TENZING PACIFIC
INVESTMENT MANAGEMENT

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At 06 September 2018

HOLDING: MONSTER BEVERAGE CORPORATION (MNST)

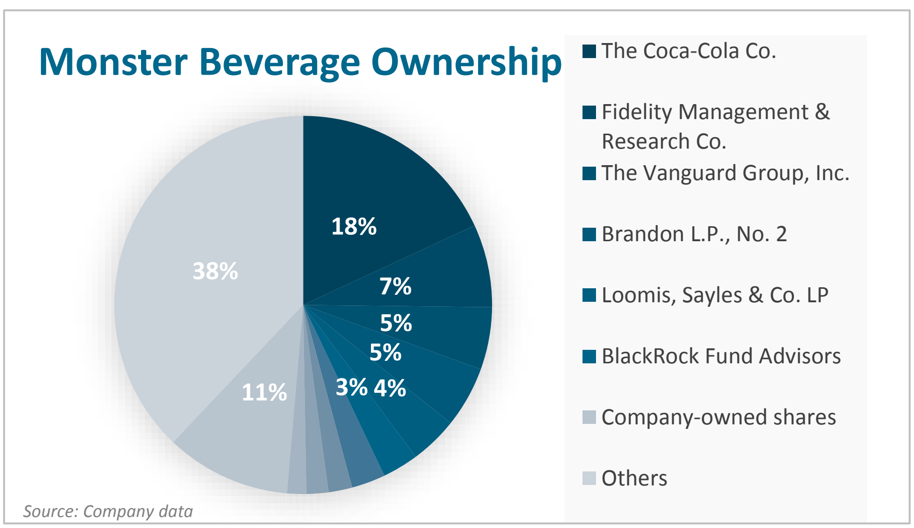
Summary

Monster Beverage Corporation, with great underlying fundamentals and excellent competitive advantages within the beverage industry, shows optimistic prospects for the future. Given medium-term investment, we believe investors can expect the earnings growth rate of over 20% p.a. in the next several years from expansion strategy in Asia, Latin America and synergy with The Coca-Cola Company (TCCC) partnership globally.

What the bulls say:

Strategy with bottlers globally and TCCC

The Coca-Cola Company has become a long- term strategic partner of Monster Beverage since 2014, with minority ownership interest = 18.1%. This transaction has supported Monster to accelerate international performance, from providing scale and access to domestic and international distribution platforms.



Thanks to the worldwide bottlers network of TCCC, with companies including: The Bottling Investments Group (BIG), Coca-Cola İçecek (CCI), National Bottling Company to name a few, Monster can take advantage of expansion. It proved successful in Germany, at first, and then New Zealand and Australia. Right now the firm is targeting Asian markets, with focus on China, but this market is characterized by high barriers to entry and needs to define the right strategy for successful entry.

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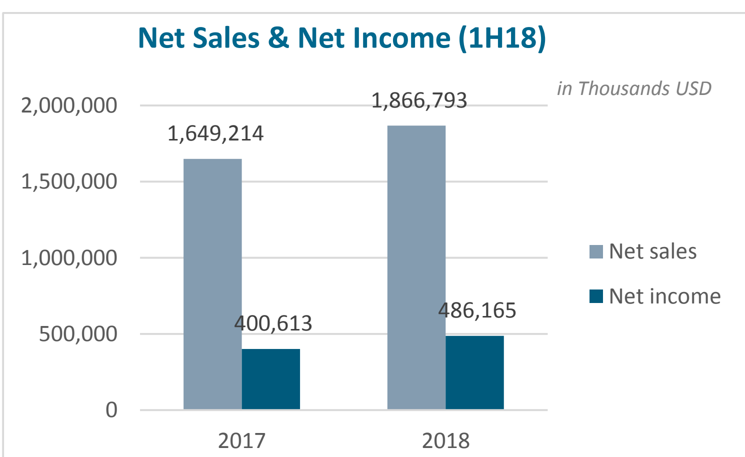
Global expansion strategy

In 2Q18, the Monster Energy brand successfully launched in Belarus, Tanzania, Uruguay, and commenced the re-launch in India. Monster Beverage is also planning further international launches in the second half of 2018, especially in Asia and Latin America, according to the CEO. We think global market share combined with increasing sales of current and new products will be the key drivers to achieve double-digit revenue and earnings growth in next several years.

