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The Coca-Cola Co. (KO)

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MANAGEMENT DISCUSSION SECTION

Operator: At this time, I'd like to welcome everyone to The Coca-Cola Company's Fourth Quarter Earnings Results Conference Call. Today's call is being recorded. If you have any objections, please disconnect at this time. All participants will be on listen-only mode until the formal question-and-answer portion of the call. I would like to remind everyone that the purpose of this conference is to talk with investors and, therefore, questions from the media will not be addressed. Media participants should contact Coca-Cola's Media Relations department if they have any questions.

I would now like to introduce Mr. Tim Leveridge, Vice President and Investor Relations Officer. Mr. Leveridge, you may now begin.

Timothy K. Leveridge

Vice President & Investor Relations Officer, The Coca-Cola Co.

Good morning and thank you for joining us today. I'm here with James Quincey, our Chief Executive Officer; Kathy Waller, our Chief Financial Officer; and John Murphy, our incoming Chief Financial Officer.

Before we begin, I'd like to remind you that this conference call may contain forward-looking statements, including statements concerning long-term earnings objectives and should be considered in conjunction with cautionary statements contained in our earnings release and in the company's most recent periodic SEC report. As a reminder, we will be hosting a separate Modeling Call at 10:30 AM this morning to review our 2019 outlook in greater detail and allow sufficient time to address questions pertaining to guidance.

We posted schedules under the Financial Reports & Information tab in the Investors section of our company website. These schedules reconcile certain non-GAAP financial measures, which may be referred to by our senior executives during this morning's discussion, to results as reported under generally accepted accounting principles. Finally, during today's call, when our senior executives refer to comparable performance, they are referring to comparable performance from continuing operations.

Following prepared remarks this morning, we will turn the call over for your questions. Please limit yourself to one question. If you have more than one question, please ask your most pressing question first and then re-enter to the queue.

Let me now hand the call over to James.

James Quincey

Chief Executive Officer & Chairman-elect, The Coca-Cola Co.

Thanks, Tim, and good morning, everyone. 2018, we concluded another quarter of solid operating performance capping off a successful year. The nonalcoholic beverage industry was stronger in 2018, as emerging and developing markets accelerated from the prior year, while the developed world held its volume trajectory on top of stronger pricing. Our business performed well across all key dimensions in 2018, as we leveraged our transformation as a total beverage company.

Most notably, we gained global value share and those share gains were broad-based. We held or grew value share across each of our geographic segments. Organic revenue grew 5% versus our goal of 4%, driven by strength across all operating segments.

Underlying operating income grew 11% versus our goal of 8% to 9%, as we built momentum through the year while accelerating the capture of productivity savings. This resulted in an approximate 170 basis point expansion in the underlying operating margin. And comparable EPS grew 9%, in line with our guidance of 8% to 10%, despite absorbing \$600 million in stronger currency and structural headwinds than we anticipated at the beginning of the year.

Our results reflect actions taken over the past several years to transform our business for long-term success. Execution is getting better. We set ourselves up for the future with an energized bottling system that is bringing a renewed focus on execution around the world and, in particular, several key markets, including North America where we have completed our refranchising activities.

Pricing power is improving. We are delivering accelerated top-line growth as we continue to implement revenue growth management initiatives in markets around the world. And marketing is becoming sharper. We're focusing on innovation that leverages brand edge and ritual building with increased efforts to digitally connect with consumers. And we have begun embedding a productivity mindset across the organization.

Now, let's talk specifically about how we drove disciplined growth this past year. First, we strengthened our sparkling soft drink portfolio, leveraging brand edge and innovation to build consumption rituals by offering people what they want, when and where they want it. Trademark Coke grew volume 2%, driven by solid performance in brand Coke and supported by innovation, such as Coca-Cola Plus Coffee and Coke Origins, as well as strong growth in our no-sugar variants.

Coca-Cola Zero Sugar delivered yet another year of double-digit volume growth globally. And in North America, we reinvigorated Diet Coke, with the brand growing retail value 3% after multiple years of declines.

Trademark Sprite also performed well, growing global volume 2%, through premium innovations such as Sprite plus fiber in China. Second, we rapidly scaled successful brands like Fuze Tea, smartwater and AdeS across more markets. With the launch of Fuze Tea in Europe, we delivered over 100 million incremental cases in EMEA, offsetting the volume loss from the dissolution of Beverage Partners Worldwide. This enabled us to gain leadership positions within the ready-to-drink tea category across 11 European markets, highlighting what an aligned system can accomplish.

Of course, driving disciplined growth isn't just about expanding our beverage portfolio. We need to allocate resources to those brands and strategic initiatives that are delivering the highest returns. To that end, we eliminated over 700 underperforming zombie SKUs. By finding ways like this to reduce complexity, we ensure that our system sales force is focused, our supply chain is efficient and our latest innovations get more space and visibility at the point of sale.

Third, we expanded our portfolio through M&A and strategic investments. This included smaller investments like BODYARMOR, one of the fastest growing beverage trademarks in the U.S. Of course, our biggest announcement was the acquisition of Costa, which we closed on January 3 this year. The Costa platform will give us the ability to scale within the \$500 billion global hot beverage category and create a world-class global coffee business, allowing us to better serve our customers and strengthen our ready-to-drink portfolio. All of this shows how we've been pursuing the vision we first shared with you a couple of years ago.

Now, one of the most important enablers of this work is having the right leadership team and operating structure in place. In 2018, we appointed a President and Chief Operating Officer to bring accelerated focus on execution and talent development. We announced an orderly transition for the CFO, with Kathy's retirement and John's shift from operations to finance. We added two new Group Presidents with considerable experience. And we created a new group, Global Ventures, to ensure we connect and globally scale key acquisitions, investments, and partnerships like Costa coffee, innocent and Monster. The changes we've made are significant, and they help set us up for more success in the years to come across our geographies.

