COCA COLA HBC- EQUITY REPORT

Researcher

NUMBER Date

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Introduction

Description of Organisation and Products

Company	*Coca Cola HBC*
Stock Exchange	*London Stock Exchange, FTSE 100*
Sector / Sub-sector	Beverage industry
Market capitalisation	*£ 4842.53 million*
Share price as of April, 2nd 2015	*53.21*
Report's date	*April, 5th 2015*

Source: Bloomberg (2015)

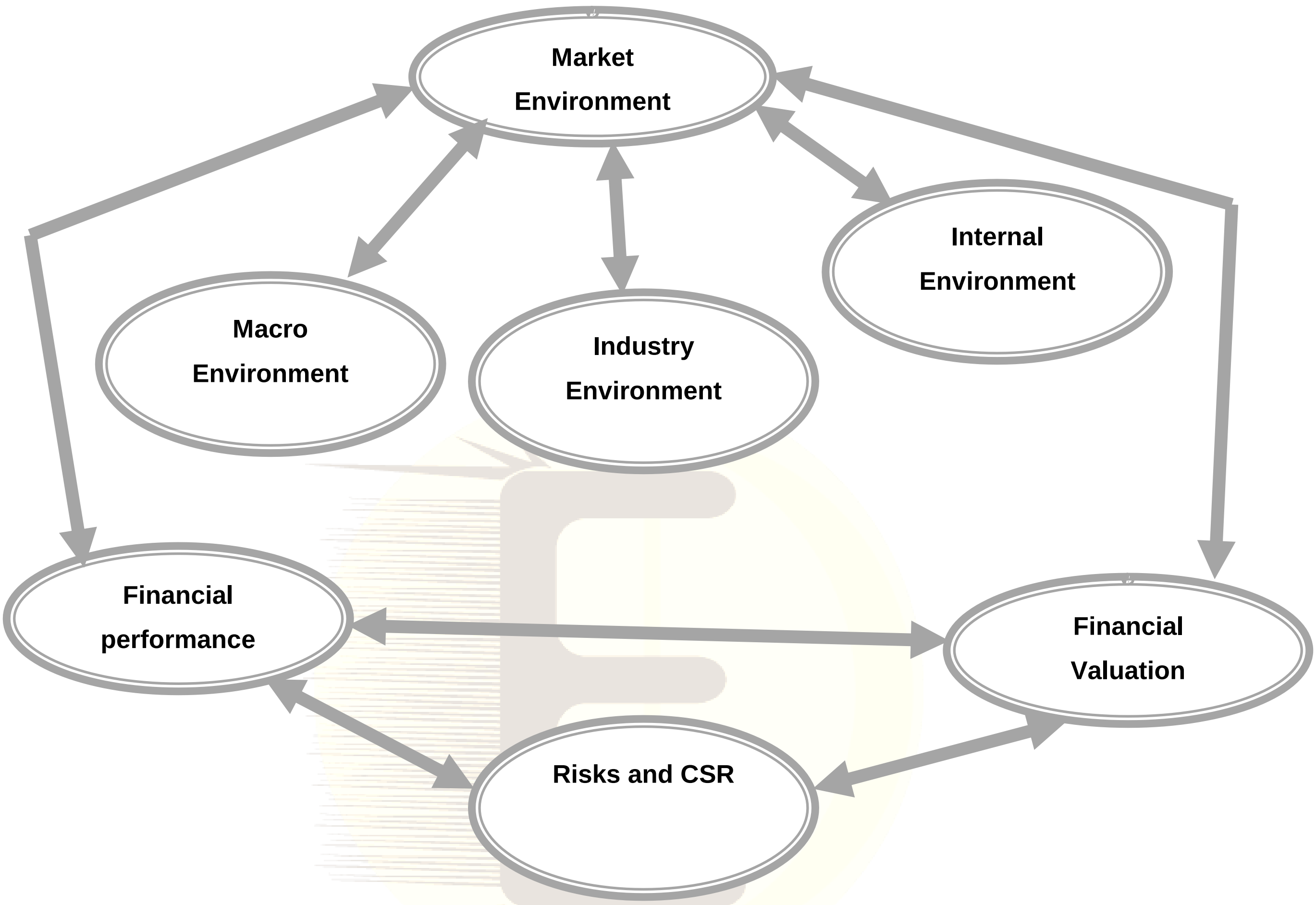
According to Coca Cola HBC (2015), since most of Coca Cola's products are manufactured and sold for specific bottling partners, the organisation adopts a sustained subsidiary and partnership approach. The Coca Cola Enterprise sells the concentrated product to authorised bottling and canning operations who exclusively deal with the Coca Cola product. The focus of this report is on one such partner of Coca Cola.

The focus of this report is on Coca-Cola HBC AG. This organisation is listed on the London Stock exchange as (LSE: CCH). It also has a secondary listing at Athens Exchange (ATHEX: EEE). The organisation is part of the FTSE 100 index and is an industry leader in the UK beverage companies list. The organisation was listed as a key constituent of the 2014, Dow Jones Sustainability Index (DJSI) (Coca Cola HBC, 2015). Coca Cola HBC (AG) is the key bottler and vendor of the Coca Cola products in Europe and Africa. The Coca-Cola HBC is a company which is formed as a result of a merger between Coca Cola Beverages Ltd and Hellenic Bottling Company. The organisation is listed in LSE as its main market but this shift only occurred in 2012.

The organisation markets all products of Coca-Cola including Coca Cola,Coca Cola Light, Coca Cola Zero, Fanta, Sprite, all water related brands of Coca Cola and juices including Minute Maid and Iced Tea. The organisation operates its business through three primary segments including the established market segment, developing countries, and emerging countries.

Reilly and Brown (2011) contend that understand the competitive position of an organisation along with its financial and historical performance is important in determining the effectiveness of its portfolio management process. Furthermore, Grant (2010) also reports that the assessment of organisation's strategy, its financial position, risk management and corporate governance help glean information on the market value and performance of the organisation. The following figure shows the key areas of focus needed in this report.

Figure 1: Report Areas of Focus



Source: Author (2015)

Therefore, this research will consider many of these attributes to arrive at clear implications on the future of the organisation's performance.

