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The Coca-Cola Co. (KO)

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MANAGEMENT DISCUSSION SECTION

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So, we're going to get started if everyone can find their seats. It's my pleasure to now welcome The Coca-Cola Company back to CAGNY represented by CEO, James Quincey; and CFO, Kathy Waller. Coke is a company that is evolving its business models to meet the challenges of a rapidly changing consumer and customer landscape. Strategically, a new top line approach has taken hold focused on revenue rather than volume and looking beyond CSDs with new brands into a broad range of categories. This change in top line strategy is supported by a new lean operating model aimed at making Coke more agile and less risk averse.

Before we welcome James and Kathy to the stage, please also join me in thanking The Coca-Cola Company for keeping us all hydrated and happy this week with the endless supply of beverages outside.

James Quincey

President, Chief Executive Officer & Director, The Coca-Cola Co.

Okay. Good morning, everyone. Kathy and I would like to talk to you about The Coca-Cola Company and our evolving journey. So, with that of course, let me start with the all too familiar page, how do we want to talk to you about it, three ways, three things we want to say. Firstly, we want to just in a way reground a little bit and talk about why we think we've reached an inflection point and what sort of characteristics of that inflection point might be.

Secondly, why we think we're positioned not just for growth, but growth in a disciplined way. And then of course, third last but not least talk about some of the numbers and how we're going to turn the benefits of that winning strategy into numbers for the shareholders. So, talking about the inflection point, I think the easiest way to start is in a way reconnect to this time last year we came and we talked about some guidance that we were going to pursue for 2017. You can see it here the top line growth 3%, 7% to 8% in the underlying profits and still slightly negative comparable EPS, although we had said we wanted to pay more attention to EPS. As you know, as you can see here, we managed to either achieve or exceed the numbers that we put out and set ourselves for 2017 having built on all the activities that come in the years before.

But it wasn't just that we managed to achieve the numbers that we talked about. We did so in a way that was orientated to build on the work we've been doing, the refranchising and reinvestment and setting ourselves up for growth into the future. We made a number of important moves on the portfolio, driving to be ever more consumer centric whether that was the updated Coke Zero Sugar, the launch of many products around the world and a greater test and learn approach, which we've talked about.

We started to move to a revenue growth management 2.0 if you like. We started to improve our approach to some of the premium opportunities, so some focus on revenue management, which I think you see came through in our pricing. Of course, the refranchising was largely complete in 2017. I won't talk much about it today, except to say, we have re-founded the system across almost half of our business. And we began a journey to digitize the enterprise and I would really underline began the journey.

And then on the people front, we made a lot of changes. I'll recap some of those and more about where we're going later on, but new faces, new people and new operating model, a leaner enterprise and a lot of updates coming.

So, we achieved the numbers. We did so by executing the plan we laid out here last year. And I think why it's appropriate to talk about a year of inflection is when you look at some of these numbers, yes, we started to gain more momentum in 2017 as the year went through, but most importantly, what we will now see going forward is the underlying operating results that we've been driving in each local country over time every year, represented by the currency neutral operating income line is finally starting to flow through to the comparable EPS. We have gone through the period of the dollar strengthening, which is a negative to our results. We have largely completed the refranchising, the divestiture of the company-owned bottling businesses, so that the structural impacts are now starting to decline, such that you will see and obviously in line with our guidance that we provided on Friday, that comparable EPS will start to grow again in a good way from 2018 and beyond. So, really an inflection point, because the underlying enduring strength of the business is now going to become more visible in the numbers and to the shareholders.

So, if we've achieved an inflection point and the numbers are starting to come through, what is it that we're going to do and why do we believe we're positioned for growth and growth in a really disciplined way. I think the first point and perhaps I make it every year, but it's worth saying yet again which is we work from and start from a strong foundation. Not only are we number one in value share for sparkling beverages, we're number one in juice and juice drinks. We're number one in hydration and we're number one in teas and coffees. We are the number one player in non-alcoholic beverages worldwide. That's a 130-plus years of success.

