Operator

At this time, I would like to welcome everyone to The Coca-Cola Company Fourth quarter 2017 earnings results conference call.

Today's call is being recorded. If you have any objections, please disconnect at this time. All participants will be in a 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 questions.

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

Timothy K. Leveridge - The Coca-Cola Co.

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

Before we begin, today, I'd like to remind you that this conference call may contain forward-looking statements, including statements concerning long-term earnings objectives and should be considered in conjunction with our cautionary statements contained in our earnings release and in the company's most recent periodic SEC report.

Before we begin, I would like to inform you that you can find additional materials in the Investors section of our company website at www.coca-colacompany.com that support the prepared remarks by James and Kathy this morning. In addition, I would also like to note that we have posted schedules under the Financial Reports and Information tab in the Investors section of our company website. These schedules contain 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 Accepted Accounting Principles. Please look on our website for this information.

Finally, during today's call, when our senior executives refer to comparable performance, they are referring to comparable performance from continuing operations. Following prepared remarks this morning, we will turn the call over for your questions.

Please limit yourself to one question. If you have more than one, please ask your most pressing question first and then re-enter the queue after that.

Now let me turn the call over to James.

James Quincey - The Coca-Cola Co.

Thanks, Tim, and good morning, everyone. In 2017, we completed another solid quarter of operating performance, capping off a successful year. The nonalcoholic beverage industry was a little soft during 2017, as the emerging and developing markets slowed slightly from prior year, but the developed world continued its growth strategy.

We continued to gain global value share for both the quarter and the year. And importantly, we achieved or exceeded the guidance we shared with you at the beginning of 2017. Full year organic revenue grew 3%, with four out of five category clusters delivering top-line growth, led by our sparkling soft drink portfolio.

Underlying PBT grew 9% versus our goal of 7% to 8%, as we accelerated the capture of certain productivity savings. And we delivered comparable EPS of $1.91, which was ahead of our plan. While we did what we said we'd do, it's still not as much as we aspired to. We need to be growing revenue and EPS at a faster rate.

Now looking around the world. All of our operating segments delivered positive organic revenue growth. We saw solid growth in our developed markets, particularly in Europe and North America, driven by improving execution in recently refranchised territories and enhanced pricing and packaging strategies. Our China business built momentum in 2017 even as we refranchised our bottling system.

Other emerging markets were more challenging, especially in the first half of the year, but we saw improvement in key markets like India, Argentina and Brazil as we moved into the second half. We accomplished this growth while driving significant change at our company as we accelerated our transformation into a total beverage company with a broad, consumer-centric brand portfolio and an asset-light business model.

First, we implemented a new operating model designed to enable an accountable, performance-driven growth culture that we believe will result in greater returns for our shareholders; a lean model with employees who are externally focused, empowered, quick to take action and willing to take smart risks. To accomplish this, we made significant changes to our leadership team, corporate structure and updated both our incentive metrics and compensation philosophy.

Second, we implemented new digital platforms to support our leaner operating environment and improve the employee experience. This lays the groundwork for initiatives like the SAP implementation that will take place this year.

Third, we expanded our consumer-centric product portfolio, scaling wins from market-to-market, leveraging M&A and embracing more of an experimental test-and-learn approach to marketing new products. For example, we entered the fast-growing U.S. ready-to-drink coffee category, capturing over 7 points of value share by the end of the year. We lifted and shifted two of our leading U.S. brands, Honest and smartwater, into multiple international markets and acquired AdeS, the leading plant-based beverage brand in Latin America with the intension of expanding it into Europe in the near future.

More importantly, we launched Coca-Cola Zero Sugar in 20 markets, with a clear four-point playbook of a great-tasting reformulated product, evolved marketing, new packaging and upgraded execution. And we saw very positive results with the brand growing revenue double digits, including a meaningful acceleration in Coca-Cola Zero Sugar strength in the U.S. since its launch in Q3.

Of course, it's not just about large brands. We balance rolling out large-scale brands and keeping an entrepreneurial focus on emerging consumer trend and identifying products that meet those trends. This is about developing brands, channels and points of engagements with our consumers. For example, we adjusted our pack price offering to adapt to the explosion of online ordering in China. And we're leveraging a decade of learnings from North America's Venturing & Emerging Brands model to approach opportunities in international markets. As I mentioned last quarter, we launched a unit in Central and Eastern Europe to test premium brands in high-value outlets and channels through a separate route-to-market. And of course, while it's still early days, the unit has met our expectations, and we are moving quickly to expand coverage to another seven cities in Europe.

Fourth, we focused on converting portfolio expansion into stronger revenue growth. This can clearly be seen in our EMEA operating segment, where organic revenue growth accelerated from a 3% run rate over the past few years to a strong 5% in 2017. We accomplished this in part due to the revenue growth management initiatives that focuses on small baskets and pack sizes. These initiatives were phased into several EMEA markets over the year, and we will continue to roll them out in additional markets in 2018 and so expect to see continued momentum this year.

And finally, we reenergized our system for future growth. Over the last few years, as you well know, we have been returning ownership of our company-owned bottling operations to independent companies around the world. In 2017, we accomplished major milestones in three of our most important markets. We sold our bottling businesses in China, creating two strong bottlers with contiguous territories. Our two largest bottlers in Japan merged creating a single bottler, covering roughly 85% of our system in that important profit pool. And most importantly, we completed refranchising of our U.S. bottling operations. At the same time, our North America business continued to deliver top-tier FMCG performance with 3% organic revenue growth.

