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The Coca-Cola Co. (KO)

Business Update Call - Financial Modeling

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MANAGEMENT DISCUSSION SECTION

Operator: At this time, I'd like to welcome everyone to the Coca-Cola Company's 2019 Financial Modeling Conference Call. Today's call is being recorded. If you have any objections, please disconnect at this time. All participants will be on listen-only mode, until the formal question-and-answer portion of the call.

I would like to remind everyone that the purpose of this conference is to talk with investors and therefore questions from the media will not be addressed. Media participants should contact Coca-Cola's Media Relations department, if they have any questions.

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

Timothy K. Leveridge
Vice President & Investor Relations Officer, The Coca-Cola Co.

Good morning and thank you for joining us today and thanks for coming back for some of you that are joining as well. I'm also joined by Lee Coker, our Director of Investor Relations. Before we begin, I'd like to inform you that you can find supplemental materials on our website that support our prepared remarks this morning.

Also, I'd 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've 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 during this morning's discussion, to our results as reported under generally accepted accounting principles. Finally, during today's call, when we refer to comparable performance, we are referring to comparable performance from continuing operations.

So, earlier today on our earnings call, James and John discussed our outlook for 2019, including 4% organic revenue growth, and 10% to 11% comparable currency-neutral operating income growth. They also made some additional commentary on items such as structural and acquisitions, currency interest and tax. And the goal of the call this morning is to talk about those points in greater detail. For the call this morning, there are three main objectives: first, to cover the net impact to our operating segments from several transactions impacting 2019, and how to think about incorporating them in your existing models; second, we'll provide additional information to frame your thinking on currencies and below the line items and their phasing throughout the year; and finally, we'll provide plenty of time to cover follow-up questions you may have.

So, starting with the changes in our business on slide 4, many things happened in 2018 and in early 2019 that will affect how our business will operate. These changes fall primarily into three buckets: number one, the acquisition of Costa and the creation of Global Ventures; second, structural changes to our Bottling Investments segment, including both bottling divestitures and an acquisition; and finally, impacts to our geographic operating segments including the acquisition of Chi.

Taken together, we expect the net result of acquisitions, divestitures and structural changes to be an 8% to 9% benefit to comparable currency-neutral net revenues and a low-single-digit benefit to comparable currency-neutral operating income. The majority of these benefits are expected to be derived from Costa.

So, let's start with Global Ventures on slide 5. As we announced in October, we created Global Ventures with the goal of scaling brands, acquisitions and investments as well as identifying and nurturing future of fast growing opportunities. Initially, the segment will consist of four businesses: Costa, our newly acquired coffee platform; Monster, our global partner in the energy drink category; innocent, our finished goods juice and smoothie business in Europe; and Doğadan, our non-ready-to-drink tea business in Eurasia.

And just for a couple of clarifications, for Costa, it will consist of all operations except for ready-to-drink. The ready-to-drink business will flow to the existing geographic operating segments. And for Monster in Global Ventures, we will record the revenue and profit we receive from fees earned through the distribution, coordination agreements. However, the equity income stemming from a minority investment in Monster will continue to be recorded in our Corporate segment, so no change there.

We believe each of these brands requires a special focus to unlock growth on a global scale, but we will continually evaluate if other brands should be added to this segment over time. Also these existing brands have been running as separate businesses and we see the value of keeping them connected, but not integrated. Now given that we just closed Costa and in the process of setting up the reporting for Global Ventures overall, we do not have the revised financials of the segments at this point. However, we do commit that before we report our first quarter 2019 results, we will provide the revised operating segment financial information reflecting this change.

To be clear though, we will not be providing historical base financials for Costa. It will contribute only to 2019 when we report benefiting the segments' comparable growth rates. When we provide revised operating segment financial information, we will be happy to walk through with you any questions that you might have as well at that time. For the time being, I would suggest setting up your models to include Global Ventures segment 2019 that would include your estimates for Costa. When we provide revised segment information, you can simply pull the right numbers out of the geographic operating segments and move them to the Global Ventures segment at that time.

So now on slide 6, let me add a little color on Costa for your modeling. While we are not providing pro forma numbers on Costa, you have access to the public historical segment data of Whitbread to give you context on the historical size of the business. Besides the information provided there, let me provide a few additional factors that should help in building out your numbers.

First on gross profit, the existing Costa business has gross margins that are generally in line with our comparable consolidated gross margins in the low to mid-60s. Second, the seasonality of the existing Costa business tends to skew toward the fourth quarter, given the colder weather and the holiday season. And finally, from a CapEx standpoint, we do expect to step up investments, as we look to grow the footprint beyond retail. As you would expect, we see tremendous opportunity to build out the platform and with attractive returns that capital employment will be a good investment. We know that the Global Ventures segment is one of the most pressing topics for those trying to model our business and hopefully this provides some needed color.

