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Company Analysis

BUSINESS PERFORMANCE OF A LARGE MULTINATIONAL ENTERPRISE

THE CASE OF COCA-COLA

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COCA-COLA is the world's largest soft drink company with $24.5[1] billion dollar assets in a $ 160 billion dollar annual sales industry. This is the market leader with 44.3% shares. Its closest rival Pepsi Cola holds 33% market share with $21.6[2] billion dollar assets. Over the last 10 years it experienced the average growth rate of 6.9%[3] in a relatively stable industry. It is out performing any of the players in the industry. Only in the replenishment (power drink and bottled water) segment of the market it is little bit lagging behind its archrival PepsiCo. But its market share is picking up in that segment too. Over the years its ROE, P/E and dividend payout ratio all were better than those of its rivals. It is certainly a good company in the ever - growing soft drink industry to invest money.

Attributes that are most important to a prospective investor: Some of the key attributes of the company and the industry, which are important to prospective investors, are as follows:

1. Unlike technology or financial services industry, this non-alcoholic beverage industry is stable. Growth or decline doesn't vary in large percentage of point.
2. Over the last few years it maintained an average growth rate of 6.1[4] %.
3. Price fluctuation of the product is very narrow (on average 5-7 cents) which is trivial to customers but good for the investors.
4. Coca Cola is the market leader in the industry all over the world.
5. It is a very popular brand in the world not only because of its product but also for its social services (education, sports, sponsorship, environment and health especially AIDS/HIV program).
6. Its average growth rate for last 10 year (1992 – 2002) is 6.9%.
7. It's ROE, P/E and dividend payout ratio all out perform its rival.

Major Strengths

1. Coca-Cola company is the industry leader in the whole world.
2. It has the strongest financial performance in the industry
3. It enjoys a strong brand recognition

Major Weakness

Coca-Cola company is comparatively weak in the replenishment (power drink and bottled water) segment of the market.

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Company Profile

The Coca-Cola Company is the largest manufacturer, distributor and marketer of soft drink concentrates and syrups in the non-alcoholic beverage industry both in the USA and in the globe. The company was incorporated in September 1919 as a successor to the business of a company with the same name that had been organized in 1892 at Atlanta, Georgia. Today, after 110 years, the company is serving almost 5 billion people in 200 countries across the globe, through 13,000 operational plants and outlets. This is the 239th largest (with $20,092.0 million revenue) company in the global 500 listing and 92nd largest (with $19,564.0 million revenue) company in the fortune 500 listing in terms of revenue (Table 1 and 2). Its main rival in the industry is Pepsi Cola. At present it has 38,000 employees.

Table 1: Coca-Cola's Rank in the Beverage Industry in the USA[5]

Fortune rank	Industry Rank	Company	Revenue ($ in millions)
92	1	Coca-Cola	19,564.0
108	2	Coca-Cola Enterprise	16,889.0
142	3	Anheuser-Busch	13,566.4
200	4	Pepsi Bottling	9,216.0
422	5	Adolph Coors	3,776.3
470	6	Pepsi Americas	3,239.8
518	7	Constellation Brands	2,820.5
683	8	Brown-Forman	1,958.0
928	9	Coca-Cola Bottling Cons.	1,246.6

Table 2: Coca-Cola's Rank in the Beverage Industry in the World[6]

Global rank	Industry Rank	Company	Revenue ($ in millions)
159	1	PepsiCo	26,935.0
239	2	Coca-Cola	20,092.0
262	3	Diageo	18,604.8
322	4	Coca-Cola Enterprise	15,700.0
397	5	Anheuser-Busch	12,911.5
485	6	Suntory	10,444.7

Product-Mix: Today Coca-Cola has 300 different brands serving customers both in domestic and international markets. These brands can be categorized into two groups, which are as follows:

i) **Carbonated soft drinks:** The two types of carbonated soft drinks are as follows:

(a) **With Sugar:** Among the sugary carbonated drinks Coca-Cola is the most popular one. This is the number 1 selling soft drink brand worldwide, and is among the most recognized trademarks around the globe. Others are Fanta (orange-flavored), Sprite (lemon-lime flavored), etc.

