Operator

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

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

Timothy Leveridge

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

Before we begin, I 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.

As a reminder, we will be hosting a separate modeling call at 10:30 AM this morning to review our 2019 outlook in greater detail and allow sufficient time to address questions pertaining to guidance. We posted schedules under the Financial Reports and Information tab in the Investor Section of our company website. These schedules reconcile certain non-GAAP financial measures, which may be referred to by our senior executives during this morning's discussion, to results as reported under generally accepted accounting principles. Finally, during today's call, when our senior executives refer to comparable performance, they are referring to comparable performance from continuing operations.

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

Let me now hand the call over to James.

James Quincey

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

Most notably, we gained global value share and those share gains were broad based. We held or grew value share across each of our geographic segments. Organic revenue grew 5% versus our goal of 4% driven by strength across all operating segments. Underlying operating income grew 11% versus our goal of 8% to 9% as we built momentum through the year while accelerating the capture of productivity savings. This resulted in an approximate 170 basis point expansion in the underlying operating margin. And comparable EPS grew 9% in line with our guidance of 8% to 10% despite absorbing $600 million in stronger currency and structural headwinds than we anticipated at the beginning of the year.

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

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

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

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

Sprite also performed well growing global volume 2% through premium innovations such as Sprite Plus Fiber in China.

Second, we rapidly scaled successful brands like Fuze Tea, smartwater and AdeZ across more markets. With the launch of Fuze Tea in Europe we delivered over 100 million incremental cases in EMEA offsetting the volume loss from the dissolution of Beverage Partners Worldwide. This enabled us to gain leadership positions within the ready-to-drink tea category across 11 European markets highlighting what an aligned system can accomplish.

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

Third, we expanded our portfolio through M&A and strategic investments. This included smaller investments like BODYARMOR, one of the fastest growing beverage trademarks in the U.S. Of course our biggest announcement was the acquisition of Costa which we closed on January 03, this year. Costa platform will give us the ability to scale within the $500 billion global hot beverage category and create a world-class global coffee business allowing us to better serve our customers and strengthen our ready-to-drink portfolio. All of this shows how we've been pursuing the vision we first shared with you a couple of years ago.

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

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

In Asia Pacific good results across several large emerging markets drove our strongest organic revenue growth in over five years. We had a stronger innovation pipeline, solid digital initiatives and steadily improving execution by our bottling partners. For example, in India, 25% of our revenue growth came from new products. And in China, digital initiatives coupled with a robust innovation pipeline resulted in solid performance. During the fourth quarter our B2C business capitalized on Singles Day, the massive online shopping holiday. Both our digital B2C and B2B businesses grew over 40% for the year and now account for over 5% of the system revenues in the market. And collectively across the group, our bottling system opened approximately 1 million new customer outlets.

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

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

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

Before moving on to 2019, let me provide some context on the fourth quarter. We continue to grow global organic revenues 5%. The composition of the growth changed. We delivered stronger sequential price mix while unit case volume was flat. Volume was impacted by slowing economic conditions in some countries like Argentina, plus decisions to focus on value of our volume in certain margins. However, we have seen a good start to 2019 with more balance to volume and price mix and this is consistent with our expectation for the full year.

Looking ahead, we're seeing the impact of some increasing uncertainty and volatility in global macroeconomic conditions. Consumers are under more pressure as we head into the New Year. However, demand for our categories remained healthy and our business is built to perform even if the tailwinds behind us moderate somewhat. Ultimately we will focus on what we can control taking steps to manage the business as we become a total beverage company.

Further lifting, shifting and scaling entrée brands like Fuze Tea, smartwater and Innocent across markets, reformulating products to reduce sugar levels, rolling out revenue growth initiatives across additional territories to improve performance within our sparkling soft drink portfolio, connecting costs across many of our business units build a leading global coffee business and leveraging digitization to build a business for the future. Therefore, we feel confident that we can deliver against our 2019 guidance.

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

With that, let me turn it over to Kathy.

Kathy Waller

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

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

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

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

John Murphy

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

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

Turning to our financial performance, as James said, 2018 was a good year. We delivered 9% comparable EPS growth due to momentum in the underlying business, accelerated productivity, and a favorable tax rate. Our press release covered our fourth quarter results in detail so I will focus on our 2019 guidance. At our high level we expect 4% organic revenue growth, double-digit comparable currency neutral operating income growth, comparable EPS to range from plus 1% to minus 1%, and free cash flow of at least $6 billion.

