

COKE GOES FLAT FOR SHAREHOLDERS; MANAGEMENT AND DIRECTORS GET THE FIZZ
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The intent of this week's Chairman's Corner is not to evaluate Coca-Cola (KO), but rather to focus on the conflicts that corporate management constantly faces regarding their personal interests and those of their shareholders.

Coca-Cola's recent action regarding management/director compensation is a stark example of management's decision to benefit themselves at the expense of the shareholder. Coca-Cola recently announced a change to their directors' compensation (see the Chairman's Corner dated May 9, 2006: "What Goes Better with Coke?"). This change was based on the statement that directors' compensation would be more in line with the shareholders' interests. In fact, the compensation scheme created essentially mirrors that of management.

Management/director compensation is tied directly to growth in earnings per share. In theory, growth in earnings per share should drive increased stock price (a benefit to shareholders) but this connection is very loose. In fact while Coke has reported increased earnings per share, its stock price has substantially lagged its peers. Regardless, Coke management (and now the directors) will achieve their increased compensation per the new plan.

Adding insult to injury, as we have seen in the past, the easiest accounting number to manipulate is reported earnings per share. A quick analysis of Coke's reported earnings illustrates this fact. Coke's quarterly earnings per share ending June 30, 2006 were reported to be \$0.76 versus \$0.72 from the prior year. If one merely adjusts out \$0.04 for a nonrecurring sale plus an additional \$0.015 for a reduction in shares from their share repurchase plan, earnings per share growth plummets to near zero. In fact one could easily argue that the share repurchase with shareholders' money to benefit management is clearly a violation of fiduciary responsibility. Paying directors for making the numbers look good replicated the motivation behind the actions that destroyed Enron, Worldcom, and others.

This simple analysis excludes other forensic evidence that supports the possibility of additional earnings manipulation. See below;

Flagged Metrics									
Metric		AGR Impact			Metric		Metric Operations		
						Comparison		Change	Volatility
Order	Risk	Metric	Metric Impact	Cumul. Pct	Company Value	Industry Avg/Med.	Co./ Industry Difference	1-Year Change	2-Year Volatility
1	High Risk Events	Corporate Number of Mergers, Trailing 12 Mths	(10.9)	13.8%	3.000	0.833	HIGH	-	-
2	Governance	Compensation Short Term over Total Compensation, Last Yr	(8.7)	24.7%	0.719	0.438	HIGH	-	-
3	High Risk Events	Corporate Number of Divestitures, Trailing 12 Mths	(8.2)	35.1%	1.000	0.167	HIGH	-	-
4	Governance	Oversight Number of Litigation/Regulatory Issues, Trailing 12 Mths	(8.1)	45.3%	1.000	0.111	HIGH	-	-
5	Asset-Liability Valuation	Other Assets over Assets	(6.8)	53.9%	0.090	0.017	HIGH	-	-
6	Governance	Officer Number of Changes, Trailing 12 Mths	(6.7)	62.4%	1.000	0.278	HIGH	-	-
7	Expense Recognition	Prepaid Expenses over Operating Expenses	(5.6)	69.5%	0.478	0.031	HIGH	-	-
8	Revenue Recognition	Operating Revenues over Operating Expenses	(5.3)	76.3%	1.364	1.055	HIGH	-	-
9	Revenue Recognition	Gain on Sale of Investments over Revenues	(5.2)	82.9%	0.001	0.003	-	-	HIGH
10	Expense Recognition	Other Operating Expenses over Operating Expenses	(4.9)	89.1%	0.012	0.374	-	LOW	-
11	High Risk Events	Corporate Number of Share Repurchases, Trailing 12 Mths	(4.4)	94.7%	1.000	0.222	HIGH	-	-
12	Asset-Liability Valuation	Investments Long Term over Assets	(4.2)	100.0%	0.234	0.025	HIGH	-	-

All in all, it is not difficult to imagine why Coca-Cola's performance has been sub marginal. We have found that there is a strong correlation in returns to shareholders based on the management/shareholder relationship. Good management transparency coupled with strong governance equals higher returns to shareholders. Poor transparency and poor governance leads to lower returns over time. Being able to discriminate between these two forms of behavior is an important factor in any valuation model.

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