Operator

At this time, I would like to welcome everyone to The Coca-Cola Company Second Quarter 2012 Earnings Results Conference Call. Today's call is being recorded. If you have any objection, you may disconnect at this time. [Operator Instructions] 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 Jackson Kelly, Vice President and Investor Relations Officer. Mr. Kelly, you may begin.

Jackson Kelly

Good morning, and thank you for being with us today. I'm joined by Muhtar Kent, our Chairman and Chief Executive Officer; and Gary Fayard, our Chief Financial Officer. Following prepared remarks this morning, we'll turn the call over for your questions.

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

In addition, I would also like to note that we have posted schedules on our company website at www.thecoca-colacompany.com, under the Reports and Financial Information tab in the Investors section, which reconcile certain non-GAAP financial measures that may be referred to by our senior executives in our discussions this morning and from time to time in discussing our financial performance, to our results as reported under Generally Accepted Accounting Principles. Please look at our website for this information.

Now I'll turn the call over to Muhtar.

Muhtar Kent

Thank you, Jackson, and good morning, everyone. Let me begin by saying that I'm pleased with our second quarter and year-to-date results. We're delivering consistent top line performance in line with our 2020 Vision and long-term growth targets despite an increasingly unpredictable global economy. Our business realized solid top line results this past quarter, growing worldwide volume by 4% in the quarter and 5% year-to-date. Our second quarter comparable currency neutral net revenue was up 7% in the quarter, driven by solid price mix of 3%. Year-to-date, comparable currency neutral net revenue was also up 7% and our comparable currency neutral operating income also grew 7% in the quarter, raising our year-to-date operating income growth to 6%.

We once again led industry growth, extending our volume and value share gains globally in nonalcoholic ready-to-drink beverages. We gained global share in the sparkling beverage category, where our portfolio is now up 3% year-to-date. This was driven by the global growth of brand Coca-Cola, which is also up a healthy 3% year-to-date. We gained global share in the still beverages category, where our portfolio grew a solid 9% in both the quarter as well as year-to-date.

Importantly, we delivered these results while further enhancing the well-being of the communities and customers we proudly serve and the consumers whose lives we touch each and every day. During today's call as we discuss our performance, I'll also share a few of the meaningful ways we are serving our communities across our geographic operations, as these efforts are an integral part of realizing and sustaining our 2020 Vision.

We recognize that consumers across the globe continue to feel the effects and impacts of prolonged uncertainty in Europe, the further cooling of the economy in China and a protracted recovery here in the United States. Despite this, our consistent quality performance results, as well as our systems commitment to invest in the business for long-term growth, give us confidence that we have the right strategies and the right plans in place to deliver full year 2012 results that meet our long-term growth targets, for in times like these, there is no better industry to be in than the nonalcoholic ready-to-drink beverage industry. We're proud to be part of a strong and growing industry that passionately serves millions of outlets and refreshes billions of consumers every single day.

Now let us review our performance results across our global markets in more detail, beginning with our flagship market, North America, where this past quarter, our business delivered its ninth consecutive quarter of growth, up 1% for both the quarter as well as year-to-date. Importantly, we achieved this growth in North America while sustaining a positive 3% price mix for our total beverage business. And in the process, we once again captured value share in nonalcoholic ready-to-drink beverages this quarter, consistent with our focus on driving profitable growth in North America. This growth was led by our still beverage portfolio, which was up 8% this quarter, gaining both volume and value share across nearly all of the categories in which we compete.

In sports drinks, POWERADE once again grew double-digits this quarter, while also capturing volume and value share. This marks the third consecutive quarter in which POWERADE has led the North America sports drink category in absolute unit case volume growth.

Our glacéau brands, up 5% this quarter, also captured share, driven by the further momentum of vitaminwater zero, up high single-digits, as well as by another quarter of double-digit growth for smartwater. In addition, smartwater began using PlantBottle packaging this past May, as we further leverage this proprietary, innovative and sustainable packaging that we launched nationally with our DASANI water brand last year. Speaking of DASANI, this brand provided yet another quarter of double-digit growth in North America, delivering both volume and value share gains.

The acceleration of our tea portfolio in North America also continued this quarter, up double-digits while gaining both volume and value share. This result was led by Gold Peak, which has now grown double-digits for 21 consecutive quarters.

Finally, our juice and juice drink portfolio in North America was up 3%, led by high single-digit growth for our Simply brands, as well as mid-single-digit growth for our Minute Maid brands. These results solidify our share leadership in the high-value, 100% chilled orange juice segment.

Our sparkling beverages in North America was down 2% in our second quarter, in line with the broader sparkling beverage industry's results during the same April to June time frame. Importantly, our sparkling beverage portfolio earned a positive 5% price mix this quarter in a rational pricing environment. We also sustained our momentum behind both Coke Zero and Fanta, with both these brands up mid-single-digits this quarter. We're particularly pleased to see this continued solid growth for Coke Zero in North America, considering that this brand's baseline was built off of 5 consecutive years of double-digit growth.

This winning track record reflects our commitment to sustainable innovation that delivers year-over-year growth. And Coca-Cola's brand equity scores keep improving, with Coca-Cola's favorite brand score among the total U.S. population up when compared to a year ago. This favorite brand score for Coca-Cola is now nearly 2x greater than the score of its primary competitor. Finally, our Coca-Cola Freestyle fountain dispenser, which recently won the Gold Innovation Award from the National Automatic Merchandising Association, is now available in more than 4,400 outlets across North America.

One of the many ways we've consistently served our communities in North America is through our investments in initiatives that promote physical activity and well-being. A good example is how we are encouraging physical activity through our Sprite Spark Parks Project. Launched in 2011, this project has supported the construction and refurbishment of more than 150 neighborhood parks, athletic fields and basketball courts. We're also partnering with the National Foundation for Governors' Fitness Councils and the American College of Sports Medicine to build gyms in schools across the country. Last month, we announced that we will dedicate $5 million to provide 100 communities with new fitness centers for schools. While our commitment to our communities both in North America, as well as across the globe, goes well beyond just physical activity programs, we will always encourage our consumers to be healthy and active and provide them with opportunities to do so. This is at the heart of our brand values.

