Operator

At this time, I would like to welcome everyone to The Coca-Cola Company's First 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. [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 any questions.

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

Tim Leveridge

Good morning and thank you for joining us today. I'm here with James Quincey, our Chief Executive Officer; and Kathy Waller, our Chief Financial Officer. Before we begin, I'd like to remind you that this conference call may contain forward-looking statements, including statements concerning long-term earnings objectives, and should be considered in conjunction with cautionary statements contained in our earnings release and in the company's most recent periodic SEC report.

We have posted schedules under the Financial Reports & Information tab in the Investors section of our company website. These schedules reconcile certain non-GAAP financial measures, which may be referred to by our senior executives during the morning's discussion, to our results as reported under generally accepted accounting principles. Finally during today's call when our senior executives referred to comparable performance, they were 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 question, please ask your most pressing question first, and then reenter to the queue.

Now let me turn the call over to James.

James Quincey

Thanks, Tim, and good morning everyone. 2018 is of to a good start back by strong financial performance and volume acceleration. Our results build on our continued execution against the strategic priorities that we first shared with you more than a year ago, accelerating ad transformation into total beverage with a broad consumer centric brand portfolio and asset light business model and a performance driven growth culture. Our strategies are working and while our quarterly facing will be lumpy, we're on track to deliver our plan this year.

Improving global economy help non-alcoholic beverage industry grow a little faster and our actions enabled us to gain global value share. During the quarter, we delivered 5% organic revenue growth driven by growth across all our operating segments. Concentrating shipments grew 4% driven by an acceleration at developing and emerging markets as well as the timing of shipments during the quarter. And price/mix was 1% trending lower than our recent rate largely due to timing across multiple markets as well as the few factors impacting North America during the quarter.

Those of you who followed us closely will know that our organic revenue composition was driven more by volume and less by price than last year. While I expected top-line composition, however, to be more balanced between volume and price/mix over the remainder of the year, I am encouraged with the stock for this year and the sustainability of that growth. Importantly, I am also pleased that we converted top-line growth into 9% underlying operating income growth even in the face of arising cost environment.

As such I am confident in our ability to achieve our bottom line outlook.

Looking around the world, organic revenue growth and volume growth were broad based we've grown across every operating segments. In addition to momentum in the business, volume benefited from the timing of Easter and Chinese New Year this year. We also saw revenue and volume growth in each of our category clusters as we continue to focus on our total beverage platform. Even as we evolve our portfolio, our foundation is strong. For example, Trademark Coca-Cola led the way growing volume a healthy 4% globally due to improving trends in our developing and emerging markets along with strong momentum in our low and no calorie beverage.

In North America, organic revenue grew 1% as stronger volume growth was partially offset by 1% decline in price/mix. We delivered solid performance in the marketplace gaining value share, innovation across our multiple category clusters including sparkling and Zero Sugar portfolio drove strong consumer update. North American price/mix declined 1% as positive low single-digit underlying price was offset by a few factors which Kathy will walk you through.

We have given the change in reported price/mix; I want to be clear our pricing strategy have not changed. We have seen clear benefit in our move from volume centric to value centric mindset and that velocity have not changed. You can see evidence of this as we achieved positive retail pricing in Nielsen all measure channels even with these during the quarter and since then we have seen retail pricing accelerated. We remain committed to take the actions needed to earn the price and value in the marketplace and we expect to achieve low single digit price/mix for our total beverage portfolio in North America again this year.

Now looking at markets outside North America, Europe delivered strong organic revenue growth as we launch new products like FUZE TEA while continuing to drive revenue growth management initiatives. China and India have accelerated top-line growth in the quarter and we also saw better performance in some of the markets that have been struggling, notably Brazil and Argentina. And let me just talk a little bit about some of the actions we have taken to achieve these results. Across all our markets and especially in the development markets, consumers are seeking more beverage choices while looking for products that fit different needs, moods and moments. To meet these desires, we are shaping and expanding our portfolio through innovation, expansion of the list, shift and scale model and bolt-on M&A all being driven by disciplined approach to growth.

For example, the global ready-to-drink tea category represents $60 billion in retail value and is projected to continue growing solidly as consumers seek out more natural beverage choices that can deliver functional benefits. Our tea portfolio has grown over the past several years cheaply behind the strength of brands, FUZE TEA, Ayataka and Gold Peak as well as strong local and regional brands such as Honest Tea.

Earlier I mentioned the launch of FUZE TEA in Europe. At the end of last year, FUZE TEA was available in almost 50 countries, but not yet been launched in Europe. At the beginning of this year, we initiated a complex rollout. This required a flexible and agile approach as we successfully launched the brands in 37 countries in a single day, but we still have a lot of distribution to build, we are ahead of plan. With this expansion, we have effectively doubled the value of the FUZE TEA brand globally. This is a great example of how we can rapidly lift and shipped proven successful brands and scale them quickly.

We are also working to get high growth brands we have acquired. Last October, we have acquired the U.S. rights to Topo Chico premium sparkling mineral water for Mexico. With that with the intent of using our venturing and emerging brands unit as an incubated guide the expansion in the brand’s distribution footprint. By the end of the first quarter, our first full quarter of ownership, we increased distribution coverage within the highly valuable convenience retail channel by 25%. Finally, we continue to innovate in our core brands. I’ve spoke before about our success with Coca-Cola Zero

Sugar. During the first quarter, the Brand continued its trend of strong double-digit volume and revenue growth globally.

