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The Coca-Cola Co. (KO)
Q2 2022 Earnings Call
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MANAGEMENT DISCUSSION SECTION

Operator: At this time, I'd like to welcome everyone to The Coca-Cola Company's Second 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 of IR and FP&A. Mr. Leveridge, you may now begin.

Timothy K. Leveridge
Vice President, Investor Relations Officer & Head of Financial Planning & Analysis, The Coca-Cola Co.

Good morning, and thank you for joining us today. I'm here with: James Quincey, our Chairman and Chief Executive Officer; and John Murphy, our Chief Financial Officer. Note that we've posted schedules on our financial information in the Investors section of our company website at www.Coca-ColaCompany.com. These schedules reconcile certain non-GAAP financial measures, which may be referred to by our senior executives during this morning's discussion to our results as reported under generally reported accounting principles. You can also find schedules in the same section of our website that provide an analysis of our gross and operating margins.

In addition, this call may contain forward-looking statements, including statements concerning long-term earnings objectives, which should be considered in conjunction with cautionary statements contained in our earnings release and in the company’s periodic SEC reports.

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

Now, I'll turn the call over to James.

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

Thanks, Tim, and good morning, everyone. In the second quarter, we delivered strong performance by continuing to execute on our growth strategy. Our industry remained robust, and we gained both volume and value share in the quarter. Our first half 2022 results and the resiliency of our business give us confidence to raise our top line guidance. This is offsetting the meaningful increases in costs and currency headwinds to hold our bottom line US dollar outlook of 5% to 6% growth, even as we accelerate investments in our business to drive future growth.

These results are enabled by our organization's purpose-led culture, strong alignment with our bottling partners and the dedication and flexibility of our people who are driving our growth agenda.

This morning, I'll discuss the current operating environment and how we're delivering results and building for the future in that environment and the progress on our sustainability agenda. Then, John will discuss the financial details of the quarter and how we are building resilience to manage through external factors worldwide.
During the second quarter, the operating environment continued to be asynchronous, with many moving parts. Some regions continued to experience broad-based macro strength, while others are experiencing strong inflationary pressures. Some countries are still recovering from the pandemic, while China experienced pandemic-related lockdowns. And the conflict in Ukraine is ongoing. And we’d like to extend our thoughts and deepest sympathies to all of those who continue to be affected.

With this as the backdrop, we have managed well with our bottlers and delivered robust revenue growth across all our geographic segments, that encompassed strong pricing actions and strong volume performance helped by away-from-home recovery. Consumer elasticities have largely held up better than expected year-to-date, though we are watching closely for signs of changing consumer behavior as the year goes on and as the average cost of the consumer basket continues to go up.

We expect the consumer environment to be more challenging. And we are preparing accordingly, stepping up our investments, sharpening our resource allocation capabilities and tapping into data to better reach our consumers.

We also recognize that the dollar strength is impacting our translated earnings. And we remain committed to delivering US dollar growth. As a system, we are focusing on expanding the circumference of what we can control, understanding and providing what consumers want, ultimately giving them more reasons to choose our great brands and driving value for our consumers, our customers and the industry.

Now, recapping Q2 performance across the world, starting with Asia Pacific. In India, we delivered our best-ever quarter volumetrically and added 1 billion incremental transactions in the quarter, led by affordable single-serve packs. We gained share in sparkling soft drinks and juices. And our system is continuing to go invest in the marketplace availability and execution to capture growth. Japan made progress in recovery, and we gained share and consumers year-to-date versus 2019. Additionally, we gained 7 points of share of visible inventory, driven by coffee and tea in the ambient space. We continue to have a strong innovation pipeline, with the launch of Ayataka Hojicha Latte, non-alcohol Lemon-Dou [indiscernible] and Georgia Latte Nista.

Performance in China was under pressure, driven by COVID lockdowns. Volume was down for all months in the quarter, but the team persevered through a challenging environment, and recovery began in June as most restrictions started to lift. We focused on the core, prioritized top SKUs and reallocated resources to digital engagement, e-commerce and O2O, as consumer demand shifted to at-home consumption.

In ASEAN and South Pacific, macro fundamentals remained strong, despite ongoing supply chain headwinds. We added new consumers, and transactions grew ahead of volume. We invested in consumer-facing marketing and improvement in execution and increased distribution across key entry packs and multi-packs.

Turning to EMEA. Europe saw strong volume performance, leading to value-share gains across total NARTD and online. Strong marketing campaigns, including Coca-Cola Zero Sugar Zero Words, What the Fanta 3.0 and Sprite’s screen time messaging are tying our beverages to more consumption occasions with better results.

In Africa, we delivered strong performance that translated into NARTD volume and value share gains. We continued to focus on stills, affordability and in-market execution.

Digital initiatives remained strong and gross merchandise value of our e-B2B marketplace businesses were up approximately 50% sequentially. We accelerated cooler placement, reduced retail out-of-stocks and continued building RGM capability across markets.
In Eurasia and Middle East, amidst an unprecedented inflationary environment, the industry is growing. And the recovery of the on-premise channel is driving our growth. Through the FIFA World Cup Trophy Tour, we leveraged the iconic Coca-Cola Trademark to generate significant media traction across the markets.

