

Always Coca-Cola?

On May 8, 1886, Dr John Pemberton served the world's first version of Coca-Cola at Jacobs Pharmacy in Atlanta. Advertised as a tonic to relieve headaches and exhaustion, Coca-Cola gets its name from two of its ingredients namely cocaine derived from the coca plant (only 9mg/glass which was removed in 1903) and caffeine, from the kola nut. Well-known brands include Coca-Cola (Diet/Light/Zero), Sprite, Fanta, Minute Maid, Powerade, Glacéau Vitaminwater, Bonaqua, Costa Coffee and Schweppes. What makes Coke so unique is that it doesn't just sell drinks in a bottle. Rather it sells consumers the experience and lifestyle associated with its iconic brand. The US remains its largest market (32% of sales) but Emerging Markets is where the growth potential lies. After 135 years in business, can the soft drink giant stay on top? This article will explore how the company has navigated very choppy waters during the global pandemic, its main strategy as well as the risks that remain.



**Nick
Rogers**

Firstly, distribution is key to the success of any beverage company. In 1943, at the request of the US government, Coke distributed 5 billion bottles to US troops fighting abroad - an early indication of what was to come. Today, Coca-Cola is officially available in every country except Cuba and North Korea. The company sells 1.9 billion drinks per day through the largest beverage distribution system in the world.

The actual production and distribution of Coca-Cola follow a franchising model which frees up the company to “stick to its knitting” (i.e. brand, marketing and innovation) and have partners that focus on execution, manufacturing, and local distribution. The Coca-Cola Company produces concentrate, which is then sold to licensed Coca-Cola bottlers throughout the world. The bottlers produce the final drink by mixing the syrup with filtered water and sweeteners, putting the mixture into cans and bottles, and carbonating it. Finally, the bottlers sell and distribute to retail stores, vending machines, restaurants, and foodservice distributors.

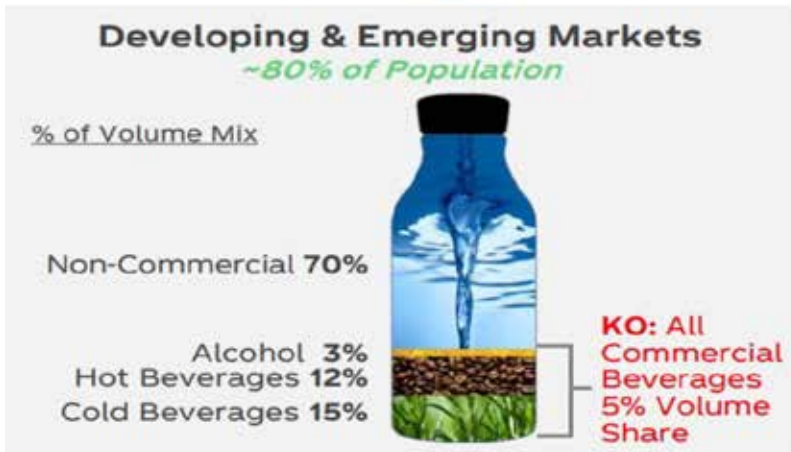
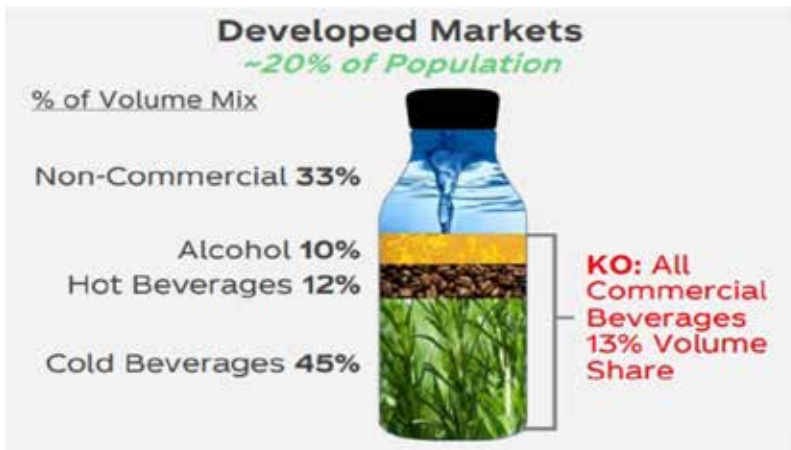
Coca-Cola Beverages Africa (CCBA) is the largest Coke bottler in Africa, accounting for over 40% of Coke's volumes on the continent and active in 14 markets. It has confirmed that it will list later this year, with an estimated market capitalization of about R120 billion, making it a similar size to Shoprite. Africa's young population and growing urbanisation on the continent will support the potential for increased per capita consumption, including in the categories of juice, water and energy drinks. Energy