And in North America, we've been working hard to reinvigorate the Diet Coke brand through an integrated approach. We introduced new packaging, a new marketing campaign and new flavors designed to appeal to the next generation consumers. We’ve got off to a strong start returning Diet Coke to growth in North America. Now, we recognized it's still very early in the process, but we are encouraged by the initial consumer response. Importantly, I'm pleased to see the team take bold action to change the trajectory of the results.

Our strategy is to focus on specific growth disciplines and capabilities. Digital marketing is a capability that helps us to build strong connections with younger consumers. For example, during Chinese New Year, we launched a digital marketing campaign with one of the country's largest online and mobile payment providers. This integrated campaign connected brand Coca-Cola with a cultural rituals of Chinese New Year through an augmented reality shopper’s smartphone [ph] experience.

Packaging innovation is another capability that plays an important role in building and maintaining relevance, particularly when coupled with broader marketing campaigns. Again in China, we created sleek cans with localized labels portraying cities across the country. We partnered with leading Internet providers to create an integrated digital experience where consumers learn more about these cities by scanning the counter on their mobile devices. This premium price revenue growth initiatives has been very successful in interacting a new generation of Chinese consumers. The two digital initiatives I just described are help to generate nearly 1 billion consumer impressions and supported the strong performance of Brand Coca-Cola in China where volume grew over 20% in the quarter.

With so much going on in our business, it’s kind of sounded to be challenging to setback and see the commonalities of driving – that is driving our performance across the various categories and geographies. However, when I think about it, the shift in our culture, one that is moving faster, taking more risks and approaching growth with discipline, this is the single largest driver of our performance. For example after launching FUZE TEA in Western Europe, we had an opportunity to enhance the attractiveness of our packaging to work with Coca-Cola European partners to revamp the packaging just launched, revamp the passion graphics in less than eight weeks. At the end of the day, speed and agility are critical for the success in this rapidly changing consumer landscape.

Of course, all of this is supported by a stronger global bottling system. Our bottling partners are energized. They are investing in capabilities and assets, driving enhanced execution and focused on bringing a total beverage portfolio to the customers. Looking towards the reminder of the year, there's a lot of activity ahead. We are implementing new revenue growth management initiatives in several countries, launching new products across geographies and adapting to new taxes in certain markets like the U.K. and South Africa. With that said I'm confident in our overall plan and with the guidance we laid out at the beginning of the year. Specifically, we expect to deliver 4% organic revenue growth and 8% to 10% comparable EPS growth this year.

Kathy, over to you.

Kathy Waller

Thanks and good morning everyone. We delivered solid underlying financial results slightly ahead of our expectations due to the timing of shipments with 5% organic revenue growth and operating expense leverage driving 9% growth in underlying operating income. This translated into strong comparable EPS growth of 8%. And based on where we stand today, we remain confident that we can deliver our full year guidance of 4% organic revenue growth and 8% to 10% comparable EPS growth.

Today, I will cover three topics: price/mix, our comparable results and our outlook. Starting with price/mix, as James mentioned, our consolidated price/mix turned at lower than our recent run rate largely due to timing as well as a few factors impacting North America during the quarter. However, as we move through the year, we expect the timing factors to reverse into a net benefit and for the pressures in North America to moderate, resulting in stronger global price/mix.

In North America price/mix during the quarter was unfavorably impacted by the timing of new product launches, incremental outbound freight costs and the shift of the Easter holiday. Like other CPG companies, we faced significant headwinds in North America this year. Historically, we have accounted for the cost of outbound freight as reduction from revenue. Therefore, it impacts our price/mix calculations. We estimate that this will be a 1-point impact on North America’s full year price/mix or be more front loaded due to the timing of when freight costs began increasing last year.

Outside of North America, emerging and developing markets outpaced developed markets in both our Asia Pacific and EMEA operating groups, impacting price/mix at the group level. However, at the local level, we generated positive price/mix in most of our markets. And in Latin America, we continued to benefit from strong price/mix in our Mexico and South Latin business units while operating in an overall low inflationary environment.

Turing to our comparable financial performance in the quarter, as I mentioned on our fourth quarter call, there are two factors creating noise in our comparable financial performance this year, with varying impacts by quarter and by operating segment. So first, structural. We expect comparable revenue and operating income to decline on an absolute basis. The growth in operating margins to improve as we cycle exiting lower margins, capital intensive businesses last year.

Second, [indiscernible]. As we mentioned on the fourth quarter call, two new accounting standards went into effect this quarter. The first required companies to split out net pension expense, keeping these service costs and SG&A and moving other components of pension expense to other income. So in accordance, we issued reclassified 2017 quarterly and full year financial information on April 3rd and now to you are comparable.

