DETERMINING THE VALUE OF THE COCA COLA COMPANY – A CASE ANALYSIS

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CASE DESCRIPTION

The primary subject matter of this case concerns finance related topics and uses actual financial data to assess the rationale for why and when various models can be used to determine the stock price performance of the Coca Cola Company. Secondary issues examined include a determination of the value of the company using the discounted cash flow model. The case enables students to apply their knowledge of the principles of finance and accounting to a real world example. It is specifically designed to enhance, among other things, students' understanding of the selection of appropriate financial techniques and to apply those methods to a specific company, in this case the Coca Cola Company.

The case has difficulty levels of three, four, and five. The content is appropriate for the both an undergraduate principles of finance course taken primarily by students at the junior or senior level (levels three and four) as well as for first-year graduate students (level five). The case is designed to be completed primarily outside of class as group work with limited discussion in an in-class setting. Outside preparation time is expected to be three to four hours for students who have adequate background in the topics included. In-class discussion may range from thirty minutes to one hour.

CASE SYNOPSIS

Nicki James, a CFO of a wealth fund management advisory group, had been successful in solving the financial woes of her clients for a number of years. During that time, she had also dabbled in some investing of her own and was always looking for new opportunities. Therefore it was no surprise that ideas randomly came to her as one did on that fall day in 2009 as she was sipping from her can of Classic Coca Cola. Coke, as many referred to the product, had been a part of her life ever since her early childhood. Thus the well-established nature of the company along with the new prospects in sight for the organization inspired her to instruct her assistant and recent MBA graduate, Sarah Mills, to perform some financial analysis on her behalf. Could Coca Cola stock be the financial goldmine that both Nicki and her clients had always sought? With a little research and a few calculations, Nicki and Sarah were determined to find out!

BODY OF CASE

On a fall day in 2009, Nicki James, the chief financial officer (CFO) of a wealth fund management advisory group, was sitting outside enjoying a cool breeze while sipping from her can of classic Coca Cola. As she was sipping, she thought about how Coke, as a beverage, has evolved over the years. She could remember how, as a young girl, her mother would persuade her and her siblings to be well behaved and to be kind to each other and would even offer them a can of Coke as an incentive for their good manners. As she grew older, new versions of the classic soft drink including Diet Coke, Caffeine Free Coke, Cherry Coke, Coke Zero, and many others emerged. As incredible as the variations of the coke flavors were, the Coca Cola Company even began to diversify and began to produce PowerAde, vitamin water, energy drinks, and juices.

With all of the other newly introduced beverages, the company somehow managed and even thrived throughout all of the transitions and remained the undisputed leader in the industry notwithstanding the competitive challenges it faced by the entrance of Pepsi, Dr. Pepper/Snapple, and others into the market. In fact, being the financial guru Nicki was, she recalled reading in a business article recently that the company had once again and for the ninth consecutive year claimed the title of the top world brand outshining a number of equally well-reputable and successful companies like Toyota, Disney, IBM, Microsoft, Google, and Intel. The Coca Cola Company, with a listed brand value of $68.7 billion, had gained an amazing three percent in this measure in less than a year (Trubey, 2009).

Like most financial professionals, Nicki not only utilized her expertise exclusively for her clients but also delved into investing for her own account in hopes of striking it rich so she could retire early and lead a comfortable life. Many already knew that the key to her successful career lied in her ability to select companies with steadily improving and predictable financial performances. However, she had never investigated Coca Cola as an alternative investment option in any detail. The memory of what her mother used to say and the encouraging headline news about Coke's brand caught her attention by surprise and she decided to explore whether the stock price performance of the company justified the risk.

One other item that also stuck in her mind, though, was an announcement that had been released a few months prior regarding a possible national (U.S.) tax on the sugary beverages of the industry. The tax, if imposed, as she recalled, would be collected as an additional revenue source for the nation's healthcare system (Adamy, 2009). The ramifications of such a measure on the demand for the company's products could be worth examining as well. With such news and prospects as her motivators, Nicki began gathering additional information and data needed to properly analyze The Coca Cola Company and explore whether or not the company's stock should possibly be one of the investments included in her portfolio.

Among the latest news that Nicki uncovered, was an announcement by the company of its plans to double its revenue by 2020. According to company officials, such phenomenal growth could be achieved, among other ways, through the penetration of new and untapped markets like China, India, Mexico, and South Africa (Geller, 2009). Nicki was quite intrigued by these potential market outlets and the company's growth prospects. On a trip she took a few years back, she had the privilege of visiting a Coca Cola World museum and had the opportunity to taste Coke blends that were actually native to many of the countries represented. She had assumed that the brand that she was familiar with was just as popular in those nations as it was in the United States but was unaware of the exact expansionary opportunities available.

