

Flash Comment — April 25, 2022

## Beverages

# The Coca-Cola Company (KO)

## KO: Q122 First Take—Handily Beat, Maintaining 2022 with Flex

### Initial Thoughts

KO Q122 top line beat in every division (driven by *volumes*) with gross margins about in line and op margins ahead. A caveat is that shipments were ahead of consumption (namely in LatAm), but sales nevertheless still came in noticeably ahead, even if normalizing for shipment timing. Reiterated FY organic sales guidance implies +4-5% delivery for the remainder of the year, decelerating from Q1 +18% (implies notable deceleration on a 3-year stack which normalizes for the COVID base) - KO is likely leaving itself flex here (likely factoring normalization of shipments vs consumption, and any potential elasticity impact from higher pricing). EPS too is implied ~+2% in Q2-4 vs Q1 +16%. **See variance tables in this note for results vs WFS expectations.**

**2022 guidance left unchanged.** Despite strength in Q1, the company is maintaining the bulk of its 2022 outlook (*only change being updated tax rate now seen 19.5% vs prior 20.0%*). This includes a reiterated outlook for organic sales +7-8% vs WFS/Street (per VisibleAlpha) +8.1%/+7.8%, with comparable EPS +5-6% vs a \$2.32 base, still implying EPS of \$2.44-2.46 vs WFS/Street EPS of \$2.45/\$2.45. Other details *also unchanged* include: M&A +3pts to sales with FX 2-3pt headwind to sales and 3-4pts to EPS, with FX neutral EPS still seen +8-10%; commodity inflation a MSD headwind to COGS; cash from ops \$12.0bn with FCF \$10.5bn with \$1.5bn in capex.

**Q221 considerations.** -4% FX headwind (vs WFS/Street -2.7/-3.3%) with M&A +3%, and FX -4% to EPS.

**Russia/Ukraine.** ~1% hit to FY unit case volumes, 1-2% impact to net rev and op income, and a ~\$0.04/shr impact to EPS - consistent with prior commentary.

**Q122—volumes drive upside. Organic sales** +18% y/y vs WFS/Street +7.6%/+9.8%. **Concentrate sales** +11% y/y vs WFS/Street +0.8%/+3.9%, +3pts vs unit case of +8% (actually implies more like ~+4.5pts vs unit case when normalizing for one less selling day), with **price/mix** +7% y/y (WFS/Street +6.8%/+6.0%). **Gross margin** was -90bps y/y to 59.7% vs WFS/Street 60.1%/59.8% (underlying +50bps includes 20bps from segment mix, offset by FX -30bps and BODYARMOR -110bps). Op margin was +50ps y/y to 31.4% vs WFS/Street 30.1%/30.0% (underlying +170bps as top-line strength partly offset by marketing, with FX -40bps and BODYARMOR -90bps). **EPS** \$0.64 vs WFS/Street \$0.58/\$0.58.

**BODYARMOR margins?** On our math, BA GM were 11.6% in Q122 (were negative in Q421). We think run-rate BA is in the mid-30s, and would expect improvement through the FY.

**Segment organic sales growth. EMEA** +22% vs WFS/Street +8.9%/+13.2% (*on price/mix +6%, conc sales +15% - unit case of +11%*), **LatAm** +39% vs WFS/Street +12.9%/+12.9% (*on price/mix +19%, conc sales +20% - unit case of +9%*), **N. America** +14% vs WFS/Street +10.8%/+11.2% (*on price/mix +11%, conc sales +3% - unit case of +5%*), **APAC +5%** vs WFS/Street -1.1%/+3.1% (*on price/mix +6%, conc sales flat - unit case of +4%*), **Global Ventures** +34% vs WFS/Street +18.3%/+15.7% (*on price/mix +12%, conc sales +22% - unit case of +23%*), **Bottling Investments** +12% vs. WFS/Street +2.4%/+5.8% (*on price/mix +5%, conc sales +7% - unit case of +8%*).

**Q122 category performance.** Sparkling soft drinks +7%; Trademark Coca-Cola +6%, and Coca-Cola Zero Sugar +14%; Sparkling flavors +7%; Nutrition, juice dairy, and plant-based

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### The Coca-Cola Company (KO)

Overweight

Price: \$65.25/Price Target: \$72.00

Market Cap: \$282,858 MM

Note: Pricing as of 04/22/2022

Source: Company Data, Wells Fargo Securities estimates, and Refinitiv.

bevs +12%; Hydration, sports, coffee, and tea +10% - hydration +8%; sports drinks +22% (driven by BODYARMOR and also Powerade); Tea +8%; Coffee +27% (continued UK Costa recovery and expansion elsewhere).