The second pertains to revenue recognition. The primary impact this quarter is that certain revenue and costs and contracts that were previously netted together in revenue are now grossed up into the revenue [indiscernible] components. We expect this to result in higher growth in both comparable net revenue and cost of goods sold, with no material impact to gross profit or operating income for the full year. However, this will mathematically affect the calculation of growth and operating margins. An example is outbound freight. We just now, after the implementation of the new revenue recognition standard, accounted for as part of cost of goods sold.

As I said earlier, this was previously recorded as a reduction to revenue price of the customer includes outbound freight. However, we applied this accounting change perspective does not restate our historical financial statement. Therefore, in organic revenue, we have adjusted for that change to make our 2018 quarterly results comparable to the 2017 compared to the period. As a result, both our organic revenue growth and price/mix will continue to be impacted by the outbound freight costs this year.

So looking at our performance in the quarter, comparable net revenue declined as organic revenue growth and benefits from the new accounting standard and a currency tailwind were more than offset by a 26% structural impact from cycling bottler refranchising last year. However, comparable operating margin increased 600 basis points due to refranchising and strong underlying performance, partially offset by an almost 100 basis point impact from the new accounting standards.

Below the line, higher net interest expense offset higher other income and equity income in the quarter and our lower effective tax rate and net share repurchases contributed to comparable EPS of $0.47, up 8% in the quarter. Finally, we generated approximately $340 million of free cash flow, up 5% driven by reduced capital investment needs as we divest bottling operations, partially offset by the impact of one less day in the quarter.

Now looking at the remainder of the year, our full year guidance remains intact, 45 organic revenue, 8% to 10% comparable EPS growth and at least $8.5 billion in cash from operations. As you model the flow of the year, there are a few items to consider in terms of phasing. Consistent with what we said on the fourth quarter call, we still expect full year EPS growth to be driven by the second half of the year, primarily due to the timing of expenses and productivity initiatives. Also in the first quarter, concentrate shipment outpace the volume growth, particularly in our EMEA operating segment. This pulls some revenue and profit into the first quarter.

As we move through the remainder of the year, we expect this to normalize, with full year concentrate shipment running in line with unit case volume growth. Now there are also a few things to consider specific the second quarter. We are adapting to new sugar excise taxes in both the U.K. and South Africa while cycling strong results from Western Europe last year. While we feel confident in our strategies and ability to adapt our portfolio to the new operating environment, we expect some level of impact, particularly as consumers first adjust to the new prices.

And we are cycling a low SG&A base last year due to the timing of expenses. From a nonoperational perspective, we expect a 4 to 5 point headwind from structural items and a 1 point headwind from currency on operating income. And we expect to change in revenue recognition to be a 1 to 2 point tailwind to revenue. And while we still expect the revenue recognition to have no impact to operating income for the full year, we do expect a 2 point headwind to operating income in the second quarter that reverse in the third quarter.

So these considerations taken together will put pressure on comparable EPS in the second quarter relative to our full year targets. As always, our Investor Relations team will be happy to walk through each element in more detail as you build out your models for the year. So in summary, we delivered solid underlying financial performance in the quarter. This translated into strong comparable EPS growth and we are on track to deliver our full year guidance of 8% to 10% comparable EPS growth.

Operator, we are now ready for questions?

Question-and-Answer Session

Operator

Thank you, speakers. We will now begin the question-and-answer portion of today's conference. [Operator Instructions] And your first question comes from Dara Mohsenian from Morgan Stanley. Your line is now open.

Dara Mohsenian

Good morning.

James Quincey

Well, good morning.

Kathy Waller

Good morning.

Dara Mohsenian

So I just wanted to touch on the mix of your organic sales growth in the quarter. Clearly, we saw shift away from price/mix more to volume growth, which is opposite of what we've seen in the last few years. And don't get me wrong, it was great overall result, but I just wanted you to sort of flesh that out a bit more. A, on the volume front, are you feeling more comfortable there with the good Q1 result? What drove the pickup? How sustainable is it? Maybe can touch on emerging markets there.

And then B, on pricing, should we expect more modest pricing going forward? And why? And I heard the comments about underlying pricing being solid in North America for Coke. But with your key competitors seeing weaker pricing in scanner data and some pushback we've heard from retailers around pricing across the CPG landscape, I'd love sort of an update on the competitive environment commentary in the U.S. Thanks.

James Quincey

Sure, let me start with the volume. I mean I think volume has accelerated across the board. As I mentioned in the comments, it's not just broadly geographically based. It's broad in terms of the categories. So there is no silver bullet or one lever there. It's really the sum, the right strategies, the innovation, the programs, the execution by the bottlers that are creating value for the customer. It's really a broad-based effort that has been ongoing across the system. Yes, the macros in some of the emerging markets have improved slightly, and of course, that is helping a little bit. So I think it's broad-based for the right reasons.

And I make that point because, actually, what we're doing in pricing is also consistent with the strategy and what we've been doing for the last number of years. So actually, the two things are working together. But let me make a couple of points on pricing. Firstly, now that we've refranchised so much about bottling revenue, the revenue of us as a concentrate business or largely a concentrate business is further down the supply chain. So some of these timing impacts of shipments or other things tend to be a little magnified but more magnified than they were in the past when you look at some of the groups.