Looking around the world, we are already delivering better performance in key markets. In EMEA, we grew organic revenue 7%, delivering a second sequential year of accelerated top-line growth. We accomplished this in part due to revenue growth management initiatives that focus on small baskets and pack sizes. These were phased into multiple markets over the year. As we continue to build on these actions in 2019, we expect continued good performance.

In Asia Pacific, good results across several large emerging markets drove our strongest organic revenue growth in over five years. We had a stronger innovation pipeline, solid digital initiatives and steadily improving execution by our bottling partners. For example, in India, 25% of our revenue growth came from new products. And in China, digital initiatives coupled with a robust innovation pipeline resulted in solid performance.

During the fourth quarter, our B2C business capitalized on Singles' Day, the massive online shopping holiday. Both our digital B2C and B2B businesses grew over 40% for the year and now account for over 5% of the system revenues in the market. And collectively across the group, our bottling system opened approximately 1 million new customer outlets.

Turning to Latin America, we delivered 11% organic revenue growth for the year, as we continued to execute against the fundamentals amidst varying macro environments. In Argentina, the economy tipped into recession in the back half of 2018, so we adjusted quickly our plan to maintain affordability and protect our consumer base. In Mexico, our business continued to perform well amidst a volatile backdrop. And in Brazil, the operating environment became more certain after the elections. The turnaround of our business there is taking hold, and our strategies are driving improved performance.

Finally, in North America, we continue to deliver strong performance in the marketplace and gain value share, supported by a stronger fully-refranchised bottling system. During the year, we undertook a significant package resizing initiative across our chilled juice and tea portfolios and implemented pricing actions across our sparkling soft drink portfolio to manage through a challenging cost environment, while adding over \$1 billion in incremental retail value to our customers for the brands the Coke system sells. Due to the strength of our brands and increased investments from our independent bottling partners, we were able to capture price/mix in the marketplace while beating historical elasticity. So lots of activity across our various regions.

Overall, there is a consistent thread in what's driving better results across our territories. We've strengthened our brands, including Coca-Cola, through strategic innovation and more disciplined ritual building. Our bottling partners have increased investments and improved execution. And together, we're aligned as a system on how to capture the growth opportunities before us.

Before moving on to 2019, let me provide some context on the fourth quarter. We continued to grow global organic revenues 5%. The composition of the growth changed. We delivered stronger sequential price/mix, while unit case volume was flat. Volume was impacted by slowing economic conditions in some countries like

Argentina, plus decisions to focus on value over volume in certain markets. However, we've seen a good start to 2019, with more balanced volume and price/mix, and this is consistent with our expectation for the full year.

Looking ahead, we're seeing the impact of some increasing uncertainty and volatility in global macroeconomic conditions. Consumers are under more pressure as we head into the new year; however, demand for our categories remains healthy. And our business is built to perform even if the tailwinds behind us moderate somewhat. Ultimately, we'll focus on what we can control, taking steps to manage the business as we become a total beverage company: further lifting, shifting, and scaling on-trend brands like Fuze Tea, smartwater, and innocent across markets; reformulating products to reduce sugar levels; rolling out revenue growth initiatives across additional territories to improve performance within our sparkling soft drink portfolio; connecting Costa across many of our business units to build a leading global coffee business; and leveraging digitization to build a business for the future. Therefore, we feel confident that we can deliver against our 2019 guidance.

Finally, I'd like to thank Kathy. Kathy has made significant contributions to our company, our system and our people, working her way from Financial Analyst all the way to the most senior financial role in the company, truly a testament to the value she has brought through every phase of her journey. As CFO, she has stewarded the company's financials through an extremely complex refranchising process. And she is leaving a strong foundation for John to build upon. Finally, she has been a critical partner to me and I have appreciated all of her valuable support.

With that, let me turn it over to Kathy.

Kathy N. Waller

Executive Vice President & Chief Financial Officer, The Coca-Cola Co.

Thank you, James, and good morning, everyone. During my time as CFO, I've met personally with many people who are on the call this morning, from analysts who follow our industry to investors in our company, many of our associates and partners that I know are listening this morning. I thank each and every one of you, and many others, for your help, whether it was in the form of guidance, support, prodding or challenging. Each encounter helped me to be a better CFO and a better representative of this company that I love.

Effective March 15, I retire after 30-plus years with The Coca-Cola Company. From the very beginning with my start in Accounting Research, I have had amazing opportunities to learn and grow and eventually become a leader in the company. I am very proud to have been a part of this company and this system.

Coca-Cola is about experiences and making lives better for everyone who touches our system, from the smallest shop or kiosk owner to the largest customer, those who simply enjoy drinking our products. It has been my privilege to be a part of this extraordinary business. And it will be my pleasure to watch Coca-Cola continue to grow and evolve under the leadership of James, Brian and John and the rest of the leadership team, along with the hard work and support of the 700,000 people who are taking this system into the future.

And with that, I will hand this call over to the future and let John take it from here.

John Murphy

Deputy Chief Financial Officer & Senior Vice President, The Coca-Cola Co.

Thank you, Kathy. You have been a great partner over the years, and you leave behind a tremendous legacy. My congratulations to you on your retirement and my appreciation as well for your many contributions over the years to the company and especially to many people in the company.

Now, I look forward to partnering with James and Brian to drive the business going forward. And before I begin, let me just take a moment to talk about my key priorities going into this role. Number one will be [audio gap] (14:54) drive healthy top-line growth, leveraging our expanding portfolio. Number two will be to improve margins in all our operating segments. Number three will be to optimize our balance sheet and allocate capital in a disciplined manner to our highest return activities. Number four will be to drive a culture of agility and productivity across the enterprise. And number five will be to develop our people and build the capabilities that we need in the company going forward. Ultimately, I will be looking to push our enterprise to find opportunities to sustainably maximize free cash flow and returns.

