

October, 20, 2017

## Monster Beverage Corp: MNST

Nico Dumas

Sector: Consumer Staples

Industry: Beverages

Current Price: \$56.22

Target Price: \$65.11

Monster Beverage Corporation, based in Corona, California, is a US holding company that develops, markets, sells, and distributes energy drinks through its subsidiaries. Monster operates through three segments: Energy Drinks, Strategic Brands, and other. The other segment consists of certain products sold by American Fruits & Flavors, LLC; a wholly owned subsidiary of Monster. The company developed a strategic partnership with Coca-Cola in 2015, positioned well to expand into international markets. Monster currently holds 22% share of the fast growing \$42.9 billion global energy drink market. The company generates strong cash flow and has no debt, allowing them to regularly repurchase shares.

### BUY

Current Price:	\$56.22
Target Price:	\$65.11
Market Cap:	31,942.5M
Volume:	1,578,124
52 Week Range	\$40.64-\$57.25
ROIC	22.58%
WACC	10.5%
EBIT Margin	38.7%
Net Income Margin	24%

### Catalysts:

- **Short Term(within the year):** New product development and consistent revenue growth along with rising margins
- **Mid Term(1-2 years):** Monster's partnership with Coca-Cola causing internationally expansion
- **Long Term(3+):** Further development and distribution in China



**Thesis:** Monster Beverage Corporation is an aggressive competitor within the Beverage industry. With a market cap of just below \$32 billion, this company has endless upside with Coca-Cola as a strategic partner. Compared to the soft drink index and competitor Dr. Pepper in the price chart above, anyone can see how fast Monster’s stock price is increasing. With consistent revenue growth and rising

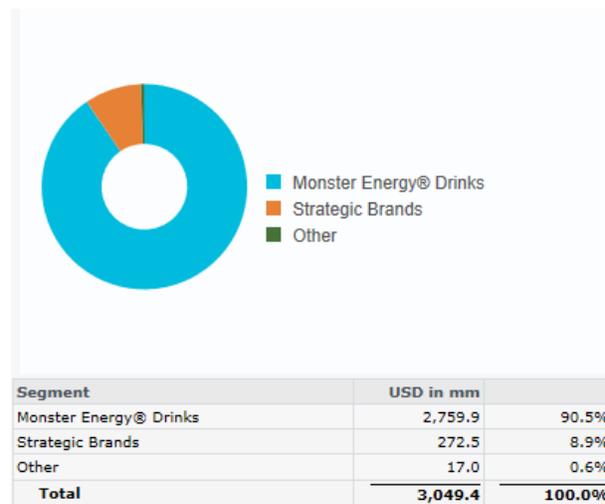


margins in quarter 2, this trend will continue forward. New product development is a crucial part of Monster’s sales growth as well, constantly removing non-performing products and introducing new flavors. Analysts are forecasting double-digit expected earnings growth within the upcoming year. The main driver of this is Monster’s international presence. With 73% of total sales currently in the United States, the company realizes the potential profitability from expansion throughout Europe and Asia. Monster has already started launching new operating units in countries such as China, Hong Kong, and Macau. China

is currently the world’s second leading Energy Drink market taking up 16% of consumption. Monster launched 14 new operating units in China during the second quarter. With Coca-Cola’s knowledge of the international market, Monster could be looking at easy double-digit earnings growth.

## Segments:

Monster Beverage Corporation operates in three segments: Monster Energy Drinks, Strategic Brands, and “Other”. The Energy Drink segment sells packaged drinks and dairy-based coffee energy drinks to full service beverage distributors, retail grocery and specialty chains, wholesalers, club stores, mass merchandisers, convenience chains, food service customers, and the military. This segment takes up the majority of Monster’s sales revenue at \$2.76 billion in 2016. This accounted for 90.5% of the company’s total revenue. The Strategic Brands segment contributed the second largest share towards Monster’s revenue at 8.9%. Monster is turning a lot of focus towards this segment, which consists of various energy drink brands acquired from The Coca-Cola Company (TCCC). Monster generates revenue here through selling “concentrates” and/or “beverage bases” to authorizing bottling and canning operations. These companies, mostly Coca-Cola, then take the “beverage bases” and add sweeteners, water, and other ingredients to personalize the product to their specific company. The Strategic Brands segment currently generates a higher operating margin than the Energy Drink segment, showing that the company is focused in the correct direction. If you look at the chart on the left, it