I think that's just worth bearing in mind going forward. And then when you look at pricing on a global basis, as we talked about, underlying pricing in the marketplace is good. It's very consistent with what we've been doing over the last few years. But there are certain types of timing effects that have reduced how that looks in the P&L. So the marketplace has the pricing. In a way, our operational pricing through to the marketplace is consistent with what's going on in the marketplace. But globally, that has been reduced coming into the P&L for a couple of timing things.

One, some of the gallons that we sold in the first quarter, which were ahead of cases, were particularly in some of the developing and emerging markets where the average price tends to be a bit lower. And so that kind of mechanically brings down the price. That's a quarter-to-quarter effect that will wash itself out. Similarly, we had a timing effect that brought out more revenue reductions into the first quarter. So again, that will wash itself out in the rest of the year. Some of the stuff that is more ongoing geographic mix, the developing, the reemergence of the developing and emerging markets, which is good for volume, tends to be a little more pressure on price/mix.

And a lower inflation in Latin America, those perhaps is a little more contained. But we absolutely believe that once you look past these kind of quarter to quarter effect, you will see good global pricing going forward very consistent with what we have been doing over the last few years. And then specifically, our North America, the minus one is not consistent with where we expect the full year to end up. There are a number of things in North America. One is the timing is much more -- the Easter is much more in the first quarter. The freight that Kathy talked about and then we're giving a kind of an old accounting comparison where is a deduction for revenue, and that will mitigate as we go into the rest of the year.

And then we're cycling some of the big innovations in the first quarter over last year, which drove up price per gallon and some of the packaging stuff we're doing. All of these things will moderate in North America for the rest of the year. And so we haven't our strategy. You can see in the Nielsen's that we're getting pricing in the marketplace. We fully expect that to continue for the rest of the year. And so low single digit is much more likely for North America, and that's our expectation. So we have an outlook of 4% globally for the full year. We expect that to be balanced between volume and price. And so we look through these quarterly of the timing of things, which as I said a little more magnified now given that business model. We are on track with our strategy and execution.

Operator

And our next question comes from Bryan Spillane from Bank of America Merrill Lynch. Your line is now open.

Bryan Spillane

Good morning everyone.

Kathy Waller

Good morning.

James Quincey

Good morning, Bryan.

Bryan Spillane

I guess, James in your prepared remarks you have mentioned or Kathy I guess, you have mentioned Great Britain in the second quarter and the sugar tax. And now that it's in the market, can you just give any sort of early read, not so much on performance, but just how the consumers reacted to it, how you feel like your marketing, your messaging around the preparing for this has resonated with consumers? Just any sort of early sort feedback I guess if you will in terms of it being in the market and how consumers are responding to it? It would be helpful.

James Quincey

Bryan, good morning. I honestly think it's too early, but let me tell you what we've been doing and what's been happening. The U.K. sugar tax, unlike some other countries, is actually a tier tax. So at the certain level of sugar, it’s one level of tax. You go down and sugar, it's a more moderate tax and then below a certain level, there's no tax. But we have done a number of things. We have reformulated a number of our major brands that reduced the sugar level. We have really pushed hard on the One Brand strategy for Coca-Cola.

So we still have Coke original there, but we put really hard on Coke Zero and really hard on the invigorating Diet Coke such that about two thirds of that total portfolio will not pay the sugar tax because of the way we have adapted the reformulations for the GB marketplace. On top of that, we've put a lot of emphasis on smaller packaging in the GB marketplace and changes in packaging sizes to try and accommodate this in the way that shoppers actually go for the occasions and the rituals that they are part of in the U.K. So we've been building towards this. This is obviously something that's been in the works for long time [indiscernible] tax that we have adapted.

So the first thing is I think about we actually the rest of the industry and the retailers have adopted a lot of this regime. So I don't think it's going to be as disruptive for the marketplace as perhaps some of the other ones. Yet, it is also going to reduce calories effectively. And that's been in the marketplace, I guess, now for three weeks. It is worth nothing that in the course of those three weeks, it's been like the hardest Easter like for a long time.

It was like 29 degrees centigrade last weekend in the U.K. So I'm sure the beverage industry is pretty well in those first three weeks kind of irrespective of pricing. But it's way too early to call. I think the GB team has done a great job with Coca-Cola European partners in preparing for this. I'm sure it will have some disruption on Coke original in Q2. The rest of the portfolio is set up to continue with the pricing strategy we have before. So I don't think it is going to be too disruptive, but I think there will be some impact.

Operator

Our next question comes from Nik Modi from RBC Capital Markets. Your line is now open.

Nik Modi

Yeah, thanks. Good morning everyone.

James Quincey

Hi.

Kathy Waller

Hi.

Nik Modi

Maybe some thoughts James from you on early metrics on the Diet Coke relaunch. I know it's still early. I know, obviously, it did well in terms of retail display activity, et cetera. But maybe you can just key us in on what you're seeing at a consumer level in the early innings.

James Quincey

Sure, yeah, I mean – I am not a big fan of drawing a trend line through one quarter. Look, we did three things. We've been learning over last couple of years. The team has been learning on what is going to help a great ramp like Diet Coke reengage with some of the last consumers and with new consumers. And I think this round, we came up with some good marketing, soma reinvigorated packaging, shapes, sizes and looks and, obviously, the flavors -- the innovation on the flavors. And I think the combination of those three things was bold enough and interesting enough to not just engage some of the people who, perhaps that blast from Diet Coke but also millennials and even some of the people who are, perhaps, drinking flavored sparkling water.