Turning to our financial performance, as James said, 2018 was a good year. We delivered 9% comparable EPS growth, due to momentum in the underlying business, accelerated productivity and a favorable tax rate. Our press release covered our fourth quarter results in detail, so I will focus on our 2019 guidance.

At a high level, we expect 4% organic revenue growth, double-digit comparable currency neutral operating income growth, comparable EPS to range from plus 1% to minus 1% and free cash flow of at least \$6 billion.

Now, let me touch on the key considerations and assumptions embedded in our outlook. We expect global growth to be slightly lower than in 2018, with continued growth in the developed world and macroeconomic challenges in certain emerging markets. However, there is a significant amount of uncertainty and geopolitical tension, which could result in further changes in this macro environment. That said, we focus on the things we can control. And the actions we've taken over the past few years have set us up for continued success, despite shifting macros.

We expect organic revenue growth to benefit from our continued focus on lifting, shifting and scaling products, such as Coca-Cola Zero Sugar and Fuze Tea, as well as implementing revenue growth management activities across more markets.

In addition to solid organic growth, we expect an 8 to 9 point benefit to revenue from net M&A and structural activity. We completed our North American franchising efforts and divested our company-owned bottlers in Uruguay and Guatemala last year. We also took full ownership of our Philippines bottler in the fourth quarter. And earlier this year, we closed the acquisitions of both Costa coffee and the remaining stake in Chi, Africa's leading value-added dairy and juice company.

We expect the net effect of these transactions to result in lower comparable gross margins for the year, driven by the Philippines bottling operation. In the U.S., while freight costs are expected to remain above historical levels, we do not expect to see the same level of year-over-year increases we saw last year.

And we have \$600 million remaining in growth productivity to capture in 2019. A portion of these savings will be reinvested in the business. Recent investments are generating a good return, as evidenced by our strong top line relative to most CPG peers. So all-in, we expect solid pricing, a continued focus on expense management, and a net benefit from acquisitions to deliver 10% to 11% comparable currency neutral operating income growth.

We expect currency to be a 6% to 7% headwind to operating income, as we face a strengthened dollar and cycle hedging gains in 2018. Below the line, we expect deleverage driven by higher net interest expense. And we expect an effective tax rate of 19.5%; however, this rate could vary from quarter-to-quarter.

So in summary, we expect double-digit comparable currency neutral operating income growth, but the impact of currency, along with higher interest and taxes, will lead to the stated range of plus 1% to minus 1% for comparable EPS growth in 2019.

As you model the flow of the year, there are a few items to consider in terms of phasing. The first quarter will have one less day than in 2018. Easter will fall in the second quarter this year compared to the first quarter last year. Due to the timing of Fed rate increases, the year-over-year increase in interest expense will be more heavily skewed to the first half of 2019 than the back half. And similarly, because of when the dollar strengthened last year, we expect a more significant currency headwind in early 2019, which will then begin to moderate as we move through the year.

As James said, we created a new operating group, Global Ventures. This will be a new reporting segment in 2019 and will include Costa coffee, Doğadan Tea, innocent and Monster. As such, we will provide the revised operating segment financial information reflecting this change before first quarter results are released.

I realize that, at times, our company can be complex to model. For example, our M&A and structural changes impact several of our operating segments this year. Our Investor Relations team will host a call at 10:30 this morning to answer any further questions as you build out your models for the year.

But in summary, we delivered against our EPS guidance in 2018, amidst stronger headwinds than anticipated at the beginning of the year. We maintained a discipline approach to our use of capital, and we are well positioned to capture growth opportunities as we enter 2019.

Operator, we are now ready for questions.

QUESTION AND ANSWER SECTION

Operator: Thank you. [Operator Instructions] Our first question comes from Bryan Spillane with Bank of America. Your line is now open.

Bryan D. Spillane
Analyst, Bank of America Merrill Lynch

Q

Hey. Good morning, everyone. And...

James Quincey
Chief Executive Officer & Chairman-elect, The Coca-Cola Co.

A

Good morning, Bryan.

Kathy N. Waller
Executive Vice President & Chief Financial Officer, The Coca-Cola Co.

A

Morning, Bryan.

John Murphy
Deputy Chief Financial Officer & Senior Vice President, The Coca-Cola Co.

A

Good morning.

Timothy K. Leveridge

Vice President & Investor Relations Officer, The Coca-Cola Co.

Good morning.

A

Bryan D. Spillane

Analyst, Bank of America Merrill Lynch

And, Kathy, just again one more time, just congratulations on a great career and wish you all the best as you move on.

Q

Kathy N. Waller

Executive Vice President & Chief Financial Officer, The Coca-Cola Co.

Thank you, Bryan.

A

Bryan D. Spillane

Analyst, Bank of America Merrill Lynch

So I guess, James, my one question is really around EPS guidance this year being flat. And I think previously, we've talked before about kind of a commitment to dollar EPS growth. So I guess, one, is that still sort of a commitment going forward? But more importantly, maybe could you talk about some of the considerations. I understand the currency headwinds being a big part of it this year, but just what other trade-offs you might have made in terms of what you're choosing to invest this year versus maybe dropping more to the bottom line.

Q

James Quincey

Chief Executive Officer & Chairman-elect, The Coca-Cola Co.

Sure. Morning, Bryan. Firstly, the whole idea of, in a way, the three-legged stool is still absolutely valid and important. And just to recap what I meant by that, this is a business that predominantly wins or loses, but our focus is on winning in the local marketplaces. We focus on getting the consumers and growing customer value in each and every country, and so there's very much a focus on getting that to work. And I think over the last few years, you've seen accelerated performance of us able to drive industry growth and capture share within that.