Turning to North America, we gained both volume and value share through the strength of our brands, despite navigating a challenging supply chain, including higher labor and freight costs. We continued to drive mix improvement in sparkling soft drinks and more than doubled mini can availability on display. New product innovations including Coke Starlight, Fanta Dragon Fruit Zero Sugar and Minute Maid Aguas Frescas are showing promising early results. We're continuing to work closely with our bottling partners to accelerate overall commercial execution.

Turning to Latin America, we leveraged compelling occasion-based marketing campaigns and execution in the marketplace, and our share losses improved sequentially. Coca-Cola Trademark focused on building meals and breaks rituals under the Real Magic platform, with returnable packages as the main enabler, while in juice and dairy, we focused on everyday meals occasions. Our flavored alcohol beverage business is growing strongly. We are gaining share in the direct-to-consumer business and now reaching approximately 6.3 million consumers via digital channels.

In Global Ventures, the Costa retail business was under pressure, as footfall in the UK stayed below 2019 levels; however, the Costa Express platform remained robust. And the launch of the new Frappé range in the UK drove growth.

Finally, our Bottling Investments Group delivered strong top line performance, driven by a focus on recruitment through affordable entry packs, including a relaunch of returnable glass bottles in India. Additionally, we saw continued sparkling soft drink share gains versus 2019 in the Philippines and Vietnam.

While the macro environment is still asynchronous around the world, we are operating in an industry with a relatively predictable pattern of growth and attractive growth potential over the long term. So we're investing in our business and are anticipating the many futures that may come at us. We have managed a broad-based recovery coming out of the pandemic. Our five-year average organic revenue growth rate is at the top end of our long-term growth target of 4% to 6%, which is a proof point of our transformed and strengthened organization.

As we look to the second half of the year, we will continue to focus on raising the bar on the elements of our flywheels for top line growth and, as I said earlier, expand the circumference of what we can control, namely, through building our strong portfolio of loved brands, excellence in revenue growth management and the power of our system execution.

We are making targeted investments to unlock our growth agenda. We've built capabilities in brand building, innovation, RGM and execution, leveraging the power of scale, while still being locally relevant to consumers. These investments enable us to win not only in today's environment, but continue to build our business for the long term.

Our new marketing model is focused on adding and retaining consumers, and we're doing this through an ecosystem of experiences that link consumption occasions with consumer passion points. The launch of the global Magic Weekends campaign with Trademark Coke, in partnership with more than 20 foodservice aggregators, is showing great results. This campaign engages consumers at key moments, from gaming, to
music, to mealtimes. We are seeing 3.5 times the redemption levels for Coca-Cola combo meals versus pre-campaign levels and a 50% lift in outlets with Coca-Cola’s Zero Sugar availability.

We also launched end-to-end digital-first brand campaigns for smartwater and vitaminwater. The snackable video content on social platforms for smartwater with global icon Zendaya and the launch of vitaminwater Lil Nas X partnership on TikTok is a different engagement approach to marketing that is already delivering strong results across channels. With new faces and new platforms for some of our $1 billion brands, we are creating excitement and recruiting a new generation of drinkers.

We continue to strengthen our RGM capabilities, which allows us to drive value for our consumers and our customers. RGM allows us to better navigate a dynamic consumer and retail environment, using effective tools such as: price and promotional intelligence to leverage the power of our brands; proactive mix management and premiumization; and addressing affordability to drive recruitment and keep value-conscious consumers.

We work to bring these elements to life at a local level with our bottling partners. For example, in India, we focus on segmented pricing, increasing prices on multi-serves and premium packs, while holding transaction-driving price points in single-serve and the affordable portfolio. Additionally, we reached our highest-ever outlet availability and drove a 4 point increase in single-serve availability and a 6 point increase in affordable pack availability.

In Europe, our system implemented several affordability and premiumization initiatives. We drove strong transaction and volume growth through initiatives like incentivizing multi-packs to drive value on a price-per-ounce basis for consumers, and driving single-serve packages like cans and returnable glass bottles in HORECA channels. By keeping transaction-driving price points in play, we expanded our consumer base with sparkling soft drinks in the region year-to-date.

We are building consumer-centric loved brands and products, and our improving excellence in execution extends to building a more sustainable future for our business and the planet. During the quarter, we released our fourth World Without Waste Report, which provides an update on our ambitious sustainable packaging initiatives. It showcases how we are using our global reach and expertise to drive solutions at scale.

Our operating units are further integrating sustainable practices into the business to drive growth. For example, in the United States, we are executing a set of initiatives to help solve the plastic waste problem. We recently joined the industry groups, including the Consumer Goods Forum and the American Beverage Association, to support our model extended producer responsibility bill in Colorado. This is in addition to the support we provided for well-designed minimum recycled content legislation in three states. These have now been enacted into law.

Currently, 20-ounce bottles for Coca-Cola Trademark and DASANI in California, Texas, New York and throughout the Northeast, are in 100% recycled PET. In 2021, we launched a bold label clearly communicating that the bottles, excluding the caps and labels, are made from 100% recycled content, which is driving strong performance in the marketplace.

