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MANAGEMENT DISCUSSION SECTION

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All right, we're going to get started. So our next presenting company is The Coca-Cola Company and we're excited to welcome back Coke this year, and representing Coke is Mr. Alfredo Rivera. He's the president of Latin-American Group. Alfredo is a seasoned executive with over 20 years of experience with The Coca-Cola Company, including many leadership positions throughout Latin America, and he's also had 13 years with the Coke bottlers prior to that. So Latin America obviously is a very important region for Coke and one that is coming out of significant market volatility, we've seen some signs of improvement in this region and we really look forward to discussing with Alfredo his outlook for the key Latin American markets.

Mario Alfredo Rivera García
President-Latin America Group, The Coca-Cola Co.

Thank you, Judy. Hello, everyone. Good morning.

Judy Hong
Analyst, Goldman Sachs & Co. LLC

Welcome. So this is a fireside chat. You have the Q&A instruction here, but I'll start with a few questions and then we'll just open it up for Q&A.

QUESTION AND ANSWER SECTION

Judy Hong
Analyst, Goldman Sachs & Co. LLC

Q

So obviously, as I said earlier, Latin America is a very important market for Coke. It's coming out of some of the volatility. So maybe you can just give us your perspective on some of the things that you're focused on, three or four key priorities. You've got obviously new CEO since last year and just you know really three or four key priorities that you're focused on for the next 12 to 24 months?

Mario Alfredo Rivera García
President-Latin America Group, The Coca-Cola Co.

A

Right. I think of the idea of getting back to growth in Latin America as we see the economies stabilizing is a priority. Within that, we're working on accelerating growth in our sparkling category, that's the first priority, particularly making a move towards zero-cal beverages. That's going very well. The reason behind that, and I'm sure we'll get to that later, is around tax and regulatory pressures, but also about consumers moving into that space. We see a clear trend for that. And because zero-sugar beverages are more profitable than full sugar, it actually is a step that's helping us improve margins.

The second priority is around scaling our challenger brands, so – particularly in the still sector, so juices, water, isotonic; scaling them up profitably, increasing their availability. And the third one is around value-added dairy and plant-based. As we enter the value-added dairy space by acquiring four dairy firms in Latin America, and acquiring obviously plant-based beverage company in Latin America last year. So that's what we think will continue to help us – will help us accelerate growth going forward in a more stable environment and from an economic standpoint.

Judy Hong
Analyst, Goldman Sachs & Co. LLC

Q

So let's maybe talk about the macros a little bit. So we talk about more stable environment, obviously different markets and different phases of that economic recovery. So talk about Mexico being more resilient over the last few years, but you've got the election coming up, Brazil seems like it's starting to move up a little bit, but certainly not a big improvement that I think some of us are hoping to see sooner rather than later. And then the markets like Argentina and others, so perhaps you can just go around Latin America and talk about your key markets?

Mario Alfredo Rivera García
President-Latin America Group, The Coca-Cola Co.

A

Well, I guess, a starting point, maybe I've got ahead of myself, the starting point would be the end of the commodity super cycle which happened around 2012, more or less, that impacted the government's ability to attract investment and to capture revenue. In that period, till 2017, 2016, the economies either declined or a very slow growth, putting a lot of pressure on consumers. So consumers were being taxed, now that the government needed revenues; subsidies were eliminated to some degree in some countries, and this created pressure on the consumer. We were, I think, not ready for that abrupt change, we didn't adapt as quickly as we would have liked. Now we've been able to reset our package and pricing strategy to be more relevant in this space.

The stabilization of the economies across Argentina, Brazil in particular, have helped us as we start to see growth now in those markets. But we have a year where we have three elections in the three largest countries in terms of population. So you have the Mexican election coming up on July 1, and then we have Colombia and Brazil later this year in October. And from a political standpoint, in my opinion, we'll be able to adapt to whatever governments come in. I think that the macros will continue to be stable, and whoever wins the election will probably not be able to make significant changes to that stabilization process.

So from a business standpoint I think we're facing stability, it's going to be up to us to really adapt to any changing circumstances and accelerate our growth. But it's a better scenario than it has been in a while in Latin America. So we're optimistic in terms of the environment that should help us accelerate our growth.