A

And that's the starting point of value creation for the Coke company, to work on then making sure the operating margins of how we do that are the same or better, such that we turn that revenue growth into profit growth at a local level. And then, as you say, we have, in more recent years, had a more intense focus on making sure the sum of the parts is more than just the sum of the parts and to pull the levers necessary to turn that into U.S. dollar EPS earnings, after a number of years where currency had eroded that and the EPS had effectively declined. That's still our going in objective. The guidance is where we stand today, it's a really strong operating plan for 2019.

I think we are being cautious about the macroeconomics and how that's going to be a little softer than 2018, but a strong plan behind the marketing, the execution, and the innovation. And absolutely, we are reflecting here in our guidance where currency and interest rates and tax fit today, which are the three, in a way, uncontrollable factors.

There's a long way to the end of the year and they could change markedly, but our focus will remain and our ambition will remain to end the year with positive EPS growth. We would be disappointed if it wasn't positive. But we wanted to share with you where things stand today, and we will focus on pulling the levers that we can pull to get to the result that we want.

Operator: Thank you. And our next question comes from Lauren Lieberman with Barclays. Your line is now open.

Lauren R. Lieberman

Analyst, Barclays Capital, Inc.

Q

Great. Thank you. Good morning.

James Quincey

Chief Executive Officer & Chairman-elect, The Coca-Cola Co.

A

Good morning, Lauren.

Kathy N. Waller

Executive Vice President & Chief Financial Officer, The Coca-Cola Co.

A

Morning, Lauren.

John Murphy

Deputy Chief Financial Officer & Senior Vice President, The Coca-Cola Co.

A

Morning, Lauren.

Timothy K. Leveridge

Vice President & Investor Relations Officer, The Coca-Cola Co.

A

Morning.

Lauren R. Lieberman

Analyst, Barclays Capital, Inc.

Q

Hey. I was hoping you guys could talk a little bit about North America this quarter. So the flat organic sales growth looks pretty different than what we've seen in the Nielsen data. So I think a big question would be kind of what drove that gap, and if you could give us any update specific to North America outlook. I think everyone is worried about is do you have a resurgent set of competitors? Is that driving an impact or even how you're planning for that as you look into 2019? Thanks.

James Quincey

Chief Executive Officer & Chairman-elect, The Coca-Cola Co.

A

Sure. Yeah, we were a little softer in the fourth quarter in North America. And I think part of that is we took the mid-year price increase in the middle of the summer, and it took a while for it to flow all the way through to the consumers. And so, really, I think it was more fully in the marketplace by the end of the summer and obviously then coming into the fourth quarter. So I think you saw a little of the effect of the price increase more actually in the fourth quarter than in the third quarter when the system was taking it. And I think that kind of combined with a little bit of consumer outlook malaise in that period of time. So you saw a little softening in the volume, but then it started to pick up.

So we started the year well this year, in terms of North America volume, and price/mix was also continued to be the positive through the back of the year. I know it's only come through as 2% in the fourth quarter for North America. Bear in mind this carries with it some of the oddities of which business system was growing because the

juice business, which is a finished goods business, where we were rightsizing the packaging and seeing volumes go down; obviously, finished goods versus the sparkling, which is concentrate and it has that mechanical effect that the faster the sparkling business grows, the more it actually affects mix in a negative way. But that doesn't affect profits, and it doesn't affect the marketplace. So there's a little bit of mix and the freight and all the noise, but let's draw a line because the good news is 2018 has ended.

The freight accounting issue has disappeared for 2019. The marketplace pricing is clear and positive for going into 2019. And the business has started with a foot forward. And so, we're confident we have the right strategy for North America and that we will see the benefits of that strategy flowing more simply and more clearly through to the results in 2019.

Operator: Thank you. And our next question comes from Judy Hong with Goldman Sachs. Your line is now open.

Judy Hong

Analyst, Goldman Sachs & Co. LLC

Q

Thank you. Good morning.

James Quincey

Chief Executive Officer & Chairman-elect, The Coca-Cola Co.

A

Good morning, Judy.

Kathy N. Waller

Executive Vice President & Chief Financial Officer, The Coca-Cola Co.

A

Morning, Judy.

Timothy K. Leveridge

Vice President & Investor Relations Officer, The Coca-Cola Co.

A

Good morning.

John Murphy

Deputy Chief Financial Officer & Senior Vice President, The Coca-Cola Co.

A

Morning.

Judy Hong

Analyst, Goldman Sachs & Co. LLC

Q

And, Kathy, again congratulations from my end as well.

Kathy N. Waller

Executive Vice President & Chief Financial Officer, The Coca-Cola Co.

A

Thank you.

Judy Hong

Analyst, Goldman Sachs & Co. LLC

Q

I guess, James, just your comment about a good start to the year, was that specific to North America as you alluded to the prior question? And then as you kind of think about the comment about increased volatility in the global macro environment, maybe you can talk a little bit about some of the key markets where some of that concerns persist, and how much is that sort of factored into the 4% organic revenue guidance? Thanks.

James Quincey

Chief Executive Officer & Chairman-elect, The Coca-Cola Co.

A

Sure. My comment about a good start to year was both about North America and globally. We have started the year. It's only six weeks, it's a long year. But what is good is it started off well in terms of volume and, therefore, we see ourselves starting the year with a good balance of volume growth and price/mix that is very consistent with having a balanced contribution to driving the top-line guidance.