Ultimately, all of these strategic and tactical changes mean something very important. We are assertively shifting our culture, the way we operate, the way we look at growth opportunities and the way we engage with our bottling system. It's been a lot of change, and much of it is only just starting to show tangible results, which is a good thing when you think about future performance.

Looking ahead, 2018 is shaping up to be stronger than 2017. We are well positioned to accelerate our top-line performance based on the actions we've taken, the impact of new U.S. tax legislation on consumer spending and the improvement in the global economy. And while the economic environment in key emerging markets like Brazil and Argentina may not yet have tipped into a tailwind scenario, they are also not causing the same level of headwinds they did last year for our industry.

With that as a backdrop, we feel confident that the revenue growth initiatives we've launched in multiple markets, coupled with the strong rollout of brands like Coca-Cola Zero Sugar, FUZE Tea, AdeS plant-based beverages and smartwater will enable us to deliver 4% organic revenue growth. We will balance productivity with reinvestment to deliver significant underlying operating new (10:48) margin expansion for the year. And our refranchising effort's largely complete and a benign currency environment, we expect to grow comparable EPS 8% to 10%.

Now, of course, many of you have asked us how U.S. tax reform will impact our business. Overall, we view this as encouraging for the operating environment. Clearly, tax reform will make investing in the U.S. more attractive and should spur economic growth. We are currently evaluating it and expect our system to accelerate investments to capture further opportunities.

The tax reform also eliminates a long-standing distortion due to the former U.S. worldwide tax system, which will make it easier for our company to manage its cash and debt balances. However, in the short term, there are puts and takes to the financial benefit. Over the next eight years, the lower effective tax rate will mostly be offset by the annual payment on the tax charge we took during the fourth quarter.

Now, while we are focused on delivering this year's plan, we must also keep an eye on the long-term health of our business. In order to have a healthy business, you need to operate in a healthy community. One of today's biggest problems is packaging waste. And over the decades, Coca-Cola has done a lot of work on recycling. We made most of our packaging fully recyclable, and we've invested a lot in R&D around reusing plastic. And now we're doing more. Our system is fundamentally reshaping our approach to packaging, with a goal to collect and recycle the equivalent of 100% of all the bottles and cans we sell by 2030.

We're also increasing the amount of recycled content in our packaging, and we're working to make all of our packaging finally 100% recyclable. In a world where packaging waste, especially plastic waste, is a growing problem, we are working to make sure that no bottle is ever a single-use bottle. Through recycling, it'll have more than one life.

This is the next step in our ongoing sustainability efforts, building off our success in replenishing 100% of the water we use in making our beverages. We must grow with conscience and, therefore, becoming a total beverage company that grows the right way because it is the correct thing to do for the consumers and our business.

So finally, to recap, we had a successful year. We implemented a culture shift, which is ongoing. We made large scale changes to strengthen our bottling system, met or exceeded our financial guidance and delivered top-tier FMCG organic revenue growth. And we are encouraged that 2018 will be even stronger.

With that, I'm going to hand over to Kathy.

Kathy N. Waller - The Coca-Cola Co.

Thanks, and good morning, everyone. As James said, 2017 was a good year as we met or exceeded our financial guidance during significant change at the company. Our press release covers our fourth quarter results in detail, so I will focus on the implications from the U.S. tax reform, two accounting changes that will affect our operating margins and our 2018 guidance.

Starting with the U.S. Tax Cuts and Jobs Act, while I won't touch on every element, I think there are three important factors to review: the impact to our underlying effective tax rate; the tax liability on our foreign accumulated earnings; and capital structure implications.

First, based on our expected earnings split between U.S. and international locations, we estimate this will lower our global effective tax rate to approximately 21% in 2018 compared to our 24% rate in 2017 and our previously expected 2018 tax rate of 26%. However, we expect increased variability from quarter-to-quarter, as future interpretations of the law and updates to the related accounting guidance could have an impact on our effective tax rate for 2018 and beyond. Therefore, the 21% effective tax rate estimate is just that, an estimate, and will be subject to change. As we go through the year, we will update you on any potential changes.

Second, in the fourth quarter, we recorded a one-time non-cash charge of $3.6 billion associated with the enactment. The charge encompasses several elements, including a one-time $4.6 billion tax on accumulated foreign earnings and a primarily offsetting net deferred tax benefit of $1 billion.

Despite being recorded in the fourth quarter, the one-time tax will be paid over an eight-year period, as stipulated by the Act. So the cash flow impact from the $4.6 billion charge will fall in future periods, but will be more than offset by the accumulated cash benefit from the lower ongoing tax rate after a six- to seven-year payback period.

While the accumulated impact is a benefit to free cash flow, the tax payments impact the company's free cash flow conversion target over the next eight years. At our Investor Day last November, we introduced a free cash flow conversion target of 95% to 100% of GAAP net income, adjusted to exclude non-cash items impacting comparability.

While the lower effective tax rate will benefit both earnings and cash flow by the same amount, the tax on historical foreign earnings will only impact our free cash flow. So this has the mathematical effect of lowering our free cash flow conversion. Since the impact of tax reform was not anticipated when we provided the guidance during our Investor Day, we are now adjusting our target to 90% to 95% during this eight-year period of tax payments.

