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ASSESSMENT OF FINANCIAL RISK AND STRATEGIES TO REDUCE THIS RISK

CASE STUDY COCA COLA HBC AG (CCH)

TABLE OF CONTENT

1) *INTRODUCTION*
2) *DEFINITION OF KEY TERMS*
3) *ASSESSMENT OF FINANCIAL RISK .*
4) *STRATEGIES TO REDUCE THIS RISK*
5) *Dividend policy Rational*

INTRODUCTION

COCA COLA HBC, Steinhausen, Switzerland, From 2000.

Net sales revenue (€m)

2020: 6,131.8

Volume (m unit cases)

2,135.6

The total asset: 7,573.1 (€m)

Strategic bottling partner
of The Coca-Cola Company
having the exclusive
authorisation to bottle and
sell the beverages
in our 28 markets.

Coca-Cola
owns
Develops
markets the brands
Coca-Cola HBC
Produces
distributes
Sells them

Cost savings of €120m
versus original plan,
supporting profitability.

(Coca Cola Hellenic Bottling co, 2021.)

DEFINITION OF FINANCIAL RISK

"Financial Risk: The risk in the cash flows to shareholders that is due to the way in which the firm has financed its activities." (Moles, et al., 2011)

"Financial risk: the variability of a company's distributable profit arising from the need to pay interest on debt finance." (Watson , 2019)

"Financial risk is the risk associated with the introduction of debt in capital structure of a firm." (Siyanbola, et al., 2015)

187.59% @ 2020

Gearing ratio of the company in 2020 = Total debt/Total Equity

Total Liabilities 4,939.80

Total Equity 2,633.30 € million

COCA COLA IS HIGHLY GEARED OR LEVERAGED BECAUSE A MAJOR PROPORTION OF THEIR ASSETS ARE FINANCE BY DEBT (Coca Cola.2020)

WHAT IS GEARING RATIO

Gearing Ratio Formula

- Total Debt/ total equity = x %

- “Gearing, also known as financial leverage, is the “amount of debt, in relation to equity, in the capital structure of an entity or debt interest in relation to profit” (WILL , 2021)

- pearson education The lower the capital gearing ratio, the better for the organisation. A low gearing of not more than 50% is considered ideal (CLAIRE , 2021)

REASONS FOR DEBT LEVEL

- An investment strategy.
- Debt has a lower Financing cost.
- Companies use highly leverage positions to maximise returns on investments (cost related) (BALASUBRAMANIAM, 2021)
- Inability to issue share due to high market uncertainty.
- The tax deductibility of interest payments can decrease the debt cost to sustainability of the firm. (Fatica, et al., 2013).
- Coca Cola HBC's debt decreased from €3.11b in 2019 to €2.74b in 2020, by €370m
  - **One scenario**: having a **cash reserve** of €1.31b, meaning to have a **very strong liquidity** position." (Simply Wall St, 2021)
  - **Second scenario:** prediction by managers before pandemic, to control the unstable situation, or even run a related project.

IMPACT OF HIGH GEARING RATIO ON FINANCIAL STABILITY AND OPERATIONS

RISK OF A HIGH GEARING RATIO

- **A gearing ratio higher than 50%** places the company at greater financial risk, because during times of lower profits and higher interest rates, the company would be more susceptible to loan default and bankruptcy. (CLAIRE , 2021)

- Capital risk: It happens when the company is at the edge of losing assets, like some or total part of investments.(Adam, H, 2020)

- Legislative risk – changes in tax legislation and the regulatory framework may reduce the tax benefits of gearing. (BT Academy, 2020)

Ratios to Assess the Impact of High Gearing on the Financial Stability of Coca Cola

Historical data from Annual reports	2018	2019	2020
Interest Gearing Ratio	6.41%	9.83%	10.71%
Debt Ratio	0.545	0.671	0.652
Time Interest Earned Ratio	23.175	15.578	14.752

(Coca Cola Hellenic Bottling Company, 2019) & (Coca Cola Hellenic Bottling co, 2021)

Interpretation of Financial stability Ratios of Coca cola

- The result of this interest gearing ratio proves only 10.71% of profit is spent on debt serving, hence a lower Financial risk.
- Debt ratios in all three years show the high stability of the company. Also, the growth of this ration during this period suggests an improvement in this feature.
- Coca Cola operating income can cover its cost of debt 14.752 times.

