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# The Coca-Cola Co. (KO)

Q1 2023 Earnings Call

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## MANAGEMENT DISCUSSION SECTION

**Operator:** At this time, I'd like to welcome everyone to The Coca-Cola Company's First Quarter 2023 Earnings Results Conference Call. Today's call is being recorded. If you have any objections, please disconnect at this time. All participants will be on a 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 Mrs. Robin Halpern, Vice President, Head of Investor Relations. Ms. Halpern, you may now begin.

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### Robin Halpern

*Global Director, Investor Relations, The Coca-Cola Co.*

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

We posted schedules under Financial Information in the Investors section of our company website at [cocacolacompany.com](http://cocacolacompany.com). These schedules reconcile certain non-GAAP financial measures which may be referred to by our senior executives during this morning's discussion to our results as reported under Generally Accepted Accounting Principles. You can also find schedules in the same section of our website that provide an analysis of our gross and operating margins.

In addition, this call may contain forward-looking statements, including statements concerning long-term earnings objectives, which should be considered in conjunction with cautionary statements contained in our earnings release and in the company's periodic SEC reports.

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

Now, I'll turn the call over to James.

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### James Quincey

*Chairman & Chief Executive Officer, The Coca-Cola Co.*

Thanks, Robin, and good morning, everyone. 2023 is off to a good start. We continue to execute well and grow amidst a dynamic macro environment. We like to say we have an all-weather strategy, one that enables us to strive with no matter what's happening in the world. We pursue excellence globally with an eye towards winning locally as a system and our brand investments continue to create value for our customers and consumers, leading to our ability to drive quality growth for our stakeholders.

Today, I'll discuss our first quarter performance and provide some perspective around today's global consumer and macro environment. I'll then reiterate why we are confident in our ability to deliver on our guidance for the full year and finally, I'll elaborate on how the actions we're taking set us up for success in any environment and how

we're driving resilience for our business and continued growth in 2023 and over the long term. John will then discuss our results and go to more detail on the 2023 outlook.

In the first quarter, pandemic restrictions in parts of the world relaxed and many supply chain pressures abated. At the same time, inflation and geopolitical tensions persisted and new concerns emerged around the stability in the banking sector and the magnitude of the potential squeeze on consumers. In the face of these factors, we continued to generate momentum as investments in our brands got the year off to a positive start. We remained focused on creating value by meeting the needs of our customers and consumers.

We delivered 12% organic revenue growth in the quarter. This was primarily driven by pricing actions across markets and revenue growth management initiatives to retain and add consumers. We also delivered volume growth of 3%, which is in line with last year versus 2019. We saw growth across developed as well as developing and emerging markets and we continued to gain both volume and value share for the quarter, including at-home and away-from-home channels. We're encouraged by this momentum and are operating the business with a focus on growth, while closely monitoring macro trends with signs of a slowdown. As we look around the world today, the consumer picture varies across our markets.

In Asia-Pacific, the reopening of China has led to an increase in consumer activity, but consumption is still recovering to pre-pandemic levels. India's economy remains resilient with a strong job market and robust consumption. In Japan, consumers are feeling inflationary pressure for the first time in many years. In Europe, the recent banking crisis added to last year's energy spike, driving further uncertainty to purchasing behaviors and consumers continue to increasingly seek out affordable and private-label options across many FMCG categories.

In North America, the picture is a mixed bag. With unemployment low, gas prices improved and savings holding up, but inflation and higher mortgage rates are top of mind concerns for many consumers. In many developing and emerging markets in Latin America, Africa and the Middle East, consumers continue to face varying levels of inflation and volatility in the macroeconomic conditions. Clearly, there's uncertainty on how the consumer environment may ultimately play out in 2023. But thanks to the hard work of our people and partners, we are a more flexible network enterprise today and with our enhanced system alignment, we're confident we can win together locally in a wide variety of environments.

Let's start with the portfolio. We have a growth portfolio of consumer-centric brands across categories, including 26 billion \$1 brands and networked organization is allowing us to raise the bar of innovation and marketing to leverage our loved brands more effectively in the marketplace.

We're keeping our streamlined portfolio of brands relevant with consumers and finding innovative ways to offer beverage choices for every occasion. In Japan, we recently relaunched our Georgia Coffee brand with a fresh new look and a bright proposition to inspire current consumers and expand Georgia's appeal to a broader audience, complementing Costa's premium, ready-to-drink offerings in that market.