## Our Call

KO has momentum, and flex to guidance.

## Exhibit 1 - KO Q122 variance vs WFSe - earnings

|                                                          | Actual vs. Estimate |                |              | Year/Year Change |              | Sequential Change |              |
|----------------------------------------------------------|---------------------|----------------|--------------|------------------|--------------|-------------------|--------------|
|                                                          | Reported<br>1Q22    | 1Q22E          | % Diff       | 1Q21             | % Change     | 4Q21              | % Change     |
| <b>Revenue</b>                                           |                     |                |              |                  |              |                   |              |
| Europe, Middle East & Africa                             | 1,831.0             | 1,638.5        | 11.7%        | 1,623.0          | 12.8%        | 1,644.0           | 11.4%        |
| Latin America                                            | 1,229.0             | 1,017.4        | 20.8%        | 909.0            | 35.2%        | 1,031.0           | 19.2%        |
| North America                                            | 3,590.0             | 3,469.4        | 3.5%         | 2,937.0          | 22.2%        | 3,393.0           | 5.8%         |
| Asia Pacific                                             | 1,409.0             | 1,343.3        | 4.9%         | 1,401.0          | 0.6%         | 1,011.0           | 39.4%        |
| Global Ventures                                          | 729.0               | 651.8          | 11.9%        | 570.0            | 27.9%        | 775.0             | -5.9%        |
| Bottling Investments                                     | 2,044.0             | 1,863.5        | 9.7%         | 1,896.0          | 7.8%         | 1,904.0           | 7.4%         |
| Corporate                                                | 25.0                | 17.9           | 40.1%        | 17.0             | 47.1%        | 26.0              | -3.8%        |
| Eliminations                                             | (355.0)             | (250.0)        | 42.0%        | (334.0)          | 6.3%         | (314.0)           | 13.1%        |
| <b>Consolidated Revenue</b>                              | <b>10,502.0</b>     | <b>9,751.8</b> | <b>7.7%</b>  | <b>9,019.0</b>   | <b>16.4%</b> | <b>9,470.0</b>    | <b>10.9%</b> |
| Cost of Goods Sold                                       | 4,233.0             | 3,893.7        | 8.7%         | 3,556.0          | 19.0%        | 4,042.0           | 4.7%         |
| <b>Gross Profit</b>                                      | <b>6,269.0</b>      | <b>5,858.1</b> | <b>7.0%</b>  | <b>5,463.0</b>   | <b>14.8%</b> | <b>5,428.0</b>    | <b>15.5%</b> |
| Selling, General and Administrative Expenses             | 2,967.0             | 2,926.3        | 1.4%         | 2,669.0          | 11.2%        | 3,336.0           | -11.1%       |
| Other Operating Charges (non-recurring)                  | 28.0                | 368.0          | -92.4%       | 124.0            | -77.4%       | 368.0             | -92.4%       |
| Europe, Middle East & Africa                             | 1,004.0             | 870.1          | 15.4%        | 870.0            | 15.4%        | 829.0             | 21.1%        |
| Latin America                                            | 775.0               | 625.1          | 24.0%        | 563.0            | 37.7%        | 593.0             | 30.7%        |
| North America                                            | 901.0               | 774.0          | 16.4%        | 758.0            | 18.9%        | 774.0             | 16.4%        |
| Asia Pacific                                             | 662.0               | 689.4          | -4.0%        | 698.0            | -5.2%        | 277.0             | 139.0%       |
| Global Ventures                                          | 52.0                | 88.7           | -41.4%       | 29.0             | 79.3%        | 79.0              | -34.2%       |
| Bottling Investments                                     | 188.0               | 144.7          | 29.9%        | 133.0            | 41.4%        | 172.0             | 9.3%         |
| Corporate                                                | (280.0)             | (260.3)        | 7.6%         | (257.0)          | 8.9%         | (632.0)           | -55.7%       |
| <b>Operating Income</b>                                  | <b>3,302.0</b>      | <b>2,931.8</b> | <b>12.6%</b> | <b>2,794.0</b>   | <b>18.2%</b> | <b>2,092.0</b>    | <b>57.8%</b> |
| Interest Income                                          | 78.0                | 65.0           | 20.0%        | 66.0             | 18.2%        | 71.0              | 9.9%         |
| Interest Expense                                         | 188.0               | 190.7          | -1.4%        | 195.0            | -3.6%        | 171.0             | 9.9%         |
| Equity Income (loss) - net                               | 257.0               | 258.2          | -0.5%        | 242.0            | 6.2%         | 310.0             | -17.1%       |
| Other Income (loss) - net                                | 38.0                | 73.5           | -48.3%       | 70.0             | -45.7%       | 118.0             | -67.8%       |
| <b>Income Before Income Taxes</b>                        | <b>3,487.0</b>      | <b>3,137.7</b> | <b>11.1%</b> | <b>2,977.0</b>   | <b>17.1%</b> | <b>2,420.0</b>    | <b>44.1%</b> |
| Income Taxes                                             | 680.0               | 627.5          | 8.4%         | 569.0            | 19.5%        | 447.0             | 52.1%        |
| <b>Consolidated Net Income</b>                           | <b>2,807.0</b>      | <b>2,510.2</b> | <b>11.8%</b> | <b>2,408.0</b>   | <b>16.6%</b> | <b>1,973.0</b>    | <b>42.3%</b> |
| Less: Net Inc Attributable to Noncontrolling Interests   | 12.0                | 2.5            | 378.1%       | 10.0             | 20.0%        | 36.0              | -66.7%       |
| <b>Net Income Attributable to Coca-Cola Shareholders</b> | <b>2,795.0</b>      | <b>2,507.7</b> | <b>11.5%</b> | <b>2,398.0</b>   | <b>16.6%</b> | <b>1,937.0</b>    | <b>44.3%</b> |
| <b>Earnings per Share</b>                                | <b>\$0.64</b>       | <b>\$0.58</b>  | <b>11.2%</b> | <b>\$0.55</b>    | <b>15.8%</b> | <b>\$0.45</b>     | <b>44.0%</b> |
| Diluted Shares Outstanding                               | 4,357.0             | 4,348.7        | 0.2%         | 4,330.0          | 0.6%         | 4,347.0           | 0.2%         |