In summary, we have every reason to remain optimistic about the long-term outlook for this market, which has the best demographics of the developed world and remains an unparalleled center of innovation and entrepreneurial activity.

Now let me turn to our Pacific Group, which grew 8% in both the quarter and year-to-date, including 6% year-to-date growth for brand Coca-Cola. Additionally, our Pacific Group captured both volume and value share in nonalcoholic beverages this quarter.

During our last earnings call, we shared our expectations that our volume growth in China might moderate to some extent as our business would not be immune to China's cooling economy. In fact, China's GDP growth rate is at a 3-year low, yet still above 7%. As anticipated, the broader beverage industry in China has felt the impact of this economic slowdown. Despite this, our business in China delivered 7% growth in the second quarter, while cycling a strong 21% growth from last year. Year-to-date growth in China was a solid 8%, cycling 17% from last year.

The rightsized packaging efforts we put in place in China last year keep generating consistent, strong incremental transactions, in line with our expectations. As such, both sparkling beverage and total beverage transactions were up double-digits for both the quarter as well as year-to-date in China. And importantly, we once again captured both volume and value share in the sparkling category -- beverage category in China this past quarter.

We're very excited about our opportunities in this region. Our clear focus on building our business for sustainable growth provides us with confidence that

China will continue to serve as a double-digit growth market over the long term.

Our business in Japan delivered yet another quarter of strong growth, with volume up 4%, bringing our year-to-date growth in this important critical market to up to 4% as well on a year-to-date basis. Importantly, these results in Japan were broad-based, with growth seen across all channels, including convenience stores as well as vending. And our Japan business gained both volume and value share in the nonalcoholic ready-to-drink beverage category this quarter. So looking ahead, we expect our third quarter volume results in Japan to moderate below our 4% year-to-date trend as we enter what is forecasted to be a cooler summer season when compared to last summer's historically record hot temperatures. Having said that, we remain confident that our system in Japan is well aligned and in a strong position to deliver full year low single-digit growth in 2012.

I also want to update our results in Thailand. Our business in this market sustained its solid momentum, growing over 20% for both the quarter and year-to-date. In the process, we gained volume and value share in Thailand across nonalcoholic ready-to-drink beverages, as well as in both sparkling and still beverage categories. We are excited about the future growth opportunities in Thailand, and we'll keep investing for the future in this vibrant market.

As for the Philippines, we just celebrated the 100th anniversary of our entry into this market. Importantly, we again captured volume and value share in nonalcoholic beverages in the Philippines and have grown our volume mid-single-digits for both the quarter as well as year-to-date.

We launched our 5 BY 20 program in the Philippines almost exactly 1 year ago. As background, this program is our global initiative to enable the economic empowerment of 5 million women entrepreneurs by 2012 -- 2020. In the Philippines, we are working with local partners to implement a pilot business skills training program, and we are now in the process of scaling up this program nationwide to economically empower 100,000 women store owners and operators by 2020. We believe there is no better investment we can make to spur economic growth and foster sustainable development.

Moving now to Latin America. Our volume grew 3% for the quarter and is up 4% year-to-date. This growth was once again led by brand Coca-Cola, up 3% year-to-date. In the process, we once again captured both volume and value share in nonalcoholic ready-to-drink beverages in Latin America, as well as share gains in both sparkling and still beverages.

In Mexico, our volume growth in the quarter was up 1% as we cycled a very strong 10% growth from previous year. This brings our year-to-date volume growth in Mexico to 2%, while cycling 12% from last year. Importantly, we once again outperformed the beverage industry in Mexico, capturing nonalcoholic ready-to-drink beverage volume and value share, as well as in sparkling and still beverages.

In Brazil, our business continued to deliver solid results, with volume growth up 6% in the quarter and 5% year-to-date. And our business in Brazil is also driving industry growth, gaining both volume and value share in nonalcoholic beverages, as well as again in sparkling and still beverages. Looking ahead, we expect our 2012 growth results in Brazil to hold steady at low to single -- low to mid-single-digits, especially in light of recent revisions to the Brazilian economy's GDP forecast for the remainder of this year.

Our Eurasia & Africa business extended its momentum, growing a strong 12% in the quarter and 11% year-to-date, including solid 11% year-to-date growth for brand Coca-Cola. This group's overall performance was once again led by India, which grew a strong 20% for both the quarter and year-to-date, delivering balanced and consistent growth across all beverage categories. Sparkling beverage growth in India was led by brand Coca-Cola, up 35% in the quarter and 32% year-to-date. In still beverages in India, our Maaza juice brand was up over 30% in both quarter and year-to-date. And importantly, our business in India captured volume and value share in nonalcoholic ready-to-drink beverages and also in both sparkling and still beverages.

I was recently in India, where we announced our systems plan to increase investments in India by $3 billion, bringing total system investments to $5 billion between now and 2020. These investments will drive innovation and enable our efforts to deliver a portfolio that enhances the consumer experience and builds brand loyalty to deliver long-term sustainable growth.

Russia was up 9% this quarter, raising our year-to-date growth to 7%. The steady acceleration of our business in Russia was once again led by the strong momentum of brand Coca-Cola, which grew 23% in the quarter and is now up 22% year-to-date. Similarly, strong results were also observed across our broader sparkling portfolio as Fanta and Sprite both registered double-digit growth this past quarter in Russia. And our Dobriy juice brand delivered 12% growth in the quarter, bringing this brand's year-to-date results to double digits. As a result, our overall business in Russia keeps outperforming the rest of the industry, gaining nonalcoholic ready-to-drink beverage volume and value share.

We also saw robust growth across the rest of Eurasia & Africa region this quarter, including double-digit growth in South Africa and the Middle East, as well as North Africa region.