Now, let me touch on the key considerations and assumptions embedded in our outlook. We expect global growth to be slightly lower than in 2018 with continued growth in the developed world and macroeconomic challenges in certain emerging markets. However, there is a significant amount of uncertainty and geopolitical tension which could result in further changes in this macro environment.

That said, we focus on the things we can control and the actions we've taken over the past few years has set us up for continued success despite shifting macros. We expect organic revenue growth to benefit from our continued focus on lifting, shifting, and scaling products such as good quality of sugar and Fuze Tea, as well as implementing revenue growth management activities across lower markets. In addition to the solid organic growth we expect an 8 to 9 point benefit to revenue from net M&A and structural activity.

We completed our North American franchising efforts and divested our company owned bottlers in Uruguay and Guatemala last year. We also took full ownership of our Philippines bottler in the fourth quarter. And earlier this year we closed the acquisitions of both Costa Coffee and the remaining stake in Chi, Africa's leading value-added dairy and juice company. We expect the net effect of these transactions to result in lower comparable gross margins for the year driven by the Philippines bottling operations.

In the U.S. while freight costs are expected to remain above historical levels, we do not expect to see the same level of year-over-year increases as we saw last year. And we have $600 million remaining in growth productivity to capture in 2019. A portion of these savings will be reinvested in the business. Recent investments are generating a good return as evidenced by our strong top line relative to most CPG peers.

So all in, we expect solid pricing, a continued focus on expense management, and a net benefit from acquisitions to deliver 10% to 11% comparable currency neutral operating income growth. We expect currency to be at 6% to 7% headwind to operating income as we faced strength in dollar and cycle hedging gains in 2018. Below the line we expect the leverage driven by higher net interest expense and we expect an effective tax rate of 19.5%. However, this rate could vary from quarter to quarter.

So in summary, we expect double-digit, comparable, currency neutral operating income growth, but the impact of currency along with higher interest and taxes will lead to the standard range of plus 1% to minus 1% or comparable EPS growth in 2019. As you model the flow of the year there are a few items to consider in terms of phasing. The first quarter will have one less day than in 2018.

Easter will fall in the second quarter this year compared to the first quarter last year. Due to the timing of fed rate increases the year-over-year increase in interest expense will be more heavily skewed to the first half of 2019 than the back half. And similarly because of when the dollar strengthened last year we expect a more significant currency headwind in early 2019 which will then begin to moderate as we move through the year.

As James said, we created a new operating group, Global Ventures. This will be a new reporting segment in 2019 and will include Costa Coffee, [indiscernible] tea, Innocent and Monster. As such we will provide the revised operating segment financial information reflecting this change before first quarter results are released. There are times our company can be complex to model. For example our M&A and structural changes impact several of our operating segments this year. Our investor relations team will hold a call at 10:30 this morning to answer any further questions as you build out your models for the year.

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

Operator, we are now ready for questions.

Question-and-Answer Session

Operator

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

Bryan Spillane

Hey, good morning everyone.

James Quincey

Good morning, Bryan.

Bryan Spillane

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

Kathy Waller

Thank you, Bryan.

Bryan Spillane

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

James Quincey

Sure, good morning Bryan. Firstly, the whole idea of the in a way the three-legged stool is still absolutely valid and important and just to recap what I meant by that. This is a business that predominantly wins all those, but our focus is on wining in the local marketplaces. We focus on getting the consumers and growing customer value in each and every country and so there is very much a focus on getting that to work and I think over the last few years you've seen accelerated performance of us able to drive the industry grow and capture share within that and that's a starting point of value creation for the Coke company to work on that and making sure the operating margins of how we do that are all the same or better, such that we turn that revenue growth into profit growth at the local level.

And then as you said we have in more recent years had a more intense focus on making sure that sum of the parts is more than just the sum of the parts and the lever is necessary to turn that into U.S. dollar EPS earnings after a number of years where currency had eroded that and the EPS had effectively declined. That's still our going in objective.

The guidance is where we stand today, it's a really strong operating plan for 2019. I think we are being cautious about the macroeconomics and how that's going to be a little softer than 2018, but a strong plan behind the marketing, the execution and innovation. And absolutely we are reflecting here in our guidance where currency and interest rates and tax sit today which are the three in a way non-controllable factors. There is a long way to the end of the year and they could change markedly. But our focus will remain and our mission will remain to end the year with positive EPS growth. We would be disappointed if it wasn’t positive. But we wanted to share with you where things stand today and we will focus on pulling the levers that we can pull to get to the result that we want.