Source: Company reports and Wells Fargo Securities, LLC estimates

\$mn except per share data

## Exhibit 2 - KO Q122 variance vs WFSe - revenue growth and margins

|                                   | Actual vs. Estimate |              |            | Year/Year Change |            | Sequential Change |            |
|-----------------------------------|---------------------|--------------|------------|------------------|------------|-------------------|------------|
|                                   | Reported<br>1Q22    | 1Q22E        | Diff (bps) | 1Q21             | Diff (bps) | 4Q21              | Diff (bps) |
| <b>Organic Sales Growth</b>       | <b>18.0%</b>        | <b>7.6%</b>  | 1,037      | <b>6.0%</b>      | 1,200      | <b>9.0%</b>       | 900        |
| Europe, Middle East & Africa      | 22.0%               | 8.9%         | 1,313      | -7.0%            | 2,900      | 17.0%             | 500        |
| Latin America                     | 39.0%               | 12.9%        | 2,614      | 8.0%             | 3,100      | 2.0%              | 3,700      |
| North America                     | 14.0%               | 10.8%        | 317        | 4.0%             | 1,000      | 14.0%             | 0          |
| Asia Pacific                      | 5.0%                | -1.1%        | 609        | 18.0%            | (1,300)    | -3.0%             | 800        |
| Global Ventures                   | 34.0%               | 18.3%        | 1,571      | -5.0%            | 3,900      | 25.0%             | 900        |
| Bottling Investments              | 12.0%               | 2.4%         | 963        | 17.0%            | (500)      | 3.0%              | 900        |
| <b>Unit Volume Growth</b>         | <b>8.0%</b>         | <b>2.2%</b>  | 576        | <b>0.0%</b>      | 800        | <b>9.0%</b>       | (100)      |
| Europe, Middle East & Africa      | 11.0%               | 1.5%         | 950        | -2.0%            | 1,300      | 11.0%             | 0          |
| Latin America                     | 9.0%                | 3.0%         | 600        | 0.0%             | 900        | 5.0%              | 400        |
| North America                     | 5.0%                | 5.5%         | (50)       | -6.0%            | 1,100      | 8.0%              | (300)      |
| Asia Pacific                      | 4.0%                | -2.0%        | 600        | 9.0%             | (500)      | 11.0%             | (700)      |
| Global Ventures                   | 23.0%               | 9.0%         | 1,400      | -3.0%            | 2,600      | 19.0%             | 400        |
| Bottling Investments              | 8.0%                | 2.0%         | 600        | 5.0%             | 300        | 13.0%             | (500)      |
| <b>Concentrate Volume Growth</b>  | <b>11.0%</b>        | <b>0.8%</b>  | 1,020      | <b>5.0%</b>      | 600        | <b>-1.0%</b>      | 1,200      |
| Europe, Middle East & Africa      | 15.0%               | 0.4%         | 1,463      | -2.0%            | 1,700      | 4.0%              | 1,100      |
| Latin America                     | 20.0%               | 1.9%         | 1,814      | 2.0%             | 1,800      | -10.0%            | 3,000      |
| North America                     | 3.0%                | 4.3%         | (133)      | 0.0%             | 300        | 4.0%              | (100)      |
| Asia Pacific                      | 0.0%                | -3.1%        | 309        | 20.0%            | (2,000)    | 4.0%              | (400)      |
| Global Ventures                   | 22.0%               | 7.8%         | 1,421      | 3.0%             | 1,900      | 10.0%             | 1,200      |
| Bottling Investments              | 7.0%                | 0.9%         | 613        | 11.0%            | (400)      | 6.0%              | 100        |