At this position we affirm:

We conclude that the company has a very strong financial position after maximising profit from debt capital investments.

Ratios to Assess the Impact of High Gearing on the operations of Coca cola

Historical Data Annual Report	2018	2019	2020
Inventory Turnover	9	9	8
Receivables Turnover	7	7	7
Payables Turnover	3	3	2
Cash Conversion Cycle	1	6	-2
ROA	7%	6%	5%
Operating Ratio	0.903861	0.898093	0.895449

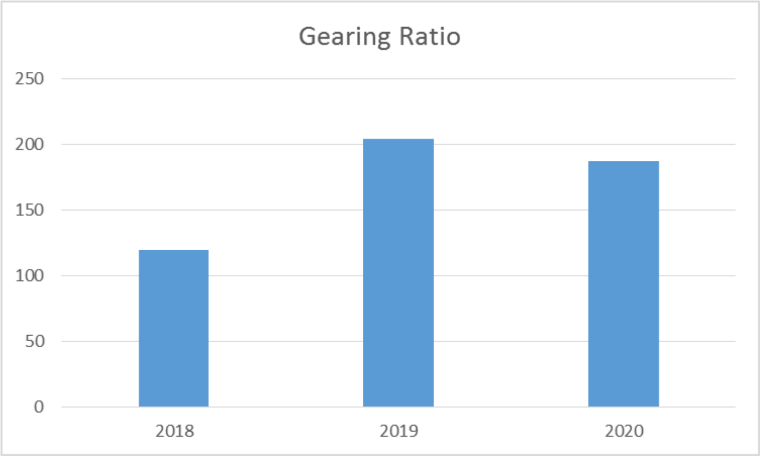
(Coca Cola Hellenic Bottling Company, 2019) & (Coca Cola Hellenic Bottling co, 2021)

Interpretation of operational Efficiency Ratios Of Coca Cola at a Highly Leverage Positions

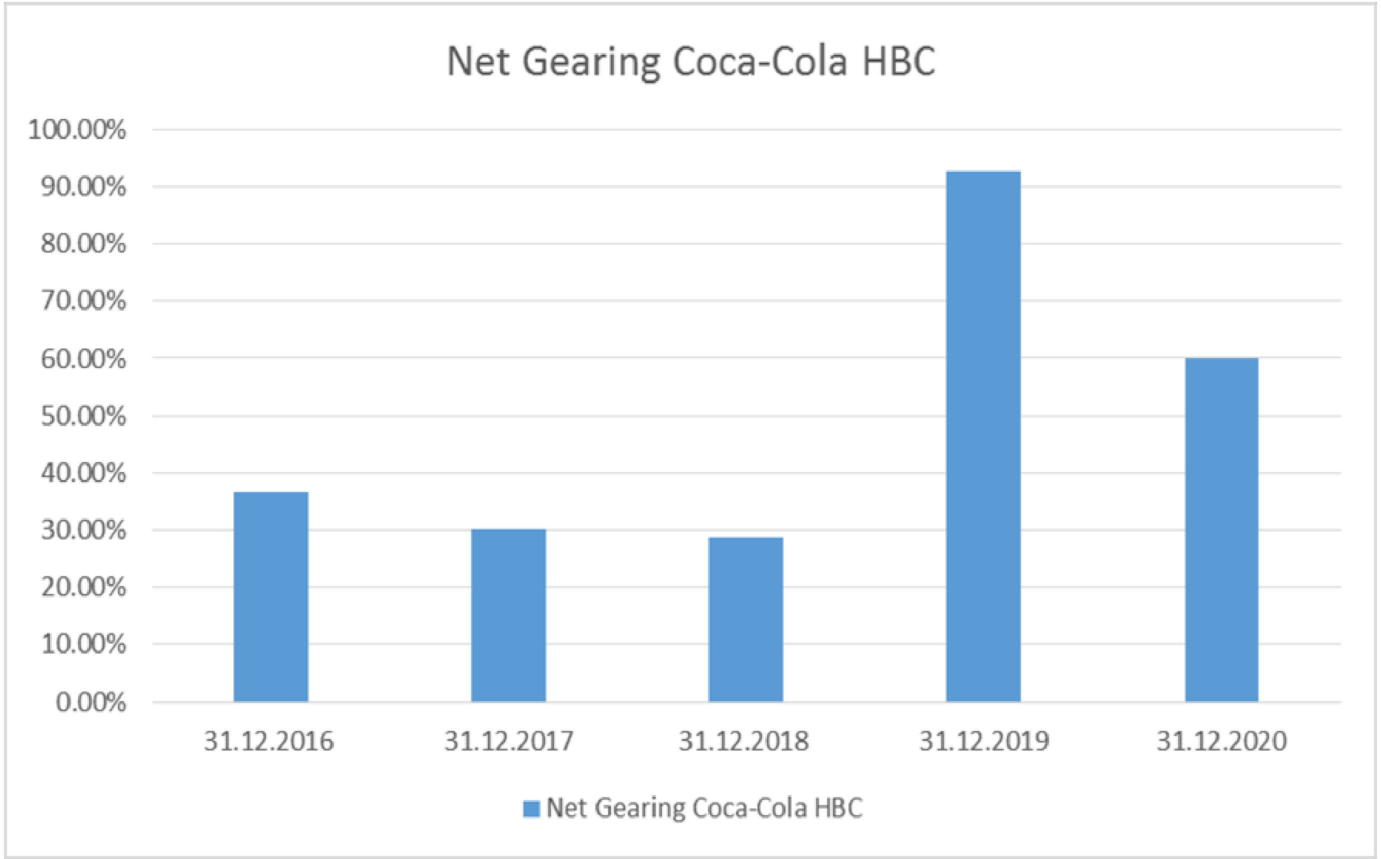
- They can sell and restock their inventory every 1-2 months and having enough inventory on hand.
- Receivable show us they collect their sale on credit in 52 days.
- Taking a long period for paying to their supplier.
- ROA are good but not excellent. And falling ROA indicates the company might have over-invested in assets that have failed to produce revenue growth.