Operator

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

Lauren Lieberman

Great, thank you, good morning.

James Quincey

Good morning, Lauren.

Lauren Lieberman

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

James Quincey

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

But then it started to pick up and so we started the year well, this year in terms of North America volume and price mix was also continued to be positive through the back of the year. I know it's only comes through as 2% in the fourth quarter for North America. There remain - this carries with it some of the oddities of which business system was growing because the juice business which is finished goods business where we were rightsizing the packaging and seeing volumes go down, obviously finished goods versus the sparkling which is concentrate and it has that mechanical effect that the faster the sparkling business grows the more it actually affects mix in a negative way, but that does not affect profits and it does not affect the marketplace.

So there's a little bit of mix and the freight and all the noise, but let's draw a line because the good news is 2018 has ended. The freight accounting issue is disappeared for 2019. The marketplace pricing is clear and positive going into 2019 and the businesses started with a foot forward and so we are confident we have the right strategy for North America and that we will see the benefits of that strategy flowing more simply and more clearly through the results in 2019.

Operator

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

Judy Hong

Thank you, good morning.

James Quincey

Good morning, Judy.

John Murphy

Good morning.

Judy Hong

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

James Quincey

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

We have seen to have had a good Chinese New Year. You never quite really know until the end of February, but it seems like it has been a strong Chine

New Year. Brazil is looking a little better. Mexico seemed to have started well given some cold weather at the back end of last year.

You heard about the European outlook today this morning. So we think we started well, a long year to go, great plans. Also that will need managing no doubt and the volatility, so we baked in what we know today. Clearly there are places where weakness is apparent. Argentina went down quite strongly in the fourth quarter and that's likely to continue in the first half of this year. Turkey, very similarly, some parts of the Middle East.

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

Operator

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

Ali Dibadj

Hey guys.

James Quincey

Good morning.

John Murphy

Good morning.

Ali Dibadj

I think you may have missed the memo on lowering 2019 expectations. So we are all kind of thinking Pepsi would do that tomorrow and not Coke today. And so I'm a little confused about the drivers of it and if we start with top line, you're saying approximately 4%. Not too long ago you insist on quarter 6% being the right number. Then you have a big gap from that to 10% to 11% OI which seems aggressive, so a big improvement there.

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

James Quincey

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

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

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

There is a piece of that that we're cycling hedging gains in 2018 as we commented earlier. But the number of the 6 to 7 is as things stand today. How it will stand at the end of the year we will see. And then of course we're losing some leverage from operating income. Finally down to EPS through the higher tax rates which the Fed has taken through the year and through the changes in the tax rates. The interest rates from the Fed and the tax rates, the tax rate is going to be slightly higher in 2019 than it was in ‘18. So that's pretty straightforward.

Clearly that's leading to EPS growth. That is not what we aspire to. We're going to focus on controlling what we can control and driving the business. We'll be pulling the levers as I talked about earlier on the call to make sure we focus on our aspirations of turning our winning local plans into growth of dollar EPS. But we want to be prudent in our outlook guidance given the macro environment, despite a strong good momentum winning plan and to put the FX as it stands today. The only thing that is for sure is it will be different tomorrow and we will update it as we go through the year.

Operator

Thank you. And our next question comes from Dara Mohsenian with Morgan Stanley.

Your line is now open.

Dara Mohsenian

Hi guys.

James Quincey

Hi, Dara.

Dara Mohsenian

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

James Quincey

Okay, I think it sort of seems all wrapped up in one burst of the same idea. We are committed to growing the earnings of the company. I mean, in simple terms, the earnings of the company are the fuel to pay the dividends of the company and drive the stock price and reinvest back in the business. So without dollar increased earnings of EPS it is not going to be a growth company and therefore we reaffirmed the long term growth model at some of our previous investor presentations, the 4 to 6 on revenue and the growth in EPS. Yes, there'll be years where currency will weigh on it more heavily. We certainly have the aspiration that there will be no negative years.

We have said we will not do things that are irrational just to get a positive EPS, but we will focus on trying to pull levers to get there. But as you look out into the future, we absolutely expect to keep focusing on coming back to the long term growth mode. Now, to the question well what happens if the dollar always gets stronger? Well, then that simply put assuming that there still is a global trading system that will export inflation to the other parts of the world. And therefore, if we enter some very long extended period of dollar strengthening then we will logically expect to see higher pricing in other parts of the world that will compensate for some prolonged ongoing strengthening of the dollar. So either way we want to get back to our long term growth model in dollars realized for the shareholders.