| <b>Price/ Mix</b>                 | <b>7.0%</b>         | <b>6.8%</b>  | 16         | <b>1.0%</b>      | 600        | <b>10.0%</b>      | (300)      |
| Europe, Middle East & Africa      | 6.0%                | 8.5%         | (250)      | -5.0%            | 1,100      | 13.0%             | (700)      |
| Latin America                     | 19.0%               | 11.0%        | 800        | 7.0%             | 1,200      | 11.0%             | 800        |
| North America                     | 11.0%               | 6.5%         | 450        | 4.0%             | 700        | 9.0%              | 200        |
| Asia Pacific                      | 6.0%                | 2.0%         | 400        | -2.0%            | 800        | -8.0%             | 1,400      |
| Global Ventures                   | 12.0%               | 10.5%        | 150        | -8.0%            | 2,000      | 15.0%             | (300)      |
| Bottling Investments              | 5.0%                | 1.5%         | 350        | 5.0%             | 0          | -3.0%             | 800        |
| <b>Currency Impact on Revenue</b> | <b>-4.0%</b>        | <b>-2.7%</b> | (129)      | <b>-1.0%</b>     | (300)      | <b>-1.0%</b>      | (300)      |
| Europe, Middle East & Africa      | -9.0%               | -7.3%        | (170)      | 1.0%             | (1,000)    | -2.0%             | (700)      |
| Latin America                     | -6.0%               | -1.0%        | (500)      | -10.0%           | 400        | 1.0%              | (700)      |
| North America                     | 0.0%                | 0.0%         | 0          | 0.0%             | 0          | 0.0%              | 0          |
| Asia Pacific                      | -5.0%               | -3.0%        | (200)      | 6.0%             | (1,100)    | -3.0%             | (200)      |
| Global Ventures                   | -6.0%               | -4.0%        | (200)      | 5.0%             | (1,100)    | 2.0%              | (800)      |
| Bottling Investments              | -5.0%               | -4.0%        | (100)      | -2.0%            | (300)      | -1.0%             | (400)      |

|                              | Actual vs. Estimate |              |            | Year/Year Change |            | Sequential Change |            |
|------------------------------|---------------------|--------------|------------|------------------|------------|-------------------|------------|
|                              | Reported<br>1Q22    | 1Q22E        | Diff (bps) | 1Q21             | Diff (bps) | 4Q21              | Diff (bps) |
| <b>Gross Profit Margin</b>   | <b>59.7%</b>        | <b>60.1%</b> | (38)       | <b>60.6%</b>     | (88)       | <b>57.3%</b>      | 238        |
| <b>Operating Margin</b>      | <b>31.4%</b>        | <b>30.1%</b> | <b>138</b> | <b>31.0%</b>     | 46         | <b>22.1%</b>      | 935        |
| Europe, Middle East & Africa | 54.8%               | 53.1%        | 173        | 53.6%            | 123        | 50.4%             | 441        |
| Latin America                | 63.1%               | 61.4%        | 162        | 61.9%            | 112        | 57.5%             | 554        |
| North America                | 25.1%               | 22.3%        | 279        | 25.8%            | (71)       | 22.8%             | 229        |
| Asia Pacific                 | 47.0%               | 51.3%        | (434)      | 49.8%            | (284)      | 27.4%             | 1,959      |
| Global Ventures              | 7.1%                | 13.6%        | (648)      | 5.1%             | 205        | 10.2%             | (306)      |
| Bottling Investments         | 9.2%                | 7.8%         | 143        | 7.0%             | 218        | 9.0%              | 16         |