We're expanding our exploration in alcohol ready-to-drink beverages with a keen focus on responsibility. We worked with Brown-Forman to roll out Jack and Coke cocktails in the US during the quarter, with more markets launching now. It's early days, but the ability to get one of the most popular bar-calls in the world in a can is proving to be compelling to retailers and consumers based on preliminary volumes and velocities. We're encouraged by the level of engagement as distribution expands.

We're driving bigger and bolder innovations that can leverage consumer insights, leading to a higher success rate and enduring growth. In North America, we continue to foster brand love for fairlife, which has grown volume

double-digits for eight consecutive years. fairlife became a billion dollar brand last year and we're building on the momentum of the brand, including the success of Core Power, with fairlife Nutrition Plan. Launched with a digital-first campaign in the Club Channel, fairlife Nutrition Plan has seen strong consumer interest from those looking for a high protein, low sugar shake that tastes great and is lactose-free. We're planning to expand the product to more channels and packages in the coming months.

We're working with WPP, our global marketing network partner, and increasingly leveraging digital capabilities to engage consumers through passion points, personalized experiences and collaborations. The Coke Studio concept first drove cultural relevance and brand performance in Pakistan, with the latest season streamed over a billion times. We scaled the program to 30 markets last year and in 2023, it will become an always-on platform across the globe. Connecting consumers' love of music to consumption occasions by spotlighting breakthrough talent, Coke Studio provides a portal for live digital experiences and can be activated using QR codes on our packages. Consumers can drink, scan and enjoy their favorite beverage along with music from genres around the world.

Working as a network system with our bottlers, we're managing through macroeconomic uncertainty with enhanced capabilities in revenue growth management and integrated execution. We often talk about the many levers of revenue growth management. While the inflationary environment led to proactive pricing increases over the past 18 months, it's important to recognize that our RGM capabilities extend far beyond pricing.

At its core, revenue growth management is about consumer-centric segmentation, ensuring we have the right product in the right package in the right channel at the right price point, drive transactions and meet consumers where they are. Affordability and premiumization are key levers to maintain and expand our consumer base and we continue to balance affordable offerings with compelling premium propositions to ensure we have beverage options across income levels.

Affordability is a driver in developing and emerging markets, evidenced by double-digit volume growth in these offerings in Indonesia and Vietnam, helping to drive record sparkling share in Vietnam and driving approximately 3 billion transactions at affordable price points in India this quarter.

Premium packages like slim cans and mini cans are seeing strong growth in many markets, including Australia, where mini cans drove 40 million transactions and contributed to share growth in the region. Premiumization also include indulgent products and occasions. In addition to alcohol ready-to-drink beverages, we're also participating more broadly in adult alcohol drinking occasions.

In North America, we've expanded our Simply premium juice brand into the mixer segment with Simply Mixology available in three flavors to serve as a cocktail or mocktail. In Europe, we've relaunched our Kinley and Royal Bliss brands as harmonized platforms to participate in the adult mixer segment. For both affordability and premiumization, the value proposition is often messaged at the point-of-sale such as the expansion of the value bundle in certain channels in the US and the Mini Can Mini Price campaign that drove strong growth in small packages in Japan.

RGM, coupled with integrated execution, also drives value for our customers. By providing key insights and offering the right mix of brands, packages, price points and compelling data-driven promotions, we are able to partner with customers that deliver traffic, basket and incidence growth.

Latin America is a great example of how this came to life in the first quarter, evidenced by revenue growth ahead of transactions and transaction growth ahead of volume. By working closely with key retailers, our system focused

on the availability of cold, single-serve beverages in premium brands such as Schweppes and smartwater. We introduced refillable packages into new channels, all while driving better in-stock levels and higher consumer traffic in-store, earning accolades from customers.

Our business has largely recovered from the effects of the pandemic and remains well-equipped to navigate the dynamic macro environment and is emerging with even stronger capabilities and system alignment to deliver vibrant, long-term growth for many years to come.

At the same time, our consumers also care about sustainability. While we strive to grow our business, we also want to be water-positive, drive a circular economy for our packaging and grow consumer beverage choices, including low and no-calorie brands as part of our Total Beverage strategy. These goals are integral to our business and beneficial for society.