Judy Hong
Analyst, Goldman Sachs & Co. LLC

Q

So you talk about it's a better environment. I guess you also could argue that Coke is maybe more nimble and more flexible in meeting some of the challenges that you haven't been able to meet as quickly. So maybe just give us your perspective on how Coke is different today. And you've been with the Coca-Cola Company for a long time, we've heard James talk about Coke being much more of a risk-taking maybe going forward. Just give us your perspective on how Coke is different, how is that relevant to the Latin American region that you're running as well?

Mario Alfredo Rivera García
President-Latin America Group, The Coca-Cola Co.

A

Well, one of the things that we did was to begin to think differently about Latin America. 90% of the population in Latin America speaks Spanish or Portuguese, so we're basically from the same cultural heritage. So we're looking at connecting across geographies. What does that mean specifically for our portfolio is that we are now reusing successful formulations or products across that are successful, whether in Mexico or Brazil, and then moving them to other markets.

In the past, we would redo them. We would take a perfectly good formula that was being successful in Mexico and redo it in another market, let's say Peru, to conform to consumer taste based on some research that we would do.

But as we thought about consumers, consumers are actually interested in more choices and on trying different things. And we saw an opportunity to expand what we call hero products, products that are very successful in one market, and test them in other markets. So we're very focused on reusing versus redoing. To give an example, by the end of this year, we'll have done this in about 20 products across Latin America. That gives us more speed to market. It allows us to focus our resources not on reformulating or on doing more research, but simply putting the products in the market and seeing how they do. And I think that's a big change to how we used to do this.

We're also took a hard look at the number of projects that our business units were working on. And as I mentioned last night, as an example, we took an inventory – we actually asked our associates across the business units what projects they were involved in and then we added it all up. And in one case, in the case of Brazil, we had our associates working on over 500 projects.

When you think about that, there's actually very little impact that you can have across 500 projects. So we actually were able to pare it down to 20, which I still think is a big number. But if you think about how we deploy resources, people and money, around big tickets, big ideas and big initiatives, we really need to focus on less things. And that's been a priority for us across the company. Let's start doing less, prioritizing and focusing on those things that really move the needle for us. And I think that's where I see a significant change in how we're addressing opportunities today.

Judy Hong
Analyst, Goldman Sachs & Co. LLC

Q

I mean, some of those things sound kind of obvious, reducing versus reusing – reducing number of projects some. So I guess, just what's really changed that really allows your organization to change the behavior and the mindset, and when you kind of think about opportunity going forward, where do you think we are in terms of really changing that behavior? Are we 20%, 50% along the way? How much further do you really need to kind of increase the speed and efficiency to meet some of the challenges that you've talked about?

Mario Alfredo Rivera García
President-Latin America Group, The Coca-Cola Co.

A

Well, culture is a tough thing to change, but change we must. So what we've done over the last year was, in the case of Latin America, we actually restructured and reduced our – the number of associates across the business units. And the idea behind that is not only was this an OpEx play where we're cutting costs, but it was actually about changing the way we do things by focusing people on the must – on the priority projects, on those things that must happen.

So part of it has been when you – when – in order to show that we are changing the culture, we had to take make some decisions around how do we want to be structured, what's the organizational structure like, how are we going to work with our bottlers differently. So we've implemented agile projects, not only within business units but across business units with our bottlers, so that we're working with them on big items. So for example, we are revisiting our returnables strategy for all of Latin America, and we have eight people team, four from Coca-Cola FEMSA, in this case, and four from the company working on this project. And the outcome will be to have a clear strategy in how we're going to expand and make this a critical piece of bringing more consumers into our franchise. So the end game is how do we bring consumers, add consumers to our base.

So there are these things that are sending signals across the organization and across the system that we're changing the way we do things. And as you know, in change there is always resistance, but we have to work through that. Whether it's passive or active, there is going to be resistance, which is normal. But I think that we have a mandate, if you will, that we're communicating about being faster to market.