(b) **Without Sugar:** These are mainly diet cokes, caffeine-free diet Coke. They are also known as Coca-Cola Light.

ii) **Non carbonated drinks:** This can be put under the following categories:

1. Water: Dasani
2. Fruit Juice: Minute Maid, Fruitopia
3. Power drinks: KMX, POWERADE
4. Tea: Cool Nestea etc.

Market Segmentation and Target Customers: Coca-Cola has used geographic (states, country, continent), demographic (age, sex, occupation, income), psychographics (social class, life style) and behavioral (brand loyalty, usage) variables to segment its market into following four categories:

1. **Refreshment**: Under this segment, the company targets and refreshes consumers through a variety of brands that appeal to different tastes, different cultures and lifestyles. Major global brands offered in this segment are Coca-Cola, Diet Coke/Coca-Cola Light, Fanta and Sprite, supported by local carbonated soft drinks like Kuat, Lift Apple, Barq's Root beer, Quatro Grapefruit, Thums Up and Limca.
2. **Rejuvenation:** Rejuvenation drinks are ready-to-drink beverages. These are particularly targeted to working people. These help people to feel better physically and mentally. Some of the global brands in this segment are Nestea and Nescafe coffees in Europe and Asia, Belté teas in Italy and Yang Guang teas in Hong Kong, Macau, and Saipan.
3. **Health & Nutrition**: This segment is particularly for health conscious people who are concerned about health, nutrition, weight gain/ loss, and diabetics. For these people Coca-Cola offers, Minute Maid Orange Juice, Diet coke, Diet Sprite etc.
4. **Replenishment**: The main product of this segment is Dasani (a water product). As concern grows over declining water quality in many communities throughout the world, consumers are getting inclined to buy bottled water. Coca-Cola is offering water products in nearly every major water market in the world.

Apart from that, Coca-Cola uses age and lifestyle to segment its market, and target its customers. Its non-carbonated, sugar (Diet Coke) and caffeine-free products are aimed at people who are old, health-conscious, and have concern about their weight and sugar in-take.

On the other hand, carbonated products are mainly aimed at the teen-agers and adults. Coke Classic is aimed at people who are older than 30. Others are aimed at the teen-agers market.

Industry Attributes

An overview of the industry: The US beverage industry consists of alcoholic and non-alcoholic beverages. The non-alcoholic beverage industry is the principal category where Coca-Cola company operates in. This non-alcoholic segment is a $160 billion (annually) industry, which can be further broken down into several more specific categories such as: soft drinks, bottled water, fruit juices, sports drinks and hot drinks. The market share of each of these categories is depicted in Figure 1.

Within the soft drink segment Colas enjoy the largest share. The two dominant forces alone in the Cola segment, Coca-Cola Classic and Pepsi-Cola, account for 35% of the market. These two perennial beverages are well known as substitutes, which is why a large portion of their respective advertising is based on differentiating the brand.

The sports drink market is a relatively new area. Before the year 2000, this market was completely controlled by Gatorade (formerly Quaker Oats). In 1999, it had sales of more than $2.2 billion, or

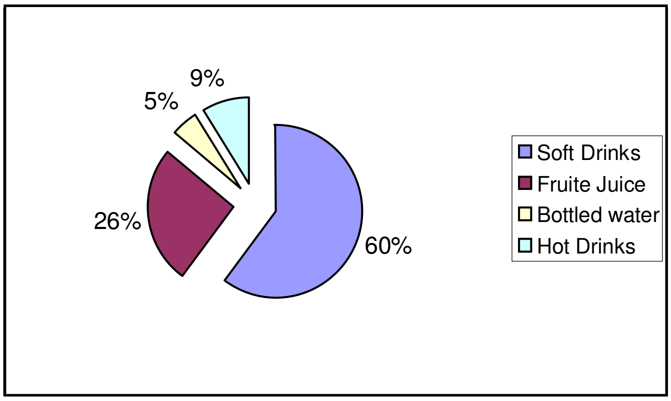

Figure 1: Distribution of various types of Beverages in the Industry

Source: ***http://www.beverage-digest.com***

roughly 80% of the sports drink market. But in December of 2000 PepsiCo announced plans to merge with The Quaker Oats Company, and thus picked up the Gatorade sport drink brand. Prior to that PepsiCo and Coca-Cola had products in this market, but had been unable to gain a significant share away from Gatorade. At that time, Coca-Cola's PowerAde brand had a 12% market share, while PepsiCo's 'All Sport' held a 4% share. Since 1995, the sports drink market has experienced double-digit annual growth.

One of the biggest areas for growth in this industry is the bottled water segment. In 1999, bottled water sales increased by 10% to $8.5 billion. Currently, Americans consume over 5.2 billion liters of bottled water each year. Consumption of bottled water has increased by 10% to 12% annually since 1995, and similar growth is forecasted to continue through 2003 when sales are anticipated to reach $11.9 billion. Currently, there are over 900 different bottled water brands available in the United States. This large number of brands has created confusion for the consumers, but dominant players are now beginning to arise.