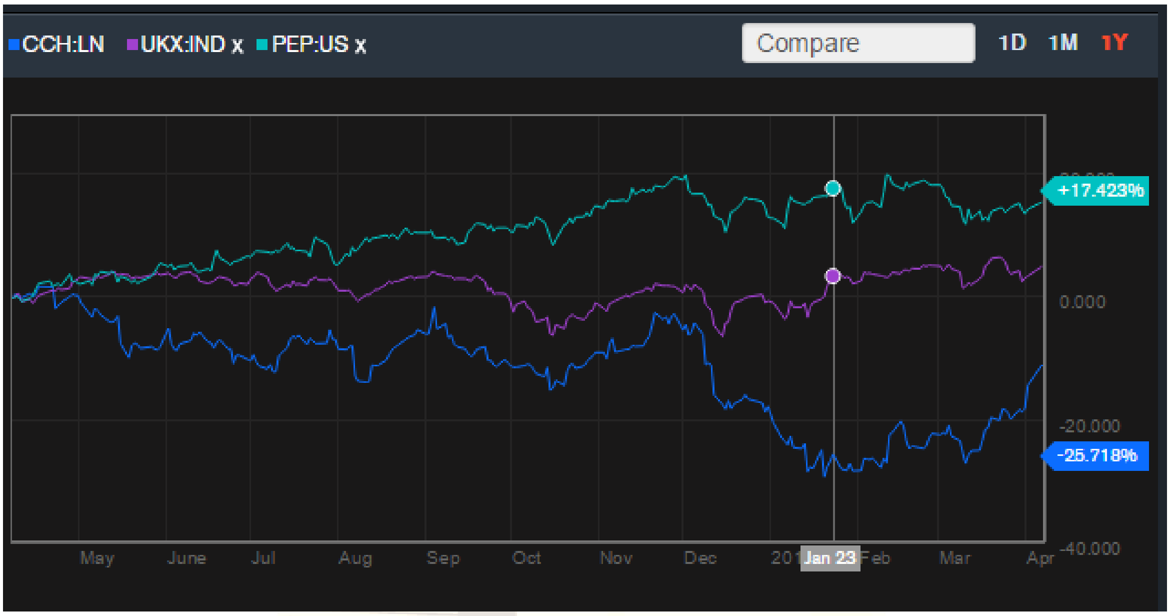
Industry, Economic Outlook and Competition

According to Grant (2010), a key factor that needs to be examined is comprehension of the economic and industrial context of the organisation. The assessment of the economic environment helps provide views on market outlook and market share of the product.

Competition

The top competitors of Coca Cola HBC include Hansen Beverage Company, Danone and PepsiCo at a global level. The following figure presents a comparison of the performance of Coca Cola HBC against that of Pepsi Co and the FTSE 100 index. It is seen that in comparison, to the FTSE 100 index and Pepsico performance, Coca Cola HBC has performed less effectively.

Figure 2: Coca Cola HCN and Competitors Stock Market Performance



Source: FT (2015),

The following table presents a comparison of Coca Cola HBC with Pepsico and Britvic Plc along with the industry average. In comparison to other industries listed on the London Stock Exchange, Coca Cola HBC has a higher market capitalisation and net income.

Table 1: Competitors of Coca Cola HBC and Competitors

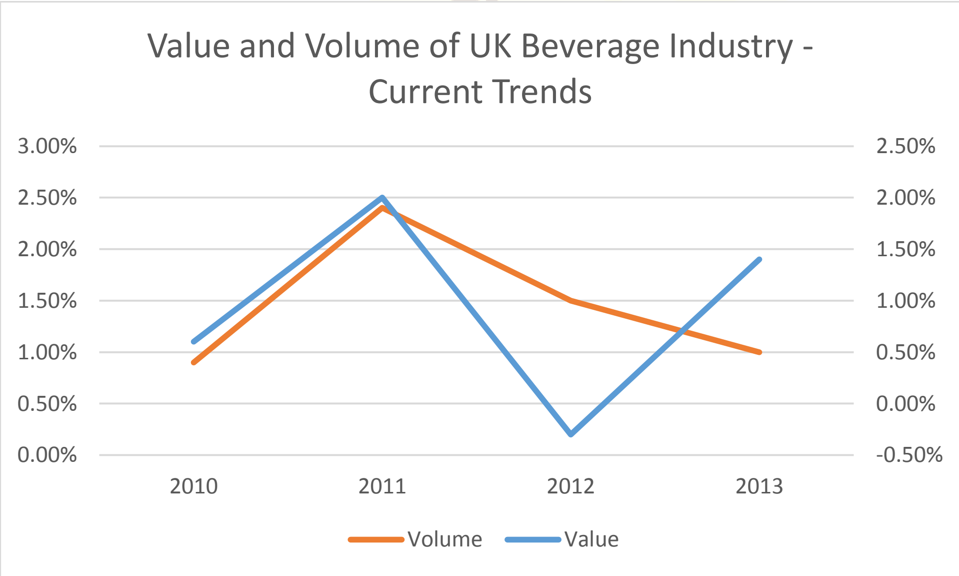
	Market Cap	Net Income
	Mil	**Mil**
Coca Cola HBC	**4,842**	**294**
PepsiCo	1,37,806	6,513
Britvic PLC (GBP)	1,860	89
Industry Average	**22,210**	**974**

Source: Morningstar (2015)

Industry Performance

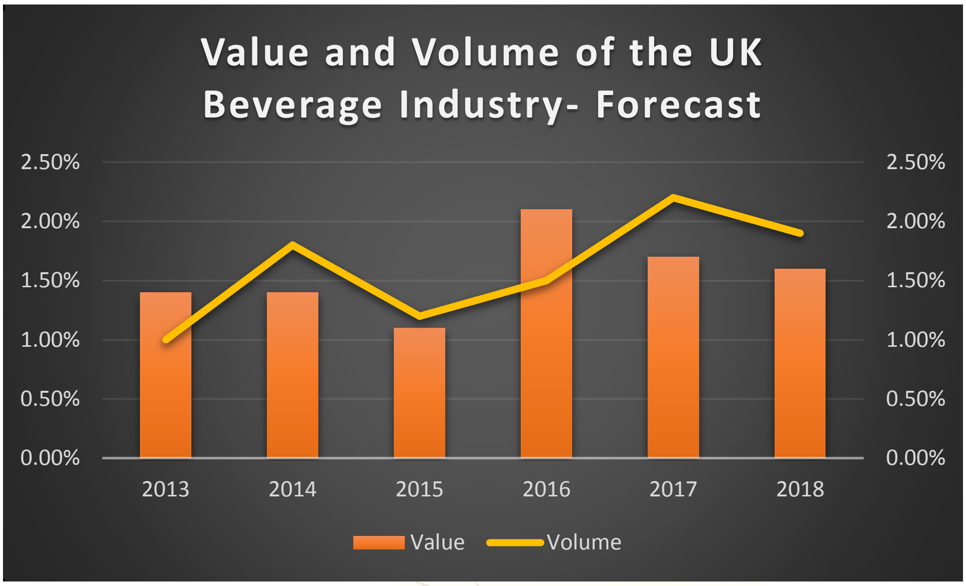
The value of the UK beverage industry can be seen from the following figure. It is evident that overall the industry has grown by 0.9% CAGR in the period 2009-2013. In the same period, the volume growth of the industry was at 1.5%. The forecast of UK beverage industry performance shows higher growth compared to existing values with a 1.6% CAGR for 2013-2018 in terms of value and 1.7% growth during the same period in terms of volume. The following figure present key highlights of this performance.

Figure 3: Value and Volume of UK Beverage Industry - Current Trends



Source: Marketline (2014)

Figure 4: Value and Volume of the UK Beverage Industry- Forecast



Source: Marketline (2014)

Economic Outlook

In general, the economic outlook for the organisation is positive given the recovery of the global economy and the increase in sale of beverages as observed below.