Our annual Business and Sustainability Report will be released soon, including an integrated section on our World Without Waste packaging initiative. We're proud of what we've accomplished so far, recognize there is still opportunity ahead and continue to lead as well as act collectively with other key stakeholders to drive progress on this agenda. I encourage you to learn more about how we're progressing against our targets across various sustainability pillars and priorities to refresh the world and make a difference.

Before I hand over to John, I'd note that it's early in the year and there's a fair amount of uncertainty around the operating environment ahead, but our first quarter results give us increased visibility to deliver on our full year 2023 guidance.

We're executing more efficiently and effectively on a local level, maintaining flexibility on a global level and continuing to reinvest in the business and build the system for the long term. In short, we're expanding the sphere of what we can control. We're well prepared to respond with speed to changing market dynamics as we've demonstrated that we can do. By staying clear on our purpose and remaining consumer-centric, we continue to execute to deliver sustainable, long-term growth.

With that, I'll turn the call over to John.

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## John Murphy

*President & Chief Financial Officer, The Coca-Cola Co.*

Thank you, James, and good morning, everyone. We've had a good start to the year, with strong first quarter results.

Starting with the top line, we grew organic revenues 12%. Unit cases grew 3%, with broad-based growth across most of our hits, driven by investments in the marketplace. Concentrate sales were two points behind unit cases for the quarter, primarily driven by timing of concentrate shipments and one less day.

Our price/mix growth was 11% for the quarter. Much of this was driven by carryover pricing coming into the base from last year, along with some new pricing actions across operating segments, as well as revenue growth management initiatives and favorable channel and package mix. Comparable gross margin for the quarter was up approximately 120 basis points, driven by underlying expansion and a slight benefit from bottle refranchising, partially offset by the impact of currency.

Underlying gross margin expansion was driven by a benefit from the phasing of inventory costs, strong organic revenue growth and cycling the timing of M&A integration expenses, partially offset by higher commodity costs.

Comparable operating margin expanded approximately 40 basis points for the quarter. This was primarily driven by underlying operating margin expansion due to robust top line growth across operating segments, partially offset by increased marketing investments and higher operating costs.

Putting it all together, first quarter comparable EPS of \$0.68 reflects an increase of 5% year-over-year despite higher-than-expected 7% currency headwinds. Free cash flow was negative by approximately \$120 million in the quarter. This was largely attributable to the timing of working capital initiatives and the previously-discussed M&A-related payments that took place in the quarter.

Our underlying cash flow generation remains strong and we feel confident in our cash flow agenda and full-year outlook. Our balance sheet is fit for purpose to support our growth agenda and our net debt leverage of 1.8 times EBITDA as of the end of the first quarter is below our targeted range of 2 to 2.5 times. Our capital allocation priorities remain the same. We continue to invest to drive long-term growth and to deliver dividend growth for our shareholders as evidenced by the 5% dividend increase announced in February.

We remain mindful of maintaining our financial flexibility amidst the ongoing tax dispute with the IRS. We are currently waiting for the Tax Court to render its final opinion in the case, allowing us to move forward with the appeals process. As previously discussed, we intend to assert our claims on appeal, vigorously defend our position, and believe we will ultimately prevail. We will continue to keep you updated.

As James mentioned, we are encouraged by our first quarter results and are harnessing what we can control to remain resilient in the face of a volatile operating environment. We remain laser-focused on top line-led growth as well as the endurance of the bottom line and will reinvest in our brands with more rigor and discipline using the refreshed resource allocation framework we discussed at CAGNY.

This approach enables the enterprise to prioritize and put more focus beyond the country and category combinations that can deliver the best return in the near term, while fueling steady progress on our Total Beverage strategy over time. It also allows us to be more dynamic and to adapt quickly.

For example, in emerging markets, where commercial beverages are still a small part of daily consumption, we're leading with core sparkling and juice drinks propositions. In developed markets, where consumers are looking for more beverage choices, we're investing behind a broader portfolio of brands and categories, including value-added dairy, enhanced water, tea and coffee.