We're also a strong brand builder. We have 21 $1 billion brands, doubled in the last 10 years, and we have a pervasive distribution system. And I'm going to underline some of the importance of not just the pervasiveness of our distribution, but the diversity of our distribution in this fast-changing world. We serve over 20 different channels, not just over 200 markets but over 20 different channels with our more than 250 bottling partners, and we reach 27 million customer outlets and we have cold drink equipment in, on average, about two-thirds of those and we're very diversified geographically.

So we have created a foundation that is a leadership position and very diverse in terms of brands, categories, channels and countries. But not only is the foundation strong, not only is the foundation robust, it's an industry that we participate in that's growing. It's growing and it's also diversified. And I wanted to underline again, as I mentioned, that idea of diversification. As the world changes quickly in certain channels, in many parts of the world, I think it's worth noting the degree of diversification of channels of beverages versus other consumer products categories, highlighted on the left here against food and some of the household products. This is a business that operates, yes, in modern grocery, but just as many of our sales goes through mom-and-pop stores or many more go through hotels and cafes, so a business that's broadly diversified in channel.

A business, an industry that is growing, growing in percentage terms, growing faster than many other comparable consumer products categories, but not just faster in terms of percentages, but factor in terms of dollars as well. It's an industry that's going to add about $150 billion by 2020, so a great foundation, diversification of the industry and lots of growth to come.

Of course, we, like all of you, see the many changes that are affecting the consumer products industries, the changes in the consumers' preferences. There are many changes in the consumers' preferences. Whether that's an appeal to more natural or even said a different way, a de-industrialization of the food chain. Please just take out everything that isn't inherent and core to the product itself.

Of course, we compete in one sector that has sugar in many of its products. People want less calories, less sugar. We need to obey those imperatives. And the consumers are also changing the way they shop. They're changing from a car-based culture or walk into the store culture, to the way digital's changing everything. And that digital evolution, I think it's fair to say that beverages are not at the tip of the spear of what's changing everything from an e-commerce point of view. But because consumers are changing the way they shop, in very fundamental ways, and not just the grocery stock-up at home, but whether it's ordering takeaway food or even when it's going to the outlet and buying products, whether it's the cinema channel or the café or the hotel. The digitization of the whole experience is ongoing and fundamental, and we need to participate in that in a very different way. It's about, said in its simplest terms, finding a way to reconstruct in the virtual world, those imperatives that have existed for so long in the physical world, at which the Coke system has been very effective executing against.

And then of course regulation/tax; taxes, we've talked about before. We've had a clear strategy on taxation as it relates to sugar, as it relates to beverages and as it relates to trying to push for the most rational approach possible, but also regulation. The reality is that the food and beverage and the whole consumer product space and actually even the whole digital space is going to be subject to more regulation. It's going to come across and affect the consumer industry in profound ways. And the nexus between food and beverage regulation and privacy regulation is going to drive lots of change. But the world has always changed. Sometimes people say to me, no, are you worried about the switch to social media or to digital? And part of the answer is, no, because we've always had a strategy to confront the ever changing world in which we operate in.

In a way, if you wind the clock back, Coke, the Coke Company with Coke the brand, was one of the first products to ever be advertised in a newspaper, probably a hundred years ago. It was one of the first companies to ever publish a coupon to buy products, one of the first to go on radio for advertising, one of the first to be on television, and one of the first to be in the digital space. [ph] Whether we were that (12:03) called out for is not that one needs to be scared of change, but one needs the right strategies. And we think we have the right strategies going forward from the change that we face in our industry, in our environments.

We're going to be more determined to start with the consumer. Large institutions, large companies often go wrong when they start from where they are rather than where the consumer is. We're very clear that we have to start with consumer and drive our portfolio of brands to be ever more consumer centric. So if the consumer moves, we must too.