According to World Bank, global incomes rose linearly (22.9% from 2010 to 2016) and forecasted to continue to grow at 3% annually, which will likely boost demand for discretionary food and beverage purchases, because of the inherent convenience and the fact that brands like Monster and peers are considered trendy. However, customer behaviors are gradually starting to switch in favour of organic and healthier food, drinks for improving living standards rather than using energy drinks. This maybe hurt company sales in medium and long-term if the company focuses too much on legacy customers in developed economies.

Excellent financial fundamentals

In the six-months ended June 30, 2018, financial performance was enhanced, with net sales growth +13.2% yoy & NI growth 21.4% yoy. Moreover, the company showed solid operations management, with net profit margin increasing from 24.3% in 2017 to 26% in 2018.



(Sources: Company Data)

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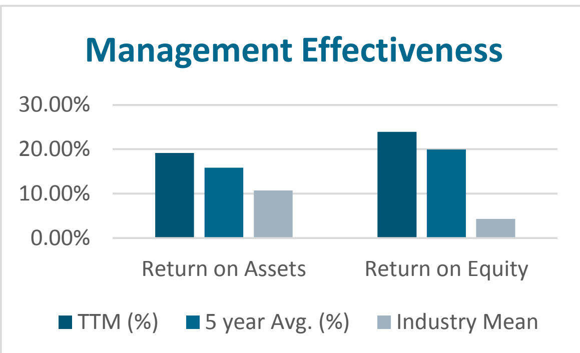
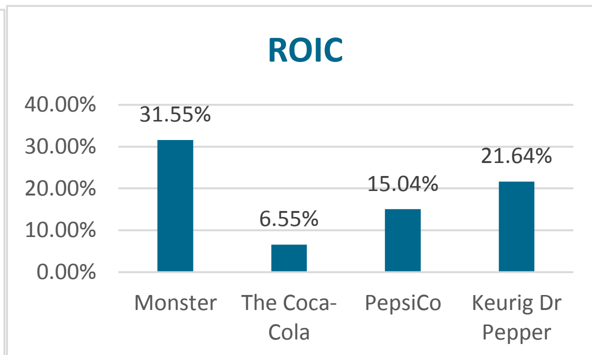
The company's current ROA, ROE of 19.2% and 23.9% respectively are well above the 5 year industry average and industry mean. The ROIC of Monster illustrates the competitive advantages Monster enjoys relative to competitors.





(Sources: Company Data, Guru)

In addition, share repurchases program from first half 2018 was up to 10,553,490 shares. In 07 August, the BOD authorized that new share repurchases program projected up to 500$ million of the Company's outstanding common stock boost investor's confidence.

Due to its strong balance sheet and solid rate of free cash flow, (Monster doesn't use financial leverage), we believe Monster uses cash to invest in growth opportunities, potentially in merger and acquisition activities, and returns cash to shareholders through share repurchase programs instead of paying dividends.

Market Consensus:

Sell side coverage sees 6/7 mainstream buy ratings, with an average upside forecast of 10.42%, with the only sell rating coming from Pablo Zuanic at Susquehanna. Though we don't really pay much attention to sell-side coverage, it remains interesting to observe such a high level of positive consensus for a company often perceived as producing a structurally impaired product.

What the bears say:

Monster's Issues

The non-alcoholic beverage market is a highly competitive industry, mainly dominated by The Coca-Cola Company and PepsiCo. Specifically, the sub-sector of energy drinks brings direct competition from Red Bull, which has a 43.40%

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market share, which leaves Monster trailing with 39%. On the other hand, with high market share in U.S, we believe Monster can maintain pricing power and customer loyalty, preventing others taking market share.