Industry players and their position: There are mainly three dominant players in the non-alcoholic beverage industry and they are Coke, Pepsi, and Dr Pepper (Cadbury). Of these, Coke owns five of the top-10-brands; Pepsi owns three and Cadbury owns two (based on the number of cases sold). There are a number of other companies in the industry, (e.g. Cott Corp, National Beverage, Red Bull, Big Red etc), but the big three (Coke, Pepsi, and Dr Pepper) account for more than 90% of the overall market.

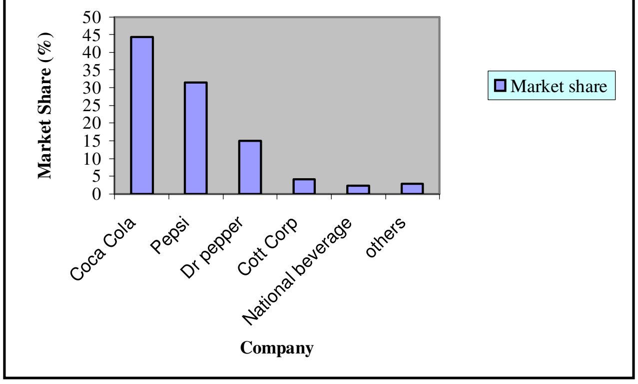

Figure 2: Market Share of Major Players in the Industry

Source: ***http://www.beverage-digest.com***

Market share of the Major Players: The Coca-Cola Company (Coke) is the largest manufacturer, distributor and marketer of soft drink concentrates and syrups in the world. Finished beverage products bearing the Company's trademarks are sold in nearly 200 countries and include the leading soft drink products in most of these countries. Coke is the largest producer of soft drinks both domestically and worldwide, and currently holds a 44.3% market share. Coke's dominance extends beyond the soft drink market as it holds the largest share of fruit juice sales at 9.5%. This is primarily due to its Minute Maid brand of juices. Coke was slow to enter the bottled water segment with its Dasani brand in 1999. However, during this short time, it has already become the 5th largest producers in this market.

Second in the industry is the staunch competitor PepsiCo. While coke has divested it's other assets to focus on the beverage industry, Pepsi has continued to acquire companies outside of the beverage industry. This is not the focus of this analysis, but it warrants naming that Pepsi owns the following brands: Frito-Lay and all of its subsequent brands (Doritos, Ruffles, Cheetos, etc), the Quaker Oats company, and Tropicana juice products. In the worldwide soft drink market, Pepsi has a 31.5% share, while in the juice market it holds a 9% share. It is notable to mention that they are the leader in the bottled water segment with their Aquafina brand at an 11% market share.

The third largest producer of non-alcoholic drinks is Cadbury Schweppes. The company is involved in confectioneries as well as the soft drink market. They are the producer of the two dominant brands not owned by either Pepsi or Coke. Dr. Pepper and 7UP, are the core brand strengths for Cadbury in the beverage industry, and are also two of the largest non-cola beverages in the industry. Cadbury has a worldwide market share of more than 15%, and with the purchase of Royal Crown cola in the fourth quarter of 2000; they are poised to enter the cola segment. While sales of Dr. Pepper have shown some growth in recent years, the real growth has been with Diet Dr. Pepper (up +7.1% to 104.5 mil cases) and Caffeine-Free Diet Dr Pepper up +15.6%).

Overall Coke is the dominant player in almost every segment of the beverage industry. With the ability to remain focused solely on the manufacturing, distribution, and marketing of beverages; they have a competitive advantage over other players. The well-established brand loyalty and worldwide recognition will allow Coke to maintain its leadership position in the industry.

Trends in the industry: The non-alcoholic beverage industry is a growing industry as additional flavors such as orange, cherry, lime, lemon, pepper, and ginger also have been added to the industry. Caffeine-free and diet versions of almost all of the industry's products have been introduced. These products are sold in a wide array of markets from lavish cruise ships to low cost eateries; with normal goods to inferior goods in the market place. Though the demand for normal good decreases during a recession, but the demand for an inferior or low priced good actually increases. So, it is expected that the current recession would not significantly set back the non-alcoholic beverage industry.

On the supply side, the prices of raw materials for the industry (sugar, preservatives, fruits, water, coloring agents, etc) are stable, and thus, there wouldn't be any pressure to raise the prices of the beverages during this recession.

Further, the current low interest rates and stable inflation levels would encourage the firms in this market to aggressively expand their market presence and enter new markets. It is expected that the three large players in the industry would expand their market presence and enter new markets by acquiring smaller firms that cater to local markets. For instance, we see a trend where large firms that were operating primarily in carbonated soft drinks (CSD) market expanded into fruit juices market, sport drinks market, and bottled water market. Such mergers and acquisitions among the companies that share close operational synergies would improve the overall savings to the industry.