And, as I said, North America is good. We seem to have had a good Chinese New Year. You never quite really know until the end of February, but it seems like it's been a strong Chinese New Year. Brazil is looking a little better. Mexico seemed to have started well, given some poor weather at the back end of last year. You heard about the European outlook today, this morning.

So we think we've started well. Long year to go, great plan, lots of it will need managing, no doubt, and the volatility, but we baked in what we know today. Clearly, there's places where weakness is apparent. Argentina went down quite strongly in the fourth quarter. That's likely to continue in the first half of this year; Turkey, very similarly, some parts of the Middle East.

So we've baked in what we see and what we believe is likely to be the softening of the global macro outlook and in the countries which are more apparent. Clearly, the visibility is more apparent in the first half of the year than the second half. Hopefully, the world will turn a little and the second half will improve, and that will certainly help us reap more even benefits from our strong plan. But that's kind of where we stand today.

Operator: Thank you. And our next question comes from Ali Dibadj with Bernstein. Your line is now open.

Ali Dibadj

Analyst, Sanford C. Bernstein & Co. LLC

Q

Hey, guys.

James Quincey

Chief Executive Officer & Chairman-elect, The Coca-Cola Co.

A

Morning.

Kathy N. Waller

Executive Vice President & Chief Financial Officer, The Coca-Cola Co.

A

Morning, Ali.

Ali Dibadj

Analyst, Sanford C. Bernstein & Co. LLC

Q

Hi. Look, I think you may have missed the memo on lowering 2019 expectations. We're all kind of thinking Pepsi would do that tomorrow and not Coke today. And so I'm a little confused about the drivers of it. And if you start with top line, you're saying approximately 4%. Not too long ago, you insisted on 4% to 6% being the right number.

Then, you have a big gap from that to 10% to 11% OI, which seems aggressive, so a big improvement there. And then, I'm still confused about the move from 10% to 11% OI to flat EPS, even with FX at, I guess, negative 6% to 7%. That doesn't jive with what we're seeing from a currency level today, so are you assuming things getting worse? I see the taxes change that you're describing. I don't really know why. So I know you have tried to explain it in bits and pieces, but there are a lot of moving parts and I want to understand the moving parts. I don't want to wait until 10:30 – I don't think many of us do – to at least understand the drivers of why we're getting so disappointed here, both on top line and on the EPS. Thanks.

James Quincey

Chief Executive Officer & Chairman-elect, The Coca-Cola Co.

A

Sure. Well, I think at the highest level, the story is a simple story. Well, obviously, we have a long-term growth model of 4% to 6% on the top line. We've been delivering within that range for the last six quarters. We are being prudent in our outlook for 2019, given the multiple reductions in global economic growth outlook for 2019 and our own experience in some of the emerging and developing markets. I think 4% is a prudent number.

We have a strong plan that's backed up by the marketing, the innovation, and the execution. So I think we're going to be in great shape on continuing to grow the top line, and I think that number will end up being at the higher end of consumer products companies in terms of revenue growth for 2019, in the same way the number for 2018 was at the high end of consumer products companies.

You're seeing then the benefits of a lot of actions over the last number of years, in terms of productivity, in terms of our focus on smaller packages and revenue growth and innovation, and premiumization of our portfolio such that we're getting operating leverage. Operating leverage is not just driven by productivity, but by better work on the portfolio. And you see that flowing through. Obviously, with some of the tailwinds from the acquisitions and the divestitures, a small piece so that we're getting excellent leverage from our revenue growth into our operating income growth at the 10% to 11%. Obviously, the currency is where it is.

That is currencies as they stand today. We're not making a forecast as to what the currencies will be by the end of the year. There is a piece of that that we're cycling hedging gains in 2018, as we commented earlier. But the number of the 6% to 7% is as things stand today. How they will stand at the end of the year, we'll see. And then, of course, we're losing some leverage from operating income finally down to EPS through the higher tax rates, which the Fed has taken through the year and through the changes in the tax rates – the interest rates from the Fed and the tax rates. The tax rate is going to be slightly higher in 2019 than it was in 2018, so that's pretty straightforward. Clearly, that's leading to a EPS growth that is not what we aspire to. We are going to focus on controlling what we can control and driving the business.

We'll be pulling the levers, as I talked about earlier on the call, to make sure we focus on our aspiration of turning our winning local plans into growth of dollar EPS. But we want to be prudent in our guidance, given the macro environment, despite a strong good momentum winning plan, and to put the FX as it stands today. The only thing that's for sure is it'll be different tomorrow, and we will update it as we go through the year.

Operator: Thank you. And our next question comes from Dara Mohsenian with Morgan Stanley. Your line is now open.

Dara W. Mohsenian

Analyst, Morgan Stanley & Co. LLC

Q

Hi, guys.

Kathy N. Waller

Executive Vice President & Chief Financial Officer, The Coca-Cola Co.

Hi, Dara.

A

James Quincey

Chief Executive Officer & Chairman-elect, The Coca-Cola Co.

Hi, Dara.

A

John Murphy

Deputy Chief Financial Officer & Senior Vice President, The Coca-Cola Co.

Hi.

A

Timothy K. Leveridge

Vice President & Investor Relations Officer, The Coca-Cola Co.

Hey, Dara.

A

Dara W. Mohsenian

Analyst, Morgan Stanley & Co. LLC

So I just wanted to quickly clarify your answer to Bryan's question earlier. I understand the 2019 underlying profit outlook is solid ex-items if, in fact, you deliver it, but I think you had intimated before that you were really looking to drive earnings growth, even in the face of FX pressure. So obviously, we have talked about 2019 guidance already, but as we think about the earnings trajectory post-2019, is it more in line with the long-term algorithm that you guys have outlined, plus or minus currency, or do you still think there's some levers you can pull over time that, even if FX continues to be unfavorable, you can hit your earnings growth targets? I don't know if that'll count as my question or not, but first maybe clarify that. And if I can ask another and you're willing to be generous, go ahead. If not, move to the next person. Thanks.