So I think, when you look at where the change in volume trend is coming from, it's those three groups, which is good news for a brand like Diet Coke. I don't know what’s going to happen in Q2, I hope the trend continues. As we say, we put a lot of our effort in Q1. But whichever way it goes, whether it continues or softens a little in Q2, I think we are learning some interesting things about what it takes to reinvigorate Diet Coke and brand. And so I'm encouraging the team to continue to learn and be bold with the next round of actions.

Operator

Our next question comes from Carlos Laboy from HSBC. Your line is now open.

Carlos Laboy

Yes, good morning everyone.

James Quincey

Good morning.

Kathy Waller

Good morning.

Carlos Laboy

James you have touched on this throughout the call, but with another quarter of experimentation done, can you expand on some of the examples that would inform us externally that the firm is becoming a bolder consumer-centric brand rather than brand-centric company?

James Quincey

Yeah, I think clearly, we’re pushing the idea of experimentation. Not experimentation for the sake of experimentation, but in the service of the consumer, in the service of wondering what will connect and engage with the consumer. And I think several of you heard me being use the old adage of never say never. And I think that was the main goal of doing anything that's great and it's about reconnecting with the consumer. And I think that's allowing us to go I think beyond our previous boundaries; whether it's the campaign that I just talked about on Diet Coke; whether it's the rapid expansion around the world of AdeS, which is the soy-based plant drink that we bought in Latin America and we've taken to Europe; whether it's the speed with which we've tried some of the reformulations on sugar reduction in Latin America or even some of the beverage innovation in Japan.

I mean, it's all about trying to connect with the consumer. And then when we got something, let's not be shy about moving it around the world quickly, sometimes we have had good successes. We've been shy about moving them around the world. We've got to lift them. We've got to shift them. We got to scale quickly. And examples of that are things like smartwater and FUZE TEA. And the last thought I'll leave you with on experimentation is we've got to be willing to kill the zombies. We can't have experimentation that is either success or continuation. There has to be, no, this is a great -- it was a good idea. It didn't work for whatever reason, and it needs to be -- it needs to be pulled out because that's also a key part of experimenting is redirecting the resources to the next idea or doubling down on something that works.

Operator

Our next question comes from Stephen Powers from Deutsche Bank. Your line is now open.

Stephen Powers

Thanks. Good morning.

James Quincey

Hi.

Stephen Powers

Hey, so a question on North American operating income. It looks like growth there was down noticeably in the quarter. Segment margins, I think, were down 400 basis points if my quick math is correct. And I just hoped you could bridge those year-over-year movements for me. How much was elevated freight effector versus accounting changes, the innovation and the Easter-led investments you mentioned? Just I would have thought that the underlying pricing ongoing productivity, the strong sparkling performance that we saw from a mix perspective would have all benefited margins more than we might be seeing.

And maybe just a part of it, but just specifically the release says that profit was unfavorably impacted by a 6 point headwind from intercompany profit eliminations, elimination benefits last year, just can you remind us what that was? Sorry for the rambling question, but I guess, what I'm trying to figure out is the 21% segment margin that we're seeing this quarter is that representative of what we might be seeing going forward or is it artificially depressed by some of the factors that we should be taking into effect? Thanks.

Kathy Waller

So, good morning, Steve. So, yes, margins for this quarter were compressed. And one part of that is that intercompany profit elimination that you talked about, that was a 6-point headwind at operating income. As you remember when we transition territories, we take onetime benefit from being able to recognize the profit that we originally had to eliminate when they became intercompany. And that went to the numbers last -- fourth quarter of 2017, and now we have to cycle that and the same amount went down the P&L. So it's one amount of revenue, and it's the same amount of operating income, but it has a different impact at operating income, so the 6 point headwind at operating income.

And then the other factors as we talked about revenue recognition, that's about 150 basis points margin headwind in North America although dollars are not compressed, but that is a margin headwind. And then there are a couple of other things with some timing of SG&A in the quarter. And then there are cost pressures that we talked about earlier on inputs and things like juice and then there are freight costs. So all of those things are the factors that you're seeing in the compression for North America.

Operator

Our next question comes from Judy Hong from Goldman Sachs. Your line is now open.

Judy Hong

Thank you. Good morning.

Kathy Waller

Good morning.

James Quincey

Good morning, Judy.

Judy Hong

So, James, I guess I wanted to get a little bit more color on Latin America. I think it was one of the regions where it was going to be, perhaps, a swing factor this year in where it was going to be, perhaps, a swing factor this year in improving off of the 2017 base. And you saw a little bit of an improvement in Brazil, but it sounds like maybe there's more to go there. So just a little bit of color broadly there. And if I kind of hear your comments about revenue growth expectation for the full year of 4%, seems like if Lat Am comes up even more, there's maybe a little bit of room to do better. At the same time, maybe your comments on Europe is a bit cautious, tax issues, weather comp issue, et cetera. So just kind of reconciling those two comments. Thanks.

