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# The Coca-Cola Co. (KO)

Q2 2019 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 and Investor Relations Officer. Mr. Leveridge, you may now begin.

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### Timothy K. Leveridge

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

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

Before we begin, I'd like to inform you that we posted schedules under the Financial Reports and Information tab in the Investors section of our company website at [www.coca-colacompany.com](http://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 discussions, to our results as reported under generally accepted accounting principles. I would also like to note that you can find additional materials on the Investors section of our company website, including those that provide an analysis of our margin structure.

In addition, 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.

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

Now, let me turn the call over to James.

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### James Quincey

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

Thanks, Tim, and good morning, everyone. So, here we are halfway through the year and we see good momentum in our business as we continue our transformation as a total beverage company. We gained global value share with a balanced contribution from both developed and emerging markets, led by strong performance in our sparkling soft drink business.

Organic revenue growth is up 6% year-to-date, including growth across all operating segments and with a good balance between volume and pricing. Worth noting, about 1 point of that is due to the benefit of timing. The underlying results, though, are still ahead of plan.

Unit case growth, volume grew 2% year-to-date and 3% in the quarter. Comparable currency neutral EPS was up 13% year-to-date, partially offset by a stronger-than-anticipated 9% currency headwind, resulting in comparable EPS growth of 3%. While currencies continued to be a headwind, we are focused on achieving our full-year EPS target through stronger performance in the underlying business.

Looking around the world, we delivered strong top line growth in the first half, driven by both developed and emerging markets. In Asia Pacific, we grew organic revenue 4% during the first half of the year. Strong performance in emerging markets like India, Southeast Asia and China drove 7% volume growth for the segment, as we focused on underserved consumption occasions. This was partially offset by performance in Japan, where our system continues to work through supply chain disruptions stemming from last year's natural disasters. In addition, volume declined in Japan during the second quarter as our system implemented the first price increase to consumers in over 25 years. Looking ahead, we expect improving results in the back half as consumers adjust their new pricing levels and we implement a robust innovation plan, including Coke Energy and Innocent chilled juice.

Turning to EMEA, here we grew organic revenue 9% year-to-date, driven by continued growth in Europe and Turkey, improved performance in South Africa and the first quarter benefit from our shipment timing. Across Europe, revenue growth management initiatives and Zero Sugar innovations are creating sustained momentum in the majority of our markets, as shown by the 3% volume growth in our European sparkling soft drink portfolio. And in Turkey, despite the challenging macro environment, we are delivering solid performance due to strong marketing and execution plans that are quickly adapting to the local conditions.

Turning to Latin America, here we delivered 7% organic revenue growth year-to-date amidst a mixed operating environment. Brazil continues to deliver strong performance, driven by better execution within a stable operating environment, while Argentina continues to grapple with the economic crisis. Mexico's economic growth is slowing. So, we expect tougher operating conditions. However, we are adjusting our plans to ensure affordability, so that the business continues to grow sustainably.

Finally, turning to North America, here, our results continue to mark steady progress, driven by improved marketing and execution. Our performance was largely driven by consumer demand for no-sugar versions of some of our best-known sparkling soft drink brands as well as for the smaller packages with less sugar.

Retail sales of our no-sugar sparkling soft drink portfolio grew 6% in the quarter in Nielsen-measured channels. Strong revenue growth for our core sparkling soft drink brands continues to fuel and enable new innovations and investments across our expanding total beverage portfolio. For example, our premium water brand, smartwater and Topo Chico are delivering healthy growth, supported by the national launch of smartwater antioxidant and smartwater alkaline and the ongoing strategic expansion of Topo Chico. Across all of our markets, we are driving a platform for sustained performance through disciplined portfolio growth, an aligned and engaged system and collaboration with our stakeholders.

Beginning with our portfolio growth, here, we are making progress in operationalizing our Leader, Challenger and Explorer framework, consistent with the strategy we outlined last year. Within our Leaders, the core sparkling soft drinks business registered healthy volume growth of 2% year-to-date, with trademark Coke continuing to perform very well, with volume up 3% year-to-date and 4% in the quarter, fueling our portfolio expansion. Importantly, we're seeing healthy household penetration growth for our sparkling soft drink portfolio.

What's also encouraging is Coke Zero Sugar is now in its third year of double-digit volume growth. Along with our focus on smaller packaging and premium innovation, year-to-date, we are growing trademark Coke revenue

faster than transactions, transactions faster than volume and reducing calories, what we believe is a winning strategy for the future.

Our innovation pipeline, our innovation pipeline for Coke trademark expanded in April with the launch of Coke Energy, offering the edge of a great refreshing taste and an inclusive brand. The energy occasion is fast growing and expanding in multiple spaces to satisfy more consumers. We remain fully committed to our partnership with Monster. And we believe there are opportunities to capture even more value in the energy category for the Coca-Cola system and to bring new drinkers into our rapidly evolving category.