Later this month, we will expand our use of 100% recycled PET throughout the US and Canada. Every part of our business understands how their actions impact the company’s wider sustainability goals, and we continue to make progress.

To sum up, we are continuing to navigate a confluence of macroeconomic factors, and our networked organization is embracing the resilience to weather many environments. Guided by our purpose and with the right
strategy through our portfolio and the right execution capabilities, we are confident about delivering top line growth for now and the long term.

Before I turn the call over to John, I want to congratulate him for assuming the role of President beginning October 1, in addition to his current responsibilities as CFO. And, of course, I also want to thank Brian Smith for his service and innumerable contributions to the system during his 25-year tenure with the company and wish him all the best for the future.

So, John, over to you.

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

Thank you, James, and good morning, everyone. I will briefly touch on the drivers of our second quarter performance and the update to our full-year 2022 guidance. Then, I'll provide commentary on building resilience in our business by investing behind our brands and driving top line-led growth.

We're pleased with the continued momentum of our business around the world. This has translated into strong top line and comparable EPS growth, notwithstanding the larger-than-expected currency headwinds and increased cost pressures.

We delivered organic revenue growth of 16%. Unit cases grew 8%, with broad-based growth across all operating segments. Concentrate sales were behind unit cases by 4 points in the quarter, primarily due to the timing of shipments in Latin America and our Europe, Middle East and Africa group. Our price/mix of 12% was primarily driven by strategic pricing actions across markets, along with revenue growth management initiatives, further improvement in away-from-home channels in most markets and positive segment mix.

Comparable gross margin for the quarter was down approximately 250 basis points versus the prior year, primarily due to the impact of three items: one, an outsized increase in costs in the business, due to the inflationary environment; two, currency headwinds, driven by the volatile macro backdrop; and, three, the mechanical effect of consolidating the BODYARMOR finished goods business.

On the marketing front, we increased our consumer and customer-facing spending to create more value for our brands and continue to earn the respective price points.

Despite increased investments and costs throughout the P&L, we expanded underlying operating margin by approximately 40 basis points, driven by a high return from our investments in the marketplace. Comparable operating margin, however, compressed by approximately 110 basis points, due to the BODYARMOR acquisition and currency headwinds.

Putting this all together, second quarter comparable EPS of $0.70 grew 4% year-over-year. And this was impacted by 9 points of currency headwinds, 5 points higher than what we'd anticipated when we last gave guidance.

On cash flow, we delivered free cash flow of $4.1 billion year-to-date, driven by our strong business performance. This was 20% lower versus the prior year, primarily due to two items: one, cycling the timing of working capital benefits in the prior year; and, two, higher 2021 annual incentives paid in the first quarter. Additionally, our debt leverage is 2.1 times EBITDA, which is within the targeted range of 2 to 2.5 times.
As we look at the operating environment and the resilience consumers have shown thus far, we are watching closely for signs that indicate this may change. We remain ready to adapt. We’re using a dynamic resource allocation framework to ensure our investments are directed towards country category combinations that drive the highest growth, thereby maximizing our returns. And we are working closely with our bottling partners to effectively navigate whatever comes our way.

With this backdrop this morning, we are raising our top line and currency-neutral EPS guidance. We now expect organic revenue growth of 12% to 13%, and comparable currency-neutral earnings per share growth of 14% to 15% versus 2021. Based on current rates and our hedge positions, we now expect currency to be a 6 point headwind to comparable net revenues and a 9 point headwind to comparable earnings per share for full year 2022.

We continue to expect an effective tax rate of 19.5% in 2022. And all-in, we continue to expect comparable earnings per share growth of 5% to 6% versus 2021. And we continue to expect to generate approximately $10.5 billion of free cash flow for 2022 through approximately $12 billion in cash from operations, less approximately $1.5 billion in capital investments.

There are some considerations to keep in mind for 2022 that we factored into our guidance. While our shipments are currently behind unit cases, we expect these to run in line for the full year, with a catch-up expected in the fourth quarter. We now expect that the direct impact of the Ukraine conflict and the resulting suspension of business in Russia will be approximately $0.03 to comparable EPS.

Based on current rates and our hedge positions, we now expect commodity price inflation to move to a high-single-digit impact from mid-single digit on comparable cost of goods sold in 2022. This is primarily due to commodity cost increases across our concentrate and finished goods businesses.

Other costs, including wages, transportation, media and operating expenses, are also increasing and adding incremental pressures. The consolidation of the BODYARMOR finished goods business will continue to have a mechanical effect on margins, partially offset by the impact of refranchising our Vietnam and Cambodia bottling operations.

And lastly, given the backdrop of rising interest rates, we expect to see an impact on our interest expense, given our exposure to floating rate debt.

As we enter the second half of the year, we continue to raise the bar in every aspect of how we do business. And we feel confident in our ability to effectively navigate this dynamic global environment and deliver on our updated guidance for 2022. Along with our bottling partners, we remain focused on the compelling growth opportunity our industry offers, and we are investing and creating flexibility in the business by taking actions on those things within our control.