GEARING RATIO COMPARISON 2016 - 2020

- **Overview:**
- In all three years the ratios were by far higher than 60 percent
- **How is the Change:**
- It grew first in 2019 dramatically, and after that even though had a decrease, It was still very huge compared to 2018.
- **Meaning:**
- The company needed to use extremely great amount of loans, while it paid back some of them in 2020.



(www.londonstockexchange.com, 2021)



(www.londonstockexchange.com, 2021)

GEARING RATIO COMPARISON 2016 - 2020

- So, we see that the ratio was finally for the two last years more than 60 percent.
- While the figure in 2019 is extremely high, which happened exactly the year before the Covid-19 pandemic.
- So, we see that the first year of COVID-19, 2020, has affected to decrease the gearing ratio by more than 30%.
- Why the company could reduce its gearing ratio on 2020?

(Simply Wall St, 2021)

STRATEGIES ON DEBT REDUCTION

- Generally two options: Decrease the asset or equity.
- Paying back some specially higher cost debts by:
  - Issuing the shares
  - Selling some unusable properties
  - Reducing short term investments
  - Decrease the dividends

STRATEGIES ON DEBT REDUCTION

- Paying first the loans with higher interest rates.
- Debt Restructuring
- Inventory Management
- Offer the customers discount to take cash in advance.
- Temporarily, decrease some parts of budgets, like new redecorations.

As the company in this case had great amount of long-term asset and cash reserve, besides a large reserve cash, the recommendation would be to use long-term loans. In this way, it can operate better in the first one or two years to gain large profit to pay back the installments, while keeping a part of that to increase ROA.

Reasons company pays dividend, 2020

- Coca Cola pay the dividend for positive development, attract additional equity investments and currently, possess high cash flow.
- Shares issued to employees exercising stock options amount 582,440. Also dividends distributed to shareholders have decreased by 76%. (*Notes to the consolidated financial statements 2020*)

(Coca Cola Hellenic Bottling co, 2021)

INTERACTION OF GEARING LEVEL AND DIVIDEND PAYOUT POLICY

Rational for dividend payout:

- Dividend payment is a positive signal to investors about the firms health.
- Demonstrates the firm's future expectation to enter the equity market

Relevance of Dividend payout:

1): Dividend Relevance theory. State that dividend payout increases the value of the firm.(Gordon and Lintner 1960)

2) The bird-in-the-hand argument: InvestorS require payments of dividend now is preferred to future dividend because it's less risky. (Myron Gordon (1960))

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