The initial results are encouraging. In Spain, the first market, where Coke Energy was launched, has already captured 2% share of the energy category in modern trade and it has achieved similar sales for last outlet as the market leader with strong repeat levels that indicate good consumer acceptance. We're taking everything we've learned and applying these insights as we rapidly scale Coke Energy across our system. We are currently in 14 countries, and by the end of 2019, we expect to have Coke Energy available in 20 markets.

Coke Energy, along with many of our other innovations, are being created to target specific occasions and need states in very different ways, particularly as we grow our Challengers and Explorers. For example, in Australia, we recently launched Nutriboost after learning from its success in Vietnam. Nutriboost is a nutritious milk drink with zero added sugar that was designed for busy families looking for a mid-morning or afternoon energizing snack.

With this, our focus on consumer-centric innovation, almost 25% of our revenue is now from new or reformulated products, up from 15% two years ago. At the same time, we are taking a disciplined approach to curating our portfolio to ensure we have the capacity to focus on the right brands. So far this year, over 275 zombie SKUs have been eliminated.

We're also making progress on our plans to build a multi-platform coffee business. Since we finalized the Costa acquisition in January, we've been moving with speed across three areas: integrating Costa into our business; making sure Costa's existing plans are executed well; and accelerating the opportunity to build a multi-platform business. As we move forward on these opportunities, our focus is on accelerating three segments: the Express vending machines, beans and machines for food service customers, and ready-to-drink products.

We've already launched ready-to-drink products in the UK with plans to roll out in additional markets in the coming months. And consistent with our other innovations, ready-to-drink Costa leverages a unique brand and product edge that will allow it to capture category growth. We're also accelerating our plans to roll out more Express machines across the number of markets. So far this year, we've placed 1,200 new vending machines and have plans for many more by the end of the year. Finally, as you may have seen last week, we reached an agreement with Coca-Cola Hellenic to launch Costa Coffee across a number of formats within all their markets over the next three years.

Returning to the overall view, of course, none of this works without our bottling partners. Globally, our bottling partners are aligned and energized, they've committed to building scale and invest into the future, and we're working with them to collectively raise the bar on our consistent execution.

I've talked before about the revenue growth management initiatives, which are helping to drive increased velocity in our portfolio. Coupled with this, has been a focus on expanding horizontal distribution through opening new outlets and placing more cold drink equipment. And we're making progress, especially in Asia, where our system opened over 750,000 new outlets so far this year. However, gaining penetration is only part of the equation. Consistently measuring and managing our performance in existing outlets is the other part that drives sustained

performance. So, we're working to better leverage data and mobile technology in order to evolve our Right Execution Daily platform from a point-in-time scorecard into a real-time integrated analytics capability that will drive faster and better informed execution decisions across our system.

Before moving off our bottling system, let me quickly address our plans in Africa. In May, we announced that we were stepping back from our plans to rebrand Coca-Cola Beverages Africa. Instead, we will hold onto the bottler until we move through a period of political and economic change in the region. But, to be clear, our bottling ownership philosophy hasn't changed. As with all our Bottling Investments, we will look to sell at the right time to the right buyer. In the meantime, we have a new and energized leadership teams on both sides of the system and we are already seeing promising results.

Finally, in order to deliver long-term sustainable growth, we must collaborate with our stakeholders. One critical issue facing the world is plastic waste. In 2018, we announced our World Without Waste goals for recycling, recyclable packaging and the use of recycled material. As noted in our earnings release, we are making progress against our goals. We used approximately 30% recycled material in our packaging globally in 2018. We now have 100% recycled PET bottles in the market in over half a dozen countries with more launches planned in 2019.

And importantly, our system is also working to improve collection. We currently refill or collect equivalents of 50% – 58% of what we sell in the marketplace. While global traction will take time, given the need for infrastructure investments and various regulations by our market, we're actively working to lift and shift successful collection models such as PETCO in South Africa, [ph] Incosia (13:04) in Mexico and Coca-Cola Amatil is already leading our collaboration to run a deposit return scheme across all of its territories in Australia.

Ultimately, the heart of our success are our people. We've been working to continue to build our growth culture because that is what will drive our performance year-after-year, moving faster, taking intelligent risks and learning from our mistakes. And I think this is beginning to show in our results.

So, in summary, we had a good first half of the year as evidenced by our solid organic growth rate. We're driving a platform for sustained performance through disciplined portfolio growth, an aligned and engaged system and collaboration with our stakeholders. And the momentum in our business gives us confidence in our ability to achieve our full year EPS target and drive shareholder value.

Now, I'll turn it over to John.

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## John Murphy

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

Thank you, James, and thanks to all of you for joining us. Before addressing our performance in the quarter and our expectations for the remainder of the year, I'd like to start by discussing a few key areas that I believe are critical to the company, specifically, driving healthy top line growth, expanding margins across our business segments, improving cash flow and leveraging a disciplined capital allocation process.

James has talked about our revenue growth management efforts. This quarter, we've continued to scale our work in both Asia and Latin America. We're implementing better analytical tools and processes to develop price/pack architectures to meet evolving consumer and customer needs. And it's showing results, contributing to the robust organic revenue growth we've delivered now for the past eight quarters.