With that, operator, we are ready to take questions.
QUESTION AND ANSWER SECTION


Bryan D. Spillane
Analyst, Bank of America Securities

All right. Thank you, operator. Good morning, everyone. So really wanted to touch on both, James and John, you talked a little bit about the second half and watching the consumer. And, again, having had such a strong first half, your guidance for the full year implies a slowdown, I guess, somewhere around 7% or so organic sales growth. And so, can you just touch on a little bit how you've maybe risk-adjusted the second half versus the first half? Is it a reflection of: A, expectation that macro environment or the consumer may weaken; or are there other considerations that kind of are underneath that sort of deceleration that's implied in the guidance? And if you could maybe talk a little bit about where the risks are geographically also, that would help. Thank you.

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

Yeah, sure. Morning, Bryan. Let me start off kind of by zooming out and then come back to the consumer and the uncertainty in the downhill. And that is in the end, it's going to be two ways underlining the kind of the relatively atypical point we are, given the end of COVID and the kind of post-COVID era. And where I'm going with that is to start by zooming out and saying, look, if you were to take a three-year or a five-year compound annual growth rate and look at the first half and what's implied in the second half guidance, you wouldn't see as much choppiness as you're seeing when you compare to prior year. And that's all related to COVID. In fact, if you take the three-year or five-year compound annual growth rate and look backwards and through the amazing roller coaster of volume down and then up, and price, down, then up, what you actually see is something simpler and more encouraging, which is that the volume has grown at two and a bit and the price has grown at three and a bit, whichever of those two time periods you take, and so you net out at about six.

And so what you see over that long time period is the thesis we've been advancing, which is we've got an industry that grows 4-ish percent. We are the leader that gains share with our portfolio, with our RGM, with our execution. And, therefore, we can get to the top end of our long-term growth model. And if you zoom out, that's the kind of picture that you can see. And I would encourage people to not to get too lost in the weeds to start with in trying to figure out the second half or even maybe the future and start with kind of starting from a macro position and saying like what does that look like when you kind of look through on a longer-term basis. And I think that'll help people think about the downhill.

The second thing I would say about the second half is we don't know how it's going to turn out. There's clearly a set of things going on, and the net impact is difficult to predict in terms of the rest of the year. One, we've clearly, in some parts of the world, got a squeeze on purchasing power and inflation's running ahead of wages. That's true in many places, the US, Europe. It's not universally true. The inflation in China and Southeast Asia is only running at 3%, but there's clearly a big part of the world where there's a purchasing power squeeze.

But at the same time, you've got relatively stable deposit balances and you've got a big very atypical re-prioritization of spend occurring by consumers. And that's an important feature of how to see what the consumer's doing, because whilst there are a number of channels and categories where things look a little tougher in the short term – so if you're looking in grocery in the developed markets, if you're looking at some of the convenience
channels in developed markets, you're seeing some pressure on consumers with less income, some early signs of trading down, depending on which category you're in, not necessarily in beverages yet. That's to be expected.

But then if you're in the away-from-home channels, the theme parks, the leisure parks, that sort of thing, travel, it's about as good as it's ever been. And so this post-COVID re-prioritization of spend by consumers is layered over what feels like a squeeze on purchasing power. Whether it's a recession with peak employment is yet to be seen, but there's a kind of a standard process going on, a squeeze in purchase power, layered over with this weird or atypical consumer re-prioritization post COVID. How that's all going to net out in the second half and going into next year, there are a lot of opinions, and I don't think anyone's going to know until we actually get there.

But let me zoom back out again. The long picture is a stable, sustained and accelerated momentum for the Coke system over a good number of years that we feel good about going into the downhill.

Operator: Our next question comes from Dara Mohsenian from Morgan Stanley. Please go ahead. Your line is open.

Dara Mohsenian
Analyst, Morgan Stanley & Co. LLC

Hi. So just two follow-ups on that. A, can you just give us a sense of how much of the full-year top line raise was due to price/mix versus volume specifically and just break it out between those two factors? And then, B, just any update on if towards the end of the quarter, in July, if you saw any of that potential squeeze in consumer purchasing power play out? Obviously, in aggregate, very strong top line numbers, but are there any regions maybe where you're seeing either demand drop off or signs of consumer trade down? It would be helpful to get a bit of compare and contrast regionally and if there are any initial signs. Thanks.

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

Sure. I mean, firstly, we don't break out price/mix and volume in the downhill. I'm expecting it to be a balance. We clearly are expecting to get both volume growth and price/mix growth going into the downhill. I would just underline again partly the commentary I made on the last answer, which is the price/mix that you see in the year-to-date, some of that is rate increase, but actually slightly more than half is mix, whether it's geographic or away-from-home recovering relative at-home.

So there are a couple of big profound effects going on. So you've got layered over that rate with reopenings and shifts in countries and shifts in channels, which are very important. But we're expecting a balance of volume and price into the downhill, not just because we continue to be biased towards investing for growth, but we are very focused on an expected squeeze on purchasing power, to anchor ourselves in affordability, to keep focused through the brand investments, through the revenue growth management strategies, to keep the entry price points for the categories and for the packages as low as we can to keep the consumer base.