### (2017 Quarter 2)

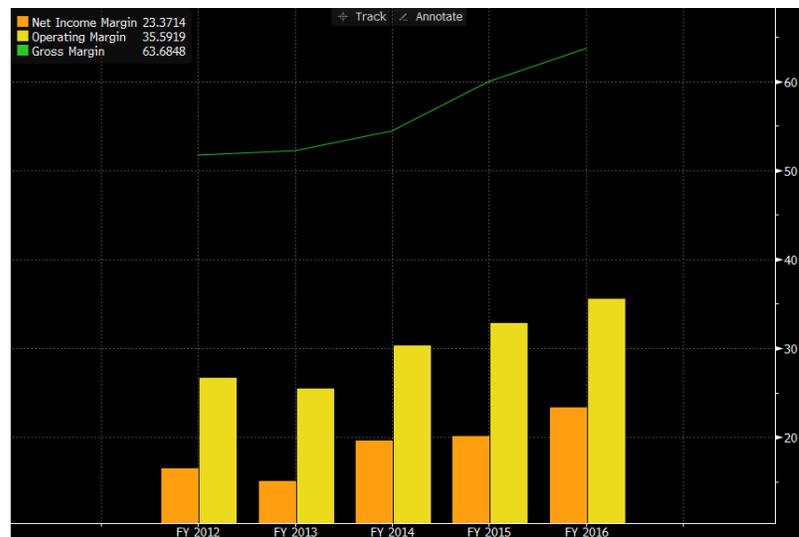
	Energy Drinks	Strategic Brands
Revenue	815.3	85.6
Operating Profit	356.2	53.2
Operating Margin	<b>43.69%</b>	<b>62.15%</b>

shows the second quarter results for both the Energy Drinks segment and the Strategic Brands segment. This chart shows that Monster’s operating efficiency in the Strategic Brands segment is far greater than the Energy

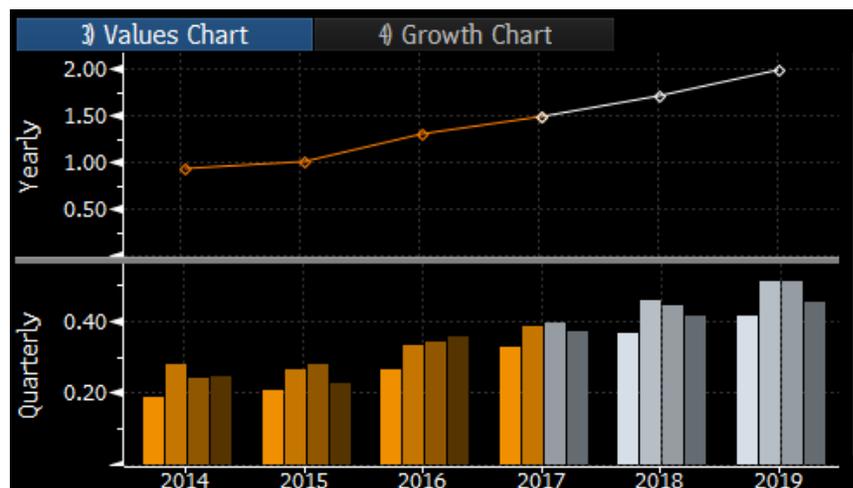
Drinks segment, having a margin of 62.15% compared to 43.69%. With Coca-Cola being a well-established international company, this is a very profitable segment to concentrate on. Monster and Coca-Cola entered into a strategic partnership in 2015, Coca-Cola obtaining Monster's non-energy business and ownership of almost 18% of the company's shares. In return, Coca-Cola transferred ownership of its worldwide energy business, including NOS, Full Throttle, Burn, and multiple other businesses. Coca-Cola is the world's largest beverage company, providing limitless expansion for Monster into new markets. In the previous quarter, Monster's revenue generated from United States transactions accounted for 72.7% of total revenue, 27.3% of sales being international. In the first quarter of 2017, international sales were 25.7% of total revenue. The percentage of international sales has been increasing steadily for the previous six quarters. Monster's presence internationally will continue to expand, as they grow more accustomed to their partnership with Coca-Cola. This soft-drink giant has positioned Monster as their preferred energy drink partner worldwide. The company is beginning to aggressively pursue unpenetrated markets outside of the United States.

