# Coca-Cola: How management alters the presentation of financial results

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The Coca-Cola Company (NYSE: KO) is the world's largest beverage company with over 500 brands that span the globe. This did not happen by accident. The company has spent considerable time and money building what many surveys have listed as the #1 brand in the world. The company is a sales and marketing powerhouse.

Though marketing is a necessary part of any business, an excessive use of marketing tactics within the reporting of financials can cause significant transparency issues for investors. Coca-Cola appears to be applying its marketing prowess to its financial reporting. Rather than presenting the information directly, management utilizes selective reporting to guide the investment community toward pre-determined outcomes.

As one can see from the chart below, many of the company's financials have been trending downward. Of the twelve financial metrics listed, only two of the metrics increased from its comparable quarters in 2008 (net income, Q2, 2009 and Q3, 2009).

Summary of Coca-Cola's recent quarterly financials:

(in millions of $)

| | *2009* | 2008 | Variance | Growth |
|---|---|---|---|---|
| Q1: | | | | |
| Revenue | *7,169* | 7,379 | -210 | -2.85% |
| Gross profit | *4,579* | 4,755 | -176 | -3.70% |
| Operating income (loss) | *1,863* | 1,874 | -11 | -0.59% |
| Net income (loss) | *1,359* | 1,511 | -152 | -10.06% |
| Q2: | | | | |
| Revenue | *8,267* | 9,046 | -779 | -8.61% |
| Gross profit | *5,354* | 5,884 | -530 | -9.01% |
| Operating income (loss) | *2,438* | 2,679 | -241 | -9.00% |
| Net income (loss) | *2,049* | 1,443 | 606 | 42.00% |
| Q3: | | | | |
| Revenue | *8,044* | 8,393 | -349 | -4.16% |
| Gross profit | *5,110* | 5,373 | -263 | -4.89% |
| Operating income (loss) | *2,150* | 2,187 | -37 | -1.69% |
| Net income (loss) | *1,920* | 1,915 | 5 | 0.26% |

**Financial information derived from Coca-cola's respective Form 10-Q's for the above reporting periods.*

Management has been able to avoid the discussion of negative variances by using non-Generally Accepted Accounting Principles ("GAAP") numbers; omitting or avoiding key information; and by using non-traditional financial comparisons. In the prepared remarks (almost 4,000 words) for the Q3, 2009 earnings call the only GAAP figure mentioned by management was the quarterly earnings per share number. Here is an example of management utilizing non-GAAP metrics when communicating with the investment community:

> "On a comparable currency neutral basis, net revenues excluding structural changes have increased 3% for this quarter and 5% year-to-date. Operating income has increased 9% for both the quarter as well as year-to-date."
>
> – Muhtar Kent, Chairman and CEO, Coca-Cola, Q3, 2009 earnings call

The above statement is in direct contrast with the actual GAAP results: Q3, 2009 revenue decreased 4.2% versus Q3, 2008; Q3, 2009 operating income decreased 1.69% versus Q3, 2008; and Q3, 2009 YTD operating income decreased 4.3% compared to Q3, 2008 YTD.

To test management's consistency in conveying its financials, we conducted an analysis on management's use of the words "increase" and "decrease," and the derivations of those words. We compared word usage in the 10-Q's Management Discussion & Analysis ("MD&A") versus the comparable earnings calls. Management has significantly more discretion in how they address financials on earnings call than in the MD&A. As a result, we were able to test how much management deviated from the MD&A in the comparable earnings calls. Within the MD&A for Q1, 2009, Q2, 2009, and Q3, 2009, management utilized derivations of the word "increase" 27, 31, and 37 times, respectively, and utilized derivations of the word "decrease" 36, 36, and 37 times, respectively. Management's use of the word "decrease" slightly outpaced the use of "increase."

During the quarterly investor earnings calls, management conveyed a much different version of the company. Management's excessive optimism and selective presentation of the company's financials becomes clear when comparing the use of the words "increase" and "decrease" in the earnings calls to the respective MD&A's. During the prepared remarks of the Q1, 2009, Q2, 2009, and Q3, 2009 earnings calls, senior management utilized "increase" 15, 10, and 9 times, respectively, while they only utilized "decrease" 2, 3, and 0, respectively. Management utilized "increase" *almost seven times more* than "decrease!" Management ignored adverse financial comparison. Management also utilized non-GAAP metrics and compared financials to sequential reporting periods to portray "increasing" metrics. During the earnings calls, management shaped the company's financials into a presentation that matched their optimism, rather than allowing the financials to dictate the presentation.

Where is the financial transparency? How will an investor actually know if Coca-Cola is doing well or not? Can they rely on management to provide a forthright assessment of the company's financial position? Whether it is intentional or not, when management chooses to use inconsistent and non-standardized measurements to explain its financials, it raises concern and skepticism. In a sense, the approach itself is its own red flag.

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*Information and analysis is based on the earnings call transcripts from investor calls on April 21, 2009 (Q1, 2009), July 21, 2009 (Q2, 2009), and October 20, 2009 (Q3, 2009).  Transcripts were obtained from Seeking Alpha at www.seekingalpha.com.*