We're going to continue to drive our growth algorithm. We're in the middle of a journey to become more value orientated rather than volume orientated. Not that volume won't play a role in driving the revenue in many parts of the world, especially the emerging markets were it'll largely be driven by volume but it's about a more determined approach to drive revenue through the highest quality consumer interactions and those are often the smallest packages. And so we are favoring driving revenue over volume or driving transactions over volume. Actually it fits very nicely with our approach on helping people consume the right amount of sugar, smaller packages helps too. So there's an intersection of many of the challenges we face and many of the opportunities we can take advantage on if we focus on smaller packages, which is why we called out on Friday the growth of transactions faster than volume. So I think there is still some period that we drive this strategy forward. In the long run, revenue will ultimately need to be a balance of price and volume, but certainly for now, we can use a lot of mileage in our small packages strategy.

The system, the bottling system has a lot of advantages around the world. It has true competitive advantage that creates value. But a bit like the same way that the nature of consumer marketing media has changed over the years, so have what the bottlers need to do to be able to have a competitively advantage position in the customer outlet, using the sales system, the distribution system, and the manufacturing systems to provide that.

Digitizing enterprise, I already mentioned that, but said in essence, we need to make sure that everything that can be done can be done with a click. It's almost as simple as, if it can't be done on the phone then it's too complicated. And to do all of that, we need to, of course, yet again, unleash the power of our employees. So, that will allow us to make the right choices and invest for growth. We think we have the right strategies to confront the future that's in front of us.

And that future, that opportunity is not just about the aggregate amount of growth that sits out there in the industry, that $150 billion, the 4% a year growth rates. It's that actually we see the opportunities as we break down the world into categories and into countries. You can see the example here where we looked at the categories across the world. Clearly, we have some where we have very strong market shares, the sparkling beverage category where we have over 50% share of the value.

We have 10% to 15%, even though we're largely category leader, in most of the other ones. Actually that's not even – I mean that is of course the global average, but it's not what happens in reality. In reality we have strong positions in some countries and relatively nothing in other countries. So it provides an opportunity to be more targeted and more laser like in terms of looking for the opportunities and looking where we should make those choices and invest for growth. Because ultimately, and actually it's in a way business school 101, market share matters, and market share matters not in an aggregate sense, on a global basis or on a total country basis. It matters relative to competitors because that's what drives our margins. I mean each of these blobs is a real country in the Coca-Cola system. And it's simply a restatement of what has always been theoretically true, a business school which is it's not just about being number one, it's about having a decent margin of leadership versus your next competitor which really drives the system margins for us and the bottling system.

So as we start to break down those global opportunities by cluster, we need to make sure that we are building ourselves into a scale leadership position which is what's going to drive our margins. And what's important about that is not just making the point about that leadership matters, but that we need to understand and we need to incorporate into our strategies and our thinking the lessons that we've learned over the last 15 or so years as we've tried to become a total beverage company. And that's what you need to do to help the brand grow, depends very much on its stage of growth. So in the – and Francisco had talked about this at the Investor Day. When you're leader, you've got to make the big decisions. The obvious example here is Coca-Cola. Here you lead the category, it's all about expanding the category's headroom for growth, it's all about capturing the disproportionate share of the value and making sure the brand stays on the cutting edge of what's relevant to consumers and customers, are not resting on your laurels of success.

And I think it'd to be fair to say that over the last 15 years, we made enough mistakes where we applied the same approach we think about for Coca-Cola to some of the other brands which weren't in leadership positions and it's just frankly not as successful. On the left-hand end, where we're just entrants into a category, it's much more of a Disruptive Explorer approach. We need to be much more agile. We need to strip down all the things that you would do because you're only going to do a few things on Coke, you might as well make them good. Well, when you're exploring and when you're entering in a way you need to test and learn. You need to disrupt.