Q

James Quincey

Chief Executive Officer & Chairman-elect, The Coca-Cola Co.

Okay. I think it sort of seems all wrapped up in one version of the same idea. Look, we are committed to growing the earnings of the company. I mean, in simple terms, the earnings of the company are the fuel to pay the dividends of the company and drive the stock price and reinvest back in the business. So without dollar increased earnings of EPS, it's not going to be a growth company.

A

And therefore, we reaffirmed the long-term growth model at some of our previous investor presentations, the 4% to 6% on revenue, and the growth in EPS. Yes, there'll be years where currency will weigh on it more heavily. We certainly have the aspiration that there'll be no negative years. We have said we will not do things that are irrational just to get a positive EPS, but we will focus on trying to pull levers to get there. But as you look out into the future, we absolutely expect to keep focusing on coming back to the long-term growth model.

Now to the question, well, what happens if the dollar always gets stronger? Well, then, simply put, assuming that there still is a global trading system, that will export inflation to the other parts of the world. And therefore, if we enter some very long extended period of dollar strengthening, then we will logically expect to see higher pricing in other parts of the world that will compensate for some prolonged ongoing strengthening of the dollar. So either way, we want to get back to our long-term growth model in dollars realized for the shareholders.

Operator: Thank you. And our next question comes from Steve Powers with Deutsche Bank. Your line is now open.

Steve Powers

Analyst, Deutsche Bank Securities, Inc.

Q

Thank you very much. Kathy, thank you from me as well and best wishes for the future. And, John, my congratulations again on the new role. James, for you, I say good job. And my gift to you is I'm going to ask Kathy and/or John a question. Related to the free cash flow guidance for next year, it implies another year of about two-thirds conversion of net income to free cash flow, which is below the company's 90%-plus target.

So I'm assuming there is still a good number of structural costs flowing through with respect to refranchising and the recent acquisitions, but can you help us get underneath those dynamics at all and paint a picture of what it will take to get to that 90-plus percent conversion ratio on a consistent basis? And can we look to 2020 to be that year of inflection?

John Murphy

Deputy Chief Financial Officer & Senior Vice President, The Coca-Cola Co.

A

So let me start. For 2019, while cash from operations is expected to increase at least 10%, it's going to be largely offset by increased CapEx from a free cash flow standpoint. And that increased CapEx is primarily due to three factors. One is the acquisition of Costa and some CapEx related to investing for the future there. Secondly, with BIG taking on the Philippines, and then, thirdly, we have a couple of strategic initiatives in the digital arena and in our concentrate business to invest in in 2019.

As we go forward, we do have a clear line of sight to get to the 90% to 95%. One area of focus is going to be to drive greater efficiencies in working capital productivity. Secondly, would be to reduce the cash flow impact from the timing of payments of one-time items related to restructuring and refranchising. And then, finally, we would love to see some of our upfront CapEx investments scaling back. So whether it's 2020 or 2021, I think it's too early to say. But clearly, the focus is to have that number back to the 90% to 95%, but, as I say, I think we have a very clear line of sight as to how to get there.

Operator: Thank you. And our next question comes from Bonnie Herzog with Wells Fargo. Your line is now open.

Bonnie Herzog

Analyst, Wells Fargo Securities LLC

Q

Thank you. Good morning, everyone.

James Quincey

Chief Executive Officer & Chairman-elect, The Coca-Cola Co.

A

Good morning.

Kathy N. Waller

Executive Vice President & Chief Financial Officer, The Coca-Cola Co.

A

Morning, Bonnie.

John Murphy

Deputy Chief Financial Officer & Senior Vice President, The Coca-Cola Co.

Morning.

A

Bonnie Herzog

Analyst, Wells Fargo Securities LLC

I wanted to circle back to your top-line guidance, which, James, you did mention is prudent. So I guess I was hoping you could drill down a little further and give us a sense as to how fast you expect your different category clusters to grow over the next year and then maybe where you see potential for faster growth. I guess I'm just trying to understand how we should think about your sparkling cluster growth, for instance, versus some of your other clusters like tea and coffee, especially everything that you have done last year and then possibly touch on juice and dairy? Thanks.

Q

James Quincey

Chief Executive Officer & Chairman-elect, The Coca-Cola Co.

Sure. Well, firstly, before I jump into the clusters, I think some of the prudence is being derived from developing and emerging markets, whether it be some of the ones like Argentina or Turkey, aforementioned Middle East and some parts of Africa as well. So I think the prudence on the softening is more geographic-based than it is cluster-based.

A

Having said that, I think we are expecting to see in 2009 (sic) [2019] continued growth of the sparkling category. We've clearly aimed going into the future to see a strategy that is more price/mix than volume in the developed markets, and more perhaps volume-centered in the developing and emerging. So as we look out into 2019, I expect the sparkling business to continue to grow. And I think we'll see a little more price/mix than volume, given some of the things that are happening in the developing markets.

As we move through some of the other categories, I mean, clearly coffee is going to grow much faster because of the incorporation of Costa and as we start to realize the synergy plans, but that's not driving, obviously, the 4% organic, which is like-for-like so it doesn't include the acquisition in that sense.

In terms of tea, we are expecting to do better in tea in 2019 than we did in 2018. 2018 has the kind of base effect of pulling out of the Beverage Partners Worldwide joint venture, where we counted volume but we didn't count revenue. And then, obviously, that made it very hard to cycle the volume in 2018, but made it easier to get the revenue. As we go into 2019, we expect to see continued growth in tea, in Fuze and leverage Gold Peak in the U.S., which should see a bit more balanced growth.