Turning to implications on our capital structure and cash repatriation, now that the U.S. has moved to a modified territorial regime, it will make it easier to manage our cash and debt. As a result, we are providing a few updates to our capital structure. First, we have a target of 2 to 2.5 times net debt leverage, as we believe this provides the right balance between reaching the optimal capital structure and preserving financial flexibility as we move forward on strategic initiatives.

We currently operate at 3.9 times gross debt leverage and 2.2 times net debt leverage, with a credit rating of AA- from S&P and a Aa3 from Moody's. Since we are already operating within our target net leverage range, we intend to use approximately $7 billion of our cash held overseas to repay gross debt. This will allow us to reduce the spread between our gross and net debt levels, support our credit rating and continue to access the commercial paper market and reduce our net interest expense.

The remaining cash will continue to be invested overseas, as a significant portion of it is non-remittable because of local regulations or is required for working capital purposes. Another portion is required to support our commercial paper program, and then some of the cash is earning a good return in certain overseas markets.

And finally, our cash priorities remain the same. We will continue to reinvest in the business, grow the dividend, fund acquisitions and use any remaining cash for net share repurchases. As we move forward, we will periodically reevaluate and balance our opportunities with our cash flow needs. At times, and as appropriate, if we have excess cash, we could use that cash to buy back shares above our previously stated goal of offsetting any equity dilution.

Moving on to changes in accounting standards. The FASB, which is the Financial Accounting Standards Board, issued an accounting standards update on revenue from customer contracts. Based on classifications provided by this new guidance, we will now be required to account for a small number of contracts differently in the future.

While there are various considerations, the primary impact will be that certain revenue and costs and contracts that were previously netted together in revenue will now be grossed up into the revenue and cost of goods sold component going forward.

Further, as this change is prospective, meaning there is no restatement of prior results, this will result in an estimated increase in net revenue growth of 1% to 2% and an increase of 3% to 5% in cost of goods sold in 2018. Importantly, there is no material impact to our consolidated profit or EPS as a result.

However, the math of this accounting change does result in operating margin compression. This change impacts the operating segments in different ways, and it causes a timing difference, which impacts the quarters. Supplementary materials with additionally details on the impact to our operating segments and our quarters are filed on our website, and our Investor Relations team can cover any additional questions with you.

The FASB also issued an accounting standards update on pensions and postretirement benefit costs, which requires companies to split out net pension expense, keeping the service costs and SG&A and moving the other components of pension expense to other income.

As this is simply a re-class on the P&L, there is no impact to profit before tax or EPS. However, there is an impact to operating margins. Taking these two accounting changes together, we expect approximately 150 basis points of operating margin compression going forward.

Turning to full year 2018 expected performance. We expect organic revenue growth to accelerate to 4%. We expect comparable EPS to grow 8% to 10%, with the majority of earnings growth coming from the second half of the year. And we expect cash from operations of at least $8.5 billion. This represents over a 20% rebound as we cycle certain cash costs associated with refranchising activities and with the restructuring of the organization in 2017. We will continue to follow our capital allocation priorities, starting with an expected $1.9 billion in capital investment. This is higher than our long-term expected spend due to investments we are making in 2018 to enhance digital capabilities.

And we will return our free cash flow to share owners through dividends of approximately $6.7 billion and approximately $1 billion in net share repurchases. As announced yesterday, our board increased the dividend for the 56th year in a row to an annual equivalent of $1.56 per share, up 5% from $1.48.

Now let me touch on key considerations and assumptions embedded in our outlook. We expect continued portfolio lift and shift initiatives such as Coca-Cola Zero Sugar and FUZE Tea, strong marketplace execution like we see in EMEA and a slightly improving macro outlook to result in stronger top-line growth. Along with some improvement in emerging markets, we see commodity prices rising. However, continued solid pricing and a focus on expense management will more than offset higher raw material costs.

As such, we expect to deliver 8% to 9% underlying operating income growth. As mentioned previously, the accounting change for customer contracts will result in a 1 to 2 point tailwind to net revenue and a 3% to 5% increase to cost of goods sold, with a minimal effect on operating income. The pension accounting change will require restatement to our 2017 results, and given the amount of the reclass, we do not expect it to impact our 2018 guidance on operating income.

Turning to structural items. We will continue to see a structural headwind in 2018, primarily due to the timing of when certain bottling operations were sold last year and the planned refranchising of bottling territories in Canada this year. Therefore, for 2018, we expect a 17% headwind to revenue and a 2% headwind to operating income from structural items.

This will result, however, in an approximate 500 basis point benefit to comparable operating margins on top of solid underlying margin expansion in the core business. We expect currency to be a 0% to 1% headwind to operating income, as improving spot rates will be offset as we cycle hedging gains from 2017.

Below the line, we expect modest deleverage. While we plan to repatriate approximately $7 billion of overseas cash to pay down debt, higher interest rates will result in an increase to net interest expense. These factors, along with our updated 21% effective tax rate, will lead to expected growth in comparable EPS of 8% to 10% in 2018.

As we model the flow of the year, there are a few items to consider in terms of phasing for the year. We expect earnings growth to be back half weighted, primarily due to the timing of expenses and productivity initiatives.

Moving specifically to the first quarter. The first quarter will have one less day than the prior year first quarter. We expect a 6 point headwind from structural items and a one point tailwind from currencies on operating income. And we expect the change in revenue recognition to be a 1 point tailwind to revenue and a neutral impact to operating income in the first quarter.

Now I realize that was a lot to cover. And as always, our Investor Relations team will be happy to walk through each of these elements in more detail as you build out your models over the year.