### Earnings Performance:

Monster Beverage Corporation's gross, operating, and net income margins have all been increasing consistently annually over the past five years. Between quarter 1 and quarter 2 of 2017 every single margin has increased except for gross (decreased by .47 of a percent), operating margin almost touching 40%. Monster is beginning to gain momentum in new markets. If revenue growth continues at its current rate of approximately 10% YOY, the company should touch \$4 billion in total revenue by the end of 2019. This is being very conservative, historical

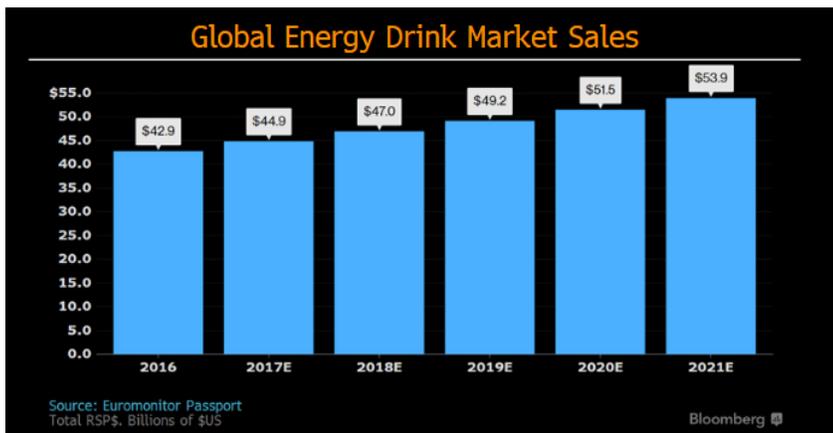


growth having little contributions from international presence. It would come to no surprise if revenue growth spiked to around 20%-25% when Coca-Cola introduces them to increased international sales of their Strategic Brands. With this segment having the largest operating margin for Monster, net profits would increase. Net sales for the second quarter of 2017 increased 9.6% to \$907.1 million from \$827.5 million in the same quarter in 2016. Gross sales increased 9.8% during this period exceeding a record of \$1 billion. Of this, international net sales increased 23.8% to \$247.9 million. Adjusted earnings per share have been increasing consistently over the past 3 1/2 years and



are forecasted to continue to do so. This indicates that Monster's profitability is on the rise, the recent quarter holding the highest adjusted earnings per share ever for the company at \$0.39. This is forecasted to reach approximately \$0.51 by 2019. With adjusted earnings and margins growing consistently accompanied by increased revenue, this stock is a for sure buy. Coca-Cola developed their strategic partnership with Monster Beverage Corp in June of 2015. The stock price has stayed relatively stable over the past two years fluctuating between the \$40s per share and low \$50s, but now it is clear that the company is starting to take their investment in Coca-Cola to the next level; targeting international expansion.

## Industry Outlook:



Analysts are forecasting that the global energy drink market could continue to rise at a 5% compound annual rate through 2021. This is a fast growing industry, maintaining 10% annual worldwide sales growth since 2010. This is the highest among all major beverage categories. People believe that this growth is mainly due to young consumers looking for a caffeine-driven boost. With Monster increasing net sales

internationally each quarter, they are looking to take over a large share of the market. The company is currently focused on development in Europe and Asia. Monster's most significant competitors outside of the United States are Suntory Holdings in Japan and the United Kingdom, Red Bull in Brazil, and TC Pharmaceuticals in Thailand. Suntory has a market cap of about \$14 billion and their adjusted revenue growth YOY has been declining rapidly, last quarter having a loss in revenue. Their net income margin is low at 3.26%, ROIC at 5.5%. This company also operates in the food industry, not specializing in beverages as Monster does. This company is not a threat at all. TC Pharmaceuticals and Red Bull will be Monster's only competition in China. TC Pharmaceuticals

is a privately-owned company that has been in the market since 1978, being a partner to Red Bull and being the sole manufacturer and distributor of Red Bull products in the Chinese market. In 2012, Red Bull's sales growth was the highest it has seen in China; almost 30% YOY. This number has been on a rapid decline through 2015, losing YOY sales growth as competition enters the market. Red Bull still controls 80% market share in China, but this goes to show the potential market share that Monster can take from them.