Despite the global macro picture remaining uncertain in the months ahead, our planned investments and operational strategy will support the momentum we've seen early in the year and give us good visibility to deliver on our 2023 guidance. This guidance is comprised of organic revenue growth of 7% to 8%, primarily led by price/mix amidst the ongoing inflationary environment, comparable currency-neutral earnings per share growth of 7% to 9%. Based on current rates and our hedge positions, we are reiterating our currency outlook of an approximate 2 point to 3 point headwind to comparable net revenues and an approximate 3 point to 4 point currency headwind to comparable earnings per share for full year 2023.

Inflationary forces are moderating in some respects. Spot prices have come down in oil and freight rates are more favorable. That said, many commodities we're exposed to have been sticky and we have some advantageous hedges that will be rolling off to less favorable rates during the year. Based on current rates and hedge positions, we continue to expect per-case commodity price inflation in the range of a mid-single-digit impact on comparable cost of goods sold in 2023. Additionally, we expect wages and inflation in media will continue to remain elevated.

Despite the increase in the first quarter effective tax rate, we continue to expect our underlying effective tax rate to be 19.5% for 2023. All-in, we are reiterating comparable earnings per share growth of 4% to 5% versus \$2.48 in 2022. We expect to generate approximately \$9.5 billion of free cash flow in 2023 through approximately \$11.4 billion in cash from operations, less approximately \$1.9 billion in capital investments.

I would like to remind you that included in cash from operations are two to three items related to, one, transaction tax payments which will take place in the second quarter, and two, payments associated with M&A transactions. Excluding these, our implied free cash flow conversion would be within our long-term guidance. This guidance does not include any payments related to our ongoing US income tax dispute with the IRS.

Overall, we don't expect the tax dispute to have a bearing on our ability to deliver on our capital allocation agenda and drive long-term business growth. There are some considerations to keep in mind as it pertains to our guidance. We expect price/mix to moderate through the year as we cycle our pricing initiatives from the prior year. The discrete gross margin benefits related to the phasing of inventory costs and cycling the timing of M&A integration expenses this quarter are unlikely to repeat.

Given the ongoing backdrop of rising interest rates, we expect to see higher net interest expense given our effective exposure to floating rate debt. And finally, due to our reporting calendar, there will be one additional day in the fourth quarter.

With a quarter of good results to start the year and our focus on driving top line-led growth in any macroeconomic environment, we are well-positioned to compound quality value by delivering on 2023 guidance. Our network structure and aligned system are enabling us to deliver on our three key objectives: pursuing excellence globally and winning locally, investing for the long-term health of the business and generating US dollar EPS growth.

The strength of our people and great partnerships with our bottlers around the world give us confidence in our ability to win with consumers in the marketplace and deliver value for our stakeholders.

With that, operator, we are ready to take questions.



## QUESTION AND ANSWER SECTION

**Operator:** [Operator Instructions] Our first question comes from Dara Mohsenian from Morgan Stanley. Please go ahead. Your line is open.

**Dara Mohsenian**

*Analyst, Morgan Stanley & Co. LLC*

Q

Hey, guys. So first, just a detailed question. You guys obviously start out with a pretty robust initial outlook forward, sales of 7% to 8% for the full year in 2023. Obviously, a strong start in Q1. You kept that full year guidance. So just can you give us a sense, did Q1 come in better than you expected? Was this more expected? Why not move on the full year?

And within that, can you also comment on away-from-home trends in Q1 as we recover from COVID and what you guys are expecting in the balance of the year, including in China, which is probably in a different place in the rest of the world? Thanks.

**James Quincey**

*Chairman & Chief Executive Officer, The Coca-Cola Co.*

A

Sure. Let me start at the back end and come in reverse. So, yes, China opening up, certainly a pattern of consumer behavior, not unlike when US or Europe opened up. So there has been a resumption in consumer activity. There was a rebound of consumption in Chinese New Year, which obviously fell in the first quarter, so we're certainly seeing the performance in China getting better and we've been focused on bringing back our marketing and increasing availability in some of the rural marketplaces.

Remember, in Q2, we'll be cycling the toughest part of 2022 I think for China, but net-net, we remain cautiously optimistic. I mean, it's still – the Chinese business is still below the 2019 level, but we're cautiously optimistic on the rest of the year for China.