Another example of change is, it would take us about 18 months to go from a zero to launch of a product. In Brazil, we launched a product, a 100% juice and the variants, in 90 days earlier this year. And the mandate, because it is, is we launch products now in 90 days, from zero to launch. It's not easy. That means changing a lot of the processes that we do and changing a lot of the paradigms that people have. But that's part of the work that we're doing to change how we work. And by the way, people are excited, I see associates, particularly the young people, are very excited about working in a different way at Coca-Cola.

Judy Hong
Analyst, Goldman Sachs & Co. LLC

Q

So, maybe let's dig a little bit deeper into Brazil, which obviously has been a challenging market, both macro and the last couple of quarters, volume started to get a little bit better. But I think you want to do much better, so what are you really focused on? What needs to go right, both, I guess – not necessarily from a macro perspective, but in terms of what you're really doing with the bottlers and increasing that affordability that I think you've talked about it in other calls?

Mario Alfredo Rivera García
President-Latin America Group, The Coca-Cola Co.

A

So, the big headline in Brazil for us is that our consumer base actually contracted over the last three or four years. So we're – so the number one priority is to get consumers back into the franchise. As we looked at it, we were not affordable. And part of the problem was that we have a narrow package and pricing offering, and a narrow portfolio in terms of categories that we're playing in. So we basically took learnings that we've had from other markets such as Chile and Mexico and said, okay, I need to broaden my portfolio in packaging and sparkling. So we went through returnables, single-serves, small portions.

So this is a – a product that's in Brazil today. And you can pay R$ 2 for it, so it's about $0.60 more or less. We didn't have that in the market. The importance of the R$ 2 is that's it's a magic price point, it's a bill. It's easy to put out, people have R$ 2 in their pockets. So that type of insight was what's driving our strategy in terms of how do we do pack and price. And again, expanding availability of these packages.

So we've had a couple of quarters of growth now, and we will continue to grow this year. So we're back on the growth side of the business – we're back growing. We just need to accelerate and scale up these initiatives that work.

Judy Hong
Analyst, Goldman Sachs & Co. LLC

Q

So I guess our understanding is broadly in Latin America, the price-pack architecture is much better developed than the U.S. market, but it sounds like within Latin America, Mexico is pretty much ahead, Brazil kind of behind. So what was it about Brazil that was more challenging to kind of get that price-pack architecture more developed, and what initiatives can you really enact this time around to make sure that Brazil catches up to Mexico? Is it really about getting the bottlers' mindset, does Coke have to invest more in that market? What are some of the [ph] synergies (15:05)?

Mario Alfredo Rivera García
President-Latin America Group, The Coca-Cola Co.

A

Yeah, I think the difference is that, historically, Brazil was actually a market similar to the U.S. in that they went to one ways, and basically dependence on two packages, on a two-liter and a can. And this was the case for many years. And what we've been working on is – and again, on broadening that portfolio, which began I would – five or six years ago. So before I even got there, they already began that work. What we're doing is accelerating that expansion, making sure that we put in the manufacturing capabilities and the commercial capabilities to be successful. And that's taking – you know, it does take some time, but I think we're making the right progress.

And again, the challenge in the country as big as Brazil, and geographically and culturally different, is how can we scale this up? So the northeast of Brazil is a very low per-cap, very – even though there's a large part of the population, it's sparsely – it's across a large territory. So distribution is a challenge, different than in the south, or in the larger urban centers in the south. So we have to adapt that and bottlers have to adapt to that, in how they service the market.

Judy Hong
Analyst, Goldman Sachs & Co. LLC

Q

Can you talk a little bit about the portfolio strategy? So LATAM generally is pretty heavily skewed to sparkling, and obviously The Coca-Cola Company has a big initiative to accelerate shift into stills and other growth categories so can you talk broadly about what categories you're really focused on accelerating the growth? And I think initially you talked about scaling profitably in those categories. So how you do that?

Mario Alfredo Rivera García
President-Latin America Group, The Coca-Cola Co.
A

Okay. So I began by talking about sparkling and the need to move to zero sugar. But the second priority around scaling stills profitably, or scaling our challenger brands, has a couple of opportunities that we're addressing. One is around our cost of goods. And the idea is very simple, is we want to be the most competitive around cost of goods than any of the other players, that gives us flexibility. And that comes with a – with rethinking our supply chain and how we're working through our supply chain. So for example, in juices, is one where we have to rethink and are working on changing in order to be able to have – be more competitive around cost of goods.

