Financial Analysis of the Coca-Cola Company

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**Horizontal Analysis**

Coca-Cola’s profitability and financial position suffered in 2020 due to the global health pandemic. The company’s performance in FY2020 is analyzed using horizontal and vertical analyses as well as financial ratios to inform the choice of strategies to improve Coca-Cola’s performance in upcoming periods. Looking at the trend in income statement accounts, the company experienced an 11.4% decrease in revenue. In comparison, Coca-Cola’s revenue increased by 8.6% in 2019; thus, the decline in sales can be attributed to lower demand as people visited grocery stores less and household income fell with the rise of unemployment. Even though both costs of goods sold and selling and administrative expenses decreased during the pandemic, the decrease in the cost of goods sold was disproportionately lower than the decrease in revenue as is evident from the vertical analysis: the cost of goods sold was equivalent to 40.7% of sales in 2020, compared to the 39.2% of sales in 2019. The higher cost of goods sold to sales ratio in 2020 can be attributed to the supply chain bottlenecks that resulted from the enforcement of dissimilar restrictions on movement across US states and more restrictive measures enforced in other countries where Coca-Cola operates.

Coca-Cola’s management significantly scaled back spending on selling, general and administrative expenses with SG&A expenses being equivalent to 29.5% of total revenue in 2020 compared to 32.5% in 2019. The commendable control of SG&A expenses allowed the company to increase its operating margin slightly from 27.1% to 27.3% in 2020. However, Coca-Cola’s interest expense increased by 52% in 2020 and was equivalent to 4.4% of revenue compared to the 2.5% of revenue in 2019. The substantial increase in interest expense suggests that Coca-Cola experienced cash shortfalls in 2020 that necessitated an increase in the level of borrowing. This was in fact the case as is evident from the 45.8% increase in long-term debt, with LTD making up 46% of assets, compared to 31.9% in 2019.

Furthermore, Coca-Cola’s income taxes increased by 10% in 2020, despite the decrease in revenue. The increase in tax expense in a period of falling revenues is unprecedented and was investigated further. The higher tax burden can be attributed to a ruling by the November 2020 US tax court that required the company to make tax back payments worth $3 million and correct its method of accounting for transfer payments from affiliates in upcoming periods (Radziewicz, 2020). The net income to sales ratio (profit margin) decreased from 23.5% to 24.1%: the decrease in profitability was mitigated by the close control of operating expenses during the period of decreasing income and could have been controlled further if the company’s interest and income tax expenses did not increase in 2020.

**Liquidity Analysis**

In 2020, Coca-Cola’s current and quick ratios were 1.318 and 0.963, signifying an improvement in liquidity when compared to 2019 when the liquidity ratios were 0.757 and 0.562, respectively. The company’s higher liquidity can be attributed to the increase in the year-end cash balance ($315 million higher in 2020) from the proceeds of long-term borrowing. Compared to the industry, Coca-Cola was more liquid both in terms of the current and quick ratios: a typical firm in the industry was able to cover its current liabilities using current assets 1.1 times, compared to Coca-Cola’s 1.3 times.

A company’s liquidity as measured by the current ratio could appear higher than competitors’ liquidity if its inventory turnover is low and it holds a large inventory balance. Thus, for manufacturing and merchandising companies, the quick ratio, which assesses a company’s ability to meet its short-term obligations using its most liquid assets, is a better measure of liquidity (Ross, Westerfield & Jaffe, 2019). At the end of 2020, Coca-Cola was in a position to repay 96.3% of its current liabilities using its most liquid assets – cash, short-term investments, and accounts receivable. In comparison, the average company in the non-alcoholic beverages industry could cover 62.6% of current liabilities using the most liquid current assets. Overall, Coca-Cola showcased high short-term solvency in 2020.

**Asset Management**

Coca-Cola’s asset use efficiency was evaluated using the asset, receivables, and inventory turnover ratios. The company’s asset turnover ratios deteriorated in 2019 with total asset turnover decreasing from 0.44 to 0.38 while fixed asset turnover decreased from 3.65 to 3.06. This was expected given the decrease in demand and the ill advisability of disposing of assets in low demand periods when sales are expected to recover in future periods. However, Coca-Cola’s asset use efficiency was lower than the industry average: typically, companies in the industry realized $0.52 and $3.79 in revenue for every dollar of asset and fixed asset investment compared to Coca-Cola’s $0.38 and $3.06, respectively.