Lastly, we finalized our acquisition of approximately half the equity of Aujan Industries this past quarter. As a reminder, Aujan holds the #1 position in the still beverage business across the entire Middle East. Between our solid performance, the strength of our bottling partners and our new partnership with Aujan, it is easy to see why we are so excited about the future of our business in this dynamic part of the world.

Moving now to Europe, where our volume was down 4% for the quarter, cycling strong 5% growth from last year. As a result, our business in Europe is now down 2% on a year-to-date basis, cycling 3% growth from prior year. This past quarter, Europe was challenged by both historically unseasonable inclement weather as well as ongoing macro uncertainties. Despite this, our business in Europe held share in nonalcoholic ready-to-drink beverages, as well as sparkling beverages, while capturing both volume and value share in still beverages. Germany remains the bright spot in this region, up 1% for the quarter and 2% on a year-to-date basis. This marks Germany's sixth consecutive quarter of positive growth. Importantly, we once again captured volume and value share in ready-to-drink beverages. This serves as a solid evidence that we have the right brands, the right strategies and the right capabilities in place to deliver long-term sustainable growth in this critically important market.

We recently concluded our highly successful activation of the UEFA Euro 2012 football tournament. In recent consumer surveys, Coca-Cola was overwhelmingly recognized as the tournament's primary brand sponsor, with this brand awareness translating into volume and value share gains in the tournament's host nations.

We're also very excited about the special opportunity to grow the value of our brands even further through our investment in the 2012 London Summer Olympics. From a brand standpoint, we shared our last quarter -- we shared last quarter how our Olympics Move to the Beat program has been launched globally and activated in over 100 markets. Additionally to brand Coca-Cola, we're leveraging this unique platform to activate and fully integrate a global Olympic POWERADE program in more than 35 markets across -- all across the world. This will be POWERADE's first global activation program since its launch 20 years ago at the 1992 Barcelona Olympic Games.

And in keeping with our LIVE POSITIVELY culture, we've placed our commitment to sustainable communities at the heart of our Olympic activation efforts. This year, we're offering the widest range of drinks and sizes ever to be made available at the Olympic Games, and we have pledged that all bottles collected at the Olympic Games venues will be recycled and back on shelves within a short 6 weeks. We have also updated the labels for our Coca-Cola packages to present consumers with a clear recycling call to action. And we've also created more than 120 permanent Coca-Cola Recycle Zones all across Great Britain.

Before closing, let me say how pleased we are with this past quarter when Coca-Cola was recognized as the #1 brand by CoreBrand, based on a survey tracking the corporate brands of 1,000 companies across 54 industries. This is the 11th straight year we have received this honor, is especially gratifying since CoreBrand's rankings are based on a poll of 10,000 business professionals with rankings based on brand familiarity, reputation, perception of management, as well as investment potential.

While all of us at The Coca-Cola Company are proud of our performance year-to-date, we believe that our best days are still ahead. Our 2020 Vision provides our system with a clear road map for growth. Our consistent quality volume, value and profit results demonstrate that our global bottling system is very well-aligned and poised for execution. As we look ahead for the balance of this year, we understand that consumers still face an unpredictable environment. Having said that, we remain confident that we have the well-loved brands, vision and road map with our global bottling partners to effectively navigate today's environment.

We will continue to passionately refresh a thirsty world. We will do so by offering a growing choice of quality beverages that refresh and hydrate our consumers while bringing them simple moments of happiness. We will do so by sustaining our commitments to communities and to the many well-being initiatives we support. And we will do so by ensuring that we always place our highest priority on creating sustainable value for our consumers, for our customers and for our shareholders.

With that, let me now turn the call over to Gary.

Gary P. Fayard

Thanks, Muhtar, and good morning, everyone. We delivered solid results this quarter, demonstrating once again that despite an unpredictable environment, our global system is well positioned to execute our strategic plans in alignment with our 2020 Vision.

Let me start with our comparable earnings per share, which came in at $1.22 this quarter, up 4% versus the prior year. This raises our year-to-date comparable earnings per share growth to 4% as well. Our comparable currency neutral operating income was up 7% this quarter, increasing our year-to-date comparable currency neutral operating income to 6%. On a comparable basis, the impact of currency on this quarter's operating income results was a 5% headwind. Comparable currency neutral net revenues grew 7% this quarter, including a 3% increase in concentrate sales and a 3% positive price mix. The currency impact from this quarter's comparable net revenue results was a 4% headwind. On a year-to-date basis, our comparable currency neutral net revenue growth held steady at 7%.

We also maintained our consolidated price mix at a positive 3% this quarter. In fact, we realized positive price mix across every one of our geographic operating groups this quarter. Looking ahead, we will cycle higher price mix comparisons during the back half of 2012, which will lead to lower consolidated price mix results in the third and fourth quarters. Having said that, we continue to expect our full year 2012 consolidated price mix results to come in between 1% and 2%, in line with our long-term target range.

Our gross margins softened a little further this past quarter, particularly in late May and June. This sequential trend is being driven by both ongoing currency headwinds, as well as by changing -- changes in channel and package mix across markets, as today's economic conditions are leading consumers to temporarily shift their channel and package preferences. As we look ahead, we anticipate that these currency and mix shift headwinds will continue through 2012. As such, we now expect our full year 2012 comparable gross margin to come in below our second quarter gross margin, with this headwind primarily observed in the third quarter of 2012. Despite this, we remain confident in our ability to deliver full year comparable currency neutral operating income growth in line with our long-term growth targets.

Our comparable currency neutral SG&A expenses were up 5% in both the quarter and year-to-date. These results include an overall increase in year-to-date direct marketing expenses, as we sustain our commitment to invest in the health and the strength of our brands. Our operating expense leverage once again came in positive this quarter, bringing our year-to-date operating expense leverage up to 1 point, in line with our previously stated outlook. We now expect our third quarter operating expense leverage to range between a negative 3 and negative 5 points. However, this pressure on operating expense leverage is expected to reverse in the fourth quarter, especially as we benefit from having 2 additional selling days in the fourth quarter, and enabling us to achieve slightly positive operating expense leverage on a full year basis.