Translating top line performance into sustainable margin improvement is where our ongoing productivity efforts and Leader Challenger Explorer framework come into play. For the first half of the year, we delivered underlying

operating margin improvement, a function of continued innovation, revenue growth management strategies and the effective management of our cost structure. We've also advanced our efforts to improve cash flow and capital allocation.

We're improving our working capital as evidenced by our year-to-date cash flow increase. We're taking a close look at all assets on our balance sheet. For example, we're in the process of selling our building in New York and we recently divested our equity stake in our Peruvian bottler. And we are reducing the sizable costs related to our productivity program that were part of the transformation of our business. So, we're making progress and we aim to do even better.

Turning now to our financial performance in the quarter, we delivered another solid quarter with broad-based organic revenue growth, underlying margin expansion and improving cash flow trends. Organic revenue grew 6%, with a healthy balance of price/mix and volume and a 1 point benefit from timing. Our developing and emerging markets drove strong volume performance, which resulted in strong growth in our Bottling Investments Group. The continued rollout of revenue growth management initiatives across our developed markets resulted in good price/mix.

Comparable margins contracted in the second quarter due to the impact of acquisitions and currency. However, both growth and operating margins expanded on an underlying basis. This translated into 14% currency neutral operating income growth, partially offset by an 8-point currency headwind. The currency impact to operating income included a 2-point impact from hedging activity, driven entirely by gains we are cycling from the prior year.

Comparable EPS grew 4% in the quarter, which was comprised of 13% comparable currency neutral growth, partially offset by a stronger-than-expected 9% currency headwind.

And finally, year-to-date free cash flow was up \$3.7 billion, up 87%, due largely to strong underlying growth, working capital initiatives and the timing of cash taxes and capital expenditures. While we do not expect a similar increase in the back half of the year, we are confident in our ability to deliver at least \$6 billion in free cash flow.

Now, looking at the remainder of the year, for the first half, we delivered 6% organic revenue growth. And as James noted about 1 point of this came from the timing of shipments, which we expect to reverse in the back half. So, after normalizing for the timing benefit, the best way to think about our underlying top line performance for the first half is 5%. Considering this strong performance, we are taking up our guidance on organic revenue to 5% for the full year, which is translating into stronger underlying profit performance. And that better underlying performance is enabling us to maintain our full year comparable EPS guidance even as currencies have gotten worse and structural changes are less of a benefit than we expected at the beginning of the year.

As you model the flow of the year, there's a few items to consider in terms of phasing. Due to cycling the timing of shipments and expenses, moderating currency headwinds and an extra day in the fourth quarter, we expect all of the comparable operating income growth in the back half of the year to occur in the fourth quarter. Specific to currency in the third quarter, we expect a 6-point currency impact to operating income. This includes a 3-point impact from hedging activity, driven almost entirely by gains we are cycling from the prior year, as year-over-year spot rate headwinds are softening.

As we move through the back half of the year, we expect the impact from currencies to become less of a headwind. Looking even further out, at current spot rates and hedged positions, we expect a benign currency environment in 2020 compared to 2019. As always, our Investor Relations team will be happy to answer any questions as you build out your models for the year.

So in summary, we've had a strong first half of the year. Our strategies are driving strong performance in our business. Cash flow is improving. And we remain very focused on delivering our full year EPS guidance.

Operator, we are now ready for questions.

## QUESTION AND ANSWER SECTION

**Operator:** Thank you. [Operator Instructions] Our first question comes from Steve Powers with Deutsche Bank. Your line is now open.

**Steve Powers**

*Analyst, Deutsche Bank Securities, Inc.*

Hey, great, thanks. Good morning.

**James Quincey**

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

Good morning.

**Steve Powers**

*Analyst, Deutsche Bank Securities, Inc.*

So, a very solid set of results today. I guess, the question from here, notwithstanding some of the timing factors that may cause some movement in the back half, just is what makes you most confident that this momentum can continue, if not further improve as you looked out over the next few years? And, perhaps, as an underappreciated part of that story, how do you view improvements in your – the current bottling footprint factoring into that momentum? I mean, bottling clearly contributed this quarter. And, I guess, the question, is that an aberration? Or do you see bottling contributions as potentially sustainably accretive to total company top line and profit growth over the next couple of years?

**James Quincey**

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

Let me try and offer three thoughts, Steve. Firstly, I think we have, in front of us, a tremendous long-term opportunity in the beverage industry. I'd refer you back to one of the pages we've used in one of the Investor decks with the two bottles, the one of the developed world, and the one of the developing world.

With the developed world, is a small portion of the world's population, 20% of the population of the world, yes, three quarters of what they drink is commercial beverage, but we still have a relatively small share of that in aggregate and we're gaining share. So, there's huge opportunity for value growth in the developed world. And yet in developing part of the world, which is 80% of the world population, only a quarter of what they drink [ph] evolves some (22:12) commercial beverage. And again, our share has lots of room for expansion. So, the first point is I would re-underline the long-term opportunity for growth of commercial beverages in the developed and the developing markets and that's a huge opportunity in front of us.