We've talked about this strategy before. It's one of our playbooks. It works for us. We believe it's very important to push ahead. Of course, we balance that out with a focus on premiumization opportunities. And it's what we're going to focus into as we go into the downhill. As I said, we have not yet experienced a very significant or a significant pull-back from the consumer. That's not surprising to us at this stage. If there were a recessionary environment or, in some countries, one country, more countries, a typical recessionary pattern, in past experience, would be consumers initially stop buying high-ticket item, discretionary things. I'll replace the car later. I'll replace the mattress later. They then start saving on the lower-ticket items, and they trade down in categories.
which have weaker leader brands and then eventually might hit the grocery categories with strong leader brands in the away-from-home.

So we tend to have some lead time going into a normal recession. We have not seen large effects of that yet. Even though, as I said, you can see, in some channels, in some countries, what looks like the beginnings of that process, it has not got to us yet. But, as I said in the beginning, the overlay from that are re-prioritization of spend, which is, I think, confusing or making hard to read whether it truly is "normal recession" or it's just a re-prioritization of spend away from typical things into things I missed out on in the last couple of years.

Operator: Our next question comes from Lauren Lieberman from Barclays. Please go ahead. Your line is open.

Lauren R. Lieberman
Analyst, Barclays Investment Bank

Thanks so much. James, you've commented before on the view that the company's taking on pricing and pricing ahead of a recession. I was curious, given just your comments on still not seeing any signs. You typically have some lead time for the business and in your categories before there would be impacts from consumer softness. Where do you feel you stand on pricing at this point? I know it's a big world, so it may be hard to give one blanket answer. But it would be great if you could give some context by larger markets where you stand on pricing and if you feel like you're in the right place, given the level of cost inflation.

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

Yeah. I mean, as you say, there's not a one-size-fits-all. We've rather atypically got relatively high inflation in the US and Europe with the kind of 8% to 10%, and there are emerging markets that are down at 3%. So it's not a normal time. We obviously have a lot of experience. I won't go over our RGM strategy and how we use that to manage through maintaining affordability.

What you see – and let me make a couple of points here. One, it's important to consider in the headline price/mix that we're reporting that a big component of price/mix in the first half is mix. Unusually, relative to the past and pre-COVID, mix is an important factor, both from a country point of view and from a channel point of view, and both are favoring reported price/mix at the moment. So underlying rate increases, if you like, are not as high as the price/mix number, and they are in the ballpark of slightly behind inflation.

And the reason that that – and that's relatively typical as well, so that's not surprising to us because what we essentially try to do, first, as I commented before, is we don't want to get behind passing cost increases through. We don't want to arrive at a recession with a big buildup of cost increases that has not gone through. But nor do we get ahead and anticipate inflation by pricing ahead of it. And so the rate increases are kind of in the ballpark of inflation would be the normal expected kind of trajectory.

And so what we're seeing is, yes, we've been passing through the commodity increases. Again, we don't price – we don't pass through to the peak. We're not chasing the spot market. We are hedged on commodities. And so as the prices come up, clearly we know when the hedges are going to roll off and we need to pass through those. But commodities are not the majority of the cost base. We've got a lot of service and other imports, and we are seeing broader-based inflation than just commodities up and down.

And so as those come through, we pass them through. And so we've passed a good bit through so far this year. We anticipate more cost increases will come through on a broad-based set of inputs. And we will continue locally
in each country, because it’s very different, we will continue to pass those through. And what that’s likely to look like in terms of rate is we’ll kind of be at inflation or slightly behind headline inflation as it goes up, with a layover of price/mix.

Operator: Our next question comes from Steve Powers from Deutsche Bank. Please go ahead. Your line is open.

Steve Powers
Analyst, Deutsche Bank Securities, Inc.

Yes, thanks. And good morning. I think this question's probably for John. And congrats, John, on the new role. But I guess I was hoping you could give us just maybe a bit more insight into your line of sight into productivity and cost savings over the balance of the year and whether the philosophy from here is still more to reinvest those savings to drive profit growth through accelerated revenue and expense leverage or whether, given the higher inflationary pressure that you called out and the prospects of deteriorating demand on the horizon, the philosophy is now biasing at all more towards harvesting those cost savings and dropping them more straight through to profit. Just some context there. And then, if you could also comment at all as to how your investment priorities may be shifting in this environment, that would be helpful as well.

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

Sure. Thanks, Steve. I think I mentioned in the script that as we look to the second half of the year, we look to continue the momentum that we have enjoyed year-to-date so far. And we're very focused on providing the resources to our markets and to our brands to continue to sustain that momentum. So the clear bias is to support the top line as we go forward.

When I look at the overall cost base, there's a number of factors, I think, to take into account. As James highlighted, we do have broad-based increases across the board, not only on the core commodities but other inputs into our concentrate business. And we have -- we're taking on board inflationary increases and operating expenses and even our marketing expenses. We do have an ongoing focus on productivity, and there's a number of levers that we've discussed in the past we have. I think we've been able to leverage the scale of our network. We've been able to build deep and even more strategic relationships with a number of our key supply partners across the world over the last couple of years, one of the benefits of COVID. And we're taking actions to simplify and streamline the way we do business.

