Price earning ratios comparison: coca cola and pepsi

Earnings per Share: In 2006, the Coca Cola’s EPS was lower than its main competitor. In this year, Coca Cola made a donation of approximately $100 million to Coca Cola Foundation; it also incurred $185 million of additional operating charges. These two outstanding expenses had reduced its profitability in 2006. In 2007, Coca Cola’s EPS rose by 20%. Because Coca-Cola Company generated between 70-75% of its revenue outside of the U. S, the strong economic growth in the international market in 2007 had certainly contributed to the growing revenues and net earnings. In 2008, the year where recession hit (see figure 1. 1), net earnings fell by $174 million. Due to this economic downturn, Coca-cola suffered a loss of $874 million from its equity investments which reduced net earnings. In 2008, also, Coca Cola’s revenues dropped. The reason of this falling net revenue was because in the second half of 2008, the U. S dollar strengthened which lower the other countries’ currencies values (see figure 1. 2). Therefore, the dollar value of revenues generated abroad was reduced by this strong U. S dollar.

Price Earnings Ratio: The trend of PE ratio relatively follows that of EPS: it increased in 2007 and decreased in 2008. At the end of 2007, investor’s confidence was driven up by the fact that Coca-Cola Enterprise, which was an independent bottler, marketer, and distributor of noncarbonated drinks, had a significant sales growth and profitability in its European market specifically in tea and juice based products. Thus, Coca Cola Company was positively impacted as there was interdependence between the two and the P/E ratio went up. In 2008, market’s price per share fell tremendously. This significant drop was due to the fear that the economy was dipping into recession and that banks were not able to give firms and households credits.

Other factors contributing to investors' uncertainty were the fluctuating commodities price such as aluminum and oil which is two commodities used primarily the company. Aluminum price fell to as low as 67 cents per pound in October 2008; this had reduced company's production cost. Oil price, however, was fluctuating heavily from $100 per barrel on January 2008 to as high as $147 on July 2008 and $33 per barrel on December 2008 (See figure 1. 3). This psychological effect caused by the economic instability had been the main reason of the lower market stock price (per share) even though the company had managed to make stable net earnings. Thus, the P/E ratio fell to 18. 08 in 2008.

PepsiCo.

Earnings Per Share: In 2007, this EPS grew (from $3. 42 in 2006 to $3. 48 in 2007) partially because its revenue increased by 12%. The growth in revenue was contributed by an increase in volume of the goods sold and more importantly, weakening U. S dollars. In January 2007, the currency for U. S dollars to Canadian dollars was $1. 18 US/ CAD; at the end of 2007, however, the currency rate was $0. 99 US/CAD (See figure 1. 2). This weakening U. S dollars had inflated the revenues received from PepsiCo's international sales which accounted for 48% of its overall sales. In 2008, PepsiCo's net earnings fell despite the 19% increase in sales and 16% increase in operating profits. This fall in net income was primarily due to company's heavy investment in R&D, marketing and distribution, and production in some of its international markets to achieve growth. This " productivity for growth" investment was amounted to $543 million and thus, lowering the operating profits and EPS ratio in 2008.

Price Earnings Ratio: PE ratio increased from 2006 – 2007 and fell from 2007 – 2008. The sustainable profit growths as well as strong products lines were driving investors’ confidence to invest more in the company in 2007; high values of the stock price per share drove up the PE ratio in 2007. In 2008, the economic downturn (See figure 1. 3) impacted PepsiCo’s share price; PepsiCo’s share price fell by 28. 90% from $77. 03 to 54. 77%. Despite PepsiCo’s growth in revenues and strategic spending for long-term goal, many investors were pessimistic about the economic downturn and most of them were exiting the market. This resulted in the lowest market share price during the past few years. Thus, PE ratio fell to 16. 8 in 2008.

Quality of Earnings Analysis

The Coca Cola Company

In the past three years, Coca Cola’s earnings had been above average in terms of sustainability and solidity. Coca Cola’s gross profits and operating earnings had been increasing from year to year: gross profits increased by 15. 87% from 2006 to 2007 and by 11. 48% from 2007-2008 while operating earnings increased by 14. 97% from 2006 to 2007 and by 16. 46% from 2006 and 2007. Considering the global economic downturn in 2008, the cash flow from operations increased 6% from the previous fiscal year. In addition to that, Coca Cola’s gross margin/ sales and operating earning/ sales ratio were above the industry average, even above its main competitor PepsiCo. (See figure 1. 5 and 1. 6).

