Macroeconomic and industry sector analysis management essay

Business, Management

Company SnapshotCoca-Cola Amatil Limited (CCA) is a large scale Australian owned ASX-listed company (ASX: CCL) who manufacturers and distributes a diversified portfolio of beverages and food products. CCA holds a significant market presence in countries that it operates including Australia and Indonesia with a total after-tax profit of for the year of 2012. CCA divides its operations into two major segments, namely Beverages and Food & Services. The portfolio for beverage products include Coca-Cola trademarked soft drinks and functional beverages (such as Coca-Cola, Sprite, Fanta), A range of juice and healthy drinks (such as Mount Franklin, Fruitbox and Goulburn Valley) and some alcoholic beverages (such as Jim Beam and Canadian Club). The food & services division manufactures and distributes packaged fruit and vegetables products in Australia and many other countries. Recent EventsOver the years, CCA's sound acquisitions policy have played a part in diversifying the company operations to other areas such as food & services to become a broader based beverage company. Recently in 2012, CCA acquired close to 90% in Fosters Group Pacific (Fiji Breweries and distillery in Fiji and Samoa) for approximately A$58m. Same year, January the company sold its 50% interest in the Pacific Beverages joint venture to its joint venture partner SABMiller. In 2011, CCA partnered with Beam Global Spirits to manufacture, sale and distribute its portfolio of spirits in Australia for a 10 year period. Further, as part of its plans to diversify beverage products, SPC Ardmona was acquired for $524m in 2005 and Neverfail was acquired for $225m in April 2003. Over the past few years, CCA's increased capital expenditure program have helped them to achieve improved productivity and self-sufficiency in terms of manufacturing. Some of the CCA's expenditure includes $110m automated warehouse development at Northmead to revitalise the existing operations and a new state-of-the-art automated distribution centre, alternative energy technology and rainwater harvesting systems at a cost of $90m at Eastern Creek. Further $500m towards 'Project Zero' from 2010 to 2014, to reduce industrial wastage and improve overall production efficiency. Project includes a new SAP IT system to implement best practice end-to-end technology platform and a PET self manufacturing system to reduce manufacturing costs. Similar capex programs in Indonesia and Pacific region continues to fuel CCA's growth. Company StrategyCCA's key strategy is to improve its market share in Australia and Pacific region by finding new outlets and to improve returns in the core business. For example, Indonesia's large population and strong GDP could act as one of the key contributor to profit growth for CCA. This potential is suggested through large investments in Indonesia where CCA holds nearly 90% of the market share.

Cash flow projections

Macroeconomic and industry sector analysis

Competition:

Australian Economy:

Beverage Industry: The Soft Drink Manufacturing industry has lost its fizz. During the five years through 2012-13, industry revenue has grown at a weak compound annual rate of 0. 9% as deteriorating economic conditions, inclement weather and changing consumer trends worked against it. Since the financial crisis of late 2008, the economy has gradually weakened under the weight of escalating domestic and global uncertainty. Consumers have generally become less confident, choosing to pay down debt rather than spend on discretionary purchases. On top of this, sales have been constrained by wetter and colder than average weather across much of the country, particularly the Queensland floods in 2010-11 and wet summer of 2011-12 in Eastern AustraliaPro forma model and cash flow projections 10Assumptions and justifications 10Management expects A$30-40mn annualised cost savings ramping up over 3 years as part of the next phase of Project Zero, as well as capex expectations of cA$420mn in FY13F, with medium-term capex expected to come down to an average of A$350-420mn per annum. We understand that a strong start to summer in Australia with higher average temperatures compared to pcp has been partially offset by ongoing competitive activity. While management is still anticipating a frugal consumer, particularly with ongoing uncertainty prior to the Australian federal election in September, we note expectations that lower interest rates, improving property prices and share market returns may boost consumer sentiment over FY13F. Our forecasts reflect improved pricing and volume in Australia and Indonesia year on year, although not to the extent we previously forecast, as well as further Project Zero related cost savings. Comprising a A$48mn Goodwill impairment, as well as a A$98mn write-down of inventory and other assets, the quantum of the SPCA write-down surprised. Following these write-downs the company has indicated it will continue to carry the current value of its existing SPCA assets however, we note should the business continue to face challenging trading conditions a further write-down of existing assets cannot be ruled out. Management commented that SPCA is likely to be a three year turnaround story. We would assess that goal as being sustainably profitable, rather than WACC-returning. We understand the turnaround focus is three-pronged: a strong cost-out program, with a large portion of Phase 2 of Project Zero focused on efficiencies and cost-out in SPCA; stronger trading performance; and focus on provenance-based marketing. We expect to see more advertising of ‘ Australian grown’ on label and in advertising, with beans and tomatoes likely to be near-term. Management expects Phase 2 of Project Zero to deliver cA$30-40mn in annualised efficiency gains and cost-out over the next three years, with a particular focus on reducing the cost base of SPC Ardmona and NZ beverage operations. While Phase 1 is expected to deliver cA$100mn in cost savings by FY14F supported by a A$500mn capex spend, we understand Phase 2 will involve minimal incremental capex and appears to be more SAP operationally related as well as further light-weighting of bottles. In response to concerns of changes to the Australian Dietary Guidelines which suggest limiting added sugar, Coca-Cola Amatil stressed that c1/3 of its volume consisted of non-sugar or low-sugar drinks, which appears largely unchanged as a proportion since 2010. With portion control packaging gaining traction, as well as new non-sugar lines in products such as Powerade, this suggests new product development is responding to increasing focus on health concerns associated with food and beverage-related obesity. Management guided to an improved COGS outlook for FY13 of +2. 5-3. 0% growth y-y (constant currency, ex-Indonesia), an improvement from 3. 0% COGS growth in FY12, on lower commodity costs, with sugar and aluminium to benefit from longer dated hedge books. Despite volume and earnings growth in Fiji, subdued trading conditions driven by continued soft consumer sentiment, poor weather and cycling of the World Cup impacted the New Zealand business, resulting in divisional EBIT decline of -11. 8% y-y and volume decline of -7%. Volumes were further impacted by a significant reduction in stock held by key customers due to customers' more efficient working capital management. In line with our expectations (NE: A$103. 1mn), Indonesia & PNG achieved a strong result, with revenue growing 12. 1% y-y to A$948. 2mn. In Indonesia, the acceleration of cold drink cooler placements underscored 19% growth y-y in one-way-packs, and completion of a number of large investments in manufacturing and distribution has materially increased production capacity. Management flagged it has commenced expansion into the high volume water category in Indonesia, with the first high speed water line capable of producing 54, 000 lightweight crushable PET bottles per hour. Further, the new Port Moresby line in PNG has doubled PET bottle production capacity, which coupled with increased promotional activity and new cold drink cooler replacements, underscored solid volume and earnings growth. EBIT was above our A$92. 7mn forecast due to solid growth in spirits and alcoholic ready-to-drink beverages and a full year benefit from Beam, partly offset by a decline in SPCA earnings, which we estimate generated low-single-digit EBIT. A higher Australian dollar, strong fresh fruit deflation and increased competition from imported private label packaged fruit and vegetables resulted in a non-cash write-down in SPCA assets and goodwill of A$48mn followed by A$139. 7mn inventory (FY10 and FY11) and other asset write-downs. We understand the Company is now in the second stage of its restructuring program for SPCA, aiming for turnaround ‘ at best’ in the next three years (which we take to mean targeting sustainable profitability rather than a return of WACC). The turnaround is a three-pronged approach: incorporating cost-out, increased focus on higher margin fresh fruit and packaged food, and increased above the line marketing spend (including provenance-based label marketing) and new product development to stimulate sales.

Discount rate

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Terminal value

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Multiples analysis

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