And so you can expect us to continue to drive productivity across the board. But the guidance that we've given this morning, I think, is reflective of the overarching bias to continue to invest to support the top line and to continue to take actions across the board to mitigate against those inflationary pressures that we're seeing in a number of key areas.

Operator: Our next question comes from Kaumil Gajrawala from Credit Suisse. Please go ahead. Your line is open.

Kaumil S. Gajrawala
Analyst, Credit Suisse Securities (USA) LLC

Hi, guys. Good morning, and, John, congratulations. For a few years now, you've talked about dollar-based EPS growth. And, James, you mentioned it again, your commitment to growing in dollar terms in your prepared remarks. Can you maybe talk about what new, maybe, policies or procedures you have in place to try to
accomplish that or perhaps how things might be different if we go through another period of years of dollar strengthening versus the last cycle?

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

Yeah, I'm mean, very much – let me start by reiterating our goals are to, on a continuous basis, strengthen the strategic position of the Coke company and to deliver ultimately, when all is said and done, increases in dollar EPS back to the shareholders. And so that is the North Star. And we've broken that out into all the strategies necessary to make that a reality. And that's what we're going to continue to pursue.

Clearly, at the moment, we're focused on increasing our ability, both the resilience in – to face up to what could be yet further unexpected twists and turns in the coming months or even years, and adaptability. One of the features of the COVID crisis was the amount of learning that took place to be able to respond to the lockdowns, so the first lockdown was very painful. The second one less so and onwards and onwards. And actually in the second quarter, there was a considerable lockdown in China. China was negative in volume each month through the second quarter, and yet we were able to both accommodate that and manage through it in China and mitigate it at a total company point of view. So bear in mind Q2 had both the disappearance of the Russian business and a quite negative China business due to the lockdown.

So this idea of focusing, continuing to focus on the strategies that have been guiding us for the last number of years, with a double-down on both resilience and adaptability, we feel is going to give us the wherewithal to manage through the twists and turns that are yet ahead of us.

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**Operator:** Our next question comes from Bonnie Herzog from Goldman Sachs. Please go ahead. Your line is open.

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**Bonnie Herzog**  
*Analyst, Goldman Sachs & Co. LLC*

All right. Thank you. Good morning. And congratulations, John. I guess I have a question on your guidance. Could you give us a sense of the scenarios you considered in your new updated guidance in terms of a potential recession and whether you've considered a severe scenario? And then, how should we think about your business relative to peers, given you over index to the on-premise channel? James, you touched on this, but just curious to hear if you see a greater potential risk on your business as consumers potentially pull back on dining out and entertainment. And, if so, is this considered in your guidance? And then, maybe just touch on the strategy you can implement to mitigate this. Thank you.

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

Look, in preparing the guidance and thinking about our way forward, we've considered a whole number of potential scenarios. What we feel is the most likely is what we've reflected in the guidance. Clearly, there's a lot of uncertainty, which is why, rather than having our operators focus on debating which scenario do they think is right, we said, look, let's lean into growth. We've been growing coming out of last year. We're growing in each of the quarters this year. We're still growing, so let's maintain our bias to growth and keep going. And in the meantime, make sure that we're doubling-down on resilience and adaptability for whatever's going to come. And that may end up being different by region of the world and by country in the world, certainly overall and in time as well. Recessions, if they arrive, generally are not completely the same everywhere. And so it's very much – we have a bias to growth and we're going to focus on resilience and adaptability.
I think the fact that our business is in round numbers, half at-home and half away-from-home, clearly at the moment is favorable. Clearly, it was a disadvantage at the height of COVID. Experience of recessions says that we have a great business system that can see us through. Let me reinforce again when you zoom out and you think of all that's happened in the last five years and you say, well, what's the net number for the Coke system or the Coke company, the organic revenue growth is, in round numbers, about 6%. And so we have seen our way through, and that's what we're focused on.

Operator: Our next question comes from Andrea Teixeira from JPMorgan. Please go ahead. Your line is open.

Andrea Teixeira
Analyst, JPMorgan Securities LLC

Thank you. Good morning. Congrats to John. My question is on the potential for increasing the concentrate incidence cost for some of the bottlers that operate in a high inflationary environment. I believe Arca spoke to higher concentrated costs, but I was just checking if this was more a pull-through from the pricing and the percentage there and – or some adjustment to the puts and takes of inflation. And just a clarification on your commentary about Europe and in general. You are seeing on-premise keeping the momentum or you're seeing any exit rate there that have been more moderate embedded in your guidance? Thank you.

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

Thanks, Andrea. So on the last point I think, as James highlighted, we're not seeing any significant changes on that front, so very much focused on continuing to drive the momentum. With regard to the whole topic of how we work with our bottling partners, as I think many of you on the call understand and appreciate, we have an economic model that is underlined by incidence pricing. That pricing allows both of us to focus on growth in the marketplace and allows greater certainty as to what to expect from our activities in the marketplace. And as we work through periods of high growth, low growth, volatility, stability, the model doesn't change that much. It's what allows us to, I think, to stay focused on delivering what we need to in whatever the context is. So there's not a lot to report out on changes. I think the model itself is actually what allows us to – one of the reasons it allows us to continue to deliver on the opportunities of the industry has that we've talked about and allows us to continue to be optimistic about sustaining momentum.