Our net interest came in even in the second quarter, exactly in line with the outlook we provided in our last earnings call. This held our year-to-date net interest income at $27 million. We now expect our net interest to come in as a slight expense in the back half of the year, primarily due to expected lower rates in some of our international locations, as well as ongoing currency headwinds. As a result, we are now updating our full year net interest income outlook to $10 million to $20 million, with the net interest expense we sense -- that we see in the second half of 2012 evenly spread between the third and fourth quarter.

Our underlying effective tax rate now stands at 24%, which is an improvement over the 24.8% rate we communicated during our last earnings call. And we expect to be able to carry this 24% tax rate through the remainder of this year and into next year. And our cash flow from operations increased a very strong 15% year-to-date.

Our year-to-date net share repurchases total $1.6 billion. This places us well on track to achieve the $2.5-billion to $3-billion range for full year 2012 that we communicated at the outset of this year. With regard to commodities, in our last call, we said we expected the full year 2012 incremental impact of our big 4 commodity cost on our results to range between $350 million and $450 million. We also said that if current trends held, we could see this outlook slowly improve. Today, I can confirm, based on our latest forecast, we now expect our full year incremental cost on commodities to come in closer to $300 million.

As for currencies, we previously provided an outlook that they would have a mid-single-digit negative impact on our full year operating income. Today, we are still seeing the dollar strengthen against other currencies, including many of those that we do not traditionally hedge, that is not effect -- because it's not effective to do so due to the high cost associated with these hedges. As such and based on our hedge positions, current spot rates and the cycling of our prior year rates, we expect currencies to have an 8% to 9% negative impact on operating income in the third quarter. In addition, we now expect the full year impact of currencies on our operating income to be a headwind at the high end of the previously communicated mid-single-digit range.

And there's one housekeeping item to keep in mind as you update your models. Our shareowners recently approved a 2-for-1 stock split, which will double the number of outstanding shares in August.

In closing, as we reach this halfway point of 2012, we find ourselves navigating through a challenging global economy. The recovery in the United States remains moderate and consumer sentiment is still challenged. Consumers in Europe are feeling the effects of that region's prolonged macroeconomic uncertainty. And the economy in China, while still growing, continues to demonstrate signs of cooling.

But it's important to put today's challenges and our business results in the proper perspective, for while consumers may be feeling some pressure in these markets, we continue to execute with excellence. We are earning price and gaining value share in North America while sequentially improving profitability. We're holding our share in Europe while investing in our brands for long-term growth. And we're delivering double-digit transactions growth in China as we solidify our leadership across multiple categories in this growing market.

The bottom line is that we are successfully managing our business for the long-term while delivering consistent and solid top line and bottom line results. Our system is healthy and is financially strong as ever, generating solid cash flow and investing to support our world-class portfolio of brands. We are also investing across the globe to support the long-term health and well-being of our communities, customers and consumers. And importantly, we continue to reward our shareowners, prudently managing our investments to deliver quality results while also paying a healthy dividend.

So as we look ahead to the rest of 2012 and a protracted and unpredictable economic recovery, we are encouraged by our consistent results, as well as by our faith in our 2020 Vision, and remain confident in our ability to deliver full year volume, revenue and operating income results in line with our long-term growth targets. Operator, we're now ready for the questions, please.

Question-and-Answer Session

Operator

[Operator Instructions] Our first question today comes from Bill Pecoriello, Consumer Edge Research.

William Pecoriello - Consumer Edge Research, LLC

Muhtar, considering the tough global macroeconomic backdrop, your Q2 results were certainly impressive. But you've been talking about on the call today, some of the incremental global macro headwinds we're seeing decelerating further in certain markets, so what's giving you the confidence that The Coca-Cola Company can continue this strong performance during the second half of the year? And what specific actions is the company taking to offset the incremental headwinds? You mentioned some of the packaging shifting. And maybe is there any reallocation of market spending, et cetera?

Muhtar Kent

I think I'd just say -- start by saying that, firstly, we're very fortunate that our business has been doing well in recent years. I think operating in this environment has become the norm for us. It's not a passing feature now, operating in this very volatile and unpredictable environment. And I think that we're meeting the long-term growth targets set out for our 2020 Vision, even in difficult economic circumstances. And I think part of our success has been because there's been a healthy appetite for investment across our global bottling system in this environment, and stronger than it's been for a long time. Our 2020 Vision is a system vision. It's focused on long-term growth collectively with our partners -- bottling partners. And when you look back at 2010, 2011, the nonalcoholic ready-to-drink industry grew by about $65 billion in total retail dollar value. And we're pleased to say that our system represented nearly 40% of that total industry growth, well above our fair share, underscoring that vision and that collective effort and that investment is working. That said, we're naturally keenly aware of how turbulent the economic landscape is today and will continue to be this year. And we've said many times before during the past few years that we may hit a bump in the road, given the continued volatility in the macro environment, but that we're focused on meeting our long-term growth targets on realizing -- and realizing our 2020 Vision. And so far, I think you can say that, quarter-after-quarter, we've proven that. All of us at Coca-Cola, the entire system, remain constructively discontent. We know that we can always do better. And I think you've got to realize we've got a wonderful portfolio of geographic regions. And so some of them may -- not all of them will not ever do well all the time. But just like this past quarter, where we had very unseasonable weather in Europe, we had tremendous, again, negative consumer sentiment brewing in Europe, we still have delivered our results and we will continue to do so. And then also, quarter-after-quarter, we're gaining share and, quarter-after-quarter, our business, our top brands have been improving. Brand health metrics, I keep on saying that's an important metric to look at. And when you look at the past sort of quarters, back to 2011 versus today, we've again delivered very strong increments of improvement in our Coke, Fanta, Sprite brand scores, as well as weekly-plus drinkers. And as you go around the world, I think certainly there is a sentiment that this is going to be a prolonged crisis, that the high levels of unemployment are here to stay, both in Europe as well as in the United States, and also that there's a little somewhat cooling off of economies in Asia, particularly China. But in this environment, I don't believe there's a better business and there is a better system to continue to crack the calculus for growth. When you look at BRICS, Brazil, Russia, India and China and the Sub-Saharan Africa, referred to as the BRICS nations, we grew in Q2 a combined plus 8%. And so it's worth noting that those markets represent nearly 400 million cases of incremental growth last year. And so we continue to generate significant growth in those emerging markets and we continue to create growth in developed markets, like Japan, what you saw in this past quarter, as well as the United States, ninth consecutive quarter of growth in the United States. And when we first talked about that, again, in the midst of economic turmoil back 2.5 years ago, very few people thought that we could achieve that. So that's why I have confidence, Bill, that we believe that we can continue to meet our long-term growth targets despite a very volatile, unpredictable and prolonged economic recovery.