Moreover, on the company's list of modifications, were plans to revise its marketing approach and to specifically target new segments including multicultural teenagers and women while also offering new product sizes including a 7.5-fluid ounce mini can boasting a mere 90 calories ("Coca Cola to offer," 2009). Additional packaging changes proposed included a front-label energy (or calorie) display to further appeal to health-conscious consumers and juice packages displaying prominent fruit images emphasizing the healthy contents of the products ("Coke putting energy," 2009; Frederix, 2009). Even more awe-inspiring was news of a Coca Cola vending machine that would allow consumers to quench their thirst by blending flavors to create their own personalized carbonated beverages (Collier, 2009). Nicki was captivated by all of these growth prospects and they reinforced her desire to carry out an exploratory investigation.

While sifting through industry news, Nicki also learned of PepsiCo's plans to buy some of its bottlers in an attempt to better control the supply chain and to partner with Anheuser Busch in an effort to cut costs (Birchall, 2009). Despite such competitive threats, from the preliminary news Nicki had gathered, she thought that the company's financial background appeared to be solid and its prospects bright.

Now, it is time to determine if the number crunching offers a similar positive outlook. Specifically, Nicki is keenly interested in knowing how much the company is worth and whether the company's stock price is under- or overvalued given its current price of $56.54 as of December 31, 2009.

Nicki has delegated Sarah Mills, her immediate assistant, who after having just graduated from a reputable business school with an MBA degree joined her wealth fund advisory group, to sift through and compile the necessary data, and to then make a recommendation. Sarah immediately got involved and put all of the necessary accounting and financial information together in order to make a recommendation.

In order to complete her analysis, Sarah made the following assumptions:

* The company carries various outstanding loans with different maturities (Table 5). These loans are assumed to be rolled over or refinanced at the existing rates upon maturity.
* Growth estimates (Table 8) in earnings and dividends over the past five years from various sources range from a low of 7.9 percent to a high of 8.5 percent. Sarah used the lowest estimate of 7.9 percent to be reasonable and to err on the side of caution.
* Sarah took the overall average of the daily returns of the S&P 500 over a 60-year period, January 1, 1950 through December 31, 2009, for which data was available on Yahoo.finance.com, to determine the annualized compound growth rate as a proxy for the market return.
* She used the 20-year Treasury bond rate (Table 6) as the risk free rate and the current beta of 0.62 (Table 7) as a measure of the firm's market risk.
* The company has outstanding short-term loans of $6.32 billion with a weighted average interest rate of 0.2%. On the grounds that the claim on operating income for such loans would be immaterial, Sarah decided to exclude them from the determination of the weighted average cost of long-term debt.

Additional financial data used include Tables 1 and 2 which provide the income statement and balance sheet, respectively, for the past five years. Table 3 provides the free cash flows generated over the past five years while Table 4 outlines the company's dividend and earnings history. Table 5 outlines the outstanding bond issues as of December 31, 2009, while Table 6 provides U.S. Treasury rates for a variety of maturities. Finally, Tables 7 and 8 itemize various company and industry data.

Table 1: The Coca Cola Company Consolidated Comparative Income Statements
For the Years Ended December 31 (In Millions of Dollars)

	2004	2005	2006	2007	2008	2009
Revenue	21,962	23,104	24,088	28,857	31,944	30,990
COGS	7,638	8,195	8,164	10,406	11,374	11,088
Gross Profit	14,324	14,909	15,924	18,451	20,570	19,902
Selling, General, and Administrative	8,626	8,739	9,431	10,945	11,774	11,358
Other	0	85	185	254	350	313
Operating Income (EBIT)	$5,698	$6,085	$6,308	$7,252	$8,446	$8,231
Net Interest Income and Other	524	605	270	621	(1,007)	715
Income before Income Taxes	6,222	6,690	6,578	7,873	7,439	8,946
Income Taxes	1,375	1,818	1,498	1,892	1,632	2,040
Minority Interest						82
Net Income	$4,847	$4,872	$5,080	$5,981	$5,807	$6,824
Diluted EPS	$2.00	$2.04	$2.16	$2.57	$2.49	$2.93
Average Shares Outstanding (diluted)	2,429	2,393	2,350	2,331	2,336	2,329