With Coca-Cola's large presence in China, it seems like an unfair advantage for Monster's entrance. With the

correct amount of capital invested on distribution penetration, marketing campaigns, and research Monster should have no problem creating a presence among Red Bull.

## Acquisition of Fruits & Flavors:

Monster Beverage Corp and American Fruits & Flavors have been long-time business partners, Fruits & Flavors being Monster's primary flavor supplier. Monster acquired this company in order to further enhance flavor development and their global flavor footprint capabilities. The acquisition costed Monster \$690 million cash and was finalized April 1<sup>st</sup>, 2016. This was a strategic move by the company, bringing their primary flavor supplier in-house so they would now have complete control over their operations. Monster's largest



competitors do not do this. This gives the company a major advantage when it comes to new flavor technologies and differentiating themselves from the rest. This acquisition has boosted adjusted earnings per share as well. Before Monster obtained Fruits & Flavors their EPS hovered around .25 never breaking .3, now their EPS has jumped well above .3. Their most recent adjusted earnings per share for the second quarter of 2017 was .39. This acquisition has made Monster increase profitability substantially. As you can see from the adjusted actual earnings per share graph on the left, EPS has increase by approximately .12

since the first quarter of 2016. After the acquisition price per share also increased from \$45 to \$49 within a month. Investors noticed how beneficial this transition would be for Monster, taking over their primary flavor supplier. Price per share has increase 27.35% since the acquisition.

## Ownership & Management: the

MONSTER BEVERAGE CORP				CUSIP 61174X10
Compare Current Stats Against 01/01/17				
Ownership Type	01/01/17	Curr ↓	Change	
11) Investment Advisor	60.85	62.63	+1.78	<input checked="" type="checkbox"/>
12) Corporation	23.38	24.51	+1.13	<input type="checkbox"/>
13) Hedge Fund Manager	6.68	3.64	-3.04	<input type="checkbox"/>
14) Pension Fund	1.90	2.27	+0.37	<input type="checkbox"/>
15) Bank	1.94	2.17	+0.23	<input type="checkbox"/>
16) Individual	2.08	1.27	-0.81	<input type="checkbox"/>
17) Government	0.97	1.02	+0.05	<input type="checkbox"/>
18) Holding Company	1.12	0.97	-0.15	<input type="checkbox"/>
19) Insurance Company	0.40	0.71	+0.31	<input type="checkbox"/>
20) Sovereign Wealth Fund	0.53	0.61	+0.08	<input type="checkbox"/>
21) Brokerage	0.07	0.12	+0.05	<input type="checkbox"/>

The ownership summary provided shows the year to date changes in ownership for 2017. As it shows, there has been almost a 2% increase in investment advisors, realizing the long-term potential of Monster. These

investment advisors mostly consist of Fidelity Management & Research, Vanguard Group, and Wellington Management Group. Corporation holds the second most shares of the company; due to Coca-Cola's 18% ownership along with Brandon Limited Partnership's 6%. Hedge Fund Managers have decreased their shares by about 3%, collecting gains as Monster's stock price rose from the low \$40s in January to the mid \$50s today. There has been relatively little insider transactions recently, increasing net shares in June by about 27,000 and decreasing net shares of approximately 11,000 between August and September. Although Monster is currently trading around its 52 week high, insiders are still holding onto shares and looking forward to