And then once you've found something, that passes the filter of consumers staying engaged with it for a while, you then enter the hardest stage in a way, the stage of the Challenger, where you've got something but you haven't yet got leadership or the scale or the margins to sustain you forever. That's the bit that in the beverage industry tends to be the marathon stage. It tends to be a multi-year journey, maybe five years, maybe seven years, if you succeed. And in that stage, it's critically important to be patient, to be persistent, to be obsessive about finding what it is is the next thing that's going to help this brand gain a little bit more market share, because if it's not gaining share each year, you're largely going to be wasting your time because you'll never get the scale to have the profitability.

So, we've learnt over the years that whilst we've always known that leadership matters, what we've really been developing is the knowhow on how to get brands, how to invent brands, how to invent products that then can be turned into challenges on their way to success. And we fuel that engine, we fuel that engine with three things; world-class innovation, whether it'd be on the marketing side, on the selling and distribution side, on the execution in the store or on the lifting and shifting of ideas around the world. The reality is something that you will be able to succeed within country A has probably already been done in country B or at least something close enough that you can take and make it better. And we use bolt-on M&A. We use bolt-on M&A to fuel the process of bringing in perhaps experiments that have been working that we believe we have the scale, the capital and the patience to take into the Challenger stage and drive them towards leadership or they can be bolted on and used as a way to expand geographically an already existing strategy.

So, we use these levers to accelerate the development of our consumer centric portfolio. And let me just use a few examples of the last couple of pages I've just talked about. Innovation, there's a lot of focus on innovation as I said on one of the earlier slides, we've launched over 500 new SKUs last year just in 2017. And we will continue to drive innovation. We've got innovation on Diet Coke that we talked about. No doubt we'll be talking about how that's going in the next earnings call, but I think it's a very exciting set of innovations. Maybe it won't fix the problem overnight. That would be relatively unusual, but I think it will certainly help to start getting renewed consumer engagement with the brand. We're making innovations in Coke, innovations with flavors, innovations with ingredients all around the world, innovations with brands like Honest, taking it into different categories that it was in before. So, we can leverage innovation not just at the Explorer end of the spectrum, but to maintain the vibrancy of our existing global brands.

We're also more focused on creating premium experiences. We've been blending the idea of premium experiences into what we've been doing over the last number of years, but we're intensifying the focus. Here are couple of examples, one with Topo Chico, the brand that we acquired and are now going to be expanding in the years to come, really a truly successful premium sparkling water. In the markets it's in, it's often category leader.

We've been going around the world, trying other things, whether they be the graffiti that you perhaps can't see, which says VIO, which is a VIO drink in Germany and expanding into other parts of Europe. This is kind of the equivalent of organic on Continental Europe. Very successful launch in Germany, but a premium experience. Re-launch of or the addition of a product line to the Schweppes brand in the UK with a premium mixer range, 1783.

So, more focus on premium, premium not just through smaller, more beautiful packages, but also through the products and through the line extensions of the products. And then innovation in some of our other categories, like the juice drinks and the plant-based drinks. Here, for example, AdeS which we bought, which is Latin America's leading essentially soy-based drink expanding into other parts of the world. Taking that idea and adapting the formulas, adapting the tastes and the benefits of the drinks to each continent's local realities, so much more global expansion to come on AdeS.

The lifts and the shifts, I think the interesting part of this diagram in a way is a couple of things. One, there's more arrows than they used to be, which is a good thing. And if we really put on all the drinks, it would of course be way too cluttered to see. But I think that's the first point.

When I used to run the European business, I used to lament with the management team that something that was successful in one country of Europe had to travel and be successful in every other part of the world before it could go to the second country in Europe, which is obviously a particular characteristic of European management. But I think what you see now is a much greater sense that we can move products around the world. And it's not unidirectional. It's not that we invent them in the U.S. and we send them elsewhere. No, the ideas of the brands are coming from multiple parts of the world and starting to travel around. And I think the strength of the company over time will be the ability to source ideas from any part of the world and have them travel.