Operator

Our next question comes from John Faucher with JPMC.

John A. Faucher - JP Morgan Chase & Co, Research Division

Gary, I want to talk a little bit about the operating leverage guidance going forward, particularly for the third quarter. You talked a little bit about the gross margin impact. In order to get to that type of negative deleveraging, we'd probably have to see a little higher level of SG&A spending. So can you talk a little bit about that? And then also, can you talk about some of the improvement that you've started to show in North America in terms of operating profit growth there? With North America sort of -- I guess, the question is, are you expecting North America to also get better from here? Because if it does, that also makes the operating leverage in Q3 seem a little bit more surprising.

Gary P. Fayard

A very good question. And let me -- I'm going to have to take it in pieces and parts, if I could, and see if we can put that all that together and come up with an answer on it. But let's start at gross margin first, because I think that's the most important place to start. Even on gross margin, I think you've got to split it into a couple of pieces, split the company, look at BIG and international operations and then North America. And on BIG and international, a lot of the gross margin pressure there is really FX currency headwinds. And it's coming through in cost of sales, and there's an impact on revenue. And so that is causing some margin pressure. And the highest impact of exchange rates -- highest headwind impact of exchange rates on us this year will be in the third quarter. And then it starts moderating again on what we're cycling. So that's the first thing. The second thing, while we're on international, on margins particularly is our expectation, as we just said, is that in Japan, we think growth is going to moderate slightly from the very strong 4% that we've seen year-to-date in Japan. They're going to still have a very good year. But I think that will moderate and that will put -- that will be some margin compression on the total company. Then if you go to North America, I think, I'd say we've been very pleased. We've seen sequential improvement in North America from -- first quarter operating income was down 9, 10-ish. This quarter, it's even. And I think we'll continue to see sequential improvement, albeit kind of slow improvement, and I'll go into why, in North America. So in North America, I think what we're seeing and what we saw happen actually in the United States is in about mid-May, we started seeing consumer shifts and the consumer started changing behavior, we think temporarily. But I think it's just you pick up the newspaper, you turn on the television and you see economic -- huge economic issues all over the world, whether it's no job creation in the U.S. to all of the issues in Europe, China slowing somewhat. And what we then saw was the consumer change go more toward future consumption, packages and channels versus immediate consumption. And one of the things that's a little surprising -- and I think we'll have to see how this goes and I think it's, for sure, a temporary shift. But as the price of gasoline came down kind of in that May-June time period, normally what you would see, particularly in convenience retail, is your immediate consumption should go up, and it did not. So that, I think, is probably going to continue somewhat through the third quarter. Again, some margin pressure. So that's what's leading us to that gross margin and that's the primary part of it. We've got -- and then we were cycling some things last year relative to SG&A. So I think there will be some increase in SG&A, particularly in the third quarter, and that kind of cycles out in the fourth. So you put all that together, that's kind of where we get to on the negative 3 to 5 points of leverage in third quarter, coming back in the fourth quarter to positive -- slightly positive and kind of the gross margin as well. That was a long answer, but I think it's complicated because there are a lot of different parts to it.

Muhtar Kent

And also, John, just one other point on what Gary mentioned in terms of the immediate consumption business. I think if you take our sort of top 22 countries in the world, in Q1, we had probably more than 15 of them realize very positive IC growth. In Q2, we had about 11 countries out of our sort of top 22 markets that had IC growth. And the primary reason for that was the very, very, very poor summer -- the start to the very poor summer in Europe. And so I think that is also an important factor that has to be kept in mind. It was a very unseasonable situation in Europe and hopefully, it will reverse itself in the coming months.

John A. Faucher - JP Morgan Chase & Co, Research Division

Okay. And then, Gary, so is it safe to say that the leverage piece is transactional? So you're looking at transactional on the leverage piece and then the translational piece is separate. Is that kind of how we look at, at least internationally? Is that what you're telling us from an FX standpoint?

Gary P. Fayard

Say it in a different way to make sure I understand your question.

John A. Faucher - JP Morgan Chase & Co, Research Division

Well, I guess, in terms of there's transactional FX impacts as opposed to translational FX impacts, so is it the raw material increase in dollars in the local currencies that's driving the negative leverage from a BIG standpoint? Is that...

Gary P. Fayard

Yes, yes. So you've got translational impact on revenue, but then you've got transactional impact on cost of goods as well.

Operator

Our next question comes from Bryan Spillane with Bank of America.

Bryan D. Spillane - BofA Merrill Lynch, Research Division

Just wanted to follow up on John's question on operating leverage, just a couple of points of clarification. First, on the commodity cost increase expectation for the year of $300 million, how much has actually happened so far year-to-date?

Gary P. Fayard

This is Gary. I would say probably about half of it. I think it's going to be pretty well sequential through the year. And a lot of it we've already locked in and hedged. So it's pretty well, probably about half, maybe slightly less than half.

Bryan D. Spillane - BofA Merrill Lynch, Research Division

Okay. And then in terms of the effect on gross margins of your outlook for price mix having less of a contribution in the first half of the year versus the second half, I just want to make sure it was clear that what you're -- this is just simply a phasing of the way your pricing -- your planned pricing rolled through the year. It's not an expectation or a change in plan in terms of being more promotional or promoting back at all for the second half. I was just trying to...