James Quincey

Sure, I think Latin America clearly improved particularly Brazil and Argentina. I think as a point of reference or contract is that we're doing good last year but it’s not that we've gone from okay to great. It's we've gone from bad to okay, and there was modest volume growth in Brazil and Argentina. Now that's not to under appreciated work of the teams and to the bottlers in those countries, but they've been tough micro economically. They've been working very hard on revamping hard on revamping the packaging, revamping the execution, revamping the marketing. And they're starting to get some reward for their troubles. But it's still not out of the woods in the case of some of those countries.

And no doubt, the improvement will be a bit lumpy. But we're starting to see that plans they put in place, the returnables in Brazil and the return to growth in sparkling working and some of the category growth working in

Argentina. So there's volume growth, which -- I mean, most of last year, we were declining in Latin America. So we're going to gain on the volume, maybe a bit lumpy, but we're going again on the volume. It's worth saying that inflationary pressure is coming down in Latin America. So off -- you've got less pricing, perhaps, than we had over the last few years in Latin America, but a better volume performance. So I am not sure it's going to get an outsized change in trend from what we're seeing, but I think it's a better underlying fundamental. So I am not sure, I would see that balancing back that Latin America because one thing is sort of offsetting the other thing, but it's kind of a healthier mix.

Operator

Our next question comes from Lauren Lieberman from Barclays. Your line is now open.

Lauren Lieberman

Great, thanks. Good morning.

James Quincey

Good morning.

Kathy Waller

Hi.

Lauren Lieberman

I wanted to go back to freight again, separate from how the accounting change is impacting the presentation. But I was just curious, I guess, how much freight is up kind of year-over-year in North America because I'm just -- I guess I'm surprised by how much it's still impacting you, given refranchising. So maybe, in that context, it'd also be helpful to just articulate what you still distribute yourself because I know there's quite a bit but it's not a 100% refranchising. How freight is actually flowing through the impact of the business as much. Thank you.

James Quincey

Yeah, so I will start and if doesn't work that well, then Kathy will help me out. Freight in North America is up like 20% or something. I mean freight is up a lot and that's a consequence of the change in regulation in terms of number of hours that the drivers can drive, et cetera, et cetera, and the way the organization of the freight is put together, and there've been changes to regulations. And that does to some extent reduced the number of drivers or reduced the number of hours. And so freight is up 20%. Why is freight relevant for us?

While, we still have some in North America, even postre-franchising, we still have two bits of the business where we are kind of selling to customer, that's the business, where we're selling direct to them. So we still got freight involved there to the final end user. And we provide a lot of the hot fill products to the bottling system and direct to some of the wholesale business. So again, we have freight. This is much, much more like the – much – and not like the rest of the world. This is very specific to the U.S. So that's where it comes in.

Now I would just point out that we, in a way, have taken the more asset version of category price/mix, which is under the old accounting standards where it's a deduction from revenue. In 2018 and going forward, freight is actually in cost of goods and not reducing price/mix. So that is -- if we have taken it out, price/mix would have been better, but just to make it apples-to-apples and make it easier for people to understand, we left it under the old scheme, but it's worth about a point of price/mix, and it's going to start washing out by the time we get into the second half.

Operator

Our next question comes from Bonnie Herzog from Wells Fargo. Your line is now open.

Bonnie Herzog

Alright, thank you. Good morning.

James Quincey

Good morning.

Kathy Waller

Good morning.

Bonnie Herzog

I wanted to actually circle back on your price/mix in North America, which was negative in the quarter and you touched on. But I guess, I'm wondering if you could give us a sense of your performance in the different channels. For instance, I'm wondering if the immediate consumption channel showed any signs of slowdown in the quarter. And then could you guys touch on pricing across different category clusters? It seems like you're getting healthy pricing in sparkling, driven by innovation and smaller packs, but maybe less so in other category clusters. So if you could touch on this, it would be helpful. Thanks.

James Quincey

Yes. Yes, great. Look, in terms of the channels, I think, actually, volume was pretty broad based. I mean, we grew the bottle business grew, the fountain business grew. The Minute Maid business grew. The venturing and emerging brand business grew. All of them grew in volume terms. And so whether it was large grocery, convenience, QSR, I mean, the volume performance was broad based in terms of channels. It was broad based in terms of categories. Virtually, every category grew in volume terms. The one – the main one that didn't was juice, but that was actually a conscious decision to change the packaging size, to some extent, to downsize the packaging, given the pressure on juice COGS. And there we did see slightly less volume, but that was kind of a known part of the plan. So our broad-based volume in terms of channels, broad-based in terms of categories.

And then pricing, as we talked about, the marketplace pricing looks good across the channels, and we have a clear expectation that our pricing strategy of creating value for our customers are capturing some of that ourselves by innovating in the marketing, innovating in the brands, in the categories, innovating in the package sizes will help to create value for everyone. And therefore, that's our strategy going forward in terms of our expectation for the year in terms of pricing. And we're going to continue to look for a way to earn price with our customers by doing the right things in the marketplace. And so, I think a continuation of what you've seen is what we're after.

Operator

Our next question comes from Ali Dibadj from Bernstein. Your line is now open.