Operator: Our next question comes from Rob Ottenstein from Evercore ISI. Please go ahead. Your line is open.

Robert Ottenstein
Analyst, Evercore ISI

Great. Yeah, I just first wanted to follow-up on the question on the bottling system. Can you just maybe, number one, talk a little bit about Swire and kind of the thought pattern there, where you stand on the refranchising in general? And then, just more specifically on the pricing, you talk about leaning into growth. How does that play into the pressures that are on the bottlers themselves? I mean, obviously, with incident pricing, you both share, but presumably the bottlers are getting hurt a little bit more in a number of countries from inflation. So how has the discussion worked between you and the bottlers in terms of how much pricing is appropriate? Thank you.

James Quincey
Chairman & Chief Executive Officer, The Coca-Cola Co.
Yeah, I mean, look, the conversation in any given country on the pricing strategy is clearly a conversation where we're trying to bring some strategic – start with the consumer, brand thinking, some RGM technology, integrate with the way the bottler sees the RGM. We are both exposed to cost basis, yes, difference in nature. We both very much have the idea that the costs ultimately, if there's an inflationary environment, then those costs are going to have to be passed through in some way, shape, or form, through to the consumer pricing. And we work very hard to do that. And so I think if you look around the world, you'll see that the bottlers are in good health. The bottlers are in good health not just in the developed markets, but the bottlers in the emerging markets where there has been a history of higher inflation. And even some of the ones where there's very high inflation currently, the bottlers are in good shape.

And let me underline that the incidence model, the model that John told you about, was essentially invented in an environment of high inflation and was invented to help the system stay focused on the consumer and the retailers and creating value for everyone in times of high inflation and volatility. In a way, it was designed for exactly the sorts of situations we're in. So this is a muscle that is well-developed in the Coke system, in the company and in the bottlers. And it has proven to be very effective in helping us stay focused on the marketplace and to work together to achieve what we need to achieve in terms of the brand investments, in terms of the RGM strategy and in terms of the marketplace investments. And that's why I think, ultimately, both the company and the bottlers are in good shape post-COVID and good shape as we stand here at the middle of 2022. And so I think that's the most important thing.

And then, I think Swire was the right partner for Vietnam and Cambodia. And then, obviously, we're left with very little of the global bottling system, predominantly some of the operations we own in India and then CCBA.

**Operator:** Our next question comes from Chris Carey from Wells Fargo Securities. Please go ahead. Your line is open.

**Chris Carey**  
*Analyst, Wells Fargo Securities LLC*

Hi. Good morning. So my question is actually on BODYARMOR. The outlook was slightly lowered today for both sales and profit. We've seen some normalization in scanner trends for the brand. So I wonder if you could just give a bit of a state of the union and again some of the developments that you're seeing both on top line and bottom line for that specific offering. Thanks.

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

Yeah, just to clear, we didn't provide any guidance for BODYARMOR itself. And clearly, we've been – it's a great brand. It's high growth with strong innovation. It's done a great job of reinvigorating the advanced hydration and bringing people into the sports drink category. We are lapping some disruption in the category from last year and that's obviously had some kind of effect on the comparisons. And I think we're in good shape. It's – we're in the process of kind of fully connecting it to the Coke system and continuing to drive it forward and continuing to do what the brand needs to do and keep it true to itself. And as and when we've got international opportunities, we will address those over time.

**Operator:** Our next question comes from Kevin Grundy from Jefferies. Please go ahead. Your line is open.

**Kevin Grundy**  
*Analyst, Jefferies LLC*
Great. Thanks. Good morning, everyone. And congrats on the strong results. James, a question for you. You kind of touched on some of this, but maybe not directly. It's on your US business and potential implications from some of the margin pressures we're seeing very publicly from large retail customers. So, understanding those issues are more around general merchandise than grocery, but nevertheless notable margin compression which, I'm sure, cannot, should not go unnoticed by any large suppliers or anyone in the industry, for that matter.

Just comment on potential implications from your business in categories where you participate, whether this is potentially less ability to take price if it's called for, greater likelihood of demands on trade dollars. So the question's very specific. I'm not asking you to be redundant, because I think it was Lauren's question you talked a little bit about pricing. But the question's very specifically on any fallout you may see from the margin pressure we're seeing at large retail customers in the US. Thank you.

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

Yeah. Look, whether it's the US or other parts of the world, as retailers come under pressure from the consumers' wallet pullbacks, whether it's because they're losing purchasing power or they're reprioritizing their spend from something in that store to a different store, clearly there will be pressure. And the way we approach it is to take a value-creation point of view.

Our idea is, like, look, we are investing in our brands to create value for the consumers that the retailers can realize in their stores. And, therefore, we've got to focus on making the category attractive to bring the consumers in, to generate value from those consumers to the retailers. And ideally, our category would grow faster than their average business and they would do well at it. Of course, we would like to see ourselves gain share within those category growth. So very much we're focused on driving a growth story, a growth story that creates value for everyone who touches the business.

