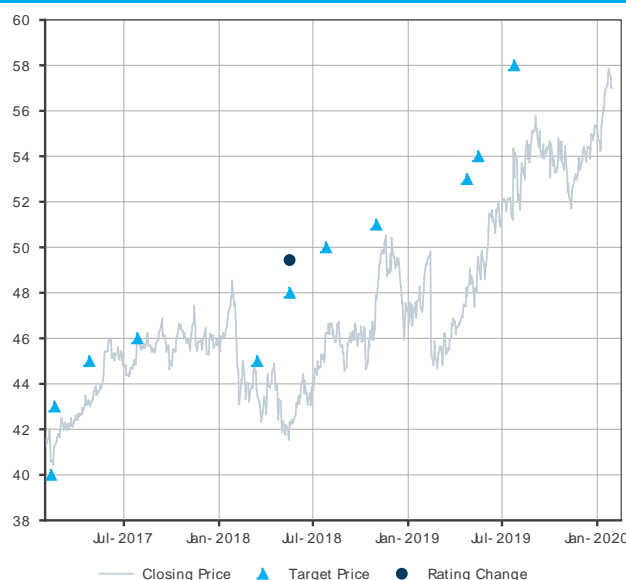
OVERWEIGHT

Industry View

NEUTRAL

Rating and Price Target Chart - USD (as of 30-Jan-2020)

Currency=USD



Publication Date	Closing Price	Rating	Adjusted Price Target
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
25-Apr-2017	43.11		45.00
17-Feb-2017	41.23		43.00
10-Feb-2017	40.58		40.00

On 30-Jan-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 42.00.

Source: Bloomberg, Barclays Research

Historical stock prices and price targets may have been adjusted for stock splits and dividends.

Source: IDC, Barclays Research

[Link to Barclays Live for interactive charting](#)

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Valuation Methodology: Our price target of \$63 is based on a +25% premium to the Large-Cap Staples group using a ~28x PE on our CY20 EPS estimate of \$2.26.

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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