Recovery of the global economy: According to Keynote (2014), the growth of UK economy is moderate with an expected average improvement by 1.7% in 2013 in the UK. The global economy has shown sustained growth during this period. For instance, in the UK the rate of inflation fell by 0.2% in 2013 increasing household disposable income.

Increase in Sale of Beverages: According to Marketline (2014), the UK beverage market had a total revenue of $84.6 billion in 2013. Furthermore, from 2009-2013, there was a 0.9% growth in the market. During the same period, the increase in sale of beverages was higher in the French and the German markets with a 1.2% and a 1.3% growth respectively.

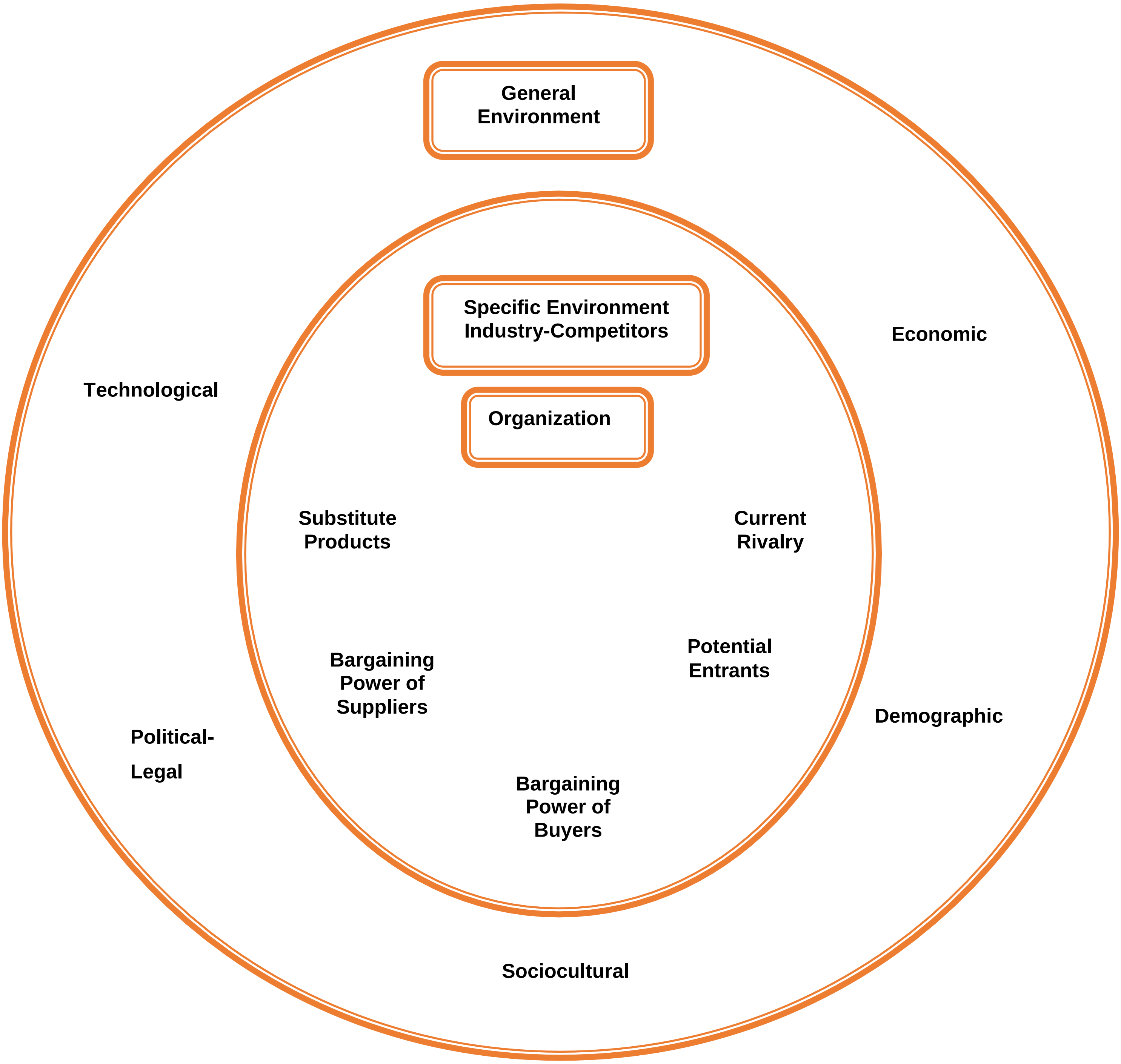
Implication for Coca Cola HBC

From the above assessment of the general competition it is seen that the organisation in general is performing better than its competitors listed on the LSE. The economic outlook for the global beverage industry is optimal along with positive growth in market performance of the industry. Therefore, the general outlook for Coca Cola HBC from this segment is positive.

External Environment Analysis

According to Grant (2010), to understand the true market position of the organisation and its related strategy an examination of the external environment position of the organisation in terms of competitive structure of the industry and the political, environmental, economic, social, technological and legal factors is important. The key factors which are to be examined in the case of Coca Cola is presented below.

Figure 5: External Environment Analysis



Source:

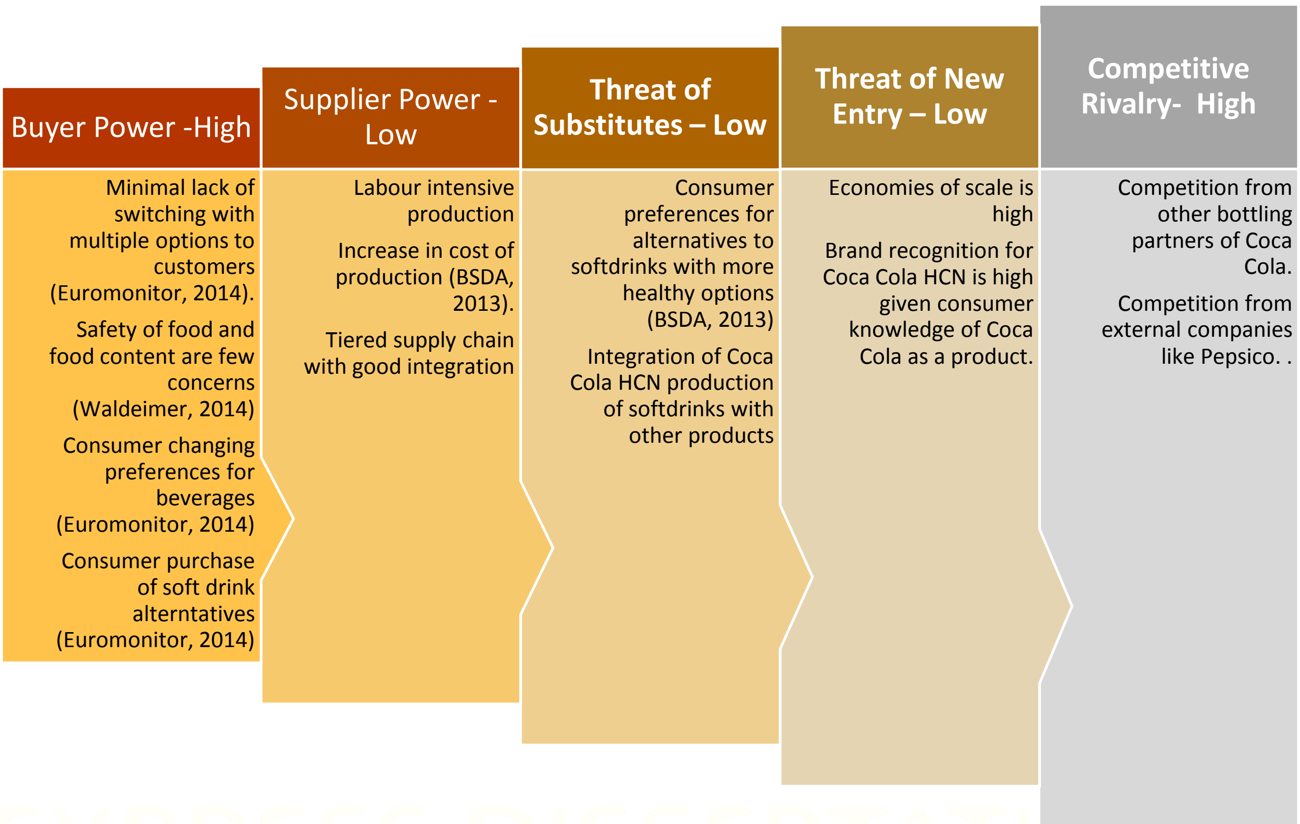
Rivalry in the Market

The purpose of the following table is to present a comparative analysis of the five forces which impact the operations of Coca Cola HBC.

- Worldwide buyer power is high given the limited costs linked to switching. The globalisation of markets has resulted in shift in consumer tastes and requirements (Euromonitor, 2014). Therefore, buyer power is considered to be ↑
- Supplier power assessment shows that in most countries Coca Cola HBC adopts a tiered supply system where the product is bottled and in some cases franchised or promoted by subsidiaries (Marketline, 2014). Therefore, there is significant vertical integration. Therefore, supplier power is considered to be ↓
- Threat of new entrants is moderately less given the large scale integration of incumbents in the market and high economies of scale by Coca Cola HBC and Coca Cola Enterprises. This along with brand recognition is a key factor impacting choice. Therefore, threat of new entrants is considered to be ↓
- Threat of substitutes is seen as many consumers would like to shift away from the drinking of soft drinks given its low health and nutritional value. However since Coca Cola HBC produces both soft drinks and other fruit juices and water, the threat of substitutes is considered to be ↓
- Threat of competitors is moderately high given that Coca Cola HBC operates in competitor with other Coca Cola Partners and its own subsidiaries along with competition from Pepsico and Bretvit Plc in the industry. Therefore, competitive rivalry is considered to be ↑

The detailed assessment of Porter’s Five Forces is given below.

Figure 6: Porter's Analysis



Source:

External Environment Analysis

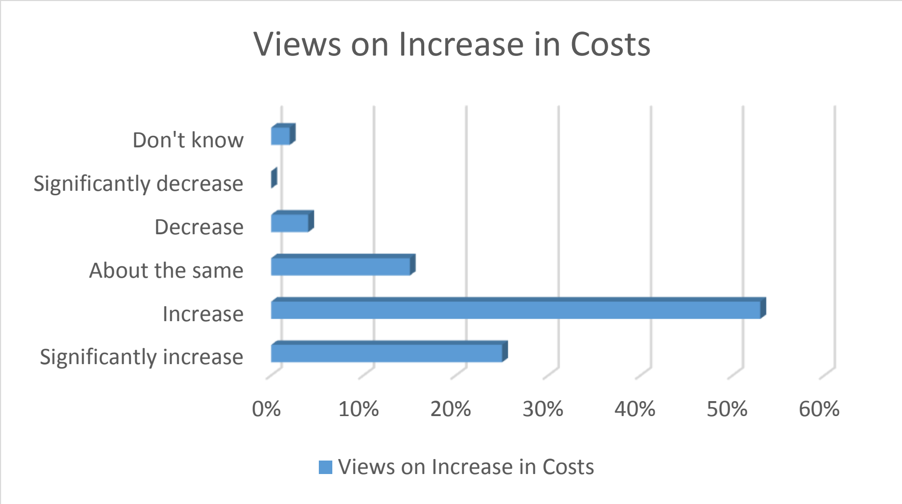
The following table presents a detailed assessment of the environmental performance of Coca Cola HCN.

Table 2: PEST Analysis

PEST Analysis
Cost of Production and Labour Supply Problems (Economic): Allegra (2013) reports that there is an expected increase in cost of labour and associated supply of labour. This can negatively impact supplier and operator costs including that of Coca Cola HCN. The report which examined food and beverage owners concluded that apart from cost of labour there was a 60% identification of skills gap as seen in the figure below.
Population Age (Social): KPMG (2013) reports that there is an increase in the percentage of ageing population in Europe. For instance, the report identifies that by 2030 the number of people who are older than 65 are expected to be 15.5 million in the UK. Therefore, as a player in the beverage market, meeting the needs of such customers is important.
Health Conscious Customers (Social): The focus on health nature of food is a key area of concern for Coca Cola HBC. As Hingley et al. (2010) report, the rise in number of UK customers who look for healthy component of food, it is important for the Coca Cola company to consider alternatives to its soft drinks.
Sustainability is the name of the game (Environmental): Mintu-Wimsatt and Lozada (2013) reports that consumers are looking for food products sourced ethically and therefore a focus on consumer preferences for environmental sustenance is important.
Online Focus (Technology): Smithers (2013) reports that technology innovation including mobile application and social media focus is important to show that the company understands the needs of its customers.
Labelling (Political and Legal): Amendments to food labelling legislation which requires detailed constituents with a focus on reducing intake of excessive sugar (Tarbella, 2015).

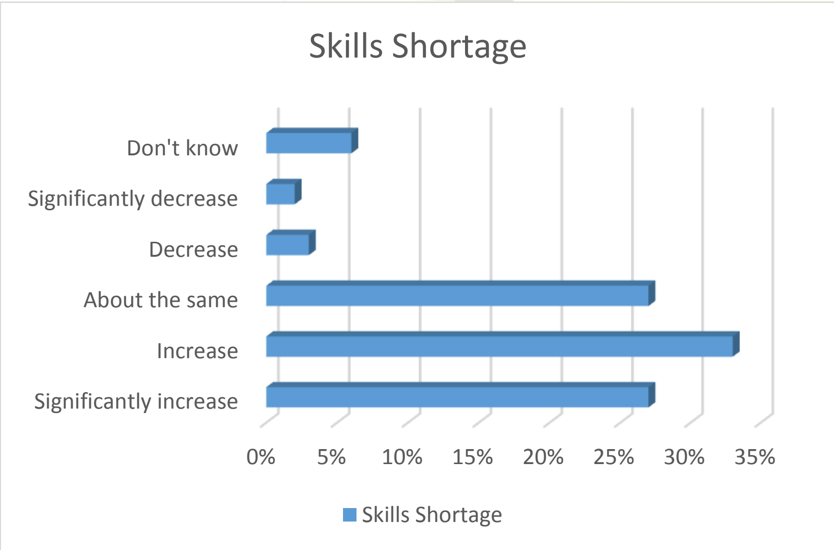
Source: Coca Cola HBC (2013)

Figure 7: Increase in Costs



Source: Allegra (2013)

Figure 8: Skills Shortage



Source: Allegra (2013)

Key Implication

From the Porter's five force analysis it is seen that the buyer preferences are the key threat that the organisation faces. This is supported by the PESTLE analysis. However, the threat from new entrants is low along with threats of substitutes given the diverse product portfolio. Furthermore, it is important to acknowledge that the organisation should look at technology advancement, environmental concerns and social needs. Therefore Coca Cola CCN should look for positive attributes which may contribute to success of the firm in the external environment.