So in summary, we delivered against our guidance in 2017 during tremendous change in the organization and our broader system. We believe we are well positioned as we enter into 2018 and expect accelerated performance.

And then, finally, abating headwinds from currency, macros and structural impacts, along with an improving tax outlook, will allow a significant acceleration in our comparable EPS versus the past several years.

Operator, we are now ready for questions.

Question-and-Answer Session

Operator

Thank you. We will now begin our formal question and answer portion of the call. Our first question is from Mr. Steve Powers with Deutsche Bank. Your line is now open.

Steve Powers - Deutsche Bank Securities, Inc.

Thank you. Good morning, everybody.

James Quincey - The Coca-Cola Co.

Good morning.

Steve Powers - Deutsche Bank Securities, Inc.

Happy Friday.

James Quincey - The Coca-Cola Co.

Yes.

Steve Powers - Deutsche Bank Securities, Inc.

So James and Kathy, you both touched upon this in your prepared remarks, and I'm sure you'll speak to it in more detail next week as well. But can you just, perhaps, expand a bit further on what makes you confident in the 4% organic growth guide for next year? It's clearly a solid number. It benchmarks really well against what we heard from peers and the momentum that you have coming out of the fourth quarter helps, I think, put it in perspective.

But what are the relative tailwinds that your system may have that other companies may lack right now? Because I think there's probably a bit of skepticism, maybe some concern out there today that 4% growth may be just be too aspirational, just given what we've heard from others this season. So I guess the question is really why is 4% the right call for Coke when the rest of global CPG seems anchored to more like 2% or 3% growth right now? Thanks so much.

James Quincey - The Coca-Cola Co.

Thanks. So a couple of thoughts that I think can underpin our expectations around the 4%. I mean, firstly, look back to 2017, clearly, we were making sequential improvement as we went through 2017, as we were finishing the refranchising, as we were building out the greater portfolio plans, we were, as you said, the fourth quarter was good and so was the third quarter in 2017. So I think the first point is, we were seeing some sequential improvement, so we were coming out of 2017 into 2018 with a better run rate.

Secondly, we talked on the Investor Day that what we needed to do to get back into our revenue growth rate range for our long-term model, there were a number of things we need to do on the portfolio, on some of the clusters, on some of the revenue growth management strategies and also, to some extent, an improvement in the macro environment in the emerging and developing markets. So there were things that we had to do, and there was some of the environment that would get us well into our range of the 4% to 6%.

So I think what you're seeing is a good – another good step forward in 2018, of us executing events what we need to execute, particularly the portfolio expansion and some of the RGM work. And you can see that some of that coming through in the fourth quarter. So I think the actions are in place.

The results are starting to come. The momentum is building. We're not out of the woods in 2018. The world still remains uncertain and volatile. But I think the momentum's in the business and the momentum's in the actions that we laid out that needed to be taken, plus a little bit of an improvement in the emerging macros, makes us confident that 4% is a good number for 2018.

Operator

Thank you. Our next question is from Lauren Lieberman with Barclays. Your line is now open.

Lauren Rae Lieberman - Barclays Capital, Inc.

Great, thanks. Good morning.

Kathy N. Waller - The Coca-Cola Co.

Good morning.

James Quincey - The Coca-Cola Co.

Good morning.

Lauren Rae Lieberman - Barclays Capital, Inc.

Want to talk a little bit about EMEA. So really solid price/mix, obviously, so revenue growth management showing through would seem for both developed and developing markets. And yet, you had margins down pretty considerably. So could you just talk a little bit about what went on there that quarter? And how we should think about that looking forward? Thanks.

James Quincey - The Coca-Cola Co.

Sure. Firstly, on EMEA, I mean, there's a couple of things. Clearly, we were executing against our plan to expand the portfolio, and I think they've got good growth and good launches, particularly coming into 2018, preparing the ground for the FUZE Tea launch and the AdeS plant-based drinks launch.

So I think there's a lot going on, on the portfolio in EMEA, which is very encouraging. They have been executing a lot of revenue growth management approaches, some smart packaging, some different choices on pack sizes and driving transactions. I think you all have seen that come through in the results of both Coke Hellenic and Coca-Cola European Partners in the last few days. So there's a lot of good work going on in revenue growth management, and we – a bit back to the previous answer – we see that carrying through into 2018.

We did have some places that weren't perfect. We had problems in Egypt and in South Africa, more to do with the macro environment in Egypt, the disruption of the supply chain. So my point of reference there is when we lose volume in some of the emerging markets, it kind of has a mechanical benefit on the price/mix.

And I think the last thing I would say, so actually, really strong start in EMEA, also end to EMEA in 2017. And the other thing that's driving the margin is the Innocent business continues to perform really well in Europe. And given that that's finished-products business, it appears to create margin compression, but it also drives top-line and good results.

Operator

Thank you. Our next question is from Bill Chappell with SunTrust. Your line is now open.

William B. Chappell - SunTrust Robinson Humphrey, Inc.

Thanks, good morning.

Kathy N. Waller - The Coca-Cola Co.

Good morning.

James Quincey - The Coca-Cola Co.

Good morning.

William B. Chappell - SunTrust Robinson Humphrey, Inc.

Can you talk a little bit more about North America? I mean, since you have and continue to look like you will outperform your competitor and there's been, at least in the scanner data, more pricing promotional pressure. I mean, is that a risk, or are you seeing any real change in terms of more aggressive pricing to try to win back some share?