So let me talk a little bit then about how we use bolt-on M&A, and a couple of examples. The first one and we've talked a little bit about Jugos Del Valle in the past but I think it's worth just looking perhaps with a different lens of this example. We bought it together with the bottlers in Mexico with Coke FEMSA led it with us. And we bought the whole system in Mexico and Brazil; and then actually we combined it conceptually with a series of other bolt-on M&A's we've made of other juice brands across Latin America. So that we created a platform and we've been able to grow that 5 times the growth since we bought that acquisition, a 17% EBITDA CAGR, a great expansion in the margins.

And part of it was, yes, combining these various bolt-ons and making them more operationally effective, but it was also through the innovation. It was also through the innovation we were able to bring in dairy. So we had a platform with Jugos Del Valle that allowed us to buy into a dairy company in Mexico, for example, with Santa Clara to acquire the soy-based drink in Latin America that I talked about, that we were able to put on top of the Jugos Del Valle platform. The Matte Leão business in Brazil that we were able to put on to the Jugos Del Valle platform and now the premium juices. So, we, through the process of some of these bolt-on M&As, we were able to create a platform from which then to springboard into other adjacent categories, and grow to a clear leadership position in juice and beyond in Latin America.

So that's a process that took well over a decade that clearly turned into real quality leadership and good margins. And it's a process, for example, that we have been replicating in Europe, the example of the Innocent premium smoothies and chilled juices. When we invested in 2009, this was a brand that you probably could say had moved out of the Explorer stage and was into Challenger. It was the number one smoothie brand in the UK and it had about – it was about 20% of the size of the chilled juice leader in Europe, so a little less than 10 years ago. Now it's the number one chilled brand in Europe, because through the investments in stages in that brand and the innovation that we've been able to move from other parts of the world and the capacity and capital support that we can provide, we've turned it into the number one chilled brand in Europe, have grown the revenue by three times and have products across a whole range of categories that allow us to use the master brand approach of Innocent to drive for leadership; still much more growth to come from the Innocent brand.

And all that investment, all that time, all that focus on creating brands, on creating The Coca-Cola Company that is post refranchising, the Coca-Cola Company that's thinking about brands, yes, innovation inside the bottle, innovation in the marketing, but it's engaging now more effectively with its bottling partners. The reformation of the bottling system of almost half the bottling system over the last five years has created an even more well-capitalized, well-motivated, highly capable system of bottlers. And that intersection with our switch from the company side to being even more revenue-orientated than volume-oriented is creating a more effective virtuous circle between ourselves and the bottlers to drive impact to the system.

We are able off the back of creating some bigger bottlers, creating some more capacity for reinvestment to continue to reinvent and rebuild not just the brand and the innovation side with the marketing, but also the execution, the execution in all the different channels that we serve to drive for quality leadership. And that's allowing us to generate funds from the healthy core, the ever more healthy core to push forward the challenges, to reinvent the Explorer so that we continue to renew and rebuild the portfolio that with the system are executing in the marketplace that leads to the winning culture. And I think what you see out there is an energized bottling system together with us winning in the marketplace. There have been many quarters where we have been winning market share on a global basis.

Now, I don't think it would be possible to make all this happening without there being some degree of refocus and re-energizing of our own organization. When we were here last year, we said we would take out some – we would do some restructuring at the corporate head office. Essentially, we said, look, the process of refranchising has got us to a point where we're just simply a smaller company. We've gone from having well over 100,000 employees, 130,000 employees and now we're down to 40,000 employees. We managed almost 40% of the global bottling volume in one way or another.

And post refranchising, we were able therefore to reinvent what the head office of the company could be. We also needed to rethink what the head office of the company could to be based on the way that the digitization of everything is changing what could be done. And then there were just some choices we made. We made some choices around the operating model that we were going to try and direct less from the center, still direct on some things of course, not just governance and compliance on leadership too, but we would push more empowerment with field. So, we made some difficult decisions. We reduced our head office to what we think is highly competitive, lean organization and pushed more empowerment and more accountability to the field.