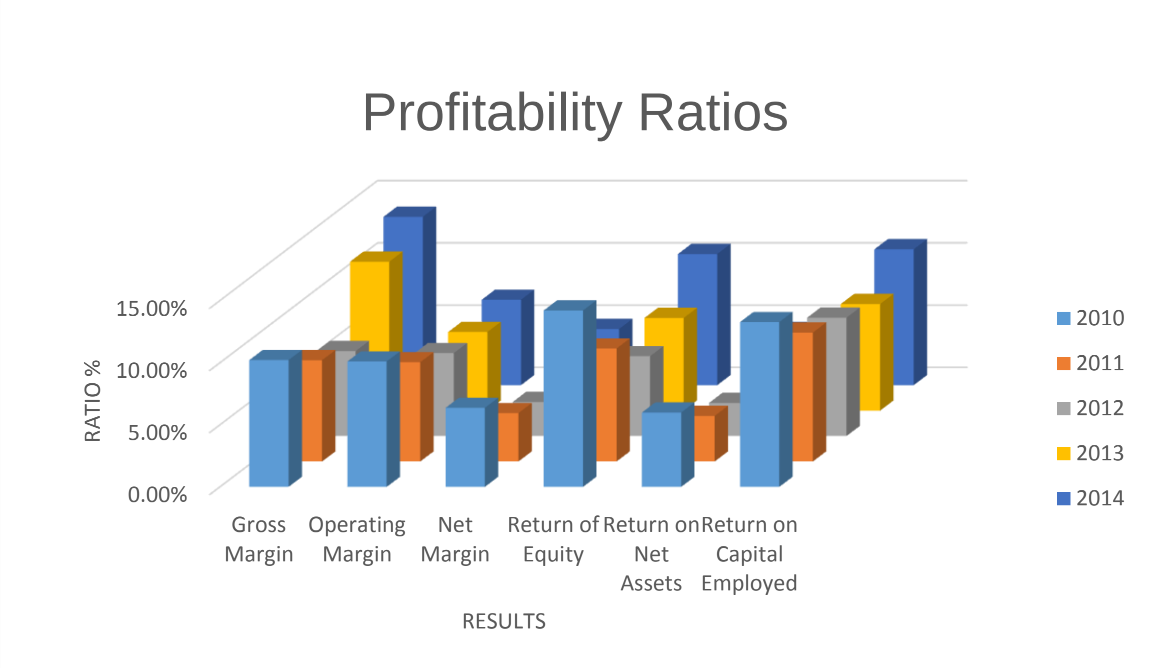
Accounting and Financial analysis

According to Arnold (2008), an examination of the financial data of the organisation from previous years is important. This helps in comparing the effective performance of the organisation with that of its competitors and thereby permit an analysis of the associated strength and weaknesses of the current financial position of the company. The different ratios which are examined in this report and their relevance is given in the following figure. It is important to understand that while ratio analysis provides some positive inputs it is also just historical performance of the organisation. Appendix I gives the formulae of the ratios used in this report. Appendix II presents the detailed ratios of Coca Cola HCN.

Profitability Assessment

- Gross margin: According to Brigham and Erdhardt (2013), the assessment of gross margin of the organisation presents a comparative analysis of the revenue of the organisation after deducting the costs linked to good and service production. The purpose of measuring gross margin is to determine the percentage of sales retained by the organisation. From the following figure, it is clear that the the gross profit margin for Coca Cola HBC has increased from 11.97% to 13.52%. A gradual growth from the drop in 2012 is seen. The fall in 2012 can be attributed to the shift in Coca Cola HCN from the US market to the UK market.
- Operating margin: According to Arnold (2008), the operating margin helps determine the ratio of operating profit to the sales of the organisation. The operating margin considers the income to the organisation before tax is made. The operating profit of the organisation increased from 6.33% in 2013 to 6.86% in 2014. The increase in operating profits is marginal as the organisation had lower net sales revenue driven by lower sales volume in countries like Russia. Furthermore, as Coca Cola HCN (2013) reports, the organisation also faced higher costs of raw material and absolute and unfavourable currency fluctuations which caused only a moderate increase in operating margin.
- Return on Equity: The assessment of ROE helps determine the profit that the organisation made as a share of the shareholder equity (Arnold, 2008). . The return on equity of the organisation increased from 7.54% in 2013 to 10.54% in 2014.
- Return on Capital Employed (ROCE): ROCE provides an assessment of the profits made by the organisation by determining the efficiency with which the organisation has used its capital (Arnold, 2008). The ROCE of Coca Cola HCN increased from 8.58% in 2013 to 10.92% in 2014.

Figure 9: Profitability Ratios



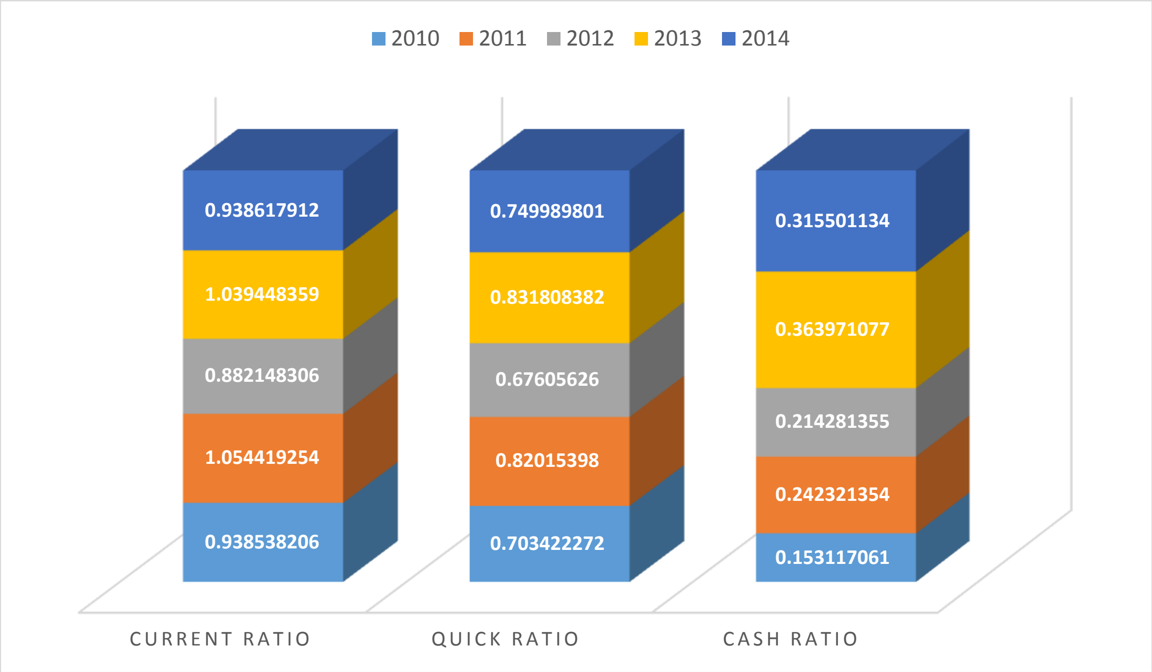
Source: FT (2015), Morningstar (2015) and Coca Cola HBC (2013)