The second thought I would offer you is, I think we're seeing not just momentum in the second quarter or the year-to-date and yes, leave aside some of the timing benefits, but what we're seeing is a sustained set of results over,

if you want to take the last four quarters and you average out the unit cases and you average out the price/mix of the last four quarters to just give you a year, I think you get about 2% in volume and about 3% in price. And if you were to do the calculation, I think you'd end up with a 3% on price with or without BIG. So, I think you're seeing sustained momentum of the core business over a 12-month period.

And, perhaps, even more encouragingly, that is now lapping a period, where we were also in the band we were looking for, for our long-term growth model of 4% to 6%. So, we've now got 5% in round numbers, lapping 5%. So I think the momentum is now multi-year. I always encourage everyone to look at some multi-quarter average, given where we are in the supply chain and the timing effects. So, long-term opportunity and we're now building momentum that is "multi-year" momentum.

And I think to the question of how much BIG can affect that going forward, yeah, look we've clearly given the BIG team a mission to grow the top line and the bottom line. I think the countries that did well this quarter are – happened to be the countries where we own the parts of the bottling operation. So that, obviously, was very helpful. But, BIG is centered in a number of countries that have long-term growth prospects. They're largely in the bottle that is only a quarter commercial beverages. So they have a lot of opportunity, and we've given them a clear mission to abandon the concept of the hospital ward. We should be aspiring for bottling operations, we ought to be just as good as all the other bottling operations, and obviously we'll look to find the right owner at the right time. And therefore, yes, we should expect the BIG operations to do better in the coming years.

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

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**Dara W. Mohsenian**

*Analyst, Morgan Stanley & Co. LLC*

Thanks, guys. John, you opened up the door crack on 2020 earnings guidance with the benign FX comment. I know you won't give us an explicit guidance range today. But, I guess, just conceptually besides FX, are there any big puts or takes we should think about for 2020 versus the typical EPS growth algorithm you've outlined?

And also maybe, perhaps, you can discuss, if FX were to worse than it become more unfavorable from the spot rates where we are today, are there any levers you can pull more to offset that from an earnings growth perspective as you think out to 2020?

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**John Murphy**

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

Yeah. Thanks. It's still very early days to talk about 2020. As you know, there's a number of factors that go into how we will ultimately perform in 2020. The global macro environment continues to be pretty volatile. There is a lot of discussion as to where interest rates will land. And in some of our – the markets that are particularly important to us, places like Mexico, like Turkey, South Africa, Argentina, there's a lot of moving parts there. So, it's very early to talk about 2020. I do think it is good to look at 2020, though, in the context of currency. We think the dollar is at the – towards the end of a strong cycle, and hence we think that we're in for a benign environment over the next year, year-and-a-half.

With respect to sort of managing the potential headwinds from currency, I think we're starting to connect the dots better across the world between the decisions that need to be taken locally to help us have a more holistic approach to dealing with this topic, because it's not going away. We – and the emerging markets represent almost 50% of our PBT. So, in the future, it's going to be a very important topic for us to address even better. So, early

days yet on that, but certainly connecting the dots better and as I said in the call, for the back half of the year, the upside on underlying operating performance is actually helping us to maintain our full year guidance.

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**Operator:** Thank you. And our next question comes from Bryan Spillane of Bank of America. Your line is now open.

Bryan D. Spillane

*Analyst, Bank of America Merrill Lynch*



Hey. Good morning, everyone.

James Quincey

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



Good morning.

Bryan D. Spillane

*Analyst, Bank of America Merrill Lynch*



So, I just wanted to dig in a little bit more on the strength in the Asia Pacific segment. It's been pretty good so far first half of the year and so maybe, James, if you could just dig in a little bit in terms of what's driving that underlying performance. And really what I'm after is, I guess, is we're kind of looking beyond this year, sort of, some view of whether or not this type of performance is sustainable.

James Quincey

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



Sure. I mean, clearly we had a good quarter in Asia Pacific. I think we were somewhat helped by the kind of a later monsoon in India or the later start of the monsoon in India. So, I think one would be cautious in extrapolating one quarter into the future. But, clearly, this quarter, we saw good growth in India, good growth in ASEAN, particularly in the Philippines, in Thailand, in Vietnam. We saw some good growth in China actually. That was despite de-prioritizing some of the low-value water and we're cycling the best quarter of last year. But I think what it's representative of is the long-term continued opportunity for the beverage business.

We basically – most of the money comes in from the Americas, North and South America, Europe and Japan and Australia. But that's a small part of the world's population. Actually if you take Africa, if you take Indian subcontinent, ASEAN and China, that's the vast majority of the world's population and we're only getting started. And that's where we're seeing good growth this quarter and we have been seeing it for a while. So, I think its representative of the long-term opportunity. I wouldn't say, let's extrapolate this one quarter, but there's absolutely long-term opportunity in those four large population zones.