James Quincey - The Coca-Cola Co.

Look, I think, a couple of things. Firstly, we're very happy with our strategy in the U.S. We've been executing it for a good number of years. The team in North America, CCR as it was and now many parts that transferred to the bottlers, have been executing a great plan and winning in the marketplace and driving top-tier revenue growth.

We've always said that it won't necessarily be a straight line in terms of pricing. However, I don't think the wheels have come off pricing in any shape or form. I think in part it's a question of comparisons. If you look at the two year run rates, you start to see much less noise than you do when you look at just versus prior year, and that includes ourselves where we're lapping a very strong price/mix from the fourth quarter of 2016. So I think, it appears to be more action than it actually is.

We think that our focus on driving value for our customers, and ideally, helping beverages grow faster than their average business, is what's creating the environment where there's a lot of value creation for everyone, and I think that strategy continues. And I think it's being successful and we're continuing to drive it forward. And so I think while it's not going to be always a straight line, I think it's still good.

Operator

Thank you. Our next question is from Ali Dibadj with Bernstein. Your line is now open.

Ali Dibadj - Sanford C. Bernstein & Co. LLC

Hey. Wanted to go back to the top-line organic sales growth, so the 4% that you mentioned for 2018; back in November 16 you said, 4% to 6% long term. I guess, do you wish you'd said 3% to 5% longer term? And if not, how do you build up to the 4% to 6% longer term in terms of price/mix, volume? And also even the 4% for 2018, how do you build up the price/mix and volume? And then a sub-question of that, hoping you'll take two questions, but a sub-question of that is you mentioned changes in compensation metrics. Can you talk about how that ties to that 4% to 6% or 4% for 2018 from a top-line growth perspective? Thanks.

James Quincey - The Coca-Cola Co.

Okay. Well, I do appreciate that you're all trying to talk me down from the revenue guidance. But let me lay it out. I mean, the 4% to 6%, couple of points. Firstly, we always said we were looking for a balance of price and volume. So in the long run, to get to our 4% to 6%, we know that that's going to be a mix of price and volume and in some degree of balance.

Clearly, what we've not had enough of in the short term is volume. Although it's worth saying, as a consequence of our focus on smaller packages, transactions are growing a whole point faster than volume. So we see that the strategy is driving us to the right place, but over the long term, we would expect to see some degree of volume growth necessary to be comfortably in our range of 4% to 6%. And no, I don't regret not taking it down to 3% to 5%. And so that's what needs to happen. And it's not something that needs to happen tomorrow morning, but over time, yes, we'll need volume growth to balance out the pricing. And I think that's what we aim to do.

Now, in terms of getting there, I would refer back to some of the material on the Investor Day, and we'll talk about it again at CAGNY on Tuesday. Clearly, what needs to happen to get comfortably into the 4% to 6%, and 2018 will be a step on that journey, which is why we're calling out 4%, which is the lower end of the range because we know, kind of, as I was saying on Steve's question, we know we need to do some more things on the portfolio. We're really driving expansion across the clusters.

I mean, in the fourth quarter, our initiatives were about half coming out of sparkling and half coming out of the other categories. So we're starting to see more of the portfolio there, more of the way (35:26) to driving growth. And we know that we need to continue with our revenue strategies, particularly around smaller packages; reference my previous comment on transaction, but also improving macros. I mean, the emerging markets need to come back. I called it out in the script.

The good news is Brazil's gone from being a major headwind. Actually, it was broadly flat in the fourth quarter. Over time, that market will come back and so will some of the other markets that have suffered. But it'll take time.

And so I think it's the right journey. We know what we need to do. We know what macro environments need to improve. We can see a path in the long-term for the 4% to 6%, and we've got back into the range for 2018, and I think it's a solid estimate for 2018. Of course, the world could be volatile, uncertain, but I think it's a good estimate. I reference you back to 2017. We made a realistic assessment of what we thought would happen in 2017. We called it, and we basically hit it or slightly beat it in 2017, taking the actions we needed to take. And I think we got a strong plan in 2018, and it's robust.

Operator

Thank you. Our next question is from Bonnie Herzog with Wells Fargo. Please go ahead.

Bonnie L. Herzog - Wells Fargo Securities LLC

Thank you. Good morning.

Kathy N. Waller - The Coca-Cola Co.

Good morning.

James Quincey - The Coca-Cola Co.

Good morning, Bonnie.

Bonnie L. Herzog - Wells Fargo Securities LLC

I have a question on margins. Very impressive growth during the quarter, so wondering if you guys could drill down a little bit and quantify the different drivers of this, especially how much your refranchising contributed versus some of your other productivity efforts. And then separately, could you walk through how much of a contributor productivity will be to your structurally-adjusted operating income growth of 8% to 9% in 2018? Thanks.

Kathy N. Waller - The Coca-Cola Co.

Sure, Bonnie. Good morning. So if I were to, first of all, disaggregate the gross margin expansion, the majority of that increase is, in 2017, was from the structural change and from pricing. Gross margins are under some pressure from various finished goods businesses, and we also faced a slight headwind from currency and some incremental costs from the hurricanes from last year.

Having said that, however, then pivoting over to our operating margins, in the fourth quarter, the margins expanded over 500 basis points. So we delivered very strong comparable margin expansion, and the primary driver of that again being the refranchising. And again offset by some of those costs and a donation that was made by corporate. So the majority of what you're seeing is driven by the refranchising, but at the operating margin level, a significant portion of that is being driven by the productivity initiatives, particularly the lean center initiatives.