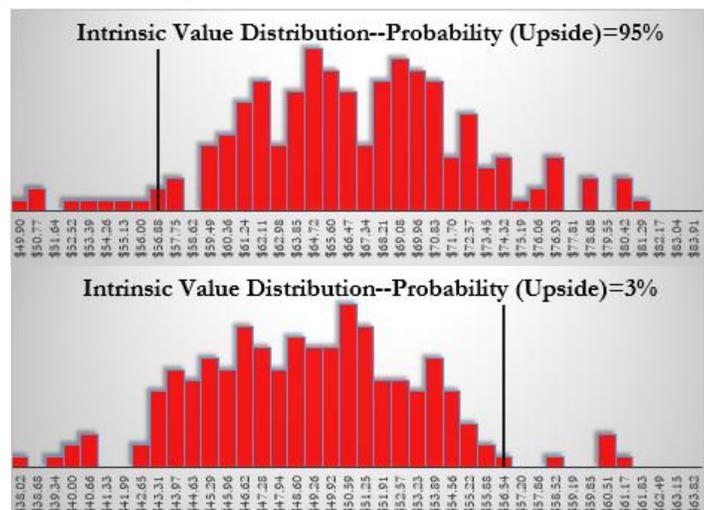
Compensation Analysis		2016
Name	Title	Total Compensation
1) Rodney Sacks	Chairman/CEO	12,028,955 (USD)
2) Hilton Schlosberg	Vice Chairman/Pres/CF...	11,995,786 (USD)
3) Mark Hall	Chief Marketing Officer	4,092,571 (USD)
4) Thomas Kelly	Senior VP:Finance	1,817,298 (USD)

higher returns. With their strong strategic alliance with Coca-Cola and an increasing market share internationally, people can see the long-term gains that are possible

from Monster. Management consists of Rodney Sacks and Hilton Schlosberg who started running the company together in 1990. Rodney is the CEO while Hilton holds the positions of Vice Chairman, CFO, and COO. Compensations seem reasonable seeing how Dr. Pepper pays their CEO almost \$10 million per year, and their company has a market cap half the size of Monster's. This CEO has only been with them since 2007 as well. Rodney and Hilton started the company together and deserve what they are making.

## Possible Forecasts:

With revenue growth increasing consistently at 3% over the next five years as Monster expands globally and operating cost to revenue staying at 60%, Monster's current valuation based on unlevered free cash flow comes out to \$59.76. The company's one-year target price from my price simulation was \$66.67 with a 95% upside probability. I used the last reported income statement and balance sheet operating components for my valuation as well. This is my projected forecast of the company being relatively conservative. About a \$10 upside. I then set up a worst-case scenario where revenue growth only increased 1% per year over the next five years, combined with operating cost/revenue increasing from 60% to 63%. The one-year target price from the Monte Carlo simulation came out to \$49.22, with only a 3% probability of upside. This is about a \$7 downside. The market's estimate of long-term return on invested capital was higher by 39.2% for this model. This worst-case scenario is highly unlikely and still only has a downside of 12.5% compared to a possible upside of almost 18%. I do not believe the stock will stop when it hits \$66-\$67 per share; if they make an international presence and take control of the market, their profits could far exceed this valuation.



## Conclusion:

Monster Beverage Corporation is beginning to enter new markets globally. Monster is focused on increasing their Strategic Brands segment, through Coca-Cola, which holds the highest operating margin among the segments. Alongside Coca-Cola, they could see double digit gains in earnings year over year. The company's revenue has been increasing consistently along with most of their margins. When they acquired American Fruits & Flavor in 2016, their adjusted earnings per share have been increasing consistently as well; turning their primary flavor supplier into an in-house operation. The one competitor that stands between them and the Chinese market is Red Bull, who has been growing at a slowed rate in this market. With the correct amount of capital spent on distribution and marketing campaigns, Monster can make their presence known in the Chinese Energy Drink market. They already have set up 14 new operating units within China in the second quarter of 2017. The European and Asian markets provide vast opportunities for Monster, only 26% of sales revenue coming from international sales in the second quarter. This percentage will continue to rise as they develop further with Coca-Cola as their parent company.

# Monster Beverage Corporation (MNST)

## CENTER FOR GLOBAL FINANCIAL STUDIES

**NEUTRAL**

Analysis by RICK  
10/27/2017

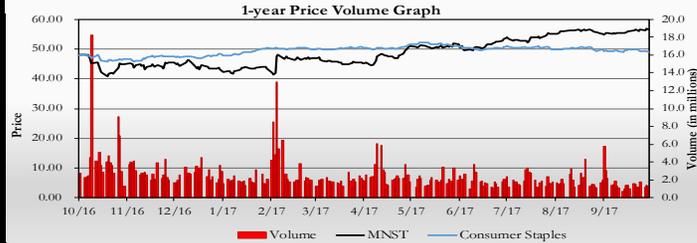
Current Price: \$56.91  
Dividend Yield: 0.0%

\$56.91  
0.0%

Intrinsic Value: \$58.37  
Target Price: \$65.11

\$58.37  
\$65.11

Target 1 year Return: 14.41%  
Probability of Price Increase: 95%



**Description**  
Monster Beverage Corporation, through its subsidiaries, develops, markets, sells, and distributes energy drink beverages, soda, and its concentrates in the United States and internationally.