Key Implications: The drop in profitability of Coca Cola in 2012 can be linked to a fall in European market due to the crisis. For instance, Coca Cola HBC (2013) reports that under optimistic conditions, in 2013 despite the fall in operational volume the organisation was able to improve its overall operating profit through efficient management of operating expenses and more importantly leveraging the scale and footprint of the organisation's performance. Furthermore, the organisation was also able to leverage their performance by investing and expanding subsidiary operations in emerging markets.

Liquidity Ratios

- Current Ratio (x): The assessment of liquidity shows the ability of the organisation to meet its immediate and long term obligations (Brigham and Ehrhardt, 2013). The assessment of the quick ratio and the current ratio as seen in the following figure for CCN is effective in understanding current liquidity position. The liquidity of the organisation has dropped moderately from 1.03 in 2013 to 0.928 in 2014. Furthermore, the cash ratio of the organisation also fell from 0.36 in 2013 to 0.31 in 2014.

Figure 10: Liquidity Ratios



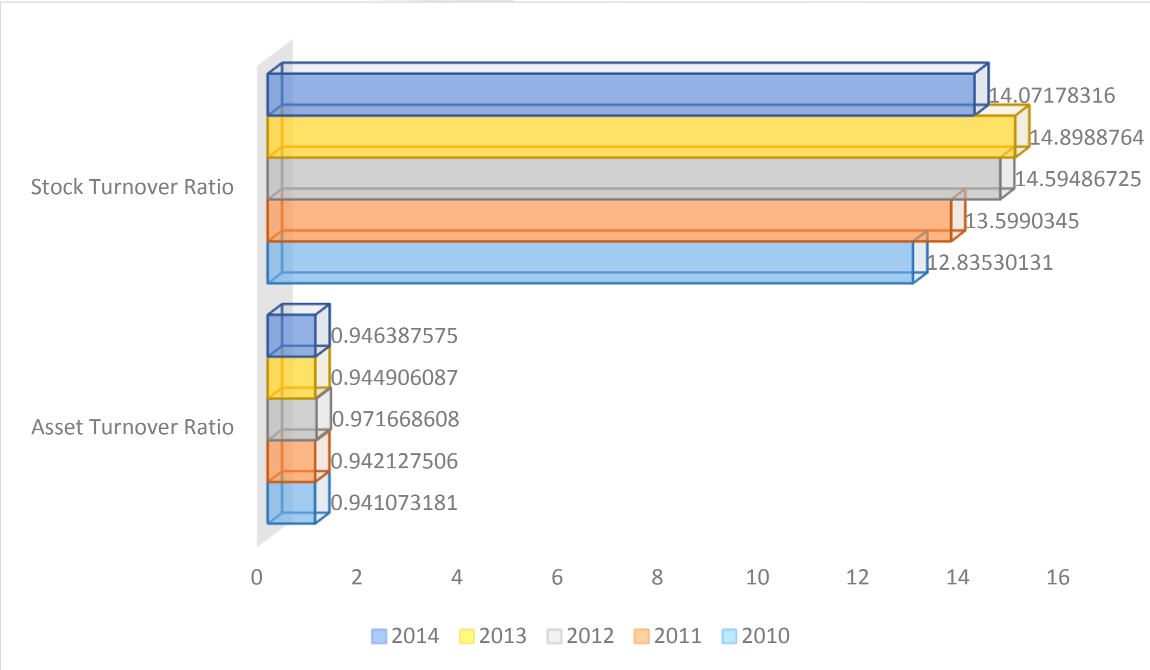
Source: FT (2015), Morningstar (2015) and Coca Cola HBC (2013)

Key Implications: According to Coca Cola HBC (2013) annual report, innovations and technology development are vital in understanding the growth of the organisation. Brigham and Houston (2011) also reports that investments in key sectors is more important. Given the possibility of change in environmental conditions and possible fluctuations in exchange rates along with high competitive rivalry as observed from the PEST and Porter's analysis, this report contends that having positive equity is important. Therefore, positive liquidity ratios present key results.

Efficiency Ratios

- Asset Turnover ratio: The asset turnover ratio identifies how effectively the organisation is able to deploy its assets to bring positive improvements in performance. It is considered as the overall sales or revenue generated for every one dollar of the asset spent. The efficiency of the organisation in terms of asset turnover has remained moderately the same across 2013 and 2014 at 0.94.
- Stock Turnover Ratio: The stock turnover identifies the ability of the organisation to reduce its inventory and thereby is a key indicator of operational efficiency (Brigham and Houston, 2011). The stock turnover on the other hand has reduced from 14.89 in 2013 to 14.07 in 2014. This is linked to improvement in overall efficiency of operations.

Figure 11: Efficiency Ratio



Source: FT (2015), Morningstar (2015) and Coca Cola HBC (2013)

Key Implications: Coca Cola HBC (2013) reports that consolidation of assets has taken place over the years which may account for the more or less steady asset turnover ratios. The organisation was able to consolidate some factories into emerging markets like Poland and expand their businesses into newer sites to meet their requirements. The launch of the may also have impacted the asset turnover