The other part of Q1 in the away-from-home, as much as it seems incredible to remember, Q1 last year, we were still talking about Omicron and not everywhere was opened up, so we are seeing in the first quarter this year additional strength in the away-from-home business. So take the US as an example. Immediate consumption packages grew ahead of future consumption packages. The away-from-home channels, for example, QSR restaurants had a good strong quarter the first quarter this year, in part because we're cycling a partially open first quarter and that will logically moderate as we get into the rest of the year because now we're starting to cycle the opening. So hopefully those are the two pieces.

Look, overall, first quarter was strong. It was certainly within the bounds of our expectations and our plans. We talked very much in February about how we expected to be able to focus on having volume, growth continuing to build the franchise of our beverages across the whole year, but expecting to see pricing moderate from what was similar levels to Q4, which is what we see in Q1 back down to sort of more normal levels by the end of the year.

And so good, strong start and we're maintaining guidance. We still feel confident in our guidance and we're well-equipped. The outlook has a degree of uncertainty in it that's I think more elevated than pre-COVID. Obviously not COVID-driven, but there's plenty of uncertainty out there in terms of the direction of travel, of inflation, both of the consumer's reaction to it and the input side, so we have a set of guidance out there that sees both input costs, our own costs and pricing moderating through the year, but there's still a long way to go.

So I think take it as we feel, we feel good about our guidance. There's a lot less to manage. We have a good strategy and we're certainly focused on this kind of all-weather results as we go into the rest of the year.

**Operator:** Our next question comes from Lauren Lieberman from Barclays. Please go ahead. Your line is open.

**Lauren R. Lieberman**

*Analyst, Barclays Capital, Inc.*

Q

Great. Thanks so much. One of the things that stood out to me this quarter was the profitability in North America. So just curious if you could comment on that. It looked like margins kind of reached toward a new high-water mark, and I was just curious how much of that – if there was anything one-time or if it has to do with the portfolio mix and realization of pricing. Thanks.

**James Quincey**

*Chairman & Chief Executive Officer, The Coca-Cola Co.*

A

Sure. Do you want this, John?

**John Murphy**

*President & Chief Financial Officer, The Coca-Cola Co.*

A

Sure. Thanks, Lauren. On the back of what James has said, strong start to the year, we expected in Q1 to see North America coming out the gates given the carryover pricing that we knew would be a tailwind for the quarter. We also saw benefits from immediate consumption been strong through the quarter. And as we look to the rest of the year, we continue to keep in mind there are ongoing objectives to expand margins.

But Q1 was – let's say, we came out of the gate strong. We knew we would and we look to the rest of the year in line with what James is saying, to moderate as we get into the back half of the year on the pricing front and to continue to be laser-focused using our RGM work to stay with the consumer.

So feel good about the start. Rest of the year is looking positive and yes, we'll take into account I think some of the trends we're seeing on the macroeconomic and consumer front and manage that environment with the various levers we have.

**Operator:** Our next question comes from Bonnie Herzog from Goldman Sachs. Please go ahead. Your line is open.

**Bonnie Herzog**

*Analyst, Goldman Sachs & Co. LLC*

Q

All right. Thank you. Good morning, everyone. I had a question on your business in Europe. Organic sales in the quarter were incredibly strong. You were up 23% on a tough comp, so just curious if you could help us unpack this a bit more. Maybe touch on the resilience of the consumer, how big of a factor the mild winter was and then were there any countries within Europe that were particularly strong, for instance? Thanks.

**James Quincey**

*Chairman & Chief Executive Officer, The Coca-Cola Co.*

A

Yeah, thanks. Thanks, Bonnie. Look, firstly, EMEA is more than just Europe. That's the first key point. It includes some countries that had some near-hyperinflationary effects, so Türkiye, and there's an impact in the first quarter of high inflation in Türkiye which has kind of pushed the price/mix up more than will be normal.

Secondly, of course, there's some carryover pricing from the inflationary burst that happened in kind of the European Union, throughout the UK last year, and that will moderate as we go over 2023 as is likely to be the Turkish inflation. There's some mix benefits of Western Europe having, as you said, a relatively mild winter. And so despite the pressures on purchasing power, actually Western Europe had a very good first quarter and that's good in its own right, but it's also good in a mix effect within EMEA. So kind of everything did pretty well. A number of the other Middle Eastern and African countries did well, perhaps all with the exception of Nigeria. So it was a strong overall result. Lots of mix in there and as I said, a bit of an inflationary effect between carryover and Türkiye that will moderate in the rest of the year.