Now turning to slide 7, the structural changes in our Bottling Investments segment. We've refranchised three company-owned bottlers at different points during 2018. CCR Canada, which closed at the end of the third quarter as well as Guatemala and Uruguay, which both closed during the second quarter. In 2019, for the Bottling Investments segment, each of these bottling transactions will represent a structural headwind to the P&L up until we cycle the closing. The other major bottling transaction was the acquisition of the Philippines bottler towards the end of the fourth quarter of 2018. This will represent a structural benefit to revenues for the Bottling Investments segment in 2019 until we cycle the closing.

Taken together, we expect a net benefit to revenues for the Bottling Investments segment almost entirely in the fourth quarter of 2019 due to the difference in timing of the Canada and the Philippines transactions. We also expect a net negative impact to operating incomes for the Bottling Investments segment, primarily due to re-franchising of profitable bottling operations. The consolidated impacts of these bottling transactions are incorporated into our overall comparable currency-neutral operating income guidance, as part of the low single-digit benefit to acquisitions, divestitures and structural items.

Turning to our geographic operating segments on slide 8. Besides the Global Ventures' impacts we covered, in EMEA, we also acquired the remaining interest in Chi at the beginning of 2019 and therefore, we'll begin to consolidate the results this year. Chi is recognized in West Africa as an innovative fast growing leader in expanding beverage categories, including juices, value-added dairy and iced tea. Given the finished goods nature of the business, you can incorporate a modest benefit to EMEA's revenues in 2019 with limited impact to operating income as a result of this acquisition.

Now that we covered the structural and acquisition considerations, you should be able to better model the currency-neutral P&L through operating income. So let's turn to the headwind between our comparable currency-neutral operating income guidance and our comparable EPS and the impact of phasing. This gap can mostly be attributed to worsening currency headwinds, increases in net interest expense and an increase in our tax rate in 2019.

So, turning to slide 9 and starting with currency, the dollar strengthened throughout 2018 creating year-over-year currency headwinds at the current spot rates. The greater of these headwinds phase more towards the beginning of 2019 as evidenced by a 10% to 11% expected currency headwind to operating income in the first quarter. Furthermore, we had hedging gains on the euro in 2018 that we will be cycling in 2019. Collectively, the total headwind represents a 3% to 4% impact to revenue and a 6% to 7% impact to operating income for the full year. At the same time, the Federal Reserve increased its benchmark rate four times in 2018, once every quarter, putting upward pressure on our interest on floating and refinanced debt, even before contemplating any further potential hikes in 2019. This headwind will also phase more towards the beginning of 2019 due to the timing of the quarterly rate increases. Additionally, the reduction in cash associated with our acquisition of Costa at the beginning of 2019 will result in lower interest income and affect the overall net interest expense.

Finally, while we got a significant tailwind from a reduction in our effective tax rate from 24% in 2017 to 18.7% in 2018, we expect our rate to slightly increase from 18.7% to 19.5% in 2019, representing about a one-point headwind to our full year comparable EPS. And due to the phasing of our quarterly tax rates in 2018, we expect a slight tailwind in the first half more than offset by headwinds in the back half of 2019, as we lap the timing.

Finally, as we discussed on the earlier call, the tax rate is definitely subject to change due to volatility both for the quarter and the full year. Regarding the de-leverage phasing, the currency and interest headwinds will disproportionately affect the front half of the year, while the tax headwind will mostly be a second half story. Taken all together, the headwinds are stronger in the first half.

So in summary on slide 10, our underlying business is strong as evidenced by our outlook for solid 4% organic revenue growth in the conversations we had this morning about the many underlying elements we have in the business. The top line growth, our continued productivity and the benefit from our global coffee platform acquisition are expected to result in 10% to 11% comparable currency-neutral operating income growth. Despite headwinds from currencies, interest rates and taxes, we expect to deliver comparable EPS in our stated range of plus 1% to minus 1%.

So on slides 11 and 12, you can find details of our 2019 outlook from our earnings release this morning with just a clarifying point to make. Historically, we have not given quarterly guidance on operating income from non-bottling acquisitions and divestitures. Consistent with this practice, our quarterly outlook for structural impacts to operating income does not include such acquisitions and divestitures, most importantly Costa. And I wanted to make that point, so it's clear as you're looking at your modeling. Finally, in the first quarter of 2019, we will have one less day when compared with the first quarter of 2018.

So with that operator, we're now ready for questions.

QUESTION AND ANSWER SECTION

Operator: Thank you. [Operator Instructions] Our first question comes from Bonnie Herzog with Wells Fargo. Your line is now open.

Timothy K. Leveridge
Vice President & Investor Relations Officer, The Coca-Cola Co.

A

Hey, Bonnie.

Lee Coker
Director-Investor Relations, The Coca-Cola Co.

A

Bonnie?

Sam Reid
Analyst, Wells Fargo Securities LLC

Q

This is actually Sam Reid filling in for Bonnie here. Thanks so much for taking my question.

Timothy K. Leveridge
Vice President & Investor Relations Officer, The Coca-Cola Co.

A

Sure.

Sam Reid
Analyst, Wells Fargo Securities LLC

Q

I wanted to ask a little bit about that euro hedging that you mentioned earlier and the reversal there, just wanted a little bit more color on that. And then curious, if there are any other reversals that we should be aware of like that for the remainder of 2019 that might also be impacting that difference between your op income guidance and your EPS guidance?