**General Information**

Sector	Consumer Staples
Industry	Beverages
Last Guidance	November 3, 2015
Next earnings date	November 4, 2017
Estimated Country Risk Premium	6.54%
Effective Tax rate	23%
Effective Operating Tax rate	23%

**Market Data**

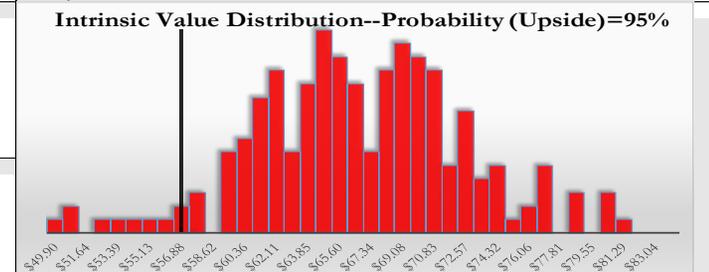
Market Capitalization	\$32,243.60
Daily volume (mil)	0.78
Shares outstanding (mil)	568.17
Diluted shares outstanding (mil)	579.76
% shares held by institutions	71%
% shares held by investments Managers	57%
% shares held by hedge funds	3%
% shares held by insiders	1.23%
Short interest	1.01%
Days to cover short interest	3.17
52 week high	\$57.25
52-week low	\$40.64
Volatility	31.24%

**Past Earning Surprises**

Quarter ending	Revenue	EBITDA
6/30/2016	3.05%	-2.82%
9/30/2016	-4.14%	-12.51%
12/31/2016	3.80%	7.62%
3/31/2017	0.21%	-0.80%
6/30/2017	1.01%	-1.41%
Mean	0.79%	-1.98%
Standard error	1.4%	3.2%

**Peers**

Dr Pepper Snapple Group, Inc.
The Coca-Cola Company
Pepsico, Inc.
Coca-Cola Bottling Co. Consolidated
Constellation Brands, Inc.
National Beverage Corp.



**Management**

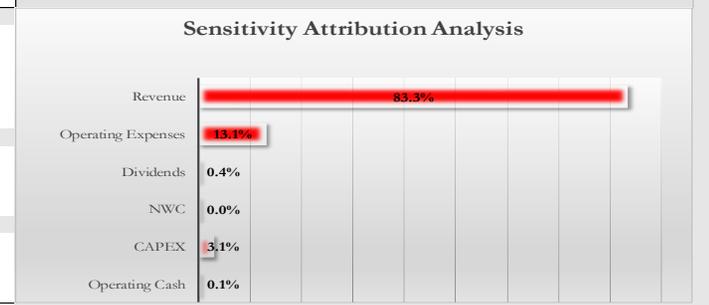
Management	Position
Sacks, Rodney	Chairman, Chief Executive Of
Schlossberg, Hilton	Vice Chairman, President, CF
Kelly, Thomas	Senior Vice President of Fin
	0.0
	0.0
	0.0

**Total compensations growth**

0.67% per annum over 5y
0.63% per annum over 5y
29.64% per annum over 5y
N/M
N/M
N/M

**Total return to shareholders**

5.06% per annum over 5y
5.06% per annum over 5y
5.06% per annum over 5y
N/M
N/M
N/M