Source: Morningstar.com

Table 2: The Coca Cola Company Comparative Balance Sheets
As of December 31: (In Millions of Dollars)

	2004	2005	2006	2007	2008	2009
Cash and cash equivalents	$6,707	$4,701	$2,440	$4,093	$4,701	$7,021
Short-term investments	61	66	150	215	278	2,192
Accounts receivable	2,171	2,281	2,587	3,317	3,090	3,758
Inventory	1,420	1,424	1,641	2,220	2,187	2,354
Other current assets	1,735	1,778	1,623	2,260	1,920	2,226
Total current assets	12,094	10,250	8,441	12,105	12,176	17,551
Property, plant, and equipment (net)	6,091	5,786	6,903	8,493	8,326	9,561
Intangibles	3,836	3,821	5,135	12,219	12,505	12,828
Other long-term assets	9,306	9,570	9,484	10,452	7,512	8,731
Total long-term assets	19,233	19,177	21,522	31,164	28,343	31,120
Total Assets	$31,327	$29,427	$29,963	$43,269	$40,519	$48,671
Accounts payable	$4,283	$4,493	$929	$1,380	$1,370	$0
Short-term debt	6,021	4,546	3,268	6,052	6,531	6,800
Taxes payable	0	0	0	0	252	264
Accrued liabilities	667	797	4,693	5,793	4,835	0
Other short-term liabilities	0	0	0	0	0	6,657
Total current liabilities	10,971	9,836	8,890	13,225	12,988	13,721
Long-Term Liabilities						
Long-term debt	1,157	1,154	1,314	3,277	2,781	5,059
Other long-term liabilities	3,264	2,082	2,839	5,023	4,278	5,092
Total long-term liabilities	4,421	3,236	4,153	8,300	7,059	10,151
Total Liabilities	$15,392	$13,072	$13,043	$21,525	$20,047	$23,872
Total Equity	$15,935	$16,355	$16,920	$21,744	$20,472	$24,799
Total Liabilities and Equity	$31,327	$29,427	$29,963	$43,269	$40,519	$48,671

Source: Morningstar.com

Table 3: Historic and Current Free Cash Flows					
	2005	2006	2007	2008	2009
Free Cash Flow (FCF)	$5,524	$4,550	$5,502	$5,603	$6,193
(In millions of dollars) Source: Morningstar.com					

Table 4: Historic Annual Dividends and Diluted Earnings per Share		
	Annual Dividend	Diluted EPS
2004	$1.00	$2.00
2005	$1.12	$2.04
2006	$1.24	$2.16
2007	$1.36	$2.57
2008	$1.52	$2.49
2009	$1.64	$2.93
Source: Yahoo Finance and Morningstar.com		

Table 5: Bonds Outstanding (Late 2009 / Early 2010 – Prices and BV roughly as shown below)				
	Maturity Date	Book Value	Price	Coupon
Coca Cola, 5.35%	11/15/2017	$1,748,000,000	109.8	5.35%
Coca Cola, 4.875%	3/15/2019	1,339,000,000	103.8	4.88%
Coca Cola, 3.625%	3/15/2014	897,000,000	104	3.63%
Coca Cola, 5.75%	3/15/2011	500,000,000	104.5	5.75%
Coca Cola, 7.375%	7/29/2093	116,000,000	116.9	7.38%
Coca Cola, 5.30%	2018	510,000,000	92.32 (Inferred from financials)	5.30%
Source: Morningstar.com & Coca Cola Company Financials				

Table 6: YTM on U.S. Treasuries (12/31/09)	
1-month	0.04%
3-month	0.06%
6-month	0.20%
1-year	0.47%
2-year	1.14%
3-year	1.70%
5-year	2.69%
7-year	3.39%
10-year	3.85%
20-year	4.58%
30-year	4.63%
Source: U.S. Treasury.gov	

Table 7: Various Other Financial Data	
Shares outstanding (non-diluted) (12/31/09)	2,310,000,000
Beta (12/31/09)	0.62
P/E – Beverage Industry	$17.23
S&P 500 overall average daily return (1950 - 2009)	0.03%
Source: Yahoo.finance.com	
Industry Growth Rate	5.07%
Source (Cooper, 2009)	

Table 8: Company Growth Rates	
5-Year Estimated Growth – Morningstar	7.90%
5-Year Long-Term Growth Rate of Earnings - Reuters	8.50%
Historical Compound Growth Rate (based on 5 years of EPS)	7.94%
Historical Average Growth Rate (based on 5 years of EPS)	8.28%

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