We did that last year. We've also in the course of the rest of 2017, been updating a number of things, compensation being one of them. We've updated our compensation system, so that truly we are supporting the growth that we want with a compensation system that rewards it. Compensation system based on clear metrics, based on market-based pay. We've moved away from a kind of tenure system. We are now being much more clear we're going to pay to market. And I know that some of the questions have been, well, you removed economic profit, and part of that of course is to simplify and bring our employees closer to the metrics. Then each quarter they know where we stand. And one of the things that we've done anyway is have what we called an M&A look back. So those people who were doing within the organization these bolt-on M&As, we make sure that over time they are held accountable for the success or failure of those individual acquisitions independent of the results of the total business.

And then the last point and probably the biggest point going forward is no amount of organizational structure or compensation update is going to work unless the culture is pushed in the right direction. And we've not attempted to reinvent the wheel, reinvent all the pieces of the culture, simply taking the decision to emphasize four points. Four points that we think will help support our growth strategy, that we want people to feel empowered. Any large organization, institutional company, people will tend to imagine there are more rules than there actually are. There are some very important rules, but they tend to imagine that they have less actual autonomy than they like. So we have to push them to think that they are empowered. We have to push them to be curious. Large organizations tend to look inwards. We have to push them to be curious about the consumers, about the customers, about the way the world is changing. We also have to drive for inclusions. Inclusion in its many aspects, but also inclusion in a sense that it's a huge global system. As I said someone has probably tried something similar or has a piece of the puzzle that you will need to make your idea work already somewhere out there in a system, bring in the other people.

And of course the last idea is not to try and perfect something before it's executed. In this world, it's much easier to have a 1.0 version, go and test it, learn and use 2.0. I'd much rather the research money – market research money was directed to testing things in the marketplace than to hypothesizing forever internally. But importantly, it's the culture, it's a culture that's what's going to drive us forward and be the piece that brings everything together.

So, with that, let me say I think we've got a clear destination. We're going to be a total beverage company. We've underlined and reinforced the piece around accountability and performance driven growth culture, about us the company being a brand focused organization and about our economics being attractive to our shareholders.

So with that, let me hand over to Kathy.

Kathy N. Waller

Executive Vice President, Chief Financial Officer and President, Enabling Services, The Coca-Cola Co.

So thank you, James, and good morning everyone. So, as you've seen from James' presentation, we have a clear growth driver to accelerate our performance in 2018 and beyond. James spoke to how we plan to grow the top line through a disciplined portfolio allocation approach, using our Explorer, Challenger and Leader framework, world-class innovation to support each of the stages of development, leveraging the power of the system to lift and shift winning brands globally and value creative both on M&A.

So I'm going to touch on how we plan to leverage the top line to drive the P&L, as we continue to make disciplined choices while driving productivity and gaining scale longer term on the path to quality leadership. I will also cover our capital structure and allocation framework resulting from stronger earnings growth, less capital intensity and tax reform consideration.

So although, we are focused on where we are going, I believe it's important to remind you of the significant progress we've made in returning to our core. Over the past few years, we have made tremendous strides restructuring our global bottling system and have taken specific actions covering over half of our systems' revenue.

We completed the refranchising of Coca-Cola Refreshments in the United States creating a strong network of local bottlers and addressing long-standing issues around national customer governance, inefficient supply chain, non-contiguous territories and perpetual contracts. These actions have set the system up for success over the long-term. We merged our German bottler with Coca-Cola Enterprises and Coca-Cola Iberian Partners and established Coca-Cola European Partners in Western Europe. And CCEP is already accelerating performance in that market.

We redrew our map in China to create two scale bottlers. And we created a pan regional bottler in Southern Africa with the creation of Coca-Cola Beverages Africa. Each of these significant actions will support the growth of our system for the long-term. And as we near the end of this work, we can clearly see the impact on our financials. While our reported net revenues have naturally declined as we divested these bottlers, strong underlying performance and our ongoing productivity efforts allowed us to manage the impact to profit. These changes are also delivering against our destination as a capital-light organization. Our operating capital has decreased by approximately $12 billion or about a third of our tangible and intangible assets.