**Profitability**

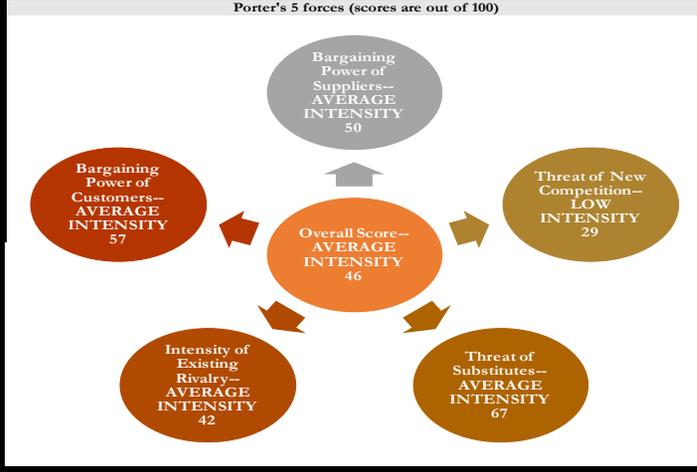
	MNST (LTM)	MNST (5 years historical average)	Peers' Median (LTM)
Return on Capital (GAAP)	23.7%	13.88%	13.96%
Operating Margin	19%	13.17%	8.15%
Revenue/Capital (GAAP)	1.22	1.05	1.71
ROE (GAAP)	19.5%	17.4%	24.8%
Net margin	24.9%	22.5%	9.5%
Revenue/Book Value (GAAP)	0.78	0.77	2.62

**Invested Funds**

	MNST (LTM)	MNST (5 years historical average)	Peers' Median (LTM)
Cash/Capital	39.2%	17.6%	14.7%
NWC/Capital	3.8%	17.1%	3.4%
Operating Assets/Capital	28.7%	60.2%	56.5%
Goodwill/Capital	28.3%	0.0%	25.4%

**Capital Structure**

	MNST (LTM)	MNST (5 years historical average)	Peers' Median (LTM)
Total Debt/Market Capitalization	0.01	0.01	0.57
Cost of Existing Debt	4.0%	4.0%	3.7%
CGFS Rating (F-score, Z-score, and default Probability)	BBB	B	BBB
WACC	10.3%	10.5%	8.7%



**Valuation**

Period	NO PAT Margin Forecast	Revenue to Capital Forecast
Base Year	10%	0.97
6/30/2018	12%	1.09
6/30/2019	15%	1.32
6/30/2020	18%	1.64
6/30/2021	25%	2.10
6/30/2022	22%	2.50
6/30/2023	20%	2.83
6/30/2024	18%	3.06
6/30/2025	16%	2.99
6/30/2026	14%	2.80
6/30/2027	12%	2.61
Continuing Period	2%	2.26

**Return on Invested Capital Forecast**

Period	Return on Invested Capital Forecast	WACC Forecast	Price per share Forecast
Base Year	30.4%	10.3%	\$57.45
6/30/2018	26.2%	10.4%	\$64.53
6/30/2019	34.8%	10.4%	\$71.10
6/30/2020	47.7%	10.5%	\$78.21
6/30/2021	64.2%	10.5%	\$85.86
6/30/2022	78.9%	10.6%	\$94.07
6/30/2023	91.2%	11.1%	\$103.21
6/30/2024	105.2%	11.1%	\$112.94
6/30/2025	105.5%	11.3%	\$123.44
6/30/2026	98.4%	11.4%	\$134.51
6/30/2027	91.4%	11.2%	\$145.87
Continuing Period	77.6%	11.2%	

**Valuation**

Period	NO PAT Margin Forecast	Revenue to Capital Forecast
Base Year	10%	0.97
6/30/2018	12%	1.09
6/30/2019	15%	1.32
6/30/2020	18%	1.64
6/30/2021	25%	2.10
6/30/2022	22%	2.50
6/30/2023	20%	2.83
6/30/2024	18%	3.06
6/30/2025	16%	2.99
6/30/2026	14%	2.80
6/30/2027	12%	2.61
Continuing Period	2%	2.26

**WACC Forecast**

Period	WACC Forecast	Price per share Forecast
Base Year	10.3%	\$57.45
6/30/2018	10.4%	\$64.53
6/30/2019	10.4%	\$71.10
6/30/2020	10.5%	\$78.21
6/30/2021	10.5%	\$85.86
6/30/2022	10.6%	\$94.07
6/30/2023	11.1%	\$103.21
6/30/2024	11.1%	\$112.94
6/30/2025	11.3%	\$123.44
6/30/2026	11.4%	\$134.51
6/30/2027	11.2%	\$145.87
Continuing Period	11.2%	