**Operator:** Our next question comes from Bryan Spillane from Bank of America. Please go ahead. Your line is open.

### Bryan D. Spillane

*Analyst, BofA Securities, Inc.*

Q

Thanks, operator. Good morning, guys. John, I wanted to just touch back on some of the gross margin comments you made earlier. And I guess looking at the slide deck, right, there was about 140 basis points of gross margin benefit, underlying gross margin expansion in the quarter. Can you just give us some sense of how much, I guess, the inventory phasing and the lapping of the M&A integration costs, just how much of the stuff that I guess is kind of more one-time impacted that 140 basis points? And I guess as we're thinking about pricing fading through the year, would we be kind of more looking at kind of flattish maybe gross margins as we move through the balance of the year? So if you could just kind of give us a little bit more color on those items, it would be helpful. Thank you.

### John Murphy

*President & Chief Financial Officer, The Coca-Cola Co.*

A

Yeah, thanks, Bryan. So of the 140 basis points, you're correct, included in that is the one-time on the inventory and the [ph] second (00:33:04) M&A, it's about half of that. The other half comes from – mainly from the carryover price and some favorable price/mix in the quarter. So as you think about the rest of the year, I would keep in mind the following.

As I just mentioned, with North America, I think it's across-the-board moderation on price, both rate and frequency. I think it's greater use of our RGM levers to help to stay with the consumer as we see the consumer in different states in different parts of the world. We'll have some FX headwinds similar to what we had in Q1 throughout the year is our current expectation. We'll have an extra day in the fourth quarter. And so I'd keep in mind that we have implicit in our long-term algorithm a ongoing objective to expand margins and that remains very much the focus if you take those items into account for the rest of the year as you think about the 2023 full year.

### James Quincey

*Chairman & Chief Executive Officer, The Coca-Cola Co.*

A

I would also say like we've talked about it historically on pricing. Well, I'd encourage people not to draw correlation through one quarter and you can use four quarters or annuals. Given our position relative to the bottlers and the

final consumer, I think it's important to kind of average out some of these effects through all of the various variables that John mentioned and take a multi-quarter view of what's going on and take that all into account.

**Operator:** Our next question comes from Steve Powers from Deutsche Bank. Please go ahead. Your line is open.

**Steve Powers**

*Analyst, Deutsche Bank Securities, Inc.*

Q

Hey, great. Good morning, everybody. Thank you. Just – maybe firstly just a quick clarification. John, I think as the year started, you had talked about an expectation of bottom line or below-the-line deleverage on higher interest costs and the like. This quarter, we saw that work in your favor just because of the higher other and equity income and just wanted to get an update as to whether you still expected deleverage on the year or if the first quarter changed that outlook.

My broader question is back to revenue growth management, and James, you talked about affordability versus premiumization, which has been a theme. I was wondering if you could maybe frame what percentage of the portfolio today is what you'd classify as affordable versus premium, how those cohorts are growing relative to the totality and just the relationship between the two.

Like, would you still be pursuing the affordability opportunity as aggressively if you didn't have the premiumization lever working for you? Are those two things related in your mind or are they mutually exclusive? Thank you.

**James Quincey**

*Chairman & Chief Executive Officer, The Coca-Cola Co.*

A

Do you want to start? I'll...

**John Murphy**

*President & Chief Financial Officer, The Coca-Cola Co.*

A

Yeah, let me take the first part, Steve. Just as you said, the first quarter, we did benefit from the equity income coming in better and we also had a couple of one-times on dividends, et cetera, that helped. For the rest of the year, no significant change in what we've guided on interest expense. You can expect Q2 and Q3 relative to prior year to be a higher impact given that we really saw the step-up starting in Q4 of last year. So we still, for the full year, expect the same quantum of deleverage as we had in indicated in our February guidance.

**James Quincey**

*Chairman & Chief Executive Officer, The Coca-Cola Co.*

A

Perhaps I'll take the RGM bit, Steve. I'm not sure I would attach a percentage to it globally, I'm not sure it drives relevance. I think a couple of thoughts though. One, clearly as over time there has been an increase in disparity of income in any given country, the need to match the consumer across a broader range of price points has gone up. So you see both more opportunity and more need to have a foot in affordability and the other foot in premium. And so both of the ends of the spectrum have been going up over time as we seek to meet the consumers where they are and where their pockets are and allow them to stay in our franchise, so see it as a need to do more of both.