Timothy K. Leveridge
Vice President & Investor Relations Officer, The Coca-Cola Co.

A

Yeah, so and thank you for asking the question. In short, yeah, we definitely benefited from some hedging gains in 2018, the bulk of those were driven through the euro as we talked about. So, the effect of what you're seeing is as we benefited from those gains in 2018, what it meant was our currency headwind in 2018 was actually less than what it would have been on a spot rate basis. Now, as we get to 2019, we're obviously going to lap the benefits of those gains in 2018. And that's where we're seeing a headwind associated above and beyond what we're seeing through just the spot rate increase or spot rate changes year-over-year.

And I know I've talked to several of you this morning and I think what it gets down to is that's probably some of the drivers of currency coming in a little bit worse than you all had expected in the models. But that's part of our- kind of stepping back, that's part of our overall hedging policy that the treasury team has done a great job over the years in terms of making sure that we're balancing risk and the cash flow of the company. And so at times when you see a multiyear dollar trend in the direction it has, you just ultimately end up with some of these hedging gains flowing through into the next year, creating headwind.

Sam Reid
Analyst, Wells Fargo Securities LLC

Q

Got you. No, that's very helpful. Thank you so much.

Timothy K. Leveridge
Vice President & Investor Relations Officer, The Coca-Cola Co.

A

You got it.

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

Timothy K. Leveridge
Vice President & Investor Relations Officer, The Coca-Cola Co.

A

Hey, Robert.

Robert Ottenstein
Analyst, Evercore ISI

Q

Hey, guys. Hey. This isn't strictly a modeling question, but it's related to this but – and we can take it offline if you want to, but I'm trying to understand a little bit better, why you feel the need or why you think it's desirable for the Global Ventures business to be a separate reporting segment rather than something which you kind of put them together a little bit and there's somebody overseeing it; why do you think it needs to be a separate reporting segment?

Timothy K. Leveridge
Vice President & Investor Relations Officer, The Coca-Cola Co.

A

Well, there's two reasons. Number one is, the focus ultimately comes down to how do we want to run the business. And clearly as we talked about on the call and as James talked about previously is, there is definitely a need to have a function that's doing the thing that Global Ventures is going to do. And I won't go through all the points, because we talked about them a few times now. But that is part of how the business is going to be structured going forward. And then there is an element of, if that's the case, then it becomes some accounting implications associated with that. And effectively, if you're going to run the business that way, it's important, and the SEC has required that we also report externally that way.

And so, obviously we want to set the business up the way that we think makes the most sense. And then of course the accounting implications follow that. And so that's why, it's being set up as a separate reporting segment overall and be reported that way. The other element of it though – that's kind of the step number one, the other element of it though is, is that it actually, it's something that we also want to be able to provide some level of transparency for you all, as you're thinking about the business, because if you think about what's going into Global Ventures, there are actually quite a few different business models, and some of those business models can conflict with the underlying geographic operating segments, in terms of understanding margin and mix variances from both the top line and the bottom line.

And I think as we do that, I think what that's going to help is, create some clarity around what's driving the underlying geographic core part of the business, create some transparency around Global Ventures, so you can understand and know we're driving that business. And then obviously we'll keep BIG under the same context. And as we think about moving forward, it's then going to be, how do we drive the margin characteristics of each of those businesses, given that they're kind of different in nature, because of what they do, and that hopefully will also provide some better insights for you all as you're thinking about the overall...

Robert Ottenstein
Analyst, Evercore ISI

Q

And why is BODYARMOR not in it?

Timothy K. Leveridge
Vice President & Investor Relations Officer, The Coca-Cola Co.

A

Because number one, it's more geared and focused towards North America and is the primary driver of it. So, as we thought about what are the Global Ventures that we have associated with it, because it's geared now towards mainly North America in terms of our investment in it. That's why it was not included.

Robert Ottenstein
Analyst, Evercore ISI

Q

Okay. Thank you.

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

Judy Hong
Analyst, Goldman Sachs & Co. LLC

Q

Thank you. Hey, everyone.

Timothy K. Leveridge
Vice President & Investor Relations Officer, The Coca-Cola Co.

A

Hey, Judy.

Judy Hong
Analyst, Goldman Sachs & Co. LLC

Q

Hey. So, the Costa acquisition impact, so when you guys talked about the 8% to 9% revenue impact that gets to, I guess, somewhere around close to $3 billion, maybe $2.7 billion. And if I kind of look at the Costa historical P&L, I think it's around $1.7 billion, $1.8 billion, so is the difference kind of the others – impact from the Bottling Investments and others, or are you actually expecting a pretty decent growth out of the Costa business in 2019?

Timothy K. Leveridge
Vice President & Investor Relations Officer, The Coca-Cola Co.

A

So, Judy, the primary difference is coming from the net impact of the BIG transaction. So, as we talked about that you have the Philippines coming in and Canada going out along with Uruguay and Guatemala, the net effect of those is a net benefit to revenues. As we talked about that's primarily going to flow through the fourth quarter and then you also have a little bit of Chi in that number as well. So, if you put the combination of those two that's what the drivers are of the difference.