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**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*



Hey, guys. So, one big controversy for investors around Coke is that as you transition from Coca-Cola of old to a total beverage company, your margins will be pressured. And so to zero in from that kind of broad controversy into the quarter, you provided this gross margin and operating margin bridge set of charts. Can you just aggregate please the "underlying green" i.e. positive bar more in terms of cost savings, one, negative stills mix, maybe geographic mix and price/mix, really with an idea of trying to get us comfortable with the sustainability and maybe

positive momentum in margins? And particularly, this quarter, we saw SG&A as a percent of the sales improve, but that overall controversy remains on the margins.

And then if I might, just a very quick clarification, you mentioned Coke Energy rolling out to 20 countries by end of this year. Is the U.S. on that list? Thanks very much.

James Quincey

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

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So, let me start. I'm not sure there's a controversy at all. I think we've been super clear on what we believe is happening on the operating margins. And I think, clearly, there's a couple of things happening here. And I would not all rotate on one quarter because of the movements of gallons and those sorts of things. So, I'll talk about the first half because that's – I would prefer to talk about four quarters rather than even two, but [ph] let go this (31:38). So, I think our messaging has been very clear. The mechanical changes to the operating income margin happened because of ins and outs, particularly of bottling operations given their very different cost structures and the acquisitions. And I think that's clear on the chart.

And I think what you can clearly see is we continue to execute against our game plan to improve operating margins over time. We've been tracking on that towards the target that we had talked about and given all the confusion, we removed and had this bridge instead. So, ongoing improvement in operating income margin, that's been happening and it's happened again in the second quarter or the first half. It's clearly driven by the sum of the parts. We're getting improved pricing. Yes, some of those are in categories, which have higher cost of goods. But as you can see in the gross profit line, the gross profit basically in the first half was flat, yet it was better in just the second quarter. But, again, I prefer the longer timeframe. So, against the question, will expansion of new categories cause the compression of the gross profit margin? We had previously said, yes, it might be a little, but it would be offset by productivity.

What you've seen in the first half is it's awash. We've been able to drive the Coke franchise and the innovation and manage the portfolio such that the net impact on gross margin is awash, which is a great result. And then, obviously, we're getting some flow-through of our ongoing productivity efforts, just because we haven't announced the new program, we are still focused on using resources effectively in the SG&A on the back – in the back office and investing wisely with the marketing such that the operating leverage is flowing through into the margin. So, I think the game plan is intact and we're continuing to drive against it.

**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. So, James, I guess, my question is just kind of looking at the coffee and energy opportunity, and you've laid out the plans for rest of the year and entering some of the newer markets. I guess, my question is, how do you determine and sort of what's the criteria in determining which markets to enter kind of the phase one and then over the next couple of years? And then I think Ali asked a question about the U.S. fits into that plan. So, if you can address that as well. Thank you.

James Quincey

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

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Yeah. I mean, just starting on the U.S., I mean, the markets we haven't announced yet, I mean, we're not going to announce until we're ready. Clearly, we're thinking about the U.S. market and when would be the right timing for Coke Energy. Clearly, it's a big market and a big opportunity.

I think, ultimately, the way I would look at it is, we've launched in a number of markets and our approach is essentially to launch in markets where we know we have capabilities and a lot of strength and a strong Coke franchise, and therefore, we think, would represent a robust good opportunity. And that should give us an idea of how well we could do. So, Spain would be an example of that. We have a great franchise in Spain. We have a great on-premise business there with the cafes and restaurants. We have a strong relationships with the modern trade and a very strong bottler. So, we know that if we do well there that in strong markets then we know what that would represent.

Then, we've also launched it in some of the other emerging markets, and some markets that we'll – that our strengths are not as good as the Spanish end of the spectrum. But it'll give us a range of learnings and experience in different types of environment. And that will give us, in a way, a set of learnings on the 1.0 of launching Coke Energy, from which we can learn. And purely from a rollout perspective and a tactical perspective, in something like this, it would probably suit us to have those learnings and have a 2.0 for the U.S. whatever tweaks that may be, whether it's tweaks in the formulation, tweaks in the graphics, tweaks in the marketing mix, tweaks in the execution approach, because it's all about accelerating the learning cycle and driving that forward. So that will be the conceptual approach on how we want to get it done.

And that's kind of will be true whether it's Coke Energy or Coke with coffee. Every time we've done it, we've tried to make sure we learn from the cycle of the 1.0 or the 2.0 before we go to the next set of countries. Obviously, that means you don't need to go back at some point to the initial countries, to bring them up to the latest thinking on what can be done. And similarly, for coffee, there, of course, we're looking at which of the formats best establishes the brand and can work. And clearly, we think that rolling out with the Express vending machines and being a kind of a beans and machines beverage partner to the restaurants and cafes and the kind of immediate consumption channels is the way to kind of drive the brand forward. And ready-to-drink coffee will play a part of that, but not necessarily be the first piece.