So, let's turn to how we intend to build off of the progress that we've made, starting first on the efforts to expand our margins. Last year at our Investor Day, we laid out our goal to continue to drive margin expansion of at least 35% by 2020. As we discussed on our earnings call last Friday, recent changes in accounting treatment will impact our operating margin by approximately 150 basis points in 2018. While this change causes a simple mathematical effect on margins, it has no significant impact on our absolute profit before tax.

Importantly, while the impact of margins is 150 basis points, we are only lowering our 2020 target by 100 basis points, effectively increasing our underlying target by 50 basis points. We will drive margin expansion by finishing the play on refranchising, continuing to drive profitability in sparkling through our revenue growth management initiatives, following a disciplined resource allocation framework as we grow our consumer-centric portfolio, gaining scale longer term as our brands reach quality leadership positions and we will deliver on our previously-announced productivity programs. Going forward, productivity will be a key tool that we use to deliver our results as a productivity mindset becomes part of the company's DNA.

In addition to higher margins, we are also reducing our capital intensity. So post-refranchising, our capital reinvestment needs declined substantially to approximately 4.5% to 5% of net revenues. This will mean a significant decrease in the absolute dollar spend over the long-term. In the near-term, we are investing in digital platforms and foundational infrastructure to support our leaner operating environment and to improve the employee experience; an example being the SAP reimplementation that begins this year.

Further, we are driving initiatives to improve our working capital. The one example is where we extended our payment terms with suppliers in Japan and in the United States. That initiative alone, it resulted in approximately $1.5 billion in savings. And we will expand these initiatives into other markets around the world. These growth drivers accelerating the top line that James spoke to, driving margin expansion and reducing our capital intensity are allowing us to accelerate returns as we have expanded our return on invested capital by over 200 basis points since 2015.

Moving to our capital allocation priorities, we will continue to invest in our business to drive sustainable growth through strong marketing, innovation and appropriate capital spending. We remain committed to growing the dividend, marking this the 56th consecutive year of annual dividend increases. We remain committed as our cash flows have been impacted significantly by currency fluctuations, but the dividend payout ratio has continued to grow. So going forward, we consider it prudent to think about the dividend in the context of free cash flow with a stated target of approximately 75% of free cash flow over the long-term.

To be clear, it is our goal that the dividend will increase annually, however, the rate of the increase will be a function of many factors, including things like currency and economic cycles. Therefore, the 75% target isn't a hard rule in any given year, but it is reflective of our longer-term destination.

As James remarked, bolt-on M&A will be an important element of the strategy going forward, but with clear performance accountability. Given the flexibility provided by tax reform, which will allow us to more easily repatriate cash and better manage our gross debt levels, we are updating our position from Investor Day on share repurchase. While we still intend to at least cover equity dilution at times, if we have excess cash, we could use that cash to buy back shares above just covering our dilutions.

We will deliver these priorities while maintaining a disciplined capital structure framework. We have a target of 2 to 2.5 times net debt leverage, as we believe that this provides the right balance between reaching the optimal capital structure and preserving financial flexibility as we move forward on strategic initiatives.

We currently operate a 3.9 times gross debt leverage and a 2.2 times net debt leverage with a credit rating of AA- from S&P and a Aa3 from Moody's. As we are already operating within our target net leverage range, we intend to use approximately $7 billion of our cash that's held overseas to repay gross debt. Now, this will allow us to reduce the spread between our gross and net debt levels, support our credit rating and continue to access the commercial paper market and reduce our net interest expense. We believe this framework provides the right balance between maintaining financial flexibility and what we believe to be our optimal capital structure.

So, before I close, let me touch on outlook for 2018. Building on the momentum we had last quarter, we plan to accelerate our growth in 2018. We intend to deliver organic revenue growth of 4% within our long-term growth algorithm. We intend to deliver organic revenue growth of 4% as I said within our long-term growth algorithm, but we will continue to drive investments in the business and diligently deliver productivity to increase margins in our underlying results.