Judy Hong
Analyst, Goldman Sachs & Co. LLC

Q

Okay. And then on the Costa acquisition, I think in prior meetings, we may have talked about potentially a lease accounting impact. So I'm just wondering if that is incorporated in the interest expense guidance or anything that is sort of part of the 2019 guidance?

Timothy K. Leveridge
Vice President & Investor Relations Officer, The Coca-Cola Co.

A

Judy, that's a great question. I'll have to check on that. I don't know immediately off the top of my head, how we accounted for or how the lease expense was running through. But let me check on that and we can get back and give you a heads up on that or I'll give you an update on it.

Judy Hong
Analyst, Goldman Sachs & Co. LLC

Q

Okay. Because maybe that also explains some of the interest expense going up more than what I think people expected on a year-over-year basis [indiscernible] (20:21)?

Timothy K. Leveridge
Vice President & Investor Relations Officer, The Coca-Cola Co.

A

Yeah. What I would say is I don't think that was the big driver. The big driver is I mean Costa is a driver of it, but it's really the investment associated with the fact that we're going to lose the interest income on the cash. We're using plus the – obviously the overall net effective interest rates on the debt portfolio, because of the rising interest rate environment and our mix of long and short-term debt.

Judy Hong
Analyst, Goldman Sachs & Co. LLC

Q

Okay. And then just on the FX clarity, so the hedging gains are, I guess, booked as part of your operating income within geography? So, this isn't like the re-measurement gains that we've had in previous years that got booked below the operating income line and you kind of have to lap that on a year-over-year basis. Is that kind of the right way to think about this because it's immediate impact, right?

Timothy K. Leveridge
Vice President & Investor Relations Officer, The Coca-Cola Co.

A

Yeah, that's correct. That's correct, yeah. These hedging gains would be to offset translational effects in the P&L above the OI. And so part of it – and this is – I'm glad you brought it up, because this is also a clarification because these gains actually flow into revenue and OI, but they flow through it basically at the same level. So, that's why you see that's one of the drivers of the kind of multiplier effect between revenue FX impact and OI FX impact, because it's clearly at the revenue line, because the absolute dollars are about the same. The margin impact is much higher at OI, because of those gains. So that's the other thing, as you're kind of thinking through this that's important to keep in mind. But the re-measurement gains that you referenced is, yes, we do have those from time-to-time, but those flow through the other income and are balance sheet related, and that's not what we are referring to here.

Judy Hong
Analyst, Goldman Sachs & Co. LLC

Q

Got it. Okay. And then, sorry, my last question, just in terms of ...

Timothy K. Leveridge
Vice President & Investor Relations Officer, The Coca-Cola Co.
A

Not a problem.

Judy Hong
Analyst, Goldman Sachs & Co. LLC
Q

...the impact on kind of gross margins in 2019 from some of the structural items. So, it sounds like Costa is more of a neutral impact, but clearly you have some of the negative impacts from the Bottling Investments?

Timothy K. Leveridge
Vice President & Investor Relations Officer, The Coca-Cola Co.
A

Correct. That's correct.

Judy Hong
Analyst, Goldman Sachs & Co. LLC
Q

So, reported basis, a net negative, and then if you kind of – so we have to adjust with some of the structural impacts if we think about the underlying gross margin trajectory?

Timothy K. Leveridge
Vice President & Investor Relations Officer, The Coca-Cola Co.
A

Yeah. So, I think there's a couple of things I would say about gross margins on a comparable basis. You're definitely going to have pressure from the bottling transactions again mainly because of the timing of the Philippines and Canada. You've got more revenue, but it's going to definitely have an offset or an impact on gross margins. The other thing that's important to consider is, is that, that margin impact that flows through on operating income, because of the delta between the net revenue and the OI currency impact, also has a similar effect on gross margins.

So as you think about kind of modeling out your gross margins, you've got to remember that currency also is having a pretty big effect on our comparable gross margins as well. But you put those two together and those are going to definitely put a headwind on the comparable gross margin, and then you have – of course, as we talked about before, you've got portfolio mix of the business both from a geographic and a category basis that we're managing against and focus on.

Judy Hong
Analyst, Goldman Sachs & Co. LLC
Q

Got it. Okay. All right, thank you.

Timothy K. Leveridge
Vice President & Investor Relations Officer, The Coca-Cola Co.
A

Sure. Yeah. Thank you.

Operator: Thank you. And our next question comes from Bryan Spillane of Bank of America. Your line is now open.

Bryan D. Spillane
Analyst, Bank of America Merrill Lynch

Q

Hey. Good morning, guys.

Timothy K. Leveridge
Vice President & Investor Relations Officer, The Coca-Cola Co.

A

Good morning.

Bryan D. Spillane
Analyst, Bank of America Merrill Lynch

Q

I guess a couple, first, just back on net interest expense, I guess if you just kind of take the pieces around it in the guidance, you plug in the tax rate and what's implied in operating income, net of currencies, it ends up – you end up at around $500 million or so of net interest expense. I just want to make sure that ballpark, that's kind of what we're looking at?

