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# Coca-Cola Explores Energy Drink Bolt-On

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On Monday, April 30, the Wall Street Journal broke a story reporting that Coca-Cola (KO) was in discussions to purchase energy drinks company Monster (MNST). Monster's share price swelled 20% on the news - its market cap popping up \$2 billion to roughly \$13 billion - but Coca-Cola ultimately decided to walk away from the deal. Coca-Cola CEO Muhtar Kent said late Monday that, "at this time," the company is not in talks to buy Monster. Monster's share price fell back to its pre-news market cap of around \$11 billion.

The Wall Street Journal reports, "Coke on Monday heard from some angry investors who questioned the idea and the price" - and they weren't just objecting to Monster's bloated share price Monday. "Monster's valuation was already seen as an obstacle to Coca-Cola pursuing a deal," writes the Wall Street Journal. "The stock price has about doubled in the past year, and Monster trades at roughly 30 times estimated 2012 earnings." Coke and its rival PepsiCo (PEP) both declined to buy Monster when the company reached out last year, citing its high price as a factor. Moreover, "Coca-Cola already has an agreement with Monster to distribute some of its drinks, and that could diminish the potential synergies from any deal-and thus Coke's willingness to pay a large premium."

So, why the speculation? To put it simply, energy drinks are big business and, for as big as Coke is, it isn't big in this game.

Energy drinks is the fastest growing beverage segment in the US - according to a recent study, 30-50% of adolescents and young adults consume energy drinks regularly - and Monster is a large part of that. Right now, the energy drinks market is valued at \$31.9 billion and boasts increased sales of 5% from 2010 to 2011. Monster has nearly 35% of the energy drink market share, while the privately held Red Bull GmbH is responsible for almost 30% of the market. The third position belongs to the privately owned Rockstar, which Pepsi distributes. Pepsi's own energy drink, AMP, is in fourth place with 4.4% of the US market last year. Coca-Cola has the brands Full Throttle and Fuze NOS but neither has done nearly as well as its competitors.

For Coke, buying a ready-made brand that already has a following (a "bolt-on acquisition") is an easy way for the company to get into the energy drinks game. Coke has already made it clear that it is in the market for this type of bolt-on acquisition and, given its poor market share in energy drinks coupled with the rapid growth of this segment, the energy drinks market makes sense. So, if not Monster, then what? Rockstar may not be an option owing to its agreements with Pepsi, but Red Bull could certainly be.

Red Bull is taking measures to counter the challenges of a consolidating industry by adopting various technologies, like issuing sales reps iPads to enable them to connect with customers using a range of social, mobile and location-based software - referred to as "SoLoMo" - but will it be enough to fend off "Big Red" if Coke sets its sights in that direction?

That is a hard question to answer. Plus, it is difficult to tell what Coca-Cola is going to do next. It's not as if the company is in a bad position. Coke recently traded at under \$77 a share. Analysts expect the company to earn \$4.10 a share this year and \$4.49 next year, making its forward price to earnings ratio just over 17 times its future earnings - a discount to its peers' average of 19.74. Further, Coca-Cola offers one of the most stable dividends in the world. It pays out \$2.04 (2.70% yield) on a 51% payout ratio and has increased those dividends consistently since 1969.

Coke also has a lot of money manager interest, which generally points to good things in store for the company. Warren Buffett famously has more than 20% of his 13F portfolio invested in Coke. The company also figures prominently in Boykin Curry's Eagle Capital Management portfolio. Lansdowne Partners, Cantillon Capital Management and Adage Capital Management are also fans of Coca-Cola.

It's hard to say what will happen next with Coke, but this is a great company with great numbers - and it is doing well even though its energy drinks brands are not. I recommend Coca-Cola as a buy, but caution investors to buy in when hype surrounding the stock is at a minimum to maximize the potential upside.

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