The increase in sales and earnings was because Coca Cola had been progressively following the changing lifestyles (towards a healthier lifestyle) by adding stronger product lines such as vitamin/ flavored water (glac´eau vitaminwater, Enhanced Water), energy drink (Powerade Zero, NOS, Full Throttle, Monster Energy), and zero calorie products (Diet Coke Plus, Crush with Splenda, Sprite Zero). This reflects that Coca Cola is able to capture new markets and thus, maintain its profitability despite the falling demand for carbonated soft drinks which now accounted only 35% of the U. S beverage sales. As of now, Coca Cola's product developments had provided the company with a higher probability of future sales and net earnings growth as consumers are becoming health conscious and that, they would consume healthier non-carbonated drinks. In the U. S, Coca Cola's market share for beverages accounted for 23% which only differs 2% from its main competitor Pepsi which has 25%.

The other external factors that contributed to the increasing sales were the integrated supply of two major company's raw materials for the beverage production: water and sweeteners. For water in particular, Coca Cola Company has developed its own water management system which ensures efficient supplies of pure water on each of the area it serves.

Considering the Coca Cola Company's revenues are mostly from concentrates (solid drink powder) sales to its independently-managed bottlers (Coca-Cola Enterprise Inc., Coca-Cola Bottling Co.) which produce and distribute 78% of all the company's products in the market, the financial condition of this bottlers directly affect the profitability of Coca Cola. In general, Coca-Cola Enterprise had been progressing profitably in the past 6 years with a steady growth of net income (except for 2008 where this company was impacted by the economic recession) which adversely has a positive effect on Coca Cola’s concentrates demand in the past 6 years.

Coca Cola’s net earnings had been fluctuating positively from 2004-2008 (see figure 1. 7). It was down in 2008 only due to a massive drop in company’s equity investment (caused by economic downturn) which reduced net earnings. Small fluctuations of net earnings indicate that Coca Cola’s net earnings are stable and sustainable. Overall, the Coca Cola Company has a strong and solid net earnings quality.

Pepsico.

From 2006-2008, Pepsico’s earnings had been above the industry average in terms of its gross sales/ sales and operating earnings/ sales (see figure 1. 5 and 1. 6) which indicate a strong profitability trend. This was because the revenue that the company received increased moderately: it increased by 12. 34% from 2006 to 2007 and by 9. 57% from 2007 to 2008. In times of 2008 economic recession, Pepsico still maintained a positive cash flow and not only that, the company managed to increase its cash flow by 2. 2% from 2007 to 2008. This was a superb performance for Pepsico considering that demand for liquid beverages declined in 2008 which is the first time in the past 50 years.

To be able to maintain stable earnings, Pepsico had implemented conservative investment program that would reduce cost and increase efficiency in the future. Thus, it doesn’t simply aim for short term profitability but also for long term profitability. In 2008, the company implemented productivity for growth program which is basically an investment program in

R&D, product development, and branding development. This would save as much as 1. 2 billion within the next 3 years in production and distribution. Pepsico also had a water conservation program which would allow the recycling of water used. In fact, the company would save as much as 55% of water used in its plants in India within the next 5 years. In addition to the company's investment, Pepsico also formed a strategic joint venture or partnership with other companies such as Unilever or Strauss Group to develop and sell a product that would fit the consumer's changing demand. With Unilever, Pepsico had strategically combined the strength of both companies to operate the production, sales, and marketing of Lipton non carbonated tea drink. All these programs that PepsiCo had developed come down to reducing expenses in the future which would maintain the quality of earnings of the company.

As of now, Pepsi is broadening its target market so that its product doesn't only appeal to baby boomers but also to the newer generations. Its newly integrated marketing system is expected to not only increase the market share but also market equity (the total lifetime of consumer's values) and thus, creating a longer and bigger profitable customer relationships.

When it comes to net earnings, Pepsico's net earnings had been fluctuating mildly over the years (see figure 1. 7), with the biggest fluctuation amounting to 38. 35% which occurred in 2006 mainly due to international product expansion. The small fluctuations indicate strong quality of earnings as it gives investors the predictive value about the future company's income.