Timothy K. Leveridge
Vice President & Investor Relations Officer, The Coca-Cola Co.

A

Yeah, I think that's right. If you look at the year-over-year increase from where we were to where we're going given that that's effectively most of the de-leverage, yeah, that's what you're going to back into.

Bryan D. Spillane
Analyst, Bank of America Merrill Lynch

Q

Okay. And then I guess the moving parts within that, right, i.e., part of it is as you've repatriated cash, there's less net interest income and part of it is the effective rates. I think you've got some debt coming due like maturing this year. So, if you roll that over, is that contemplated in the net interest expense guidance or is there something – if you refinance, is there a chance that that number could change, the net interest guidance?

Timothy K. Leveridge
Vice President & Investor Relations Officer, The Coca-Cola Co.

A

Yeah. So, kind of taking that in reverse order. So, the question you had about the refinancing, that's built into the expectation. So if you look at purely just increase in rates, it wouldn't get you all the way there. But then because exactly as you said, we're going to roll over and because we're going to be rolling over from lower rates to higher rates, just because of the nature of the timing, it'll also push the overall net interest expense up because of that. And then you just layer the overall increased rates on a variable rate debt and it's going to push that up.

And then the other piece I would add is, is that on two things around interest income is, and I don't know that everyone always kind of factors this in, is the Costa piece of it and that's clearly going to be a reduction in interest income, and as I think you know, but just for clarity for everyone listening, because of the nature of where some of our cash is held, we're usually generating fairly decent interest rates on that cash. And so, the loss of that just with the acquisition is, it's another component of it.

And then finally, I think you mentioned about paying down debt last year, certainly that was a move from cash into a lower overall particularly long-term debt portfolio. While it brought down our long-term debt, there was also the loss of the interest income associated with it as well. So, all of those factors kind of play into why that overall net interest is moving up to the level that it is.

Bryan D. Spillane
Analyst, Bank of America Merrill Lynch

Q

Okay. And then I guess as a follow-up I guess on the question that Judy asked about just the impact of acquisitions and divestitures, I just want to make sure it's clear. Roughly 9% impact on revenue is about $2.9 billion. And let's just assume for simple math sake that Costa is roughly $2 billion. So, there's an incremental roughly $900 million that comes in which is net what's coming in I guess mostly from the Philippines, a little bit from Chi, but did you say that as we kind of look at where all of that comes in the incrementality, all hits in the fourth quarter, so it'll be kind of neutral all year and then there'll be a much larger sort of net impact on I guess Bottling Investments Group in the fourth quarter?

Timothy K. Leveridge
Vice President & Investor Relations Officer, The Coca-Cola Co.

A

Yeah. Well, you have – to be fair – Chi will come in across the board, but to be fair, it's fairly small in the grand scheme of things. So, I don't want to imply that it's going to be a big driver. But that differential is, as you said, is primarily going to come in, in the fourth quarter. So, they're going to offset each other for the most part and then you get into the real timing difference between really Canada and the Philippines. It's into the fourth quarter.

Bryan D. Spillane
Analyst, Bank of America Merrill Lynch

Q

Okay.

Timothy K. Leveridge
Vice President & Investor Relations Officer, The Coca-Cola Co.

A

And for what it's worth, I feel the obligation to say this, because I think it's important to back to kind of the Judy's question about the Costa coming in. I also don't want to leave the impression that we don't have any intention to grow the Costa business. So, I don't want to leave anybody with that impression that we're just going to bring it in and not expect to be able to expand the opportunities there. But the reality of it is if you just look at absolute dollars, the BIG transactions are going to have more of an effect.

Bryan D. Spillane
Analyst, Bank of America Merrill Lynch

Q

Yeah. Okay. That helps. And then I guess another one was just on the Monster fees, is we're kind of going to strip those into the new segment, do those fees flow through revenue or do they flow through like gross profit? Is it an addition to revenue or does it just come thought the profit line?

Timothy K. Leveridge
Vice President & Investor Relations Officer, The Coca-Cola Co.

A

It's in addition to revenue.

Bryan D. Spillane
Analyst, Bank of America Merrill Lynch

Q

Okay.

Timothy K. Leveridge
Vice President & Investor Relations Officer, The Coca-Cola Co.

A

And it then flows down into the P&L. So, it's obviously very high margins [indiscernible] (29:47).

Bryan D. Spillane
Analyst, Bank of America Merrill Lynch

Q

Okay. And then I guess just the last one for me is I guess as we're thinking about the share repurchases, just want to make sure we're clear on this, it's not contributing at all to EPS. So whatever you do is you're just going to try to hold the share count like flat year-over-year, is that the idea?

Timothy K. Leveridge
Vice President & Investor Relations Officer, The Coca-Cola Co.

A

That's correct. Yeah. So, we're going to cover the dilution from employee stock-based compensation and the exercise of the shares. So, we do not expect an – well, we don't expect an increase or a decrease in the share count as a result.