In 2018, the margin expansion will again be – gross margins will continue to be under pressure as we are moving to other categories. However, we will offset that with the productivity, particularly, lean enterprise initiatives, and there will, again, be more expansion due to the refranchising.

Operator

Thank you. Our next question is from Nik Modi with RBC Capital Markets. Your line is now open.

Nik Modi - RBC Capital Markets LLC

Great. Good morning, everyone.

James Quincey - The Coca-Cola Co.

Hi, Nik.

Nik Modi - RBC Capital Markets LLC

So the question I have is on costs, just kind of following up on the last question. How much of what you've identified is really just kind of corporate versus what's going on in the region? So I'm just trying to get an understanding of how much have you explored in all of the regions in terms of what you could possibly do in terms of a cost out perspective? Thanks.

James Quincey - The Coca-Cola Co.

Yeah. Nik, hi. James here. We've been exploring what can be done in corporate and across the whole enterprise, including the field. We've been building this more as a culture than an event or a series of events. I think we made a lot of progress over the last number of years, going back to the start of several of these programs. So I think we have a clear line-of-sight to all the productivity initiatives we need to hit the targets we previously laid out.

So there are no stones that are unturned. We not necessarily can address everything at the same time. Some things depend on systems being put in place, and you can't get everything done in the same day. Having said that, I'll repeat myself, we have clear line of sight to what we need to drive the productivity that's embedded in the margin expansion, because ultimately, we're driving productivity, but we're also reinvesting, we're also covering some inflation. So all of that is netted into the margin expansion that we're driving.

Operator

Thank you. Our next question is from Laurent Grandet with Credit Suisse. Your line is now open.

Laurent Grandet - Credit Suisse Securities (USA) LLC

Hey, good morning, James and Kathy.

Kathy N. Waller - The Coca-Cola Co.

Good morning.

Laurent Grandet - Credit Suisse Securities (USA) LLC

I'd like to follow-up again on this, what seems to me, I mean, a weak profit guidance for this year. When we did the math, our initial reads suggest that the operating profit and EPS growth guidance is weaker than expected. So you said EPS would grow 8% to 10% from fiscal year 2017 based of $1.91, which, as we understand, it includes the benefit of the tax reform. So as tax will decline to 21%, that's roughly a seven-point benefit to EPS by your math?

James Quincey - The Coca-Cola Co.

No.

Laurent Grandet - Credit Suisse Securities (USA) LLC

No? So I mean, I'm just asking – I mean, did I miss something here, or I need some clarification on this because...

James Quincey - The Coca-Cola Co.

Yeah.

Laurent Grandet - Credit Suisse Securities (USA) LLC

Yeah, go head.

James Quincey - The Coca-Cola Co.

So our tax rate in 2017 was 24%. And we are estimating, and I underline Kathy's cautionary comments on it's not a fixed rate, so it could vary and particularly vary between quarters going down to 21%. So our year-to-year change in tax rate is 3 points, which, when you take it on the 76% of the cents on the dollar we were keeping, is a 4 percentage point headwind. So if you want to look at it that way, you can take 4 points off the EPS growth due to the tax changes. However, I would also point out that we have called out comparable EPS, so that includes the fact we're selling some of our bottling businesses, which is worth 2 points of growth. So you can net those two together. So actually, I think it's a pretty strong number off a 4% revenue growth in an environment where interest rates are increasing.

Operator

Thank you. Our next question is from Judy Hong with Goldman Sachs. Your line is now open.

Judy Hong - Goldman Sachs & Co. LLC

Thank you. Good morning.

James Quincey - The Coca-Cola Co.

Morning.

Kathy N. Waller - The Coca-Cola Co.

Morning.

Judy Hong - Goldman Sachs & Co. LLC

So on Latin America, one, just in terms of the price/mix improvement in the fourth quarter, it was quite strong, so just wanted to get a little bit more color there. And I know you touched on this, James, a little bit earlier about Brazil getting better, but wanted to just get a little bit more color just in terms of some of the initiatives that you had in place in the price pack architecture initiatives. How far along are you in that market? In contrast, Mexico softened a bit in the fourth quarter, so just trying to get a better sense of the outlook in that market within that region?

James Quincey - The Coca-Cola Co.

Yeah. I shall go in reverse order. So I think Mexico did weakened – softened a little bit. I think it's largely the macro environment in Mexico is getting a little softer at the moment, and I think that'll likely play through a little bit, at least into the first half of 2018. But I think that's largely macro.

Of course, we are adapting and looking to execute some initiatives around affordability, around packaging, around launching new products. We did de-prioritize in the fourth quarter a little bit of the low-margin bulk water, so that is part of the story but not the full story. So there a little bit of softness in Mexico.

Now driving the price/mix in the fourth quarter clearly got better, and in part, it was due to the ongoing improvements in Brazil, where we had clarity been executing a plan through the year to improve affordability and focus on smaller packages that are more affordable but actually helped from a price/mix point of view. Plus we have the benefit of some of the price increases and incidence increases that flowed in in the back half of the year. So I think it was a pretty strong year of actions to drive RGM.

Operator

Thank you. Our next question is from Robert Ottenstein with Evercore. Your line is now open.

