

CASE STUDY ON COCA COLA

In answering the question for ourselves whether Coca Cola is a company worth consideration as an investment, at the right price, we have used summary and other figures available from Value Line. ■

QUESTION 1: DOES THE COMPANY SELL BRAND NAME PRODUCTS THAT ARE LIKELY TO ENDURE?

The answer to this seems quite simple. The major product of the company has been around for many years, is sold worldwide and is considered the best-known brand name in the world. More importantly, its customers would not do without it, and have demonstrated a loyalty that makes it unlikely it would change to other products. It also has other well-known brands on its books – Sprite, Fanta, Evian, Minute Maid, PowerAde.

2. IS THE BUSINESS OF THE COMPANY EASILY UNDERSTOOD?

We think so. Its core operation is the production and distribution, both for itself and under franchise, of non-alcoholic beverages and associated products.

3. DOES THE COMPANY INVEST IN AND OPERATE BUSINESSES WITHIN ITS AREA OF EXPERTISE?

We would think so. Consideration of the Value Line information suggests that the company restricts itself to its core operations. We do not see it dabbling in areas outside its expertise.

4. DOES THE COMPANY HAVE THE ABILITY TO MAINTAIN OR INCREASE PROFITABILITY BY RAISING PRICES?

The real question here is whether, if Coke were to lift its prices by a margin that would allow it to keep pace with inflation, sales would suffer. This is unlikely.

5. IS THE COMPANY, LOOKING AT BOTH LONG-TERM DEBT, AND THE CURRENT POSITION, CONSERVATIVELY FINANCED?

a) Long term debt to profitability

The long-term debt of this company in 2002 was 2700 million dollars. The profit for that year was 4134 million dollars. At this rate, Coke could wipe out its long-term debt in .65 of a year, just over six months.

b) Current ratio

In 2002, Coke had current assets of 7352 million dollars and current liabilities of 7341 million dollars, a ratio of debt to assets of .99. This is lower than would be the desired ratio for industrial companies, but having regard to the nature of the business, and the ready cash flow, is acceptable.

c) Long term debt to equity

In 2002 the long-term debt was 2700 million dollars and shareholders equity was 11800 million dollars a comfortable ratio of .22.

6. DOES THE COMPANY SHOW CONSISTENTLY HIGH RETURNS ON EQUITY AND CAPITAL?

The company has shown an average rate of return on equity over the past five years of 37.08%. In the same period, it showed an average return on capital of 33.6% .The figures are consistent.

Year	ROE	ROC
1998	42.0	39.1
1999	34.0	31.5
2000	39.4	36.4
2001	35.0	31.9
2002	35.0	29.1
Average	37.08	33.6

7. HAVE THE EARNINGS PER SHARE AND SALES PER SHARE OF THE COMPANY SHOWN CONSISTENT GROWTH ABOVE MARKET AVERAGES OVER A PERIOD OF AT LEAST FIVE YEARS?

The figures for this period are as follows.

Year	EPS	+ or - %	SPS	+ or - %
1997	1.64		7.64	
1998	1.42	-13.4	7.63	-.13
1999	1.30	-8.45	8.01	+4.98
2000	1.48	+13.85	8.23	+2.74
2001	1.60	+8.11	7.06	-14.2
2002	1.66	+3.75	7.92	+12.18

Looking at a five-year rolling period, we can calculate, using a hand-held [Texas Instruments BA-35 Solar Calculator](#), the increase in earnings and sales over the rolling five-year period 1998-2002. For earnings, this is 16.9 %, for sales only 3.8%. The compound rate of return for earnings is 3.185, for sales, .75%.

This is not a strong rise in earnings or sales, and the question would be whether this is as a result of a slow-down in the US and world economies over this period or whether there is some more structural reason.

8. HS THE COMPANY BEEN BUYING BACK ITS SHARES, AND IF SO, HAS IT BOUGHT THEM RESPONSIBLY?

In 1998, the company had common shares outstanding of 2465.5 million. In 2002, the figure was 2471 million. The shares on issue are basically unchanged.

9. HAS MANAGEMENT WISELY USED RETAINED EARNINGS TO INCREASE THE RATE OF RETURN TO SHAREHOLDERS?

The company has the following earnings per share and dividend per share record over a five-year period.

Year	EPS	DPS
1998	1.42	.60
1999	1.30	.64
2000	1.48	.68
2001	1.60	.72
2002	1.66	.80
Total	7.46	3.44

The company has therefore retained earnings totalling \$4.02. In 1998, the shares reached a low of \$53.6. In 2002, the shares reached a high of \$57.9. An investor who bought at the lowest price in 1998 and still had them at the highest price in 2002 would have been showing a profit of \$4.30. Thus the shares would have just slotted into Warren Buffett's requirement for showing an increase in market value of a dollar for every dollar retained.

Using the approach of [Mary Buffett and David Clark](#), we could calculate the percentage increase in earnings per share resulting from the retained profits. EPS in 1998 were 1.42, and in 2002 were 1.66, an increase of .24. Thus, from the total earnings retained of \$4.02, earnings have increased by a total of .22, a percentage increase of 5.97%: not high.

10. IS THE COMPANY LIKELY TO REQUIRE LARGE CAPITAL SUMS TO ENSURE CONTINUING PROFITABILITY?

Value Line suggests that in the two years following 2002, the company would be spending about .40 a share on capital items. The long-term average is .31, unadjusted for inflation. These figures seem to be in line with historical expenditures.

This case study is a demonstration only and is not intended to influence or persuade visitors to this site to make any investment decisions; they should make their own decisions, based on their own research, personal and financial circumstances, and after consultation with their own financial or investment advisers.