Operator

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

Steve Powers

Thank you very much. Kathy, thank you from me as well, and best wishes for the future and John, my congratulations again on the new role. James, for USA good job and I'm actually my gift to you is I am going to ask Kathy and/or John a question, related to the to the free cash flow guidance for next year. It implies another year of about two thirds conversion of net income to free cash flow which is below the company's 90% plus target. So I'm assuming there's still a good number of structural costs flowing through with respect to refranchising and the recent acquisitions, but can you help us get underneath those dynamics at all and paint a picture of what it will take to get back to that or get to that 90% plus conversion ratio on a consistent basis and can we can we look to 2020 to be that year of inflection?

John Murphy

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

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

Operator

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

Bonnie Herzog

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

James Quincey

Sure. I think that, well firstly, before I jump into the clusters, I think that some of the prudence is being derived from developing and emerging markets, whether it - that be some of the ones like Argentina or Turkey, aforementioned Middle East and some parts of Africa as well. So I think the prudence on the softening is more geographic based than it is cluster based. Having said that, I think we are expecting to see in 2019 continued growth of the sparkling category.

We've clearly aimed going into the future to see a strategy that is more price mix than volume in the developed markets and more perhaps volume centered in the developing emerging, so as we look out into 2019 I expect the sparkling business to continue to grow and I think we'll see a little more price mix than volume given some of the things that are happening in the developing markets. As we move through some of the other categories, I mean clearly coffee is going to grow much faster because of the incorporation of posture and as we start to realize that synergy plans. But that's not driving obviously the 4% organic which is like for like so it doesn't include the acquisition in that sense.

In terms of tea, we're expecting to do better in tea in 2019 than we did in 2018. 2018 has the kind of base effect of pulling out of the beverage partners worldwide joint venture which where we counted volume but we didn't count revenue, and then obviously that sort of made it very hard to cycle the volume in 2018 but made it easier to get the revenue.

As we go into 2019 we expect to see continued growth in tea in Fuse and leverage Gold Peak in the U.S. which should see a bit more balanced growth. In juice will come off the period of the rightsizing of the packaging in North America. And so I think we will see a better performance from the juice business particularly the premium end of the juice business that speculate may be part of the world where we will question some of the juice drinks and the values that they bring.

Obviously in aggregate juice will do better because we'll have the incorporation of tea which is a great business in West Africa. But that's not part of the organic growth drivers. And then in hydration we'll be focused on more of the premium parts of hydration whether it be sports drinks, leveraging our partnership with BODYARMOR, driving things like Topo Chico and smartwater or smartwater with its new variants like alkaline.

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

Operator

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

Laurent Grandet

Yes, good morning James, Kathy, and welcome John. Kathy, I mean congrats on your extremely successful carry out Coke proscenium [ph]. I'd like to thank you for helping me head back into the Coke system a few years ago. Really a question about Costa, you mentioned at the time of the acquisition that Costa would be a slightly accretive to earnings in first full year, in the current context of the UK economic and political situation and a potential hung Brexit looming, did that change?

And if you can update us more on the Costa integration and the expansion plan and specifically we'd like to understand if you are planning to refranchise this still 51% fully owned stores? Thank you very much.

James Quincey

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

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

We're putting more flesh and detail on the bones of the plans as it rolls out. And then of course you know Brexit will be Brexit. I'm not sure anyone knows how it's going to end at this stage. We clearly have contingency plans for this business and for our other businesses in the UK and in the European environment. It's something that will be have to manage through, but it will be, whatever it is going to be, it is likely to only be a short term disruption effect if indeed it ends up in that scenario and we will manage through it.

Operator

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

Kevin Grundy

Thanks. Good morning everyone.

James Quincey

Good morning, Kevin.

James Quincey

Kevin Grundy

I wanted to come back to advertising and marketing levels in the 2019 outlook and what's embedded in your guidance because as was alluded to earlier in the call, the market widely expects higher investment from Pepsi, this year likely directed at North America Beverages and we'll find out less than 24 hours whether that's true or not. So can you talk about advertising and marketing levels for fiscal '19? Does that look similar as a percent of sales, higher as a percent of sales, many companies in CPG will guide on that. So I'm not sure if you can comment on it. And then number two to that, have you left adequate cushion in your guidance should you need to react to higher levels of investment spending? Thank you.