The other piece is around bringing more innovation in those areas. So in juices, in water, so in hydration we have flavored waters, whether still or slightly carbonated; those are working very well, high margins there. Isotonics, so Powerade has been a big success story in Mexico. It went from being a explorer to challenger brand, and now a leader, in 10 years in Mexico. So that's an example of how we focused the system behind an initiative to create this powerful franchise in Powerade. And that's what we're replicating in the other markets.

In value-added dairy and in plant-based, the approach is different. By focusing on value-added dairy, we're now taking our hero products in value-added dairy from different countries across to the other countries, and that's helping us again on the margin side and the profit side, because we're focusing on the higher-margin products.

And on plant based, on AdeS, which we acquired last year, we've now rolled it out in Latin America. The big opportunity for us – this was a brand that was essentially in supermarkets only, modern trade, and limited to soy with juice. So what we've done is we've launched now almond milk and we've launched chocolate soy milk; they are doing very well. We're growing well, and more importantly, we've entered the traditional trade, which in Latin America is very important and we're gaining scale there. So again, those are drivers of profitability that we're working on that should help us sustain profitable margins going forward.

Judy Hong
Analyst, Goldman Sachs & Co. LLC
Q

So I guess in terms of the impact on your mix, though, because those are presumably lower margin, even if you're trying to scale up profitably versus your core sparkling businesses, so how do you kind of balance that part of it, in terms of the mix impact for the broader portfolio?

Mario Alfredo Rivera García
President-Latin America Group, The Coca-Cola Co.
A

So one of the things that we're being careful about is around single-serve/multi-serve. So if I go back 10 years when we acquired Jugos del Valle in Mexico, we were probably more focused on driving volume growth at the time. And that would then by definition push you into thinking more on how do I sell the bigger packages, a more liquid – which is margin-dilutive, when you think about it. So we've actually gone in the opposite direction. So we're focused on single-serve higher margin products.

The other thing that helps in the overall equation is that we continue to work on productivity constantly, looking for opportunities, you know, whether it's cost of goods or how we operate. And moving to zero sugar or less sugar or less – or eliminating added sugar from juices again has a cost benefit, and is helping us to develop as a consumer that now appreciates products that don't necessarily have sugar.

Judy Hong
Analyst, Goldman Sachs & Co. LLC
Q

What is your mix of your calories, like zero sugar, within your sparkling?

Mario Alfredo Rivera García
President-Latin America Group, The Coca-Cola Co.

A

In sparkling today, it's about 10%. So we have a lot of room to grow. We have, for example, Chile is now at about 30%, 35%, which is a market that's ahead. Ecuador is about at 30%, Argentina is about at 20%, so it varies by market. But our intention is to move quickly to a higher mix of zero cal. There – we have a – all the business units are working on that as a priority.

Judy Hong
Analyst, Goldman Sachs & Co. LLC

Q

And do you have visibility into what the governments are doing? Obviously Mexico a few years ago, what are kind of the lessons learned from government's perspective, and then what is kind of your planning assumption in how many markets we are going to see similar tax increases on sugar drinks or other sugar products?

Mario Alfredo Rivera García
President-Latin America Group, The Coca-Cola Co.

A

Yeah. Today, we're taxed in about 40% of our volume in Latin America. And our expectation, or the way we plan, is that we assume that 100% of our sales will be taxed. The reason we do that is so that we can plan accordingly to make up for that in our plans. And we've been able to do it. But I think our approach at the beginning – and this has been a learning process, and to some degree painful – was that we resisted or denied the need for change at the beginning. And then we realized that actually if we work together with governments and other stakeholders to think about reformulation, to think about how we can actually help around this obesity issue, that would be more constructive. And I think we've made a lot of progress.