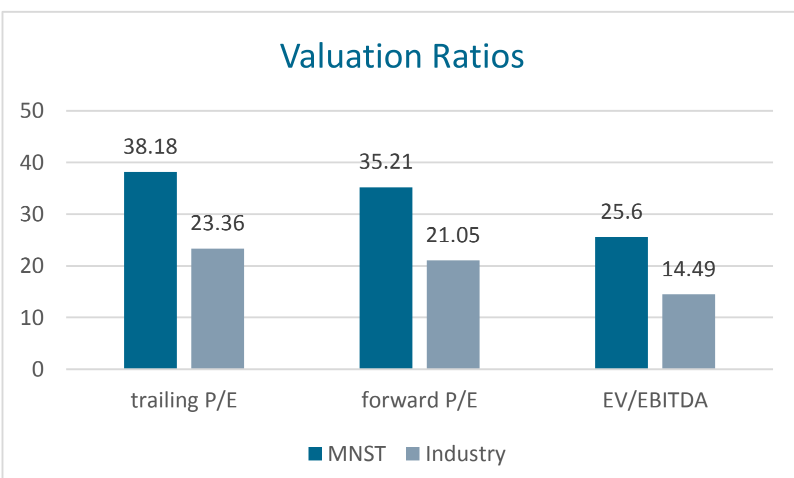
Even though Monster has had legal issues from being defendant in at least 13 lawsuits, primarily in relation to the deaths from cardiac arrest and heart attacks suffered by customers through to 2014, the Company has overcome them by decreasing focus on the energy drink category and has successfully complied US Food and Drug Administration's regulations. Furthermore, energy drinks are banned for children under 16 or 18 in the UK due to the fact that almost a third of teens who have consumed high caffeine drinks have suffered health issues like: headaches, stomach aches, hyperactivity and sleep problems. This could create a wave of energy drink barriers in Europe. Customer behavior has shifted toward consumption of healthier and more natural beverages and food, and we expect that the decline demand for energy drinks could hurt the firm's brand and revenue also. Monster has shown efforts to diversify product portfolio to a low calorie offering, but it cannot totally avoid the health issue.

Input Costs

On the input cost side, higher material costs as a result of increasing aluminum and sucralose (sweeteners) costs, as well as tariffs on steel and aluminum by the Trump Administration will also have an increasing impact on input costs.

Relative Valuation

Comparable valuation ratios point out that Monster is currently relatively overvalued compared to its industry. Particularly, trailing PE, forward PE and EV/EBIDA are all approximately 1.6 -1.7 times that of the industry mean. P/E currently is 38.25. We think, in the future, with the expansion of distribution abroad, will help to enhance the company's earnings, leading the PE ratio towards the industry mean.



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Foreign Exchange Exposure

Monster is exposed to significant foreign exchange rate risk and regulatory change in the future, but we believe that these risks can be mitigated by hedging instruments such as: entering currency swaps and continued compliance with all regulations. Additionally, a change in Fed sentiment to a less hawkish stance, evidence of which is already present in the latest remarks from Federal Reserve Chairman, Jerome Powell, could change the fundamentals of the USD going forward and finally result in foreign currency carry opportunities for USD based investors and companies.

4 Reasons to buy:

- Monster Beverage Corporation's financial performance and financial strength is excellent and healthy. The firm doesn't use leverage for operations. Free cash flow is positive and has risen around 23.04% CAGR over the last 3 years. In 1H18, EPS increased 21.12% yoy. EPS projected growth this year will continue double-digit to 16.95%, boost the value of share.

- Profitability Ratios: ROE, ROA and ROIC have also outperformed in comparison to peers, with higher compound annual growth than the company's market cap over the last 5 years. Moreover, Monster has the ability to utilize equity far better than all of it's competitors.

- Global market expansion strategy will enhanced distribution, the execution of which will be largely amplified by The Coca-Cola partnership. Monster will gain more market share in the regions or countries where it has historically been weak such as Asia Pacific and Latin America.

- The share repurchase program grown this year and will continue to grow over the next several years, provider investors with greater incentives to own shares and essentially putting a floor on share prices. With strong cash flow, the firm should be able to execute the program successfully. This will be good signal for investor sentiment and provide confidence to buy and hold.

Recommendation: We recommend buy MNST. Report written by Duyen Vo, Junior Financial Analyst