BEHIND THE NUMBERS
Quality of Earnings Analysis
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The Coca-Cola Company (KO)
Earnings Quality Update- 3/22 Qtr.

6- Exceptionally Strong
5- Strong
4- Acceptable
3- Minor Concern
2- Weak
1- Strong Concern
+ quality improving
- quality deteriorating

We are maintaining our earnings quality rating of KO at 3- (Minor Concern).

For an explanation of the EQ Review Rating scale, please refer to the end of this report.

Summary

KO's 64 cents of non-GAAP EPS beat forecasts by 6 cents. The company did not boost guidance for revenue, organic growth, or EPS. Some of that is due to stopping business in Russia which KO estimates will cost it 4 cents and Chinese lockdowns could be a headwind. We noted that:

- Depreciation and Amortization declined by $42 million y/y and $17 million sequentially, this added 0.8 cents to EPS.

- Bad debt reserves declined by $4 million on a 32% increase in receivables. Had the reserve stayed the same percentage as December, EPS would have been 2.7 cents lower.

- Stock compensation did increase and was a 0.5-cent headwind.

- Organic revenue growth was heavily influenced by a 19% price hike taken in Latin America. We regard that as low-quality because it is due to hyperinflation in Argentina and should be viewed net of the FX loss. In all foreign markets, KO's FX hit was larger than its pricing gains except in Latin America. The comps for Latin America get increasingly tougher for the 2Q and 3Q when volume, pricing and FX were all positive in 2021.

Latin America	1Q22	4Q21	3Q21	2Q21	1Q21
Volume Growth	20%	-10%	11%	29%	2%
Pricing Growth	19%	11%	23%	9%	7%
FX	-6%	1%	7%	3%	-10%

- Inventory issues remain a risk in our view. DSIs declined by 5.5 days y/y from 85.9 days to 80.4 and total inventories rose only 11% on 8% case volume growth. Inflation is likely running much hotter than 3%, and we believe KO is benefitting on margins by not replacing as much inventory and lets unit stocks decline. We noted earlier that DSIs look about 10-days too low, now that is 15-days lower than normal.

- Non-GAAP gross margin was down again too despite the hefty price hikes. Gross margin fell from 61.6% in 1Q20 to 60.6% in 1Q21 to now 59.7% in 1Q22.

Explanation of EQ Rating Scale

6- (Exceptionally Strong)- Indicates uncommonly conservative accounting policies to the point that revenue and earnings are essentially understated relative to the company's peers. Higher possibility of reporting positive earnings surprises

5 (Strong)- Indicates the company has no areas of concern with its reported results and we see very little risk of the company disappointing due to recent results being overstated from aggressive reporting in recent periods.

4 (Acceptable)- Indicates the company may have exhibited a minor “red flag”, but the severity of the issue is not yet a concern. Minimal risk of an earnings disappointment resulting from previous earnings or cash flow overstatement

3 (Minor Concern)- Indicates the company has exhibited either a larger number of or more serious warning signs than companies receiving a 4. The likelihood of an immediate earnings or cash flow disappointment is not considered to be high, but the signs mentioned deserve a higher degree of attention in the future.

2 (Weak) Indicates the company’s recently reported results have benefitted materially from aggressive accounting. Follow up work should be performed to determine the nature and extent of the problem. There is a possibility that upcoming results could disappoint as the impact of unsustainable benefits disappears.

1 (Strong Concern)- Indicates that the company’s recent results are significantly overstated and that we view a disappointment in upcoming quarters is highly likely

In addition to the numerical rating, the EQ Review Rating also include either a minus or plus sign. A minus sign indicates that our analysis shows the overall earnings quality of the company has worsened since the last review and there is a possibility the numerical rating will fall should the problem continue into upcoming quarters. Likewise, a positive sign indicates that the overall earnings quality is improving, and the company may see an upgrade in its numerical rating should the trend continue.

Key Points to Understand About the EQ Score

The EQ Review Rating is much more than a blind, quantitative scoring method. While we utilize proprietary adjustments, ratios, and methods developed over decades of earnings quality analysis, the foundation of all of our analysis is reading recent SEC filings, press releases, conference call transcripts and in some cases, conversations with managements.

The EQ Review Rating is not comparable to a traditional buy/sell rating. The Rating is intended to specifically convey the extent to which reported earnings may be over/understated. Fundamental factors such as forecasts for future growth, increasing competition, and valuation are not reflected in the rating. Therefore, a high score does not in itself indicate a company is a buy but rather indicates that recent results are a good indication of the underlying earnings and cash generation capacity of the company. A low score (1-2) will likely result in us performing a more thorough review of fundamental factors to determine if the company warrants a full-blown sell recommendation.

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