Coke is one of the most, if not the most, recognized brands in the world. As a stock, The Coca-Cola Company (KO) is a blue-chip Dividend Aristocrat that has increased its dividend for 56 consecutive years. The company is A+ rated by S&P Capital IQ, offers a current dividend yield of 3.6% and a market cap of more than $184 billion. Even though nothing that I’ve said so far is likely to be news to most people, there is a reason for me mentioning these things.

Given the quality characteristics of Coca-Cola mentioned above, the company has enjoyed a legacy of being more highly valued by the market than most companies with similar fundamental growth rates. Since 1999, operating earnings growth has averaged 5.7% per annum. However, over that same timeframe, the company’s dividend growth rate has averaged 8.9%.

This discrepancy between earnings growth and dividend growth can be partially explained by a significant increase in the company’s payout ratio since 1999. Over most of that time frame, Coca-Cola was paying out approximately half of their earnings to shareholders in the form of dividends. That number ranged from a low of 45% to a high of 55%. However, starting in 2014 Coca-Cola’s dividend payout ratio increased to 60% and has continued its upward trajectory to over 77% for fiscal 2017.

On the other hand, I think investors should be careful not to assume that Coca-Cola has suddenly become more generous with their dividend income. As previously mentioned, the company has increased their dividend every year. Nevertheless, the increasing dividend payout ratio is also related to Coca-Cola generating negative earnings growth of -1% per annum since 2014.

FAST Graphs analyze out loud video: Valuing Coca-Cola in Multiple Ways

There are numerous ways to examine and then ascertain the fair value of a business public or private. I am often asked what do I think is the best metric to use when trying to determine fair value? My answer to this question is simple and straightforward. I believe that investors should evaluate any stock they are examining over as many valuation metrics as they can. Therefore, my stock answer is to utilize every valuation resource at your disposal.

In addition to providing different perspectives on the relative valuation of a given stock, examining various metrics can also provide insights into the company’s operating strengths and/or challenges. Moreover, in addition to simply trying to ascertain valuation, I believe that examining various metrics also affords insights into important considerations such as dividend coverage. In other words, is the dividend safe and can it be expected to continue growing? Finally, examining numerous metrics provides a perspective on whether (or not) the company in question is worthy of a more comprehensive research effort.

Consequently, the following analyze out loud video will look at Coca-Cola’s valuation and the safety of its dividend utilizing numerous metrics. These will include adjusted and GAAP earnings, operating and free cash flow as well as EBITDA. I will also look at important underlying financial numbers associated with the company’s financial statements.

Summary and Conclusions
In many ways, Coca-Cola is a tale of two investments. On the one hand, the company has produced an impeccable and even enviable record of consistent and above-average dividend growth. Although their operating history has also been reasonably consistent, it has not been as solid as their dividend record. However, the quality of this worldwide and highly recognized brand is really beyond question or challenge.

On the other hand, Coca-Cola has also been historically highly valued by the market beyond what other companies with similar fundamental characteristics have enjoyed. As a result, these high valuation headwinds have precluded Coca-Cola from outperforming the general market over the long run. Stated more directly, Coca-Cola has not been able to grow fast enough to overcome the headwinds that high valuation has caused.

Nevertheless, due to the company’s long-term reputation, many investors may have been surprised to see how poorly the company has performed relative to the market since the beginning of 1999. However, I believe it’s extremely important also to recognize why Coca-Cola’s stock performance has not kept pace with the overall market.

In the video I illustrated how high valuation has been Coca-Cola’s worst enemy. In one sense, management teams might like to see their companies overvalued by the market because this usually reflects good short-term performance relative to operating performance. However, longer term high valuation makes it almost impossible for management to reward shareholders relative to their business results.

Nevertheless, Coca-Cola does seem to currently offer conservative investors an above-average dividend yield at a valuation that is aligned with historical norms for this company. However, I believe that investors should also be cognizant of the possible risk of long-term underperformance. Consumer sentiment towards sugary soft drinks has certainly changed in recent years. The question is whether companies like Coca-Cola can adapt to these changing tastes? The company’s enormous financial resources and strengths at least give them a fighting chance. Caveat emptor.

In case you missed them, here are links to Part 1 on General Mills (GIS), Part 2 on Kimberly-Clark (KMB), Part 3 on 3M (MMM), Part 4 on Campbell Soup (CPB), Part 5 on Procter & Gamble (PG) and Part 6 on PepsiCo.

Disclosure: No position.
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