In the recent years, technological advances have improved many aspects of the soft drink industry. For instance, new additives such as sugarless sweeteners, caffeine free products, and new flavorings have enabled the industry to provide products that meet changing customer tastes and preferences. Computerized manufacturing technologies will continue to contribute to improve efficiency, and better quality in bottling operations. Advances in logistics and information technology will also help companies to enjoy better inventory control, better stock rotation at the warehouse, and eliminate truckload errors. The introduction of "smart" vending machines would help the industry to better track the consumption of each brand of beverage, and track vending equipment break downs quicker. These smart vending machines can further reduce human labor by automatically reordering the stock when the beverage is low on count in the machine. Over all, this is a good industry for an investor to investment his/her money.

Financial Performance

Profitability: According to the following table Coca-Cola's NI, profit margin, ROA and ROE - all increased in 2001 but decreased in 2002. But this decrease was due to accounting changes (Table 3).

Table 3: Coca-Cola's Profitability over the 2000-2002 years[7]

Year	NI ($ million)	Profit Margin (%)	ROA (%)	ROE (%)
2002	3050	15.60	12.45	25.85
2001	3969	22.62	17.70	34.92
2000	2177	12.54	NA	23.82

Over all, Coca-Cola has been maintaining an average of $2975 million of NI for last 3 years. Its average ROE for last 3 years was 28.2%, which was definitely very good.

$$\text{Profit margin on sales} = \frac{\text{NI}}{\text{Total.. Sales}} = \frac{3050}{19546} = 15.60\%$$

$$\text{Return on total asset (ROA)} = \frac{\text{NI}}{\text{TA}} = \frac{3050}{24501} = 12.45\%$$

$$\text{Return on equity (ROE)} = \frac{\text{NI}}{\text{Common.. Equity}} = \frac{3050}{11800} = 25.85\%$$

Operating Cash Flow: Over the last three years (2000, 2001 and 2002) operating cash flow of Coca-Cola Company was $4742, $4100 and $3585[1] million dollar respectively. All these years, cash flow was positive, and there was no negative cash flow during this time period.

Growth: Coca-Cola is a growing company. Over the last 10 years (1992-2002) its average growth rate was 6.9%. In the year 2002, the company achieved world unit case growth of 5%, with nearly 950 million incremental unit cases. Excluding volume associated with the brands acquired during 2002, the growth rate was 4.5 percent. Cash from operations was at a record of $4.7 billion, showing a 15 percent increase over 2001. After investing activities, the company generated $3.6 billion of cash flow in 2002, which meant a 22 percent increase. Its current asset, fixed (long-term) asset, and total asset increased by 2.52%, 32.74%, and 9.3% respectively over 2001. Over the last 3 years the dividend pay out ratio was 0.22 and price-earning (P/E) ratio was 25.20.

Capital Structure: Under normal conditions a company maintains a capital structure of 40% debt and 60% equity. According to the annual report (2002) Coca Cola's total debt is $10042 (CL + long-tern debt =7341+2701=10042) million which is 46% ($\frac{10042}{11800 + 10042} \cong 46\%$) of the total asset. Therefore, we can say that the company is maintaining a 46% debt, which is good. Obviously rest of the 54% fund must have been raised through equity. So, we can say that in the year 2002, Coca Cola maintained a Capital structure of 46% debt and 54% equity. In the year 2001 it maintained 43% debt and 57% equity. So, over the 2 years' time period the company's capital structure didn't change much.

Asset Structure: As of 31st December 2002, the total asset (TA) of the company is $24,501 million of which current asset (CA) is $7,352 million, fixed (FA) or long-term asset is $5,911 million and inventory is $1294 million. Company's total sale is $19,564 million. Its key Asset Management ratios are as follows:

Total assets turnover = $\frac{\text{Sales}}{\text{TA}} = \frac{19546}{24501}$ 0.79 (meaning every dollar of asset generates 79 cents sales revenue)

Inventory turnover = $\frac{\text{Sales}}{\text{Inventories}} = \frac{19546}{1294} = 15.10$ times

Fixed asset turnover = $\frac{\text{Sales}}{\text{FA}} = \frac{19546}{5911} = 3.31$ (meaning that every $1 dollar worth of FA generates $3.31 worth of sales revenue)

Long-term asset is = $\frac{\text{FA}}{\text{TA}} = \frac{5911}{24501}$ 0.24 = 25% of the total asset.