Obviously what's affordable and what's premium in the US might look different than it does in Africa or China or Western Europe, but the direction of travel is more of both. And the mechanic of delivering on them again is different by countries. In Latin America, it might be with a refillable PET bottle to get down to affordability. In the

US, it might be certain package sizes or the level of promos in some of the modern trade channels. Again, premium might look different. It might be returnable glass in Spain and it might be different categories, for example, fairlife in the US.

**Operator:** Our next question comes from Andrea Teixeira from JPMorgan. Please go ahead. Your line is open.

**Andrea Teixeira**

*Analyst, JPMorgan Securities LLC*

Q

Thank you. Good morning. James, I appreciate your comment on the puts and takes, especially with the away-from-home and the easy comps for the QSRs in the US in the first quarter. We have been seeing some retailers talk about weather and also seeing companies talk about weaker recent trends, in particular in the US in March.

I know to the extent you normally don't give us the exit rates, but particularly now as we see these puts and takes and of course your guidance doesn't really imply a continuation of the trends that you saw in the first quarter. So I think obviously this start is a pretty good start and give us some more confidence on the rest of the year, but perhaps talk about this puts and takes and the easy comps in Asia that you alluded to. Thank you.

**James Quincey**

*Chairman & Chief Executive Officer, The Coca-Cola Co.*

A

I mean, we're two weeks into the second quarter, so I think that – I don't think there's anything particularly productive in it. I mean, they weren't out-of-the-park results in the first couple of weeks, but there was some worse weather in India and the US and the shift of Easter, so I don't think one can draw a lot from a couple of softer weeks in the first two weeks of April. The whole – the performance through the quarter was good. There wasn't a major ski slope from January through to March and so I think that we saw continued strength.

I would encourage people as they look out for the rest of the year and think about momentum, as I did last year, to look at some of the multi-year trends. Last year I encouraged people to look compared to 2019 on a three-year CAGR basis because then that helps see through some of the reopenings and closings and all the [indiscernible] (00:41:06). I would encourage the same thing this year in the sense of the full year CAGR to 2019 and see it that way.

Look, there's a long way to go. We've started with strong momentum. We had it in January. We had it in March. The consumer is holding up and we feel good about the strength of our strategy.

**Operator:** Our next question comes from Rob Ottenstein from Evercore. Please go ahead. Your line is open.

**Robert Ottenstein**

*Analyst, Evercore ISI*

Q

Great. Thank you very much. James, you've had some very interesting packaging, innovation and digital engagement with younger consumers trying to keep them, bring them into the CSG portfolio. Just wondering if you could give us any kind of sense of how that's developing? Are you seeing improved brand equity scores with younger consumers, better market share? Any early signs that these innovations [audio gap] (00:42:14) targeted to younger demographics – developed markets are working? Thank you.

**James Quincey**

*Chairman & Chief Executive Officer, The Coca-Cola Co.*

A

Sure. Yeah, you put your finger on kind of the nexus of a whole set of innovations and let me just focus in on just using Coca-Cola Brand just to start with for a second.

I mean, we did Coke Creations, which was kind of limited edition kind of beyond it's vanilla or it's cherry into kind of Stardust and Marshmallow. And I think it was much more engaging for consumers. Some of the advertising, I mean, we did, we partnered with OpenAI and ChatGPT and DALL-E to run a promotion where you could design Coke advertising and have it come up on the Times Square billboard. And all of that change, obviously the bigger scale through the marketing which has become much more digital over the last three years, is starting to drive a difference.

So if I were to take the US where historically we have been under-recruiting, to not say not recruiting, consumers, we can see that the growth in the Coke franchise is not just being driven by increased recruitment, by increased engagement and recruitment of Gen Z. So you're starting to see an impact come through on the aggregate recruiting numbers, on the aggregate engagement with Gen Z and the increase of Gen Z coming into the franchise.

**Operator:** Our next question comes from Nik Modi from RBC Capital Markets. Please go ahead. Your line is open.

### Nik Modi

*Analyst, RBC Capital Markets LLC*

Q

Yeah, thank you. Good morning, everyone. James, I was hoping you can talk about the non-sparkling part of the business. Less so from a consumer and product strategy side, but more from a go-to-market with this whole reorganization going on in North America in particular, is there a better infrastructure do you think for Coke to sell the entire portfolio versus kind of historically how it's been much more kind of predominantly focused on sparkling? Any thoughts on that would be helpful.