Bryan D. Spillane
Analyst, Bank of America Merrill Lynch

Q

Okay. And then just one last one, I think on the call you said that the incremental productivity is going to be $600 million in 2019. I guess for some reason I had the impression it must be closer to $800 million based on where we thought 2018 was going to be. So, did you actually pull more cost savings into 2018 than you originally expected?

Timothy K. Leveridge
Vice President & Investor Relations Officer, The Coca-Cola Co.

A

We did. We did and that was part of the benefit, because if you remember when we originally guided 2018, we said $800 million to $900 million kind of on an underlying organic OI basis. We ultimately ended up at $1,100 million. And part of the benefit associated with that was some of the pull forward of that productivity. And that's where you get to the differential between exactly what you're thinking and what we had talked about before of about $800 million for 2019 comes down to closer to $600 million because of that pull forward.

Bryan D. Spillane
Analyst, Bank of America Merrill Lynch

Q

Okay, great. All right, I'll leave it there. Thanks guys.

Timothy K. Leveridge
Vice President & Investor Relations Officer, The Coca-Cola Co.

A

You got it. Thanks, Bryan.

Operator: Thank you. And our next question comes from Ian Gordon with Bernstein. Your line is now open.

Timothy K. Leveridge
Vice President & Investor Relations Officer, The Coca-Cola Co.

A

Hi, Ian.

Ian J. Gordon
Analyst, Sanford C. Bernstein & Co. LLC

Q

Hey guys. I'm still a little confused about the hedging, if I pulled in the right numbers out, you had last year a 1% headwind to revenue and a 5% hit to OI, I think you're kind of alluding to the impact on the multiplier, but maybe you can just walk me through again how that hedging actually helped you there given that?

Timothy K. Leveridge

Vice President & Investor Relations Officer, The Coca-Cola Co.

A

Yeah. So, you kind of get into a multi-year implication from all of this, so if you look at 2018 versus 2017, we were actually lapping gains in 2018 from 2017. So part of that multiplier effect was lapping the hedge gains from 2017 which was contributed to that differential. Now keep in mind, the one thing that's important is that even if there were no hedge gains plus or minus, there would always be a multiplier effect because of the nature of the way our margins are between international and North America. So again, the U.S. has more revenue per case, but it has lower margins. International is kind of the other way, it's less revenue per case but higher margins. And so, the impact of this, the natural effect of the currency flowing through is going to mean that the currency effect on revenue is going to be less than the currency effect on OI. But then you layer in the hedge gains or the hedging components of it year-over-year.

So in 2018, we were lapping what we had in 2017. We also benefited from gains in 2018, but that was still more than offset by lapping the hedge gains in 2017. So as we get into 2019, we're now lapping the hedge gains we had in 2018. And those amounts are what is, if you were just kind of running a pure spot year-over-year, the differential of the spot impact in 2019 versus 2018, that differential is coming from the hedge gains we had in 2018.

Ian J. Gordon

Analyst, Sanford C. Bernstein & Co. LLC

Q

Okay. Yeah. I think that makes sense. Is there any reason to think that the impact on EPS or net income or anywhere below OI because I don't think you break out the FX impact from that is meaningfully different. I guess maybe you have these working capital revaluations periodically, but roughly should we assume similar impact to EPS versus OI?

Timothy K. Leveridge

Vice President & Investor Relations Officer, The Coca-Cola Co.

A

Yeah. It usually flows fairly similar. Sometimes, there's a little bit of a difference due to how things flow through on equity income and then depending as you mentioned about re-measurement gains. But for the most part, they're generally running in line.

Ian J. Gordon

Analyst, Sanford C. Bernstein & Co. LLC

Q

Okay, great. Thanks. One other on, just thinking about the net interest expense longer term, I guess historically your effective rates on cash have been very high, your rates on debt has been very low, your net interest has been fairly small. As we think about having repatriated some cash from the higher interest jurisdictions, using the cash for Costa in 2019 and beyond, I guess should we just assume maybe somewhat of a more normalized difference between the interest income and the expense?

Timothy K. Leveridge

Vice President & Investor Relations Officer, The Coca-Cola Co.

A

Yeah. I think that's probably a fair assumption. I think as interest rates – we've been moving into a higher interest rate environment. I think it's fair to say that those have been going up – the effective interest expense associated with our debt has been moving up a little bit faster than the effective interest rate on our income.

And then you factor in just the reality of we have less cash, because we've been converting some of that cash into lowering the net debt as well as obviously investing in things like Costa.

Ian J. Gordon
Analyst, Sanford C. Bernstein & Co. LLC

Q

Got it. Okay, thank you.

Timothy K. Leveridge
Vice President & Investor Relations Officer, The Coca-Cola Co.

A

You got it.

Operator: Thank you. And our next question comes from Amit Sharma with BMO Capital Markets. Your line is now open.

Amit Sharma
Analyst, BMO Capital Markets (United States)

Q

Hi, good morning, guys.

Timothy K. Leveridge
Vice President & Investor Relations Officer, The Coca-Cola Co.

A

Good morning.