Therefore, it should not be concluded that Coca Cola is a capital-intensive company. Because it is very normal for a corporation like Coca-Cola to keep that percentage of long-term asset. If it had been holding 35%-40% long-term asset then it would have been regarded as a capital-intensive company.

Liquidity Position: It is extremely important to know a company's liquidity position before making any investment decision because liquidity condition of the company tells us company's performance in short term. Specially, when the company is cash constrained, current assets are required to liquidify into cash to pay off the current liabilities. Current ratios of the company can tell us about the liquidity position of a company. In the year 2002 the current and quick ratios of Coca-Cola Company's were as follows:

Current ratio = $\frac{\text{CA}}{\text{CL}} = \frac{7352}{7341} = 1.0$ times

Quick ratio = $\frac{\text{CA} - \text{Inventories}}{\text{CL}} = \frac{7352 - 1294}{7341} = 0.82$ times

Stock price: Over the last 5 years the average stock price of Coca Cola was $ 44.51. Its 52 weeks highest and lowest prices are $57.50 (7/8/2002) and $37.01 (3/5/2003) respectively. The stock price was down due to the sluggish domestic economy and global political uncertainty. In the wake of middle-east war, many middle-eastern and Asian countries boycotted Coke products. As a result of that, sales and earning decreased, and stock price went down. But with the end of the war, and increasing indication of the improvement of the domestic economy the stock price is again picking up. As of now, the stock price $46.64 and EPS is $1.86.

Conclusion from an investor's perspective

To purchase or not to purchase decision of a stock depends on both the economic fundamentals and company financial fundamentals of that stock. Economic fundamentals, such as interest rate (monetary), tax rate (physical) have very little or no impact on the stocks of soft-drink industry as well as those of

Coca-Cola. Like food items, soft drinks have become a basic necessity for US consumers. We can't imagine of our dinner or lunch without Coke or Pepsi products. Whether we are from rich, poor or middle-class family we consume soft-drinks everyday. Whether economy is good or bad, or whether the interest rate is high or low consumers still consume soft drinks. Unlike the technology or financial services industry, this industry and its companies are not affected too much by the changes of economic fundamentals. That's why if we compare the recent stock price of Coca Cola [$46.64 as of 06/26/03] with its last 5 years average price [$44.51] we find little difference. Alcoholic beverage industry is affected by the changes in the economic fundamentals. Therefore, it can be said that investing in soft drink industry is safe and it does not carry risk like investing in technology or financial services industry (Table 4).

Table 4: Coca-Cola's Financial Performance against Pepsi Cola[9]

Financial Ratio	Year 2002		Year 2001		Comment
	Coca Cola	Pepsi	Coca Cola	Pepsi	
Current ratio	1	1.05	0.85	1.17	Ok
Quick ratio	0.82	0.84	0.72	0.91	Ok
Debt ratio	41%	36%	43%	35%	Ok
TA turnover	0.79	1.07	0.78	1.08	Somewhat low
FA turnover	3.31	3.39	3.94	3.41	Good
Inv.turnover	15.10	18.71	16.63	17.94	Low
Profit margin	15.60%	13.19%	22.62%	11.32%	Good
ROA	12.45%	14.11%	17.70%	12.27%	Good
ROE	25.85%	14.44%	34.92%	30.78%	Very Good
EPS	1.86	1.92	NA	NA	Good
P/E ratio	25.80	23	NA	NA	Very Good
Dividend payout	0.22	0.16	NA	NA	Good
Market cap	$115.48 B	$75.87B	NA	NA	Good

Source: **Annual Report – Coca-Cola, PepsiCo, for the Years 2002, 2001.**

From the above table, it can be concluded that Coca-Cola out performs its archrival Pepsi Cola in most cases. Its ROE, P/E, dividend payout, etc., all are better than those of Pepsi Cola. More over it is the market leader with a 44.3% market share in the industry with an average growth rate of 6.1%. Therefore, an investor should buy Coca-Cola stock.

Notes

1 Coca-Cola, http://www.fortune.com/fortune/fortune500/snapshot/0,14923,92,00.html

2 PepsiCo, http://www.fortune.com/fortune/global500/snapshot/0,15198,159,00.html

3 Same as in Note 1.

4 http://www.beverage-digest.com

5 Fortune 500; http://www.fortune.com

6 Global 500; http://www.fortune.com

7 Annual Reports 2002 and 2001, Coca-Cola Company

8 Cash Flow Statement, Annual Report, Coca-Coal Company

9 Data Source: Annual Reports – Coca-Cola, and PepsiCo, for the years 2002, 2001; http://www.fortune.com

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