James Quincey

Not, Ali? Hello?

Ali Dibadj

Can you here me?

James Quincey

Yes.

Ali Dibadj

Okay. So I'm still receiving lots of investor questions about price/mix in freight and the pendulum swing there. I'm not sure you're going to say more, so I have for you I kind of have questions instead. One is about the margin expansion to 600 basis points this quarter, which is obviously strong. Could you break that out in terms of how much was productivity versus how much was structural? It felt like most of it was structural and not a lot of product to be this quarter and what we should think about ramping that up for the rest of the year and ongoing?

And then second question is around EMEA share. You only mentioned gaining share on juice, dairy and plant-based beverage clusters. And related to that, it looks like Turkey and South Africa were really good volumes; Nigeria and Western Europe not so great volumes. I don't think that's just a one quarter phenomenon. So how does that in particular inform your decision-making on CCBA and the bottlers who own those particular regions of Turkey, Western Europe, Nigeria as you think about your September kind of "deadline"?

James Quincey

I think that looks like about four halves, Ali. There would you like us to focus if you don't want us to choose. Ali…

Ali Dibadj

You can't answer this.

Kathy Waller

So I think we have answered the freight. I am not sure I can add much more on that one. Do you want to say something about the…

Kathy Waller

Sure, on the operating margin, yeah. So the consolidated operating margin has increased of about 600 basis points. That is significantly structural, structural drove about 600 basis points. And then there is an – underlying business is positive, operating margin. And then that's offset a little bit by the mechanical impact of revenue recognition, which was about 100 basis points. So basically that's the drivers behind the operational – the operating margin...

Operator

Our next question comes from Carline Leavy from Macquarie. Your line is now open.

Carline Leavy

Thank you. Good morning. Can you here me?

James Quincey

Yes.

Kathy Waller

Yes.

Carline Leavy

Great. My question goes around margins, but it's a longer-term question. As you see the growth in things like teas and other nonsparkling drinks, it just seems that investment cost is higher. Your market share comps dominant the way they are in carbonated soft drink. So how can one have confidence on the longer-term story that you get to your four thoughts hopefully revenue growth globally? Over time what drives margin improvements? It would be really helpful if you could, perhaps, walk us through some areas that could be the pluses or minuses?

James Quincey

Yes, okay. I think part of this -- market share is clearly important by category and not just by category obviously, that then is important whether it's in an average across the world or whether it's concentrated in the few places. So clearly, market share matters, and the quality of the leadership versus the rest of the competition also matters in terms of scale and margins check. We are managing a broad portfolio. There are -- and clearly, as we are in some of the more challenging and explorer situations by category and by country, yes, it does require more investments to make progress. But as I say that it's a portfolio effect, we have the task of managing the portfolio of where we’ve clearly got quality and managing those places where we are investing to create more positions and leadership.

And in a way as some of those graduating to leadership positions, we can cycle the investments into newer challenges and explore. So it's a portfolio management challenge. And even without having the same kind of shares on a global basis as we have in sparkling, there are places where we have got good positions in some category country combination, and they are able to achieve margins comparable with our sparkling business.

So it's not leaving aside a couple of categories, which have inherently different economics and they tend to have high-dollar returns even if it's the percentages are lower like chilled juice and stuffs like that. The inherent economics of the different categories is possible to achieve attractive margins in each category if you can get to a quality leadership. So give an example, tea, which has done pretty well in a whole number of countries around the world and was getting – it wasn't requiring outsized investment and was trying to look better in terms of margin, we rolled that out across Europe this year. Yes, we've invested more money with it as we've got into the year.

So clearly, investing more of a case if you like but more of a dollar of revenue than we are on the sparkling, but as we get that scale and we effectively double the value of the FUZE brand, we will be able to build the equity around the brand, can keep it relevant for consumers, keeping innovation going. Then that it will allow us to get the scale ultimately in the margin structure to make it comparable to sparkling. And of course, then, we will likely choose to reinvest in the next brand we're growing to make it simple.

Operator

Our next question comes from Amit Sharma from BMO Capital Markets. Your line is now open.

Amit Sharma

Hi. Good morning, everyone.

Kathy Waller

Good morning.

James Quincey

Good morning.

Amit Sharma

James, from all this discussion on pricing, can you just comment on how are you seeing it from consumer health and retailer perspective? Because your CPG peers on the food and HBC, they are not as confident of being able to get positive pricing, especially in North America. So can you just talk about like what you are seeing and how Coca-Cola and overall beverages are doing better than your CPG peers?

James Quincey

Yeah, a couple of thoughts, Amit. Firstly, beverages are growing faster than the average of consumer staples on a global basis. It's clearly one of the more attractive categories in total – the total consumer staples landscape, driven by the investments, driven by the innovation, driven by the marking, driven by the execution. Secondly, beverages are more diversified in terms of channels. So it's not all concentrated in one place. And especially ourselves, we have a global business that we're not – the things that are going on and things that we need to adapt to and evolve against.

We are in over 200 countries and we're in over 20 channels. So we have a broad presence that that means we could adapt to changes in pressures in any one channel and in any one place without stabilizing all system, which then of course, goes back to one of the reasons why we are able to kind of mitigate some of these segments and remain an attractive, attractive category.