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**Operator:** Thank you. And our next question comes from Nik Modi with RBC. Your line is now open.

**Sunil Harshad Modi**

*Analyst, RBC Capital Markets LLC*

Yeah. Good morning. Thank you. James, I was hoping you can just give us some context on the U.S. market. Obviously, the sparkling business is doing quite well. So, maybe you can just talk about the still portfolio. I understand there's some kind of gaps and weakness in that portfolio when it comes to the Dasani, Powerade, Gold Peak. So, maybe you can just kind of talk about those brands and kind of what the plans are there to get them back in the right direction.

**James Quincey**

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

Sure. I mean, I think, again, I'll talk more about the first half than the second quarter, because, of course, you get things bouncing around in the short term. I think on the side where there's more work to be done, the water brands, the mainstream water brands like Dasani were under pressure a bit so far this year. As much as anything due to the expansion of retailer private labels and particularly in the larger formats of number of bottles in a case. So, there's some challenge there.

The flip side of that is we continue to do really well with the premium water brands. So, Topo Chico continued its fantastic growth rate; smartwater continued to grow. So, I think you see a diverging set of performance in the water market between the mainstream and the premium water brands.

Powerade, again, a bit of tale of two cities, Powerade, the main brand has not had a good start to the year, faces some executional issues. Yet, Powerade Zero is growing and I know the BodyArmor is doing well in the Coke system. So, again, a bit tale of two cities in the sports drinks category.

In terms of juice, again, it's a bit of a repeat. Minute Maid is flat, slightly soft. But we did really well in some of the new launches and Simply was growing nicely. So, again, I think you see a bit of that contrast between some of the mainstream, in this case more flattish or slightly negative, and growing in the premium, especially off Simply and the smoothie. So, I think you see a little of a dichotomy going on there.

And I think it's worth talking about the second half. We've really got a good program going into the back half of the year, a lot of focus on media and experiential samplings on some of those stilled categories, whether it's smartwater or Powerade or Gold Peak, and some agreed commercial activities with specific customers and market glitches on merchandising to kind of bring those back around. So, I think we'll see a lot of attention and focus on reverting some of those trends going into the back half of the year.

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**Operator:** Thank you. And our next question comes from Caroline Levy with Macquarie. Your line is now open.

**Caroline Levy**  
Analyst, Macquarie Capital (USA), Inc.



Thank you so much. James, it would be really helpful if you could sort of walk us around the world. You did mention a bit of softness in Mexico, if I'm not mistaken, and you said Brazil was stable even though you did better. And if you just look at the state of consumer and the friendliness towards U.S. companies, with China specifically being part of that question, could you just talk to us a little bit about how you see that around the globe? What's getting significantly better? And if anything's deteriorating? Is the Middle East getting worse for example?

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



So, just going back to – starting in Latin America, where you mentioned, the Mexico that I mentioned, there's a softness – a little softness in the economy. Mexico, we still grew volume in the second quarter slightly, but we still grew volume in the second quarter in Mexico. So I think it's more of a generalized concern of the environment.

Brazil, obviously, did well. The Argentinian business suffered, again, in the second quarter. And I think there's a clear macroeconomic environment. We're very focused on what we can do in terms of affordability and execution, but you can't completely outrun a macro crisis. So, we're definitely seeing some of that. So, Argentina was very weak.

Middle East, yes, that was negative. Clearly, there's some struggle there across the Middle East and that was negative in the quarter. But then once you get out of that, I think, it's a bit kind of the theme of the year, which is the clouds on the horizon don't quite arrive with the storm or the storm doesn't arrive. So, yeah, when you read the reports and look at the forecasts and listen to the news, you would conclude that things are worse. But there seems to be some calm underneath of that, and I think that's what we're seeing. As we've executed against our plan, the macros have not been as bad, perhaps, as one had feared. And that has allowed us to deliver strong

operational results. And I think Asia Pacific is one of the examples of that, where we continue to do well across a broad number of countries on the basis of great plans.

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

**Kevin Grundy**

Analyst, Jefferies LLC

Thanks. Good morning and congratulations on strong first half results. James, question on North America. So, broadly three consecutive quarters, where volumes have been negative, but not very consistent with the industry, where pricing has been put into place. But, I guess, the other key topic, of course, is that your key competitors ramp investment spending that started last year, this is continuing behind key brands like Pepsi and Mountain Dew and Gatorade. And arguably, to some degree, the strategic changes that they're making in North America will really be sort of a key watch point for investors whether this turnaround is indeed going to be successful. So, broadly if you could discuss sort of the competitive environment. And then the second part of that whether you're comfortable with current investment levels in your portfolio going forward? Thanks.

**James Quincey**

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

Yeah. I mean, firstly, I think I would say that if competitors are investing in the category behind branding and rational pricing and trying to create value, that is ultimately good news. Yes, it means we have to be on the top of our game, but it's better to be an industry where there's more consumer demand being created than not. So, I think that's a very important starting point that we think will be beneficial ultimately to the total beverage business in the U.S. In terms of the volume, I mean, the volume was slightly negative in the U.S.