Gary P. Fayard

Yes. No, Bryan, it's exactly what you said. That's exactly right. It's what our normal pricing had been, what we're cycling just as we phase through the year. We are -- have not engaged in anything relative to change into more promotional or anything. It's normal pricing and normal cycling. In fact, if anything, I would tell you that the pricing environment has stayed -- particularly in the U.S., has stayed very rational. And some of our competitors internationally are doing a lot of promotional pricing. But that's kind of normal. What you're seeing is exactly what we plan to do the whole year, have not deviated at all.

Bryan D. Spillane - BofA Merrill Lynch, Research Division

Okay. And then the last piece would just be in terms of understanding the different pieces on geographic mix. Europe is a high-margin market for you. And it sounds like, given the performance and just the outlook in terms of the macro, that you're expecting less of a contribution from Europe than you normally would expect. And now we're talking about profit contribution. So, a, is that the right way to think about it? And, b, or second, is there also anything that you're doing specifically in Europe to support profits while you've still got -- or to boost profitability while you've got kind of a soft patch from a demand perspective?

Gary P. Fayard

Yes. You're right on Europe. It is a high-margin, high-profitability business for us. And we're continuing to hold share. We are seeing some weakness there, obviously down 4% in the quarter. I think it's important to recognize that weather is probably as much to do with what we saw in the second quarter as the economic macros, probably 50-50 on all of Europe and probably even more so for Northwest Europe. Britain had the wettest summer so far that it's had in over the last 100 years. So the weather's been unbelievably bad. If it turns -- and I don't want to use weather as an excuse. If it turns, things will be better. We're not anticipating that, but hopefully that will be somewhat better. And we are cycling a pretty good summer from last year -- a very good summer from last year as well.

Muhtar Kent

I think, Bryan, in Europe, we've got very, very strong programs in place. We've just finished one of the most successful euro activations. We have just embarking upon the Olympics programs, which globally are going to be activated in over 100 markets. We've never had that happen before. We've reached -- the greenest ever Olympics was -- we believe that our business is very strong in Europe. And as Gary said, I think there has been an anomaly in the weather. But having said that, if you look at the past -- in the last 2 years, Europe has really performed better than expectations, given how bad the consumer sentiment was deteriorating in Europe. And this should not be taken as a kind of a fall off the cliff. But certainly, Europe is continuing -- going to continue to be challenging as an environment. But our business gets essentially stronger in Europe because our brands are stronger. We're investing with our bottlers, both CCE, our Iberian bottlers, as well as Coca-Cola Hellenic. So I do believe that probably there was some factors, one-off factors that created the current result, as opposed to it being taken as a given for the rest. But I do also believe that I think you need to understand that we're in for a very protracted recovery in Europe.

Gary P. Fayard

Bryan, I'd add one thing. If you go back to our conference call in the first quarter, if you go back to the transcript, you asked a question on that call. And the last -- I think one of the last things I said to you in answering your question was, "Remember, we are managing this business as a marathon and not a sprint." And that's exactly what you're hearing us say today. We're in a marathon. We're in this to win. We are gaining and furthering the distance between ourselves and our competitors every quarter. We're going to continue to do that. And we feel very good that we've got the right plans in place to do it.

Operator

Our next question comes from Bonnie Herzog from Wells Fargo.

Bonnie Herzog - Wells Fargo Securities, LLC, Research Division

I had a question on China. You talked about the volume in China slowing due to the economic slowdown. So I was hoping you could provide a little more color on some of the symptoms of a soft landing you're seeing in your business by some of your key categories, and then possibly by area or region. And then I also would be curious to hear how your business in China performed in the quarter compared to what your expectations were early on this quarter.

Muhtar Kent

I think during our last earnings call, again, I think we shared our expectation that our volume growth in China might moderate to some extent as, a, the business is not going to be totally immune to the cooling, particularly along the coastal areas of China. And I think as anticipated, the broader beverage industry in China has also felt the impact of that slowdown in the first half of 2012. But also -- and so it was not -- in terms of expectations, it's probably where we expected the business to land in terms of how we saw the marketplace developing. I think, year-to-date growth in China being a solid 8%, cycling plus 17% from prior year, I believe we're content. But certainly, we'll always try to achieve double-digit growth. But importantly, I think the rightsizing packaging efforts that we put into place in China last year continued to generate consistent incremental transactions, in line with our expectations. In fact, a little bit ahead of our expectations. And as such, total beverage transactions -- and you've heard us talk about transactions being really a really very good metric for the health of the business -- were up double-digits for both the quarter, up about 12%, and also on a year-to-date basis, up about 14%. So just want to stress that, a really important point. And again, we captured both volume and value share significantly in the sparkling beverage category in China in this past quarter. And our brands, particularly in the sparkling category, have been doing very well. And transactions, as I say, which is a great health of the business, have been progressing well. In terms of regions, I think the northern regions and the regions -- more inland regions are doing a little better than the coastal regions in China. And I think we'll continue to see that throughout the year as some consumers have moved back into the central and inland regions of China, given some of the slowing down of the export businesses along the coast.

Bonnie Herzog - Wells Fargo Securities, LLC, Research Division

And then just a quick follow-on. Are you seeing any signs of slowdown in any other parts of Asia? Is this spreading in any way?

Muhtar Kent

We are not. I would say Vietnam, Southeast Asia, Philippines is actually doing better. We talked about Philippines having a kind of coming off the cliff a little bit after the elections, and after tremendous amounts of sort of monetary easing preelections. I think it's coming back to a good sort of balance now. And then in terms of Indonesia, I think obviously, Australia, some of Australia's exports to China are slowing down. But actually, we've had a pretty good quarter in Australia. And I don't -- we don't really see -- it's actually a pretty strong, balanced growth across the region. I would phrase it that way, Bonnie.

Operator

Our next question comes from Ali Dibadj with Bernstein.