But the fact is that we have been taxed, and we've been able to mitigate that impact by changing our portfolio mix. So the case of Chile, the reason that we've been able to move now to 35% mix is basically because we now have only brand Coke Original as a full-sugar beverage in Chile. The rest of the portfolio, which is very broad, is either mid- or zero-cal. So that – so we've been – we've been forced to change, which has been a good thing. You know, it's been a good thing for us. And the approach on how we work with governments and other stakeholders, I think, is more constructive today than when we first began this journey.

For example, in Mexico, we're testing a Coke with reduced sugar, and you may say well that's sort of like a Diet Coke; well, no, it's actually a red-label Coca-Cola that says "original taste with less sugar." And the reason behind that is we want to help consumers start moving into a different space. So we have the Coke Zero Sugar, and now we have this variant, which is doing very well and we plan to continue to expand it in Mexico. We've been testing it for six months with good results. So we've added only one package, and now we're going to expand into another one. And eventually, we think we may go outside of Mexico with this alternative.

Judy Hong
Analyst, Goldman Sachs & Co. LLC

Q

I'm going to see if anyone in the audience has any questions? Alec?

Q

Alfredo.

Mario Alfredo Rivera García
President-Latin America Group, The Coca-Cola Co.

A

Yeah. Hi.

Q

Yes, good morning. The plan on the portfolio shifts into these stills, what have you, requires a lot of packaging initiative and a lot of production initiative. The cold drink to single-serve requires cooler placements, et cetera. So you've got a big ask on the bottling system. The margin structure in Latin America over the past few years, whether macro-driven or not, has come down, and I don't know if that's re-franchising a little bit or what have you, but there's been a low-60s to mid-50s kind of migration. So as you're asking the bottlers to pick up all these capital costs, and you have incidence pricing, are they going to get a return on all that capital that you're willing to fund? And I'd dovetail that with, how do you see your margins progressing as you unfold that program?

Mario Alfredo Rivera García
President-Latin America Group, The Coca-Cola Co.

A

Thanks, Alec. So on the still side, so we have, across Latin America, a joint venture with our bottlers. So we actually share in the investment, in the capital. So we do have a joint venture vehicle across Latin America to expand our stills category, what we now call our explorer and challenger brands, that require more investment as we develop them, and hopefully take them to be leaders, and take leadership in there – in the different categories.

On the sparkling side, we still have some changes in terms of manufacturing versatility around, for example, new technology on refillables that requires investment. At the same time, though, we're improving margins by moving into zero sugar. So there are vehicles that allow margins to improve for the bottler and for us, as we go forward. But at this point, I would say that the returns are there for our bottling system in these different markets, as we move into these new categories, and the opportunity is compelling, for them and for us.

Q

So do you see your margin structure returning to what it was five or six years ago, or is there just a structural shift?

Mario Alfredo Rivera García
President-Latin America Group, The Coca-Cola Co.

A

Well, I don't remember where we were five or six years ago. What I can say for Latin America is that our margins will improve this year relative than last year's. Yes, that will happen. And the – I cannot say we're going to have that trend, I'd love to say we're going to continue on that trend, but that's the intention. And I think that we have a – as we move into zero sugar and it starts – you get to above 30% to 50% mix eventually, that's going to be a key driver for margin expansion. As we look at productivity opportunities, rethink how we're organizing, how we work together with the bottlers, I think there's opportunities to continue to find productivity. So yes, margin expansion is something that we look at constantly. We already have pretty healthy margins in Latin America, I would say.

Judy Hong
Analyst, Goldman Sachs & Co. LLC

Q

Speaking of bottlers, just in terms of other markets within the Coca-Cola system, obviously you went through a big re-franchising activity. Latin America, we haven't seen major activity for some time. Just as you think about the some of the markets like Brazil, where it's a little bit more fragmented in terms of the bottlers versus other markets, do you see a sense of urgency there? What does your ideal kind of bottler system look like in the next five years?

Mario Alfredo Rivera García
President-Latin America Group, The Coca-Cola Co.

A

We're not pushing for any type of consolidation at this point, as long as the bottlers are committed to investing and on being – and that we can agree on what the right strategy is for Brazil. So we don't have a master – to give you an example, we don't have a master plan on how we want to move on consolidation in Brazil specifically. I do think that the investment requirements in order to move to a new place in terms of having a broader portfolio will require these investments, and the bottlers then will have to make a decision, the smaller ones, if they want to continue. But so far they all seem very excited about continuing to invest in Brazil and in their business.