I think it's important to remember what we're trying to do in the U.S. business. We're focused on building the consumer engagement and so a lot of what we've done, particularly in some of the sparkling brands, is have a focus on some of the smaller packages and drive for transaction growth. Even if that means the volume is flat, we'd love a little bit of positive, but if it's a little bit of negative that hasn't concerned us because we think we can stabilize the volumes in the long term and have the value be created ultimately through the price/mix.

So, more price versus volume, obviously like to see volume a little bit positive in the case of the U.S., but really sticking with the strategy of driving the consumer interactions, heavy lean on smaller packages. Of course, the portfolio piece that goes with that is some of the Zero Sugars and the reformulation. Now, I think that's what you see turning into the strong revenue growth rates from North America. So, you're seeing North America do consistently over time well in terms of revenue growth and they're gaining market share across a broad swathe of categories from sparkling to a number of the still categories.

So, we think it's a strategy that's working for us. We think the investment levels are good for what we're seeing at the moment. Of course, we constantly review all aspects of the business mix and the variables we control as well especially and we will go up or down and as we believe to be appropriate and necessary.

**Operator:** Thank you. And our next question comes from Sean King with UBS. Your line is now open.

**Sean R. King**

Analyst, UBS Securities LLC

Hi. Good morning. A question about the expanded launch of alcoholic beverages in Japan, while I recognize there might be market-specific competitive or maybe demographic considerations, why not look to other markets besides Japan?

James Quincey

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

A

Well, clearly, this one [ph] base (46:31) a very Japanese logic we talked about when it launched regionally. The competitive set, we can face a set of local competitors in Japan, which operate in a multi-category not just soft drinks and sparkling and stills but wine, beer and spirits, going to the same customers. And in the case of the Lemon-Do competing in for an occasion and a consumer, which heavily overlaps. So, there's a lot of logic in the context of the Japanese business. And what you're seeing is a horizontal distribution expansion in the Japanese business, still very small in the context even of our business in Japan.

The logic of taking it elsewhere has not been clear for The Coca-Cola Company. Of course, historically, our bottlers have carried beer or [ph] bean (47:30) brewers, so that in parts of the world where there's some distribution logic that it has been – there have been relationships with our bottling partners. But the Japanese example, where we own the brand is the Japanese example and anything else would need to be considered very carefully and the business logic to be very clear for why we should do something different.

**Operator:** Thank you. [Operator Instructions] Our next question comes from Bonnie Herzog with Wells Fargo. Your line is now open.

Bonnie Lee Herzog

*Analyst, Wells Fargo Securities LLC*

Q

All right. Thank you. Good morning. I actually wanted to circle back to your full year guidance. Obviously, your results so far this year were better than you originally expected, given that you increased your top line guidance. So, could you maybe highlight or summarize for us the main drivers of this or essentially what was an upside surprise from your perspective?

And then on the second half, comps are still tough, but could you highlight why you expect your organic sales to grow 1 point or 2 points? Are you just being conservative with your outlook for the back half? Thanks.

James Quincey

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

A

Sure. I think the – look, the story, I think, ultimately follows this trajectory. We had, have and still have going forward a clear strategy with a strong view on what we need to do to capture the opportunity ahead of us. And we started executing that a number of years ago. And we were getting momentum and we were getting momentum coming out of 2017. We had good result, top line momentum in 2018. We did at the beginning of this year like our plans still, but see the macro clouds on the horizon and we're a little more cautious in our guidance in February from a top line point of view. The clouds, as we've talked about, are still there, but the storm never arrived. And so, we did better in the first half. I mean, ultimately, it's a result of executing the right plans in the right place and the headwinds not being there.

So, where have we seen the benefit? I think we've seen the benefit across a whole series of places doing that a little bit better whether it's Asia Pacific or some of the parts of Europe and Africa. So, I think it's the flow-through, the execution and planning, wasn't just one place.

As I've talked about on the first question, I really do think of the first half more as a 5% than a 6%. And I – there are lots of ways of getting at that answer whether you like the simple rule of thumb of just taking the average of the unit cases and the average of the price/mix and that gets you 5%, whether it's two quarters or four quarters or you can get into the minutia of the detail on the timing of the Brexit gallons and all this sort of stuff. But ultimately, you come to the simple headline answer that it's basically a 5% and it's a 5% cycling other growth rates. So, there's really good momentum there.

And then when you come to the second half, the clouds are still there. The storm hasn't arrived. We have great plans. We have a strategy and a bottling system with momentum. And so, we think we can see our way through to delivering an underlying 5% in the second half. Of course, if those timing elements reversed, the reported numbers are going to be slightly softer than that in the second half. But that won't detract from the ultimate conclusion that it's a system that's creating momentum around 5%, with a plan that's working.

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**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.*



Great. Thanks. Good morning.

James Quincey

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



Good morning.