Ali Dibadj - Sanford C. Bernstein & Co., LLC., Research Division

So maybe going back to the comment earlier about marathon versus sprint, sort of applying that again to North America and thinking about it from a long-term perspective. And obviously this quarter, you had pricing up 5%, volume down 2%. In share, it sounds like, in sparkling, roughly flat. Is that kind of a comfortable algorithm, a comfortable elasticity that you'd be looking for going forward, longer-term, sort of maybe moderating from price but kind of in that range of elasticity? Or does some of the macro challenges you're seeing now and maybe the persistence of those challenges make you think a little bit differently about that? And I guess, if you could answer that in the [indiscernible] of your margins, the margin answer you gave about North America going forward, that would be helpful.

Muhtar Kent

Yes, Ali. First, let me just take sort of what we would term as sort of a normal outlook. I said it before. I think, look, in terms of moderate growth in volume in North America and we have -- and also certain amount of positive price mix, given the strength of our brands, I think, and also our new occasion channel-based packaging architecture that we've actually recreated with smaller packages with the mini cans, with the 14 ounces and with the advent also of a much wider Freestyle distribution of the Freestyle dispensing units, I think probably is the right way to think about. Given that it's going to be a protracted recovery, that's the way we would think about it. Moderate volume, 1% to 2%, and then also some positive price mix on top of that. And that's how we would see the business progressing. In terms of share, I think it's important to reflect on the fact that over the last 3 -- 2, 3 years, we've been gaining market share consistently quarter-after-quarter in the United States. If you look at consecutively, in terms of value share, since the beginning of 2010, every quarter, we've gained share if you look at the numbers in value share every quarter, adding on top of the quarter prior. So we've been coming through historically a very strong share gain environment. And I think certainly, we see the pricing environment to be logical and one that is rational, and that's very important. And I think we just have to ensure that we keep the right balance of both marketing and pricing and also improvements in customer service with Coca-Cola Refreshments that are taking -- that are improving every quarter. As we move into the year, I think you should also see us continuing that kind of trend in the United States going forward. And, Gary, if you want to talk about the margins?

Gary P. Fayard

A little bit on the margin. A couple of things. So North America, total volume was plus 1 on 3 points of price mix -- positive price mix. Sparkling was minus 2 on 5 points of positive price mix. And I think, Ali, your question is, is that kind of the elasticities and kind of the relationship we would expect to see going forward? And I'd tell you a couple of things. One, in a very rational pricing environment, so I think you have to underline that, and it is, the historical elasticity models would have said that you would have seen a lot greater volume decline, greater than 2%, if you took 5% of pricing. So I think that's a very good thing, obviously. Going forward, in a more normalized market, where you're not seeing the huge commodity spikes that we've seen over the last 2 years, I think a much healthier environment, we would want to see sparkling growing kind of the low 1 or 2 percentage points, kind of -- and more moderate pricing on top of that to still get a 3% or 4% or something revenue growth, but do it in a more balanced fashion with -- between volume and price, but...

Muhtar Kent

And just one thing to add to that, Ali, also. I think it's important to remember that 2011 was probably a special year, where we've had to face tremendous increases and changes in commodity costs like we hadn't faced before. I mean, that's, in the United States, to the tune of about $550 million. And although it hasn't continued, thank goodness, at the same rate, we also are facing some commodity increases, of course, this year, too, not anywhere close to what it was. So have to remember what kind of pricing we had to take to ensure that our business could continue to invest for sustainable future growth in the United States coming off of 2011.

Ali Dibadj - Sanford C. Bernstein & Co., LLC., Research Division

Okay. So that's great. And I hope the better-than-expected elasticity kind of boldens a little bit more pricing, which is good. But -- so just if I could squeeze in a housekeeping perhaps question. It may or may not be a housekeeping, I guess. But on the balance sheet -- and, Gary, this may be for you. There's always a lot of moving parts, and we kind of try to keep track of it. But this quarter was another one of kind of large shifts from cash to short-term investments, large increase in marketable securities. What exactly are you doing? And what's the impact to the P&L, if any?

Gary P. Fayard

Yes. Most of it does not have much impact to the P&L at all. What you're seeing us do is, as we continue to build cash, most of that cash or a large part of that cash is offshore. We are moving into separately managed accounts, and so reducing exposure to banks, particularly, so that we are diversifying risk. And then we're also investing some of that -- rather than in a savings account, if you will, we're putting some of it into government bonds and some -- and AAA-rated other investments, all short-term. But it's basically just ensuring that we are diversifying against any concentrations of risk.

Operator

Our next question comes from Alice Longley of Buckingham Research Group.

Alice Beebe Longley - The Buckingham Research Group Incorporated

My question is about volume in the second half. You've already indicated that price mix should be slowing. Can you give us some indication of what volume should look like, and particularly Brazil, the U.S. and China, versus what we've seen in the second quarter?

Muhtar Kent

Yes. I mean, I think you'll appreciate that we can't give forecasts. But I think you've heard us say that we feel confident, despite the volatility that we would be looking at, reiterating our long-term targets of 3% to 4% volume growth and, again, that we manage a great portfolio of 206 markets. And we believe that based on our -- both marketing programs, as well as our strength of our brands, the strength of our system, that we would be able to reiterate our long-term growth target in terms of volume of 3% to 4% for not just the remaining part of the year, but going into the future.

Alice Beebe Longley - The Buckingham Research Group Incorporated

Well, we've had some macro slowdown occur during the course of the second quarter in China and Brazil. And we've seen a little slowdown in your numbers. And then just is that going to continue? Or are we going to sort of stay at these second quarter levels?

Muhtar Kent

I can't comment on that. But look, you've seen us in the past -- if you take the last 3 or 4 years, where we've been operating in this economic environment, you've seen us have quarters of 3% or even less or 5% or 6%. And so when less than 3 or 4 things go bad, then you'll see us higher volumes. When some more things all combine in a certain time frame, you may see less. But over a period of time -- longer period of time, we feel that the 3% to 4% is a good number to look at in terms of -- which is our long-term growth targets. We've never changed them and we think -- and generating -- for a business our size, generating a 7% revenue growth, comp currency neutral revenue growth across the world, that's, in my book, continuing to crack the calculus for growth.