In juice, we'll come off the period of the rightsizing of the packaging in North America. And so, I think we will see better performance from the juice business, particularly the premium end of the juice business. There may be parts of the world where we will question some of the juice drinks and the values that they bring. Obviously, in aggregate, juice will do better because we'll have the incorporation of Chi, which is a great business in West Africa, but that's not part of the organic growth drivers.

And then in hydration, we'll be focused on more of the premium parts of hydration, whether it be sports drinks, leveraging our partnership with BODYARMOR, driving things like Topo Chico and smartwater or smartwater with its new variants, like alkaline. We still may see some backing off of very low value water in some parts of the world.

So I think you'll see positive results in the different clusters going forward. And I think versus 2018, you're likely to see a continued strong picture across the portfolio. I think the places where you would see some places where we would sacrifice some volume would be the lower value end of water and juice drinks, but otherwise a strong focus across the portfolio and balanced growth.

Operator: Thank you. And our next question comes from Laurent Grandet with Guggenheim. Your line is now open.

Laurent Grandet

Analyst, Guggenheim Securities LLC

Q

Yes. Good morning, James, Kathy, and welcome, John.

James Quincey

Chief Executive Officer & Chairman-elect, The Coca-Cola Co.

A

Good morning.

Kathy N. Waller

Executive Vice President & Chief Financial Officer, The Coca-Cola Co.

A

Morning, Laurent.

Laurent Grandet

Analyst, Guggenheim Securities LLC

Q

Kathy, congrats on your extremely successful career at Coke. And personally, I'd like to thank you for helping me hand back into the Coke system a few years ago.

Kathy N. Waller

Executive Vice President & Chief Financial Officer, The Coca-Cola Co.

A

Thank you.

Laurent Grandet

Analyst, Guggenheim Securities LLC

Q

Really a question about Costa, you mentioned at the time of the acquisition, that Costa will be slightly accretive to earnings in first full year. In the current context of the UK, the economic and political situation and the potential harm of Brexit looming, did that change? And if you can update us more generally on the Costa integration and the expansion plan? And specifically, I'd like to understand if you are planning to rebrand the still 51% fully-owned stores? Thank you very much.

James Quincey

Chief Executive Officer & Chairman-elect, The Coca-Cola Co.

A

Sure. Look, on the Costa thing, obviously, we managed. The team did a great job in closing the acquisition well ahead of the schedule in January rather than April. And we're now in the phase of the transition period of really connecting it in a system sense and also being able to finally sit down with management and bring together their kind of base underlying growth plan with our views on synergies and acceleration. That's a process that's going to take a little bit of time to work through to really validate all the synergy plans.

Once we've got to the end of that process, of course, we'll be able to come out and be more specific about how we see the Costa being rolled out against our coffee strategy of driving coffee against the pillars using the stores that we have as the experience, serving as a provider of a total beverage portfolio in foodservice, whether it's beans and machines or the vending, selling the coffee at the at-home and, of course, the potential for ready-to-drink. So the strategy remains clear. We're putting more flesh and detail on the bones of the plans as it rolls out.

And then, of course, Brexit will be Brexit. I'm not sure anyone knows how it's going to end at this stage. We clearly have contingency plans for this business and for our other businesses in the UK and in the European environment. It's something that we will have to manage through, but it'll be – whatever it's going to be, it's likely to only be a short-term disruption effect, if indeed it ends up in that scenario and we will manage through it.

Operator: Thank you. And our next question comes from Kevin Grundy with Jefferies. Your line is now open.

Kevin Grundy
Analyst, Jefferies LLC

Q

Thanks. Good morning, everyone.

Kathy N. Waller
Executive Vice President & Chief Financial Officer, The Coca-Cola Co.

A

Morning.

James Quincey
Chief Executive Officer & Chairman-elect, The Coca-Cola Co.

A

Morning.

Timothy K. Leveridge
Vice President & Investor Relations Officer, The Coca-Cola Co.

A

Morning, Kevin.

Kevin Grundy
Analyst, Jefferies LLC

Q

I wanted to come back to advertising and marketing levels in the 2019 outlook and what's embedded in your guidance. Because as was alluded to earlier on the call, the market widely expects higher investment from Pepsi this year, likely directed at North America Beverages. And we'll find out in less than 24 hours whether that's true or not.

So can you talk about advertising and marketing levels for fiscal 2019? Does that look similar as a percent of sales, higher as a percent of sales? Many companies in CPG will guide on that. So I'm not sure if you can comment on it. And then number two to that, have you left adequate cushion in your guidance should you need to react to higher levels of investment spending? Thank you.

James Quincey
Chief Executive Officer & Chairman-elect, The Coca-Cola Co.

A

Sure. Look, we grew our advertising spend in 2018. We expect to grow our advertising spend in 2019. Of course, we continue to work on how to drive productivity in our non-working marketing investments and to leverage our scale with our advertising partners and with our properties. So we're going to continue to invest in advertising.

I think it's also worth saying that we are being even more disciplined as we look through the framework of leader, challenger and explorer. Obviously, it's our leader brands which are the brands that make best use of TV commercial advertising spend. As we drive the challengers and the explorer brands, there it's some other parts of the other marketing mix that often become a more predominant element of making them work. And then, if our competitors are going to increase investment, you know what? It's going to increase the growth of the categories. Ultimately, if there are more competitors investing, it drives more market growth. We believe that we have strong brands and strong plans. And I think net-net, it's going to be overall beneficial to the industry.

Operator: Thank you. And our next question comes from Andrea Teixeira with JPMorgan. Your line is now open.

Andrea F. Teixeira

Analyst, JPMorgan Securities LLC

Q

Hello. Hi. So thank you, and good morning. Kathy, I wanted again to thank you for your leadership and legacy, and all the best to you and John in the new role.