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Lauren R. Lieberman

*Analyst, Barclays Capital, Inc.*



I was hoping you could talk a little bit more about Japan, because in the commentary so far that you've offered on Asia, you really highlighted developing and emerging markets. And I think there were supply chain issues in Japan last year that we would have been cycling through. So, if you can just run through kind of what's doing in Japan. And why that wasn't called out as being a stronger contributor. Thanks.

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James Quincey

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



Sure. No, Japan was a detractor in this quarter, and for some very specific reasons. Firstly, in the natural disasters last year, one of our important bottling – one of the important manufacturing facilities of our bottler was knocked out completely last year. So we lost capacity just as we were starting to grow in the Japanese business. And they're working very hard to install new capacity. They're doing a great job in doing it, but one cannot defeat the laws of physics. And so that's going to be brought online over the course of this year. And that has produced a constraint on the business this year.

The second reason, which is super important, is we have taken a pretty broad price increase in Japan in April, the first one in a couple of decades. So that's a big deal. And whilst our competitors did not follow us immediately, they did follow us by the end of the quarter, so, of course, there was – the [ph] prize (52:46) of leadership in those circumstances is we suffered a little bit of our volume hit in the second quarter. But, of course, as they've gone up too, we think that that will normalize. And in the context of the capacity constraint, we de-prioritized some of the lower-margin water volume.

So, some very specific reasons in Japan, but we are focused on making the right decisions to invest and drive the brands going into the future. We've got some improving trends in the vending channel. We've got some product innovation and some packaging and pricing stuff, more stuff coming through with the digital platform as well. So we think that these decisions will allow us to start to really get some better results in Japan as the production comes back on track, production capacity comes back on track as we go into the second half of the year. So we see it more as – much more as a point in time. But we believe it was what was needed to be done given the natural disasters. And it's the right decision in terms of setting the business up for the future.

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**Operator:** Thank you. And our next question comes from Bill Chappell with SunTrust. Your line is now open.

Grant O'Brien

*Analyst, SunTrust Robinson Humphrey, Inc.*

Hi. This is actually Grant on for Bill. Thanks for taking the question. Just wanted to touch on free cash flow a little bit, obviously, you guys are focused on a little bit more [ph] energy (54:13) and some of that is timing year-to-date but just wondering on some of the changes you guys have made, maybe some of the initiatives in place going forward to improve free cash flow conversion and kind of room to run on that. Thank you.

John Murphy

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

Thanks. Yeah. This is a key area of focus and we've talked about it over the last few months, has been such and there's a number of elements to improving our position as we go forward. One is in the area of working capital. We know that we can do better. We know we have opportunity to – between where we sit today and where best-in-class is. And in this quarter, we made significant strides with – in the payables arena, we've delivered almost \$600 million of benefits to our working capital number in the quarter.

A second area that we've talked about is reducing the amount of one-time cash outflows that had been a key part of the transformation work, particularly in with the refranchising in North America. That number is going to decline as we move forward and we saw a little bit of that impacting us favorably in the second quarter.

And the third area then will be to get our CapEx, capital expenditures, in line with what we think the run rate should be going forward. That's going to take a little bit longer given the fact that we have taken back for the time being the Philippines and South Africa. And so in the second quarter, in addition to the working capital improvements, the benefits from timing of cash tax payments in 2018, we did not have them this year. And our capital expenditure flow for the year is weighted more in the back half. So, good progress on working capital, some timing benefits in the quarter. But as we look to the second half of the year, we're very confident that we'll deliver on the free cash flow guidance that we've given.

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**Operator:** Thank you. And our next question comes from Kaumil Gajrawala with Credit Suisse. Your line is now open.

Kaumil Gajrawala

*Analyst, Credit Suisse Securities (USA) LLC*

Hey, good morning. Well done this quarter everybody. I guess, first on – two things, one on Coke Energy, now that it's been in the market for a little bit, can you give us some context on source of volume? Is it really coming from Red Bull as I think you guys have mentioned? And then is any of the growth coming from outside of energy?

And then the second question, John, I don't remember your words exactly, but I believe you said you felt that dollars coming to the end of a strong cycle. I'm just curious if there's something you're seeing that you could provide to help us kind of understand that comment. Thank you.

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**John Murphy**

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

**A**

Sure. Let me start with the second point. When you take a step back and you look at dollar cycles over the last 20 or 30 years, the current cycle is the longest one we've had, number one. And when you look at the both the macro indicators over the next 12 to 24 months plus some of the political commentary that has been in play around the world, it does point to us being at the high end of dollar strength. And hence my comments on the environment, as we look at it today, based on both spot rates and the outlook that we see through a number of lenses to be a benign environment in 2020.

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

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**James Quincey**

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

Thank you, everyone. Just to summarize again, bottling system is working very hard with us. We're aligned. We're delivering improved execution. We're seeing strong performance across our collective business, and we're making good progress not just in the near term but for our long-term goal. So, as always, thank you for your interest and your investment in the company and for joining us today. Thank you.

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

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