Now having said that, we have to respond to the ongoing pressures in the marketplace. And just to kind of typify a couple of them, you've got consumers doing a number of things that you see happening in the channels are moving away from with the middle in a way. There are trends towards premiumization because, in a way, they're responding to trends around the types of ingredients that people want and the types of the manufacturing that tend to lead to more of a premium product, premium packaging, but there are also people looking for value. And beverages and what we can do with products and packaging allows us to offer – to create offerings across a broad spectrum and really provide that choice in each channel and for every channel, and I think that's what's allowing us to do a bit better.

Operator

Our next question comes from Robert Ottenstein from Evercore. Your line is now open.

Theo Brito

This is Theo Brito for Robert. I am wondering if you could give us some more details on the growth in China this quarter. I think you said volumes are up over 20%. Wondering how much of that was a benefit from timing of Chinese New Year or, perhaps, a renewed kind of accelerated growth and new trajectory for your business there. Thank you.

James Quincey

Sure. China had a good quarter. And clearly, some of it was the Chinese New Year was more fully in this quarter than the previous quarter. Secondly, the 20% I mentioned was brand Coke, not the total business, actually the total business was slightly less because we made some decisions around some of our low-value water to back off on some of those. So we actually sold a little less water than we, perhaps, we did last year. But that was a clear decision to go for building consumer franchise and value.

Net-net, we're doing better in China. We've got some more effective brand communication. As I talked about, we've got some innovative digital campaigns. We've got some packaging innovations and premium offers around sleek cans and some value offers. And newly refranchised bottlers are taking that expanded portfolio. And really, Costco and Swire are really working well with some of the key channels to drive the business in China. So it's been a strategy that's been in implementation for a while. And we are starting to see the benefits come through again.

Operator

Our next question comes from Andrea Teixeira from JPMorgan. Your line is now open.

Andrea Teixeira

Thank you, and good morning. James, if I want to go back to the Latin American question from Judy, you have been having obviously an impressive balance in Brazil. It sounds in the mid-single-digits and after two years of declines a similar CAGR. So I was hoping if you can elaborate more on pricing mix in Lat Am on an environment of low inflation, as Kathy highlighted.

So in other words, if your price/ mix was up by 6% in the region, but mostly – if it was mostly driven by Mexico, so I'm assuming price/mix is still negative in Brazil because of returnables and affordable juices. So in other words, are you starting to see a lift and shift in Brazil in mix, in particular, in the new high-end juice launches as well as Coke Zero? So – or in other words are you betting that consumers will take longer to premiumize again after two recession years? Or should we think of Brazil more of an offset of the decelerating trends in Mexico? Thank you.

James Quincey

Look, I think a few thoughts on Latin America. There are a number of things that are happening here at the same time. One, the macros are improving in Brazil and Argentina in terms of GDP, but that's coming with slightly less inflation, perhaps in Mexico, it’s being a bit of a softening at the back end of last year and into this year. So it's one, the macro environment is important. Two, we are seeing less inflation. I wouldn't say there's low inflation. Inflation in Latin America continues to be above the U.S., for example, and many of the other developed countries. So it's not that we've gone from inflation to low inflation. It's still pretty medium, the inflation. You are seeing Brazil perform a little better.

That was the packaging strategy around returnables. And I think, ultimately, this is all netting out in more dollars because, along with moderating inflation is less losses on the foreign exchange, I know we came to talk about currency-neutral numbers, but in the end to generate the dollars, what's also important to us is some of the FX rates are not as negative in Latin America. So I think, I mean, you can – came in the team and get into more detail on Latin America, but it's really the sum of lots of moving parts here and driving forward.

But net-net, the teams in Latin America, the bottlers in Latin America are using the broad portfolio, a lot of thinking around packaged price architects to adapt to the changes in the marketplace, the changes in the consumer and the changes in the channels. And I think we started to see more benefits of that coming through, not just in kind of currency-neutral, but also in money.

Operator

Our last question comes from Bill Chappell from SunTrust. Your line is open.

Bill Chappell

Thanks, good morning.

Kathy Waller

Good morning.

Bill Chappell

Hey, just I want to actually go back to costs. A year ago, I think you know announced the expansion of the productivity and reinvestment program. Now I would there've been a fair amount of headcount reductions middle and late last year, but it sounds like there was kind of continue to fine tuning early this year. So maybe just an update on the program if you found more savings, if – how much we're already seeing in the current numbers and how much we expect to see this year?

Kathy Waller

Okay, hi, Bill. What you saw earlier this year was discontinuation of our lean enterprise initiative. So North America was the primary driver of the decimal headcount reduction that happened in the – or happening in the first quarter. So productivity, we are on track to do the total $3.8 billion by 2019, which includes additional $800 million that you referred to. And again, the initiatives are kind of in line and we are on track.

James Quincey

Yes. Okay. Thank you very much everyone. To conclude, we had a solid start to the year. We capitalized on our momentum coming out of 2017, and we will continue to drive our strategy through the remainder of the year. And we absolutely remain confident we will deliver our full year guidance. As always, we thank you for your interest, your investment in our company and thank you for joining us.