SPEED READ

- **Coke sells 1.9 billion commercial beverages a day (or 3% of the global total) and owns five of the world's top 10 brands.**
- **Management turned the Covid threat into an opportunity by eliminating 200 (50%) of its brands, yet sacrificing just 2% of volumes and 1% of sales.**
- **Warren Buffet's Berkshire Hathaway remains the largest shareholder having spent \$1.3 billion to amass its 400 million shares, a position it hasn't touched in 27 years. That stake is now worth \$24 billion!**
- **In 2021, Coca-Cola raised its dividend by 2%, making it the 59th consecutive annual increase.**

drinks are the fastest-growing soft drink category in Africa. 36 bottling plants serve over 600,000 outlets with South Africa representing around 70% of volumes and half of the workforce – great news for the JSE and Coke's expansion plans into Emerging Markets.

It was Winston Churchill who famously said, “Never let a good crisis go to waste.” CEO James Quincey had wanted to thin out the company's 400 brands stating, “it's a bit like cholesterol, it starts flaring up the arteries.” The pandemic offered a window of opportunity which he seized, slashing 50% of the portfolio in a fraction of the time with a fraction of the pain under normal circumstances. The rationale? These 200, mostly small, local brands only made up 2% of volume and 1% of sales! Think about it. Every bottle



needs the same amount of space on a shelf which comes at a cost. If you are not constantly monitoring and rotating stock your retail partners end up selling less especially with competitors like Pepsi. Interestingly, surveys indicated that consumers preferred smaller can sizes and were willing to pay more per ounce for them. This allowed Coke to cut shelf space and manufacturing costs. The global workforce was also trimmed by 11%. These swift actions will dramatically increase the capability for innovation which in turn should translate into huge cost savings. That is positive for defending margins in a very tough, competitive landscape.

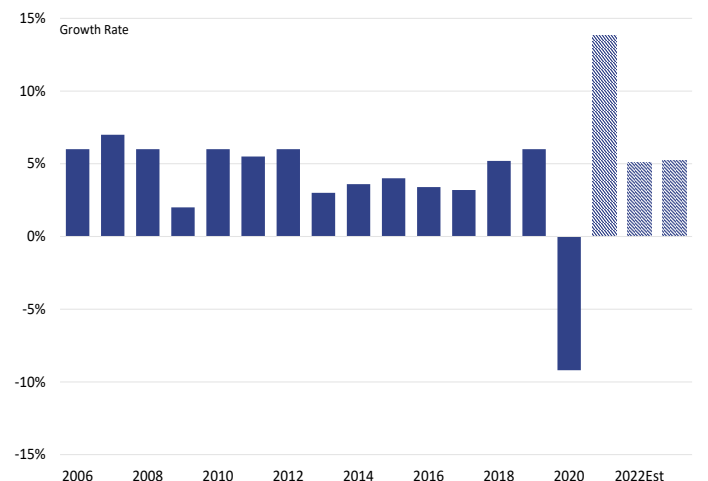
Coke has the largest share of the US beverage sector's Out-of-Home market at c50% of pre-pandemic sales. Sales plummeted in 2020 during the hard lockdowns when stadiums, bars, restaurants, cinemas etc. remained closed. Rival PepsiCo performed better than Coke throughout the lockdown period due to its breakfast and snack categories, which Coca-Cola doesn't have. But beverages are Coca-Cola's sweet spot, and organic revenue recovered strongly in 2021 and well ahead of growth for Pepsi. The latest results have seen volumes recover to pre-pandemic levels. Increased vaccinations coupled with lower Omicron death rates has seen global mobility gather pace which bodes well for 2022.

From humble beginnings, Coke's 200 brands cover sparkling soft drinks and waters, coffee and teas and sports

hydration drinks. Coke's strategy is to make fewer but bigger bets in products that can move the needle in the long run to benefit its 'Total Beverage' ambitions. Major acquisitions like Costa Coffee in 2019 for £3.9 billion made it the UK's biggest coffee shop player overnight. It also gained a foothold in what is one of the world's fastest-growing drinks categories given that the global coffee shop market is worth \$165 billion. Buying Costa just before the COVID crisis was unfortunate timing given the dependence of the business on the coffee shops, however, there were several other platforms. One was the Costa Express machines, a digital Barista with ready-to-drink Costa options coupled with what's called 'proud to serve kit' which includes the beans, the machines, the signage so that people can serve Costa within their outlets. Importantly, Costa's UK coffee shop revenues have recovered almost entirely to 2019 levels and the reopening phase adds another exciting growth opportunity.