These actions along with benefits from tax reform will allow a return to meaningful earnings growth as the headwind from refranchising and from currency start to ease. So, we also expect to significantly improve our cash from operations to at least $8.5 billion next year. This represents over a 20% rebound as we cycle certain cash one-time cost associated with refranchising activities and with the restructuring of the organization that occurred in 2017.

All of these strategies and priorities that James and I've spoken to you today give us confidence in our ability to create long-term sustainable shareholder value. We are a global leader and are building off of a strong foundation. We have clear destination and being a consumer centric total beverage company, driving an accountable performance driven growth culture and returning to an asset light, high margin and high return business. It allows us to deliver on our long-term targets of top tier revenue growth of 4% to 6%, strong operating leverage driving 6% to 8% operating income growth, driving meaningful EPS growth and then improving on our free cash flow conversion.

And with that, I thank you for your attention this morning and we are ready to answer questions.

QUESTION AND ANSWER SECTION

Q

Go over to Bill.

William B. Chappell
Analyst, SunTrust Robinson Humphrey, Inc.
Q

Thanks. Good morning. James, just a little bit more on the new product pipeline and just kind of how the innovation works, I'd say over the past year we've had major facelifts for the Diet segment. And you said that you have 500 new products over the kind of the past year. Is that the right pace going forward? Is there a goal to upgrade 10% of the portfolio every year? Is there something, as you look over the next couple of years, we see that this type of pace or the biggest splashes just happened in the past kind of six months?

James Quincey
President, Chief Executive Officer & Director, The Coca-Cola Co.
A

No, I think couple of thoughts there. The first one is I think we'll continue to see that sort of pace of launches. But I think it is importantly combined with the idea that they don't all live forever. The key is to avoid the turning into zombie products where they occupy space in the mindset and in the supply chain, but they don't grow and thrive. So, I think, yes, we will see that sort of level of activity and experimenting with the consumer, maybe not everywhere in the world, will be like Japan where we launch many each year and virtually all of them are gone. But over time, it builds categories and it builds master brands that will support [ph] mobile (48:48) products. So, it's the churn effect. It's about identifying the ones that can last and getting rid of the rest.

Q

Go ahead Judy.

Judy Hong
Analyst, Goldman Sachs & Co. LLC
Q

Thank you. James I wanted to just get your assessment of the still category performance this year. Obviously that is a clear part of your growth strategy. I think you've exited some low value segments there, but still the performance in some of the still categories seems to be lagging the category growth. So what category cluster do you really need to see more improvement? And particularly markets where the competitive nature might be a little bit different again some of the local brands, how do you compete in markets where that sort of the fragmentation to local brands are stronger.

James Quincey
President, Chief Executive Officer & Director, The Coca-Cola Co.
A

Okay. I could spend a long time answering that question. I'll try a few a few thoughts. The first one is, we saw accelerating improvement through the year. So by the fourth quarter about half the growth was coming from revenue from the stills. The stills clusters are different clusters whereas for the year it was only about a third, so you saw improvement through the year in driving revenue through the different categories. Really saying kind of taking the question down to the next level, really is a question of going by category and to some extent by geography because the dynamics are very different. There's explosive growth in the U.S. on coffee and premium waters, but that's not true in other parts of the world necessarily.

So, I think you have to break it down and that's really perhaps the one summary thought I would make is, you can't look at a country on its own or a category globally on its own. You have to have the intersection of the two, so what's happening in this category in this country and are we competing to gain leadership or not? And if not maybe we're choosing to do something different or not because we're trying them, we got to reinvent what we're doing. And I think that's what you see around the world as we look at what's going on in terms of some of the countries and some of the categories as we're making choices about where to compete or where not to. So less low-margin water and making choice about where to compete, teas, coffees, premium waters, for example.

Unverified Participant

Okay. And we're going to stop there and go to breakout. So, thank you again to The Coca-Cola Company participants, as always.

James Quincey

President, Chief Executive Officer & Director, The Coca-Cola Co.

Thank you.