Amit Sharma
Analyst, BMO Capital Markets (United States)

Q

I have a couple of questions. Can we – when you provide Global Ventures, would you give historical data on at least Monster fees.

Timothy K. Leveridge
Vice President & Investor Relations Officer, The Coca-Cola Co.

A

So, we'll go back and provide I think it's two years of historical information. And so what's going to happen is we're going to pull the outside of Costa, because Costa will just layer on to Global Ventures.

Amit Sharma
Analyst, BMO Capital Markets (United States)

Q

Sure.

Timothy K. Leveridge
Vice President & Investor Relations Officer, The Coca-Cola Co.

A

But for the other businesses I mentioned including Monster. It'll come out of the segments that it's in. So, North America, EMEA, I think all of the segments basically for Monster and it will move into Global Ventures. So – go ahead.

Amit Sharma
Analyst, BMO Capital Markets (United States)
Q

No, sorry. Go ahead. Complete that.

Timothy K. Leveridge
Vice President & Investor Relations Officer, The Coca-Cola Co.
A

So I was going to say is, you'll see it in bits and pieces. So you'll probably see a little bit more clarity in North America, because if you think about the businesses it's primarily Monster that's in North America. EMEA will be a combination of innocent, Doğadan, Monster moving. So you won't be able to necessarily get a global picture of it, but there will be bits and pieces that you'll be able to see through.

Amit Sharma
Analyst, BMO Capital Markets (United States)
Q

I got it. And any update Tim on arbitration for the Coca-Cola Energy products, any updates on how is it going, when do we expect to hear a decision there?

Timothy K. Leveridge
Vice President & Investor Relations Officer, The Coca-Cola Co.
A

No, no, no updates from what we've said publicly, and I know Monster gave some commentary at their Investor Day. So no changes from that.

Amit Sharma
Analyst, BMO Capital Markets (United States)
Q

Got it. And the final one from me. So James talked about if dollars stays strong, how do you structurally offset that and perhaps export inflation into those markets as well? And how reasonable is that view? I mean we can look at Latin America where if you look at last five, six, seven years, you have consistently stronger dollar. And yet if you look at OI in that division is down substantially from the peak. Can you just talk about that like is is that – how likely is that to happen and how quickly you could actually implement that or put that into practice if dollars continues to be a headwind?

Timothy K. Leveridge
Vice President & Investor Relations Officer, The Coca-Cola Co.
A

Yeah. It's a fair question and without kind of restating what James said in terms of addressing that specifically because I think he did a very good job of clearly articulating how we do it. I think there's a couple of things I would say is obviously number one is, if you think about where as a company we have moved in terms of a focus on volume over value or excuse me, value over volume. There is an element of that is you got to put that in context of what's happened in the past with where we are now as a strategic focus of the company.

So clearly as we move forward because we are on an incidence based pricing environment with our bottling system we're very focused on driving value for the organization and the system, that's going to create more alignment in terms of ability to get pricing in the right relative perspective to inflation. And I don't know that that was always the case necessarily. So that would be the one thing I would caveat to say, when you kind of look historically, and to give perspective against that.

And then secondly, it's going to come down to leveraging those scenarios to drive the top line, but then also making sure that we're making very good and prudent decisions in terms of our cost allocation against that. And at the end of the day, to James' point is, as inflation flows through, or as the dollar moves, ultimately inflation does have to go with it – on dollar relative to the local currency or local market inflation. And that's where again with a value focused mindset, a value focused strategy that's not just rate but also mix in the overall consumer environment consideration. We feel strongly that we'll be able to capture our fair share that'll help protect and drive the overall U.S. dollar profits over the long term.

Amit Sharma
Analyst, BMO Capital Markets (United States) Q

Got it. And just one more, sorry, on corporate tax, Tim, I certainly appreciate the commentary on the cadence for 2019. The other thing is, at least there's some conversation about reducing the SALT tax exposure for [ph] Northeast trades (40:54) and whatnot, and the offset was expected to be on the corporate tax, maybe some roll back of the offset we saw last year. Are you hearing any of that, and obviously that's not built into your forecast for 2019 at this point, right?

Timothy K. Leveridge
Vice President & Investor Relations Officer, The Coca-Cola Co. A

No, it is not built into the forecast. And to be fair, I don't know a lot more detail on that, but that doesn't mean as a company we are not focused on it, it's just I have not had that specific conversation with our tax counsel. So I can get back to you on that specifically but overall right now no, that's not built into our guidance.

Amit Sharma
Analyst, BMO Capital Markets (United States) Q

Got it. Thank you so much.

Timothy K. Leveridge
Vice President & Investor Relations Officer, The Coca-Cola Co. A

You got it, Amit.

Operator: Thank you. [Operator Instructions] Our next question comes from Laurent Grandet with Guggenheim. Your line is now open.

Clay Crumbliss
Analyst, Guggenheim Securities LLC Q

Hey, Tim. It's Clay on for Laurent.

Timothy K. Leveridge
Vice President & Investor Relations Officer, The Coca-Cola Co. A

Hey, Laurent. Hey.