Source: Company reports and Wells Fargo Securities, LLC estimates

## Investment Thesis, Valuation and Risks

### **The Coca-Cola Company (KO)**

#### **Investment Thesis**

We see upside potential to sales as the recovery takes shape with newfound flexibility around earnings delivery. We view the dividend as manageable with additional capital deployment potential ahead. Buy the recovery, in our view. Overweight KO.

#### **Target Price Valuation for KO: \$72.00 from NC**

Our \$72 price target is based on a 27.5x P/E multiple to our CY23E EPS estimate, a ~70% premium to SPX vs. historically +30%, a widening gap that reflects KO's defensive qualities in a volatile macro backdrop, a favorable cost structure (asset-light) amidst inflation, and flexibility to drive upside to earnings.

#### **Risks to Our Price Target and Rating for KO**

Risks include: (1) The global recovery may be slower than we expect; (2) Margin improvement could stall; (3) The dividend could suffer.

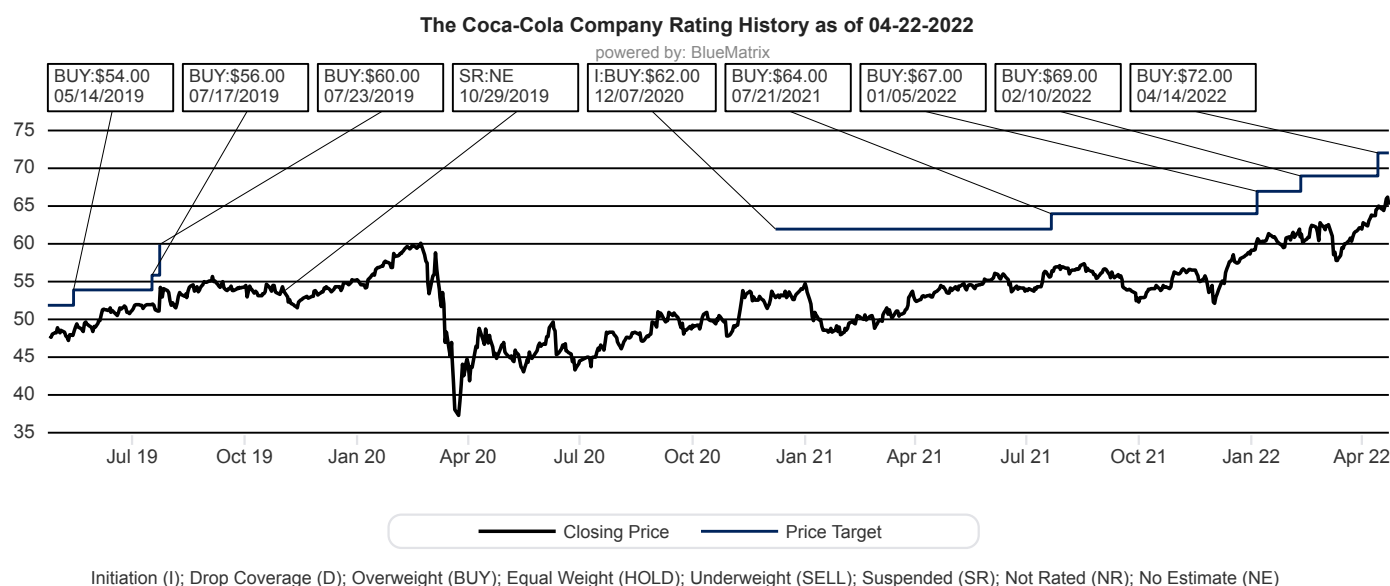
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**1=Overweight:** Total return on stock expected to be 10%+ over the next 12 months. BUY

**2=Equal Weight:** Total return on stock expected to be -10% to +10% over the next 12 months. HOLD

**3=Underweight:** Total return on stock expected to lag the Overweight- and Equal Weight-rated stocks within the analyst's coverage universe over the next 12 months. SELL

### As of April 24, 2022

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