Judy Hong
Analyst, Goldman Sachs & Co. LLC

Q

Question over here?

Q

Are you concerned at all about local brands taking share? This is something that Colgate just reported in their earnings that, in Latin America in particular, they're seeing the incumbent advantage erode a bit and coming under attack from local brands, similar to what's happening to a lot of CPG companies in the U.S. I'm curious if that's something that you're concerned about, or if you're proactively trying to defuse that?

Mario Alfredo Rivera García
President-Latin America Group, The Coca-Cola Co.

A

Well, I'm always concerned about competitors, so that's just a normal way of looking at it. But what's happening is, in my experience and what we've seen, is that during downturns in the economy, these lower-priced, lower-margin brands pick up some steam as consumers trade down. Now they trade down because we're not giving the options for them to stay in the franchise. And the options exist. Unfortunately, we haven't executed them as well as we could have or, Brazil being the example, is we were doing returnables but we didn't do it as broadly or as deeply as we needed to do, and that's what we're trying to change.

But those players will continue to be there. We don't think – as the economy in Latin American continues to improve, it will get more difficult for them – I think, this is my opinion – as consumers start back, going back to brands. At least that has been the – what's happened in the past, so I'm assuming that's going to happen. But for us is, the priority is are we relevant with consumers? Are we really increasing our consumer base? And that has to be with the right brand, pack architecture – price architecture in the market, to make sure that we continue to grow our consumer base.

Q

Just to quickly follow up, are you concerned at all that local players might go upmarket and not just be a threat at the economy level?

Mario Alfredo Rivera García
President-Latin America Group, The Coca-Cola Co.

A

Actually, that's happening. That's an excellent question, because it's happening. In Brazil, for example, if you go into modern trade, in the supermarkets, you will see high-end juices. You see a little bit of cold-pressed. Not big, but you start seeing 100% juices, or not-from-concentrate juices that are locally produced with a high price, you know, a premium price. So those players are there. We have a strategy to be in that space also that we're executing. But there, you can see that there is a growth in the number of players in that space, which is a challenge for us, and we need to get better at being able to compete in that space. But you're absolutely right, that's happening.

Judy Hong
Analyst, Goldman Sachs & Co. LLC

Q

What about the retail dynamics that – you've talked about modern trade, but just in terms of e-commerce and other kind of threats that you see in that – in your markets?

Mario Alfredo Rivera García
President-Latin America Group, The Coca-Cola Co.

A

Yes. It's – well, the e-commerce is very interesting because it's actually growing in Latin America. It's still not at a level of North America, but we can take the learnings from Europe, North America and China – China particularly because China is actually way ahead in this.

In Brazil, the advantage – I see it as an advantage – our business unit president ran China for four years, and we actually have an e-commerce platform that's doing very well. We've actually – are learning quite a bit, so I mentioned to you last night, we've found that half of what we sell in terms of sparkling beverages are zero cal beverages in e-commerce, versus 11% in the open trade. So there is a – so there's a big difference. Same thing with – as you think about sparkling as part of the portfolio, it's higher in e-commerce than in – so there's something going on there that actually encourages us to think, on the one hand, that e-commerce is a good opportunity, but also is that consumers are moving to zero sugar space, and that we need to continue working on getting better at offering consumers choices around that. So e-commerce is important.

The other thing we've done than around the digital space is we've created a digital teams in each PU, and now we're centralizing that so that we have a one approach across Latin America on digital, not only on our commercial end, but also looking for opportunities on the supply chain where we can work with bottlers, bottlers are making important investments around digitizing their businesses also.

Judy Hong
Analyst, Goldman Sachs & Co. LLC

Okay. I think we're out of time at this point. So thank you, Alfredo, for your insights and wish you good luck.

Mario Alfredo Rivera García
President-Latin America Group, The Coca-Cola Co.

Well, thank you very much, Judy. I appreciate it. And thank you all.