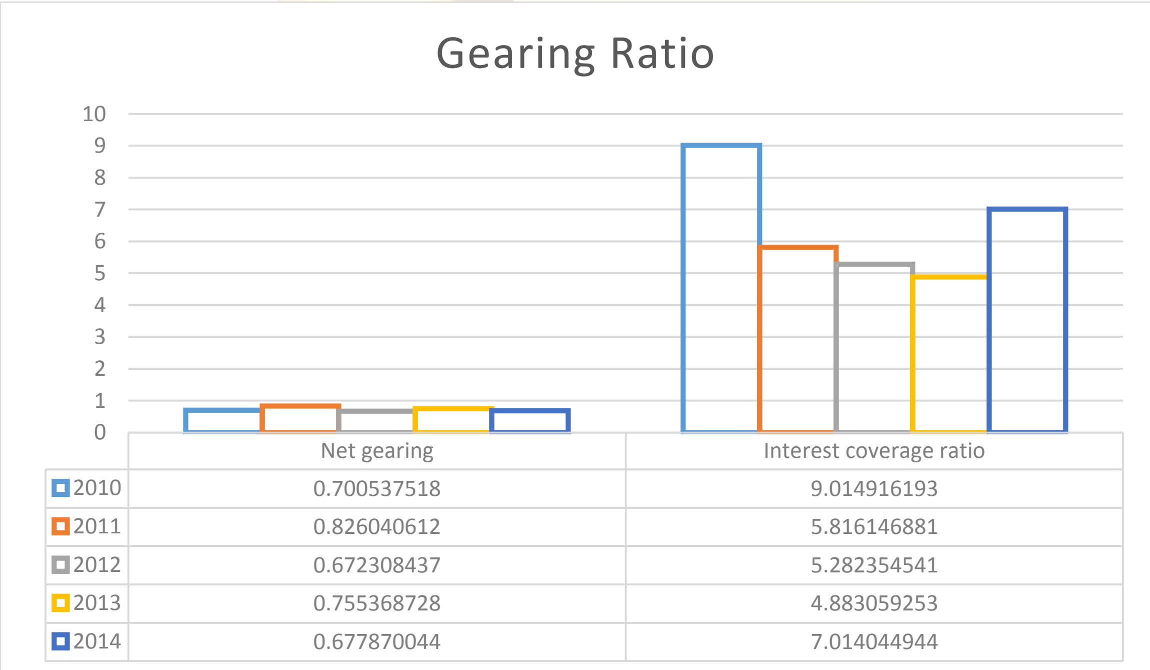
ratio. Furthermore, the annual report also shows that Belarus as an economy showed a 100% net inflation therefore reduction of assets in this section may have contributed to asset consolidation. The organisation has been able to leverage cloud technology in an effective manner for infrastructure optimisation which helps in lowering costs of additional operations.

Gearing Ratio

- Net gearing ratios: Gearings is a term used to understand the efficiency of leverage performance. The Gearings ratio helps understand the degree to which the organisation is able to maintain its capital structure (i.e debt to equity ratio).
- Interest Cover: Interest cover ratio provides an assessment of the ability of the organisation to pay the interest on its debt. A low interest cover indicates signs of financial trouble as the organisation will be unable to borrow if needed (Arnold, 2008).

The gearings has reduced from 0.75 in 2013 to 0.67 which is good. At the same time the interest coverage of the organisation has increased from 4.88 in 2013 to 7.01.

Figure 12: Gearing Ratio



Source: FT (2015), Morningstar (2015) and Coca Cola HBC (2013)

Key implications: The net debt of Coca Cola HBC is aimed at maintaining less than 45% of overall debt. The organisation has 13.3% of its debt in dollars and 63.4% of its debt in Euro. The organisation has its debt in two distinct portfolios including short term debt and long term debt with clear policies for both debt. Furthermore, the overall expenditure on new investments in R&D has also increased significantly. Given the fall in gearings and an associated rise in investment, this report concludes that more loans for R&D developments can be made as only 18% of the investments are made by the customers directly.

Share Valuation Performance

To examine the share valuation and performance firstly a projected income was presented.

Table 3: Projections of Income

		Projections				
		2015	2016	2017	2018	2019
Average five year performance (2010-2014)	Assumption	31-Dec-15	31-Dec-16	31-Dec-17	31-Dec-18	31-Dec-19
96%	Assuming average increase with 2 % growth	5,341.23	5,661.71	6,058.03	6,542.67	7,066.08
95%	Assuming average	5,060.35	5,363.97	5,739.44	6,198.60	6,694.49
11%	Assuming average	640.95	679.41	726.96	785.12	847.93
71%	Assuming Same	280.89	297.74	318.58	344.07	371.60
	Assuming Same as EBIT	**280.89**	**297.74**	**318.58**	**344.07**	**371.60**
	Assumin nil	-	-	-	-	-
-75.33	Assume average	-75.33	-75.33	-75.33	-75.33	-75.33
	Assume same interest coverage ratio	-40.05	-42.45	-45.42	-49.05	-52.98
		165.51	**179.96**	**197.83**	**219.68**	**243.28**
	Same as last year	27.18	29.55	32.48	36.07	39.95
		138.33	**150.41**	**165.35**	**183.61**	**203.34**
		-	-	-	-	-
		138.33	**150.41**	**165.35**	**183.61**	**203.34**
	Same as last year	60.53	65.82	72.36	80.35	88.98
		-	-	-	-	-
		77.80	**84.59**	**92.99**	**103.26**	**114.36**

DCF Valuation

According to Reilly and Brown (2011), the valuation of shares involves the use of financial and accounting data. The need for valuation is to identify the sale of shares by one person to another, to identify future trends for mergers or acquisitions or for purchase of large amount of shares in private companies.

This research uses the DCF valuation approach to identify the attractiveness of investment opportunities linked to a particular investment. The use of the DCF method involves the use of future cash flow projections and discounts to identify present value. The use of the DCF method in this report calculates NRR as the 1/PE ratio. It is seen that if thereis assumptions of no increase in average EPS growth in the last seven years the share price valuation of 18.49 can be arrived at.

The following table presents the valuation of shares.

Table 4: DCF Method

1. DCF Method			
in MN			
Profits for the future	Amt	Discounted at NRR	DCF
2015	77.80	0.96	74.48
2016	84.59	0.92	77.53
2017	92.99	0.88	81.60
2018	103.26	0.84	86.75
2019	114.36	0.80	91.97
Perpetual value	7,863	0.80	6,323.68
Total			**6,736.00**
Shares outstanding			364.37
Value per share			**18.49**
NRR is 1/PE Ratio i.e 25%			
Current PE Ratio		22	
NRR		4.45%	4.454343
Growth		3.0%	(Assuming seven year EPS

			growth average)