Robert Ottenstein - Evercore ISI

Great. Thank you very much. You mentioned earlier on that transactions were growing 100 basis points faster than volume, which is terrific. I was wondering if you could just give us any more thoughts on that. Do you think that is the likely outlook going forward in terms of 100 basis points? Do you think that can expand? And how does that number compare on a geographic basis? Are there some areas where transactions are down or other areas where transactions are up much more than 100 basis points? Just more color around that would be helpful. Thank you.

James Quincey - The Coca-Cola Co.

Yes, sure. So I think our objective and recent history is have transactions growing ahead of volume on an aggregate basis. So clearly, it's something that we are pursuing actively because we are pursuing a strategy of smaller packages across most of the geographies, whether it's through affordability or whether it's around helping people with portion control. There's a lot of places where we're trying to drive transactions ahead of volume.

Now, the U.S. is one of those. Clearly, we've had the strategy around this area for some time. We made great progress. The mini cans were in double-digit growth in the fourth quarter, and the U.S. absolutely had transactions more than 100 basis points ahead of volume. So we were very pleased with the execution of that strategy in the U.S.

Similarly, the other parts of the world that most of the countries' transactions are ahead of volume. Not everywhere, and that can sometimes be because we're trying to increase the affordability of the multi-serve packages, and that just happens to have a mechanical effect. But I would call out, as the kind of the lead ones in really driving smaller packages very assertively, are some of the developed markets led by places like the U.S., Australia, France, some of the places like that. And then in the emerging markets, it kind of depends on whether we're driving affordability or not.

Operator

Thank you. Our next question is from Vivien Azer with Cowen & Company. Please go ahead.

Vivien Azer - Cowen & Co. LLC

Hi, good morning.

Kathy N. Waller - The Coca-Cola Co.

Good morning.

James Quincey - The Coca-Cola Co.

Hi. Good morning.

Vivien Azer - Cowen & Co. LLC

Was hoping you could speak to the repackage and flavor expansion of Diet Coke in the U.S. if you could just talk about your objectives there, what should we be expecting to see in Nielsen? What's the picture of success? Is this cutting the volume declines in half? Is it getting the brand back into growth? Anything you could offer would be helpful. Thanks.

James Quincey - The Coca-Cola Co.

Sure. I mean, clearly, and it's one of our points of dissatisfaction in 2017 is we were not able to turnaround Diet Coke. I think the team have come up with a strong plan for 2018 with the new flavors, the new can design and size and some of the marketing. And I think we are going to have hopefully a better year in 2018 in terms of Diet Coke.

I think we're finding a path forward. Clearly, part of the story in 2017 towards the end was we started doing even better with Coke Zero Sugar as the relaunch of that drove almost 10 points of growth in the fourth quarter on Coke Zero Sugar.

Nevertheless, we want to improve Diet Coke, too. We had a strong start at the beginning of this year with the launch of new program. Clearly, we would love to at least stop declining, if not get into growth. I'm not sure just the flavors and the packages will get us there, but it's certainly going to be a good step in the right direction.

Operator

Thank you. Our next question is from Amit Sharma with BMO Capital Markets. Your line is now open.

Amit Sharma - BMO Capital Markets (United States)

Hi. Good morning, everyone.

Kathy N. Waller - The Coca-Cola Co.

Morning.

James Quincey - The Coca-Cola Co.

Morning.

Amit Sharma - BMO Capital Markets (United States)

James, you mentioned in your script about the tax changes in the U.S. and its impact on U.S. consumption. Can you talk a little bit more about that? Where do you see most impact on consumption? How much, if you can quantify that? And then just tied to that, what's the expectation for the U.S. business in terms of 2018 top-line growth?

James Quincey - The Coca-Cola Co.

Well, I think the first thing to say is, the tax reform has just come in, and so we're not actually seeing the effects into the economy yet. Clearly, as the investments behind more opportunities, because of the lower tax rate, start to occur, that will lift aggregate demand. But in the end, we are a broad enterprise. And so, lifting of consumer income ultimately is what's going to flow through to us.

As confidence returns in the economy, often you see increases in people going out and in foodservice, so you'd start to see it occur there. But we are ultimately going to benefit as the broad-based economy does better and more money flows into people's pockets.

What was the second half of the question? Oh, North America. We don't provide a guidance number by group, but clearly, we've got a good strategy in North America. We believe that the sorts of revenue growth rates we've been delivering, like in 2017, put us in the top tier of FMCG. And we want to stay in the top tier of FMCG.

Operator

Thank you. Our next question is from Pablo Zuanic with Susquehanna Financial Group. Your line is now open.

Pablo Zuanic - Susquehanna Financial Group LLLP

Thank you, and good morning, everyone.

James Quincey - The Coca-Cola Co.

Good morning.

Kathy N. Waller - The Coca-Cola Co.

Good morning.

Pablo Zuanic - Susquehanna Financial Group LLLP

My question is on the fountain business. It's just a two-part question, very simple. It's a large part of your volume, about 35% in the U.S. Why has not been that refranchised, or will it be? I suppose that bottlers would benefit from that volume. And the second part to your question is, you've done a great job in terms of moving into smaller RTDs, garnering increasing revenue per case, higher growth there. I suppose that in some outlets, over time, you can ship from fountain to literally smaller PET bottles, and that could be very profitable for the whole system. So just can you give us a sense of how that can play out in the future? Thank you.

James Quincey - The Coca-Cola Co.