If there's going to be a much more recessionary environment ahead of us, clearly it's going to get difficult all around. But as we sit here today, we've been able to drive growth, as I said, for the consumer, growth for the retailers. And I think that's what we bring to the table, which is creating something that's really working for them.

**Operator:** Our next question comes from Brett Cooper from Consumer Edge Research. Please go ahead. Your line is open.

**Brett Cooper**  
*Analyst, Consumer Edge Research LLC*

Thanks and good morning. Question for you on developed markets and pack mix. And the place where we can see the best number is in North America. And your price/mix in 2Q or year-to-date is up more than 20% from 2019. In the off-premise data, we can see that 20-ounce is now selling for about $2 a bottle. So the question is whether the rapid rise in consumer prices requires a meaningful shift in package mix in order to try to hit key price points, like you've done in other markets, in order to drive recruitment and retention over the medium term? And then, if you can just offer some color on how you can segment the market so that you don't generate trade-down from what has been a profitable pack. Thanks.

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

I mean, we're getting right down into some of the packaging stuff. Look, the price/mix I think is very important to try and disaggregate. Channel and category pricing changes. You alluded to something on the 20-ounce. I
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presume that was in a specific channel. And we very much are focused on driving not just, as I said, consumer value but also we were going to take rate, but we do focus on, as we've talked about many times, retaining affordability whilst also looking for premiumization. Now where the one pack is going up in price, then clearly that's probably more of the premiumization strategy, where the other packs will be looking to stay anchored in affordability, whether they be individual pack sizes or multi-packs.

And we use different pack sizes and different combinations of multi-packs to move across the spectrum of what price point is going to work for which consumers. And, therefore, the key in that dynamic is to increase the diversity of the packaging mix. It's almost impossible to segment and re-segment the marketplace with only one or two package sizes. So the important factor becomes the diversity in the number of packaging size or material options and the diversity of the multi-pack options. That's the dynamic that allows you to play across the spectrum of price points and elasticities. And so one going up, there's probably another one staying anchored that allows us to do this strategy. But I think the most important is the overall dynamic of using the diversification of the packages, the growth in the mini cans, the introduction of some smaller size PET bottles to be able to capture the whole kind of demand-curve spectrum.

Operator: Our next question comes from Bill Chappell from Truist Securities. Please go ahead. Your line is open.

William B. Chappell
Analyst, Truist Securities, Inc.

Thanks. Good morning.

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

Morning.

William B. Chappell
Analyst, Truist Securities, Inc.

Hey, just kind of a follow-up on the pack sizes. I mean, one of the things you had said was you benefited from country mix and, I guess, product mix, but not necessarily pack mix. And I would think that as the higher prices are being flowed through, maybe you have some acceleration to smaller pack sizes, which are higher margin. So I guess is that - are you seeing any of that? And if not, if you're not seeing any trade-down, is there any reason down the road in the back half if commodity prices come down, you would roll back any of these price increases? Or do you feel like, hey, there's no real elasticity, we're just going to hold the line here?

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

Okay. Let me try and unpack that a bit and start at the end. I commented earlier we don't price to commodity spikes. So there are some commodities that shot up from January through to March and have come back down again. Like we didn't chase the commodity price up. Because we use a hedging program on long-term relationships, we have a lot of – and many of our bottlers, too – we have a smooth curve, if you like, on the pricing of commodities. So what's important there is the overall underlying trend in the commodity price, not the spot market. And so we haven't priced up.

Now, having said that, commodities, the basket of commodities, particularly energy and some other ones, still is trending up. And so are services and labor. So I don't think – I don't foresee the total basket of inputs, whether
they be the sum of the commodities or the sum of the services and other inputs, suddenly being in a deflationary environment. I mean, if you take the commodities and not the majority of the costs of the services and everything else, basically for the price to have to roll back, we need to – overall economy to enter deflation before it’s even really a question, which does not seem the most likely scenario in the short term, certainly not on a global basis. So I think price roll-backs, in that sense, seems very unlikely. I think it’s more likely that inflation softens and, therefore, the rate of increase can come down, but I don’t foresee a big global deflationary burst at the moment.

In terms of the – I didn't mention pack mix as one of the mix things. Well, clearly channel mix is intimately related to pack mix. So away-from-home versus at-home, that being a positive mix effect for price is somewhat synonymous to we’ve got more IC packs, immediate consumption packs, than we have larger packs. And so the two – they're not the same, but they are relatively correlated. So, for example, in the US, the reopening has increased fountain, has increased smaller pack sizes as people travel. So pack sizes very much go with channel mix; not the same, but there's a reasonably close correlation.

Operator: Ladies and gentlemen, this concludes our question-and-answer session. I would now like to turn the call back over to James Quincey for any closing remarks.

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

Great. Thanks very much, everyone. Clearly, we feel our second quarter exemplified the strength in our brands, the execution of our bottlers, and the momentum in our business. We’re pleased with the performance so far in the first half. We enter the second half with confidence that we can sustain value for the long run. And thanks for your interest, investment in the company and for joining us this morning.

Operator: Ladies and gentlemen, this concludes today’s conference call. Thank you for participating. You may now disconnect.

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