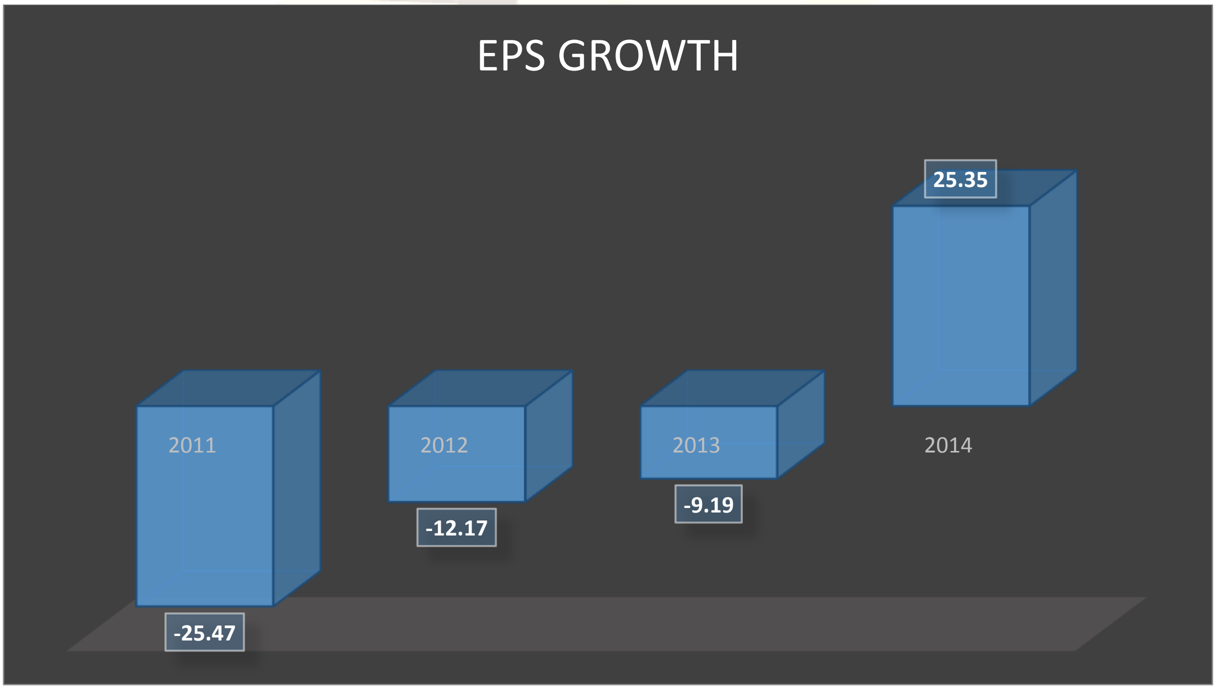
Key Implications: From the above table it is clear that the organisation is expected to have a positive valuation in the next five years. The presence of a positive five year performance in terms of financial ratios as well as future forecasts of valuation shows that the organisation has a positive future growth.

Investor Importance Ratios

Investor Ratios Assessment

According to Brigham and Houston (2011), the EPS growth of the organisation has been negative over the last three years has been negative. However, 25.35% growth in 2015 is clear.

Figure 13: EPS growth



Source: Morningstar (2015)

The above table compares the performance of Coca Cola HBC with that of its competitors. It is seen that the P/E ratio of Coca Cola HBC is higher than that of its LSE listed competitor at

20.7. It is also seen that the growth of Coca Cola HBC in terms of five year revenue is at 5.6% which is higher than the industry average of 3.2%. Similarly the debt equity ratio of Coca Cola is at 0.6 when compared to Britvic Plc which has 6.5. Therefore, performance is better.

Table 5: Industry Comparison

	P/E	Dividend Yield%	5-Yr Rev CAGR%	Med Oper. Margin%	Interest Coverage	D/E
Coca Cola HBC	**21.9**	**2.1**	**5.6**	**5.6**	**6.2**	**0.6**
PepsiCo	22.9	2.7	9.1	14.4	10.6	1.4
Britvic PLC (GBP)	20.7	2.8	6.6	8.6	5.7	6.5
Industry Average	—	—	**3.2**	**10.7**	**23.2**	—

Risk Assessment

Liquidity risk, Exchange risk and Credit risk are the three important risks that the organisation faces.

- According to Coca Cola HBC (2013), the liquidity risk of the organisation is a factor that should be considered given the wide range of countries which the organisation operates. It is clear that the organisation is able to manage its liquidity risks based on sufficient funds that it has a strict capital structure
- Another key risk that the organisation faces is the foreign exchange risk where changes in exchange currency rates between the Euro and US dollar along with currencies in non-Euro territories is faced. To overcome this risk, the exposure that the organisation has is high especially when the raw material is purchased from a foreign market where there is no operation (Coca Cola HBC, 2013).

- Finally, the credit risk faced by the organisation needs to be examined to ensure that if the counterparties are unable to perform their obligations then the group should be able to bear the losses. To reduce the impact of the risk proper assessment of credit rating of the parties is carried out and credit limits are set (Coca Cola HSB, 2013).

Corporate Governance

According to Bauer et al. (2004) the portfolio management of the organisation and the investor performance also requires a detailed assessment of how the organisation is able to maintain its code of governance. The governance structure is a bit different at Coca Cola HBC. For instance, the remuneration committee which is independent and non-executive does not decide the compensation of the organisation. The organisation follows European rules where the entire board gets together to decide remuneration. This is a negative factor which may have impact on the organisation's view in the industry (Coca Cola HBC, 2013).

Key Implication: The organisation has performed well in the market with a moderately high P/E and is part of the FTSE index. However, the recovery in EPS performance is found to be recent. Furthermore, the organisation also has low debt/equity and has good interest cover. The risks of the organisation are understood and are often focused on to help reduce impact. Furthermore, the governance is slowly changing from a Euro structure to the UK structure which needs to be examined in detail by investors.

Conclusion

The organisation has performed moderately well in the market with a marginally high P/E ratio. Furthermore, it is argued that the organisation has shown a moderate increase in price since the recession recovery in 2013. The financial position of the organisation is effective and most importantly the organisation has a positive five year share valuation. However, this report also cautions that changes in economic climate, recent shift to the LSE without complete following of UK code of conduct in corporate governance and possible negative growth in emerging markets of Eastern Europe makes it important to hold the stock. Therefore, this report recommends holding the stocks of Coca Cola.

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Appendix – I

Ratio Analysis

S No	Ratio	Formula
	Profitability Ratios	
1	Gross Margin	Gross Profit/Net Sales
2	Operating Margin	Operating Profit/Net Sales
3	Net Margin	Net Profit/Net Sales
4	Return on Equity	Net Income/Equity
5	Return on Net Assets	Net Income/(Fixed Assets+Working capital)
6	Return on Capital Employed	EBIT/Capital Employed

Appendix II

Calculated ratios

Ratio	Result				
	2010	2011	2012	2013	2014
Profitability Ratios					
Gross Margin	10.22%	8.16%	6.84%	11.97%	13.52%
Operating Margin	10.11%	7.99%	6.68%	6.33%	6.86%
Net Margin	6.37%	3.89%	2.75%	3.22%	4.52%
Return on Equity	14.21%	9.10%	6.43%	7.45%	10.54%
Return on Net Assets	5.99%	3.67%	2.67%	3.04%	4.28%
Return on Capital Employed	13.27%	10.38%	9.53%	8.58%	10.92%
Liquidity Ratios	2010	2011	2012	2013	2014
Current Ratio	0.938538	1.054419	0.882148	1.039448	0.938618
Quick ratio	0.703422	0.820154	0.676056	0.831808	0.74999
Cash Ratio	0.153117	0.242321	0.214281	0.363971	0.315501
Efficiency Ratio	2010	2011	2012	2013	2014
Average Collection Period	60.31893	59.06369	53.16957	51.32495	53.49263
Average Payment Period	120.9497	109.4371	120.9391	116.0139	130.3443
Efficiency ratio	2010	2011	2012	2013	2014
Asset Turnover Ratio	0.941073	0.942128	0.971669	0.944906	0.946388
Stock Turnover Ratio	12.8353	13.59903	14.59487	14.89888	14.07178
Gearing Ratio	2010	2011	2012	2013	2014
Net gearing	0.700538	0.826041	0.672308	0.755369	0.67787
Interest coverage ratio	9.014916	5.816147	5.282355	4.883059	7.014045