The company’s cash management also deteriorated in 2020 with days sales outstanding increasing from 33.10 to 36.11 days while the inventory turnover decreased from 4.33 to 4.11 times. Compared to the industry average, Coca-Cola’s receivables period was longer by 4 days while the company held inventory before converting it to sales for approximately 25 more days than the average company in the industry. The longer days in inventory and receivables have negative implications for Coca-Cola’s profitability since cash that could be used in other profit-generating projects is tied up in customers’ debt and inventory (Ross et al., 2019). Furthermore, the poorer cash management increases Coca-Cola’s reliance on debt to boost its liquidity ratios: this is evident from the jump in the current and quick ratio following the $12,609 increase in long-term debt.

**Debt Management**

Coca-Cola’s total debt ratio remained constant at 76% in 2020 despite the 46% increase in long-term debt. This was possible due to the substantial decrease in current liabilities and the increase in total stockholders’ equity. While the 76% of debt financing seems excessive, Coca-Cola was less indebted than the average company in the industry whose assets were 80% debt financed. Coca-Cola’s better solvency compared to the typical firm in the industry is further evidenced by its higher times interest earned. The company could cover its interest expense using operating income 6 times over, compared to the 5.8 times by the average industry. However, the company’s times interest earned deteriorated from 10.66 times in 2019 signifying higher business risk, given the fixed nature of interest expense (Ross et al., 2019).

**Profitability**

The company was less profitable in 2020 compared to 2019 but more profitable than the average company in the industry. From the profit margin, Coca-Cola realized $0.235 in net income for every dollar of sales in 2020, only slightly lower than the $0.241 realized in 2019. In comparison, the typical participant in the industry recorded $0.126 in net income for every dollar of sales. Coca-Cola’s high-profit margin compared to competitors and the slight decrease in the profit margin despite the sharp decrease in revenue is a testament to management’s sound cost control practices. The company’s ROA and ROE decreased by a larger margin than the profit margin due to the increase in total assets and equity. However, Coca-Cola’s return on investment ratios were considerably higher than competitors: the company realized $0.089 and $0.365 in net income for every dollar of asset and equity invested compared to the industry average of $0.057 and $0.113, respectively.

**Market Value**

Market value ratios compare the company’s performance to equity investors’ valuation and expectations about the future valuation of the company. Coca-Cola’s price-earnings (P-E) ratio increased from 24.19 to 27.62 in 2020. The higher price-earnings ratio signified increasing investor confidence in Coca-Cola’s recovery and future profitability as they were willing to pay 27.62 times the company’s EPS for a share compared to the 24.19 times paid in 2021 (Ross et al., 2019). Compared to the industry average of 57.4, Coca-Cola’s P-E ratio is significantly lower than its competitors. While investors are optimistic about the company’s future profitability, their expectations for the improved profitability of Coca-Cola’s competitors are higher. Coca-Cola’s market-to-book value fell slightly from 10.3 to 10.08 in 2020 but remained higher than the industry average ratio of 3.43. The higher M/B ratio, when compared to competitors, is expected given Coca-Cola’s higher brand worth, which is reflected in its share price but not on the financial statements.

**Conclusion and Recommendations**

Coca-Cola is lagging behind its competitors only in the asset efficiency ratios. The company is significantly more profitable than the average competitor while maintaining lower levels of indebtedness. While Coca-Cola was more liquid than its competitors in 2020, the high liquidity appears to stem from the high proceeds from long-term borrowing and short-term solvency could fall below competitors in future periods. Suppliers and short-term lenders pay close attention to liquidity estimates and significantly lower liquidity compared to the industry could result in worse credit terms from both suppliers and lenders as compensation for the higher risk of extending credit to a relatively insolvent firm. Since liquidity and asset use efficiency, more so receivables and inventory, are closely related, the company could address the potential decline in liquidity and its poor asset management at a go. Coca-Cola should structure its operations including its credit terms and production schedules to improve its asset use efficiency. The company could achieve a shorter receivables period by providing discounts for early payment and decreasing its payables period using lean production techniques. The improvement in asset use efficiency will also improve the company’s liquidity without the need for short-term debt, consequently improving profitability by decreasing the interest expense.

References

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Education.