Continued bolt-on M&A is important, allowing Coke to invest in interesting brands that can disrupt categories. For example, the acquisition of the remaining 85% of BODYARMOR reinforces its overarching strategy of expanding its business beyond the mature carbonated soft-drink market and brings full control of a fast-growing, premium-priced sports and hydration brand that is hugely popular with a younger, more health-conscious and cash-flush demographic. Adding Powerade and Coke's 19.3% stake in the world's second-biggest energy drink brand, Monster (1st is Red Bull) to the mix illustrates Coke's ability to adapt to structural shifts like Health & Wellness. In 2020, U.S. consumption of ready-to-drink cocktails grew 53% from the previous year. A new strategic partnership with US liquor

COKE: ORGANIC SALES GROWTH



Despite being available in nearly every country worldwide, Coke still manages to grow its sales every year - a remarkable feat.

giant, Constellation Brands, will see Coca-Cola's Fresca being used as a cocktail mixer. Diversifying and adding new categories to its 'Total Beverage' portfolio is vital to its long-term growth since two-thirds of the company's sales are still tied to carbonated beverages, where growth is decelerating due mainly to shifting consumer demand for options with less sugar.

With ESG gaining more prominence and impacting investor decision-making, Coca-Cola is paying full attention. Coke produces nearly double the amount of plastic packaging (3 million tons p.a equivalent to 200,000 bottles a minute) than the 2nd-largest culprit, Nestle. Approximately 85% of its overall carbon footprint lies within Coke's supply chain which will take time to address. Coke has already committed to cut plastic use by 50% by 2030 and is currently testing a new paper bottle in an attempt to eliminate plastic from its packaging. In the meantime, it offers packages made of 100% recycled PET in around 30 markets and fortunately, global collaboration is gathering pace quickly.

Results for the 12 months to December 2021 are due in February. Management is confident that the 4-6% organic sales growth target will be met in 2022 and 2023. Despite headwinds from the Delta variant and labour shortages in certain markets, Coke managed to deliver unit case volumes ahead of 2019 levels for the nine months to September. Cash flows were also strong, implying a significantly improved dividend payout ratio that moves Coke closer to its long-term target of 75%. Fortunately, Coke's profitability is

relatively less impacted (v peers) by input-cost pressures due to its asset-light franchise model. Its strong brand equity has seen 2 successful price increases achieved in the US in 2021 to help mitigate inflation. Despite all this, the valuation is compelling relative to both its own history and to its peers.

“...the evidence to date points to Coke emerging from the pandemic as a stronger and leaner company...”

Despite the obvious risks, one risk worth highlighting is the company's ongoing tax dispute with the IRS, which could result in a tax liability of \$12 billion. The outcome is uncertain and a ruling in favour of the IRS would see a short-term reaction in the

share price. However, resolution thereof will lift a major overhang, allowing investors to focus on Coca-Cola's fundamentals and strong underlying momentum from the rebound in on-premise sales.

In conclusion, the evidence to date points to Coke emerging from the pandemic as a stronger and leaner company as it strikes a better balance with its big bets on scalable ideas and local risk-taking. Sales momentum will build into 2022, in line with vaccine roll-out success which will in turn fuel the global reopening. Coke will also not be left behind as alcoholic and non-alcoholic occasions “converge”. In a market that is obsessed with technology at all costs, we find Coke to be a refreshing alternative that offers investors solid inflation-beating returns at an acceptable and attractive valuation, underpinned by a consistent and growing dividend. Cheers!



An early Coke advert with its spirit of adventure.



Topic: **To be confirmed**

Natal Midlands

Date:	TBC
Venue:	Oasis Conference Centre, 72 Main Road, Howick
Morning Time:	10am for 10.30am
Evening Time:	5.30pm for 6pm

Johannesburg

Date:	TBC
Venue:	Rosebank Union Church, Cnr William Nichol and St Andrews Road, Hurlingham
Time:	7am for 7.30am

Our seminar schedule for 2022 will be published shortly
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