Sure. I think you said the fountain was 75% of the volume. I'm not sure I heard you correctly. But just to clarify, the fountain business in the U.S. is about a third of the U.S. system volume, not 75% if that was the number you said. So it's about a third of the U.S. volume. It operates in a very different way to the bottle-can business. It requires different capabilities, both in the supply chain and the customer. And it operates largely with the national chains of customers, even more so and much more so than the grocery retail and the mom-and-pop business and the convenience store businesses or the kind of the brick-and-mortar store.

So I don't think that there's any likelihood of us doing that in the short-term. I'm not sure I see the acceleration of performance advantage in doing so. And so I think we will stick to the strategy that we have.

And then, in terms of fountain versus smaller PET, what we're focused on is making sure we're delivering the consumer experience that they are after in the outlet in which they're buying and optimizing that and providing that in the package form that best fits that consumer experience with the customer that they're at. So we're not trying to artificially drive the packaging structure one way or the other. We're trying to optimize the consumer experience.

Operator

Thank you. Our next question is from Ms. Andrea Teixeira with JPMorgan Chase. Your line is now open.

Andrea F. Teixeira - JPMorgan Chase & Co.

Hello. Yeah, so good morning and thanks for taking my question. I would like to just focus on FX outlook. I understand that now it's becoming a tailwind, finally. And how I understand that in the past was obviously a major drag to EPS. So how would you think for pricing and your ability to take more risks in innovation, let's say, in Latin America or even reinvest more in products that are less – like you quoted Honest Tea – on products that are less margin accretive in the beginning, but would be very growth accruing in the future? Thank you.

James Quincey - The Coca-Cola Co.

I'll maybe take the first one. And if I've missed something, then you can jump in, Kathy.

Kathy N. Waller - The Coca-Cola Co.

Okay.

James Quincey - The Coca-Cola Co.

I'm not sure that we link the two pieces of the question you're putting out. I mean, we largely have an approach where we drive our business in local terms. The world's not one-size-fits-all. So we look at each marketplace and say, what do we need to win in this marketplace with these consumers, working with the customers to create value for them. And the company is, in a way, the sum of all those local actions.

Now a year ago, we talked about we were going to take some extra effort to make sure the sum of all that turns into positive comparable EPS growth in U.S. dollars, which it hadn't done necessarily for a few years. And we got to flat last year, and we're going to drive for some good growth in 2018. But the variations in FX, assuming they're not completely wild, don't drive our operational local market decisions. The expansion of the brands like Honest and all the other innovations are really driven by the market.

And so, therefore, pricing is really driven by those local opportunities of launching the portfolio and local inflation. So to the extent that, I guess, FX somehow theoretically is linked to local inflation, it comes to play. But we start at the other end of the equation, which is what does the local market need in terms of products and pricing, and then work it back.

Kathy N. Waller - The Coca-Cola Co.

Yeah, if I can just add. We talked about the tailwind in the first quarter, however, remember, we have a hedging strategy and that so whether it's a tailwind or a headwind, and we're really guiding towards more of a headwind, is because of our hedging strategy that we have employed. And so we're cycling some really good hedging gains from last year, which is causing most of that headwind for next year.

Operator

Thank you. Our last question is from Bryan Spillane with Bank of America Merrill Lynch. Your line is now open.

Bryan Spillane - Bank of America Merrill Lynch

Hey, good morning, everyone.

Kathy N. Waller - The Coca-Cola Co.

Morning.

James Quincey - The Coca-Cola Co.

Morning.

Bryan Spillane - Bank of America Merrill Lynch

Hi. I guess, question for you, Kathy. I just wanted to follow-up on some of the comments you made about free cash flow and the effect of the tax code change. We think about two things, gross debt and then, I guess, net interest expense, understand that the free cash flow conversion maybe comes down a bit, but seems like you had more access to cash. So I guess, over time, forgetting about what's going to happen this year, will you have the ability to maybe take gross debt balances down over the next few years is the first question? And then related to that as we think about interest expense, with rates rising and then whatever you may do with gross debt balances, just how we should think about net interest expense, both for 2018 and beyond?

Kathy N. Waller - The Coca-Cola Co.

Hi, Bryan. So gross debt balances will – are initially going to come down about $7 billion, as we said in our remarks. And that will allow us to then kind of balance out our spread.

Over the long term, yes, we have – tax reform gives us the ability to have flexibility with our cash. So we will employ the right capital structure for us. We're going to keep a net leverage position of 2 to 2.5 times and as we need to, yes, we could potentially bring down more gross debt. The focus right now is maintaining that net debt leverage position.

Interest expense is, obviously, we're in a rising interest environment, and our interest expense will be going up, even though we are going to pay down some of our gross debt. And over time, I guess, you asked about specifically the longer-term kind of outlook for interest expense.

Today, we only have about 20% floating. As we are, I guess, moving over time, more into – we will, I believe move more into a floating rate environment, as we see the benefit, and that will hopefully help us to temper that interest rate expense increase. But for now, interest rates are going up as we have continued to move our debt into longer-term maturities over time. And because of when we bring back the $7 billion, we will take out some of our commercial paper, which has a lower interest rate.

So basically, I would say we'll take a look at the capital structure, always manage it over time for now. We believe the right thing is to bring back the $7 billion, pay down gross debt, manage to a 2% to 2.5% net leverage position. And that does impact our interest expense going forward. And over time, we'll continue to manage that as well.

James Quincey - The Coca-Cola Co.

Great. Thank you very much, everyone. So to conclude, we had a successful 2017, and we are encouraged that 2018 will be even stronger. As always, we thank you for your interest, your investment in our company and for joining us. Thank you very much.