James Quincey

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

So we're going to continue to invest in advertising.

I think it's also worth saying that we are being even more disciplined as we look through the framework of leader, challenger and explorer. Obviously is our leader brands which are the brands that make best use of TV commercial, advertising spend. As we drive the challenges and the explorer brands, there in some other parts of the marketing mix that often become a more predominant element of making them work.

And then, if our competitors are going to increase investment, you know what it is going to increase the growth of the categories. Ultimately, if there are more competitors investing, it drives more market growth. We believe that we have strong brands and strong plans. And I think net-net it's going to be overall beneficial to the industry.

Operator

Thank you. And our next question comes from Andrea Teixeira with J.P. Morgan. Your line is now open.

Andrea Teixeira

Hello. Hi. So thank you and good morning. Kathy, I wanted again to thank you for your leadership and legacy and all the best to you and John in the new role. So thank you. So I was hoping if you could revisit the 2020 operating margin expansion targets that you outlined at CAGNY last year of 34% plus. I realize there have been a number of key changes in accounting and acquisitions and FX is there, but with the guidance that you have now implying operating margins now year-on-year in 2019 and the noise like the puts and takes, but how should we think about the reinvestments and other moving pieces that relates to the 2020 target?

James Quincey

Yes, so the 34% target that was outlined is one that was outlined I think at the time to provide guidance to the refranchising process and today we are on track to get to that 34% over the next couple of years. We've had some margin expansion over the last couple of years and there's implied margin expansion in our 2019 numbers. However, given the fact that we have new businesses coming into the mix, I would like to really focus on improving margins across all of our different business segments as we go into 2019, 2020.

Maintaining the underlying objective outlined in the 34% margin target, but being a lot more focused on making sure that our core business, our Global Ventures business and our BIG business are delivering margin expansion as they develop their respective portfolios and businesses.

Operator

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

Robert Ottenstein

Great, thank you very much. Over the last year, year and a half or so, you've been more assertive on taking price and driving that in North America and then in Europe and we see some of the results. But I was wondering if you could kind of stand back and give us an assessment of what you've learned from that change in tactics or strategy if you will. And in terms of your brand equity and need to perhaps tweak investment in certain areas, your bottler execution in terms of executing on those price increases and then obviously kind of the general customer demand suggests you know kind of big picture what you've learned from the price initiatives over the last year or so? Thank you.

James Quincey

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

And there's the sum of all those pieces backed up by good execution that creates the willingness of the customer to go with the plan because it creates more value for the customers in their stores often the beverage industry then grows faster than the average, and so the learning and the relearning it's the complex task of pulling all the pieces together that earns you the opportunity to drive price mix, perhaps ahead of where we had been. And I think that's something that we and the bottling partners have dedicated ourselves to even more over the last number of years, I think it's showing through in some of the headline numbers that you see and we absolutely are going to stick to strategy.

Operator

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

Carlos Laboy

Yes, good morning.

James Quincey

Good morning.

John Murphy

Good morning.

Carlos Laboy

James, your Brazil business looked unbelievable last week. Lots of innovation and new SKUs, but how do you see beer in Brazil and the importance of keeping these Coke bottlers competitive on beer? And while on the subject of M&A if you could just give us a quick update on the refranchising process in general and the urgency to see through the sale of the remaining properties?

James Quincey

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

And I think as we see the refranchising business or the refranchising strategy, we've largely refranchised the world. We're down to just a small percentage of the volume. It's been very successful whether it was North America, the creation of bottlers like European Partners or the Japan bottler. And so we think that has been very successful. Clearly, we're still working on our beverages Africa, in terms of refranchising started it has obviously been slower than anyone would have liked. I think some of that has been process and macros related. We're still working on that one.

And that leaves us obviously with the Southeast Asian set of bottlers. Obviously, we'll be thinking about what's the right strategic direction for that part of the world. But the ongoing, you know curation of refranchising is not refranchising for the sake of franchising. It's in the service of creating a stronger and more energized bottling system that is aligned set of partners with the company to drive our collective business with more growth and with better margins into the future and that takes different forms and places and of course we allocate capital within the process whether it's owning bottlers or having stakes in bottlers. We drive that process with the objective of using capital as and when necessary, sometimes yes, sometimes no, to get the most energized bottling system out there and bringing new partners in. That's an ongoing management as we curate our remaining bottling operations and some of our other investments in bottlers