Clay Crumbliss
Analyst, Guggenheim Securities LLC Q

I think the big ones have been asked so maybe just a couple of housekeeping things. In the first quarter can you just give us an idea of the magnitude related to the trading day and then the Easter shift?

Timothy K. Leveridge
Vice President & Investor Relations Officer, The Coca-Cola Co.

A

Yeah, so the magnitude is a day in the quarter is about 1% impact on the top line. And what that normally happens is when we give our unit case guidance, that's on an average daily sales, so that kind of factors that out, but the CSCs which ultimately drive revenues will be about a point behind the expected unit case growth. So as you factor that in that's important to consider.

The other thing to keep in mind though is that that while the top line from CSC volume comes down by about a – does come down by a point, the OpEx and the cost associated with our P&L don't necessarily move in the same mode because they're more fixed in nature and some of our DME is unit case driven versus CSC driven. So that's usually and typically results in margin compression between the top and the OI line. So, that's number one.

Number two on the Easter shift, we have not historically given that context out. It's usually in generals ran somewhere from about a 0.5 point or so of impact, depending on what the nature of the move is. So, that gives you a little bit of context to think about, but sometimes that's more of an estimation, but that's usually about where it tends to be.

Clay Crumbliss
Analyst, Guggenheim Securities LLC

Q

Okay. Thanks. And then I think Laurent tried to ask it on the call and I'm not sure that James answered it. Related to Costa, are your assumptions still that Costa is accretive? And then on the FX side for that not to be nuanced but is the FX impact of Costa just given the weaker pound included in the structural impacts on the top-line in the operating income, or is it in the FX line?

Timothy K. Leveridge
Vice President & Investor Relations Officer, The Coca-Cola Co.

A

So, on the accretive to profit, the answer is yes, we still expect it to be slightly accretive to EPS. From a FX or from a layering it in, we're going to be layering in the structural at kind of currency neutral rates, so it'd be effectively the 2018 rates and then the FX associated with that will flow through the FX line.

Clay Crumbliss
Analyst, Guggenheim Securities LLC

Q

Got it. That's helpful. Thank you.

Timothy K. Leveridge
Vice President & Investor Relations Officer, The Coca-Cola Co.

A

Okay. You got it.

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

Brendan James Metrano
Analyst, Evercore Group LLC

Q

Well, hey, guys. It's actually Brendan Metrano from Evercore for Robert.

Timothy K. Leveridge
Vice President & Investor Relations Officer, The Coca-Cola Co.

A

Hey, Brendan.

Brendan James Metrano
Analyst, Evercore Group LLC

Q

How are you?

Timothy K. Leveridge
Vice President & Investor Relations Officer, The Coca-Cola Co.

A

Good.

Brendan James Metrano
Analyst, Evercore Group LLC

Q

Two quick follow-ups. Concentrated sales seem to kind of be ahead of unit case volume pretty persistently in the second half of the year. So, is there any concentrated inventory build that's also factored into the 2019 guidance or?

Timothy K. Leveridge
Vice President & Investor Relations Officer, The Coca-Cola Co.

A

Yeah. So we had a little bit of inventory build in the fourth quarter. There was two drivers of it, we had a little bit in Japan come through and a little bit in EMEA. We would expect particularly the EMEA portion of it to cycle out more so in the first half, probably – likely the first quarter. So that's part of the consideration. The other thing to keep in mind and I think we've talked about this particularly with some of the folks on the call is the fact that because of the nature of the FUZE TEA launch versus Nestea where Nestea was down in equity income, the benefit from FUZE TEA resulted in CSCs running a little bit ahead of unit cases particularly in EMEA. So that's also a factor when you look at it overall. So, net-net a little bit of benefit but not a significant amount, most of it coming out in Q1.

Brendan James Metrano
Analyst, Evercore Group LLC

Q

Okay. And then North America it looks like operating expenses or costs overall increased a good deal in 2018 over the course of the year and the margin in the fourth quarter a little bit lower than we had expected. So I was kind of wondering how that might play out next year?

Lee Coker
Director-Investor Relations, The Coca-Cola Co.

A

Hey, Brendan, it's Lee. I think one thing to remember about North America or that operating segment in particular was that, you know, we talked about the accounting impact or benefit from revenue recognition at a consolidated level and how it varied at the different operating segments. For North America in 2018 it was a really large benefit. I think if you look in the earnings release, it was about an 11% benefit to revenues with really you know sort of a subsequent gross up to COGS. So, on a gross profit and OI dollar profit basis, no impact, but because you're grossing up the revenue base, it has an impact to your operating and your gross margins. So, that's what was compressing margins in North America in 2018. You're not going to see the same kind of accounting impact in 2019 or at least we're not expecting anything like that, because there's been no announcement of a subsequent accounting change. So, I wouldn't expect to see that same level of compression, no.

Brendan James Metrano
Analyst, Evercore Group LLC

Q

Okay. Thanks.

Operator: Thank you. Ladies and gentlemen, thank you for participating in today's conference. This does conclude today's program and you may all disconnect. Everyone have a wonderful day.