Alice Beebe Longley - The Buckingham Research Group Incorporated

And then could I ask a different question, which follows up with some that have been asked before? And this is the operating profit performance in North America. I think you've indicated that it will continue to get better sequentially in North America. And yet you've highlighted a sort of unfavorable mix in terms of channel and I think product as well and price mix here. So why do we have sequential improvement in operating profits here in North America coming?

Muhtar Kent

Gary, do you want to...

Gary P. Fayard

Yes, yes. I'll take that one. I think what -- you've been seeing us deliver sequential improvements. I don't know that the third quarter versus the second quarter in North America -- probably, it won't be the same kind of sequential improvement you saw from minus 9 to 0. But I think you'll see some improvement in the third quarter, although there are some macro and consumer issues in the United States just because of the condition of this economy and all. And then you will see -- I would expect to see a fairly significant improvement then in the fourth quarter, particularly as you has that [ph] -- as an operating business, a finished products business has significant leverage that will come through in the fourth quarter, particularly with the extra days and the 2 extra days in the fourth quarter.

Alice Beebe Longley - The Buckingham Research Group Incorporated

The fourth quarter is clear. I'm just trying to figure out why we get improvement in the third quarter versus the second.

Gary P. Fayard

Just because we continue to work on the business. But I'm not saying it's going to be significant improvement. It's just there should be -- our expectation is there should be a little improvement in the third quarter.

Muhtar Kent

Look, we have said that in the United States, we started -- when we started the business that we pointed out that there's going to be sequential improvement. It's also partly on how the commodities are priced into our business, and also how marketing spend operates -- the marketing spend curve operates in our business and a number of other things. So we do expect to see, as we have seen in the second quarter, which we pointed out in the first quarter, we will continue to see sequential improvement as a result of some of those other things that I've also mentioned, as well as the strength of our marketing programs going into the third quarter, particularly related to the Olympics, as well as many other local programs. In the United States, we've never had more customer partners pick up and align with us on the Olympic activation as in these Olympic Games.

Gary P. Fayard

One other thing I'll point out, and it's kind of tactical, but in timing, in the last year, most of or about half of the Fourth of July holiday was in the second quarter. The impact was in the second quarter, and then a little bit in the third quarter. The way the calendar fell this year, basically all or most of the Fourth of July holiday in North America will be in the third quarter, which helps the third quarter.

Operator

And our final question today comes from Judy Hong with Goldman Sachs.

Judy E. Hong - Goldman Sachs Group Inc., Research Division

Gary, just a follow-up to some of the earlier questions. If I take the puts and takes in terms of some of the changes to your guidance, so you've got better commodities, you've got better tax rate, and then you've got a bit worse interest income, and then worse FX. So net-net, my math sort of comes to kind of a wash in terms of some of those puts and takes. Do you sort of get the same calculation, just in terms of some of the puts and takes, to those aspects of the changes that you've talked about?

Gary P. Fayard

Yes. If you look at tax, so you've got -- kind of depending on where you were. But if you take 0.8 points on tax, that will give you $0.03 or $0.04 a share. You've got probably down $0.01 or so relative to interest. So commodities, let's call it $50 million probably positive. That's another $0.01 or so. So those are starting to wash. But then FX is going to be worse, and particularly worse in the third quarter, significantly worse in the third quarter. And then we have previously said kind of mid-single-digits headwind. I think my words were exactly the high end of our previously communicated mid-single-digits. So kind of depending on where you were. But the risk aversion that investors around the world have gone to has really driven the dollar, particularly against the emerging market currencies because the others, even on the euro, were hedged for the year. But it's primarily those emerging market currencies have really been driven hard -- hit hard just because of risk aversion.

Judy E. Hong - Goldman Sachs Group Inc., Research Division

Yes. I guess, I was just trying to understand how the gross margin impact in BIG and international from a transactional perspective, that is captured in your FX guidance.

Gary P. Fayard

No, no. We do not include the impact of currency on cost of goods in the FX guidance. So that's on top of it.

Judy E. Hong - Goldman Sachs Group Inc., Research Division

Okay. That's on top, okay. And then just finally, switch quickly on the U.S. So the channel and the pack shift that you're seeing, why do you think it's only a temporary shift? And sort of -- and a little bit more of a color, just because if you look at the data, I mean, take-home channel has been declining at a faster pace. You've had immediate consumption channel that's been growing. Is that not enough to really offset what's going on within kind of the immediate consumption side, the mix shift that you're seeing? And then if that's the case, I'm just surprised that the categories, like energy drink, continues to really accelerate even into June. So what are some of dynamics that you're seeing as it relates to some of the channel and product shift that you've talked about? And I guess, why is that more of a temporary situation in your view?

Muhtar Kent

I think, first -- this is Muhtar. I think, first, you've got to take into account the pricing environment. 5%, I mean, that is a pricing environment that you won't see coming through all the time. And therefore, I think you need to put it into that perspective, and therefore, look at it in that regard. And also as you know, over time, the pricing impact gets evened out and the consumers get back to a normalized sort of sequence. And so I think you will be seeing some of that happen in the United States. That's one reason. The second reason is the strength of our programs. The third reason is what Gary mentioned in terms of holiday season falling into the quarter as opposed to not in the quarter, et cetera, et cetera. So there's a lot of number of reasons why we're talking about it being not a permanent feature but a feature that will wash out through time. That's why. And so I hope that explains some of that.

Thank you, Gary and Jackson. And in closing, I think I'd like to once again reiterate that we had a strong quarter and delivered quality midyear performance results. Along with our partners, bottling partners, customer partners, we're successfully navigating through an unpredictable external economic environment with a well-aligned system equipped for long-term sustainable growth. Our 2020 Vision is working. Our system remains resolutely focused on capturing the great opportunities we see ahead in all of the markets. And as we partner with our global consumers, customers, communities, we fundamentally believe we are building something lasting and something good while creating long-term sustainable value for our shareholders. As always, we thank you for your interest and your investment in our company, and thank you for joining us this morning.