Kathy N. Waller

Executive Vice President & Chief Financial Officer, The Coca-Cola Co.

A

Thank you.

Andrea F. Teixeira

Analyst, JPMorgan Securities LLC

Q

Yeah, thank you. So I was hoping if you could revisit the 2020 operating margin expansion target that you outlined at CAGNY last year of 34%-and-plus. I realize there have been a number of key changes in accounting and acquisitions and effects of them. But with the guidance that you have now implying operating margins down year-on-year in 2019, I don't know if like the puts and takes, but how should we think about reinvestments and other moving pieces that relates to the 2020 target?

John Murphy

Deputy Chief Financial Officer & Senior Vice President, The Coca-Cola Co.

A

Yeah, so the 34% target that was outlined is one that was outlined, I think at a time to provide guidance through the franchising process. And today, we are on track to get to that 34% over the next couple of years. We've had some margin expansion over the last couple of years, and there's implied margin expansion in our 2019 numbers. However, given the fact that we have new businesses coming into the mix, I would like to really focus on improving margins across all of our different business segments as we go into 2019, 2020, maintaining the underlying objective outlined in the 34% margin target, but being a lot more focused on making sure that our core business, our Global Ventures business and our BIG business are delivering margin expansion as they develop their respective portfolios and businesses.

Operator: Thank you. And our next question comes from Robert Ottenstein with Evercore ISI. Your line is now open.

Robert Ottenstein

Analyst, Evercore ISI

Q

Great. Thank you very much. Over the last year, year and a half or so, you've been more assertive on taking price and driving that in North America and in Europe. And we see some of the results, but I was wondering if you could

kind of stand back and give us an assessment of what you've learned from that change in tactics or strategy, if you will, and in terms of your brand equity and need to perhaps tweak investment in certain areas, your bottler execution in terms of executing on those price increases, and then obviously, kind of the general customer demand, so just kind of big picture what you've learned from the price initiatives over the last year or so. Thank you.

James Quincey

Chief Executive Officer & Chairman-elect, The Coca-Cola Co.

A

Sure, Robert. Look, I think the simple conclusion is the following. If we just think we can depend on headline rate increases in the absence of other, everything else, then we're very likely to see high elasticity. And therefore, what we've learned and I guess relearned is that it's really important that pricing become part of our strategy, a strategy that starts with the right brands, the investment behind the brands to build equity with the consumers, and then to provide the consumers the innovation, not just in the brands and the product, but also in the packaging that allows pricing to be taken, sometimes with the headline price, sometimes through mix.

And it's the sum of all those pieces, backed up by good execution, that creates the willingness of the customer to go with the plan because it creates more value for the customers in their stores. Often, the beverage industry then grows faster than the average.

And so the learning and the relearning is it's the complex task of pulling all the pieces together that earns you the opportunity to drive price/mix perhaps ahead of where we have been. And I think that's something that we and the bottling partners have dedicated ourselves to even more over the last number of years. I think it's showing through in some of the headline numbers that you see. And we absolutely are going to stick to strategy.

Operator: Thank you. And our next question comes from Carlos Laboy with HSBC. Your line is now open.

Carlos Laboy

Analyst, HSBC Securities USA, Inc.

Q

Yes. Good morning.

Kathy N. Waller

Executive Vice President & Chief Financial Officer, The Coca-Cola Co.

A

Good morning.

James Quincey

Chief Executive Officer & Chairman-elect, The Coca-Cola Co.

A

Morning.

John Murphy

Deputy Chief Financial Officer & Senior Vice President, The Coca-Cola Co.

A

Morning.

Carlos Laboy

Analyst, HSBC Securities USA, Inc.

Q

James, your Brazil business looked unbelievable last week, lots of innovation and new SKUs, but how do you see the year in Brazil and the importance of keeping these Coke bottlers competitive on beer? And while on the

subject of M&A, if you could just give us a quick update on the refranchising process in general and the urgency to see through the sale of the remaining properties.

James Quincey

Chief Executive Officer & Chairman-elect, The Coca-Cola Co.

A

Sure. Well, thank you for the feedback on the Brazil business. I'm sure the Brazil team will be pleased with that. They have had a number of years trying very hard to adapt and update the business and bring the affordability and the innovation in line with the marketplace. And I think with the improvements in the macro conditions in Brazil, that business is starting to do a lot better. And it's a multichannel business. And they distribute the beer only in some of those channels. So that's a work in progress as the relationship with Heineken is in question.

And I think as we see the refranchising strategy, we've largely refranchised the world. We're down to just a small percentage of the volume. It's been very successful, whether it was North America, the creation of bottlers like European Partners or the Japan bottler. And so we think that has been very successful.

Clearly, we're still working on Beverages Africa in terms of the refranchising strategy there. It's, obviously, been slower than anyone would have liked. I think some of that has been process and macros-related. We're still working on that one. And that leaves us, obviously, with the Southeast Asian set of bottlers.

Obviously, we'll be thinking about what is the right strategic direction for that part of the world. But the ongoing curation of refranchising is not refranchising for the sake of refranchising. It's in the service of creating a stronger and more energized bottling system that is an aligned set of partners with the company to drive our collective business with more growth and with better margins into the future. And that takes different forms in places.

And, of course, we allocate capital within that process, whether it's owning bottlers or having stakes in bottlers. We drive that process with the objective of using capital as and when necessary, sometimes yes, sometimes no, to get the most energized bottling system out there bringing new partners in. That's an ongoing management as we curate our remaining bottling operations and some of our other investments in bottlers.

Operator: Ladies and gentlemen, thank you for participating in today's conference. This does conclude today's program, and you may all disconnect. Everyone, have a wonderful day.

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