### James Quincey

*Chairman & Chief Executive Officer, The Coca-Cola Co.*

A

So let me talk about the portfolio and then the go-to-market. I mean, clearly, the portfolio in North America has been expanding over the last decade, but a lot recently as well. I think the results you're seeing in North America is actually driven by the overused expression of the [ph] AND (00:45:00) strategy. We're seeing growth in soft drinks, good resonance in Coke and Coke Zero, but also growth in the rest of the portfolio.

We talked about in the script how fairlife has been on a multiyear journey really doing well. Obviously that builds on some of the previous acquisitions with Vitamin Water and smartwater doing really well in the quarter and so you're starting to see the portfolio being built out across the different categories.

Clearly, it's not all plain sailing in every category. We've talked how we need to stabilize and reinvigorate BODYARMOR in tandem with POWERADE. You're starting to see some growth in the coffee ready-to-drink in North America. Now, all of that feeds into a set of routes to the market which are – there are multiple platforms in the US and there have been. Clearly the biggest piece is the bottlers, largely to, obviously, retailers and lots of away-from-home channels complemented by the chilled route and the fountain route. So I think there's much greater focus on getting the portfolio be the portfolio that works for consumers and drives a winning strategy for the retailers and then a vastly strengthened bottling system over the last number of years through the refranchising, through great work by the bottlers in the US to both increase their capability and to increase their rate of investment.

**Operator:** Our next question comes from Peter Grom from UBS. Please go ahead. Your line is open.

**Peter Grom**

*Analyst, UBS Securities LLC*

Q

Thanks, operator, and good morning, everyone. So, James, I was hoping to follow up on that a little bit and just kind of get some perspective on the current trends in the sports drink category, specifically here in the US. I think you called out BODYARMOR and POWERADE as being under some pressure in the release and you just alluded to that in your response to Nik's question.

So can you maybe just talk about the competitive dynamics in that category and then kind of how you see that evolving as we look out over the balance of the year? Thanks.

**James Quincey**

*Chairman & Chief Executive Officer, The Coca-Cola Co.*

A

Yeah, sure. Obviously we've got two brands. We've got BODYARMOR and POWERADE. We talked on previous calls where we had not had the greatest integration into the Coke system last year on BODYARMOR and obviously there's some new players and new categories in that mix. We're very focused on stabilizing our portfolio and growing from here. We've brought out some product innovation in the first quarter with BODYARMOR Flash I.V., BODYARMOR SportWater continued to be the fastest-growing premium water and POWERADE Zero Sugar, so we're starting to see some innovation coming through, so better marketing.

There will be some missing package formats going into the marketplace in Q2 with our multi-serve multi-pack versions of BODYARMOR. And so we think we can do well as we've talked about before with BODYARMOR and POWERADE and it's early days, but we see some promising signs to reversing the trends by the end of the year.

**Operator:** Our next question comes from Bill Chappell from Truist Securities. Please go ahead. Your line is open.

**William B. Chappell**

*Analyst, Truist Securities, Inc.*

Q

Thanks. Thanks for slotting me in. Just a follow up on distill and kind of elasticity. It seems like sparkling, you have plenty of pricing opportunity even from here, but maybe also on juice, water, kind of base level. Do you see promotions coming back in? Do you see like – you feel like you're running into a feeling at some point this year in terms of pricing because especially as you're getting more of a middle and lower-end consumer that's buying some of those products, any thoughts there would be great. Thanks.

**James Quincey**

*Chairman & Chief Executive Officer, The Coca-Cola Co.*

A

Yeah, look, I think in recent times the elasticities on water have been stronger than they have on soft drinks and juice somewhere in there as well. And so clearly consumers are being differentiating by category and brand strength and whether the brand or the category has earned the right to do the pricing, even if the pricing is largely cost-driven. So that definitely has been a feature of recent quarters.

As we look out, as I said, we see pricing moderating, which means in the context of markets like the US or Europe, is a reduction in the level of off-cycle price increases. We may, as we go forward, see slightly more promotions as we look for those consumers that are under pressure to offer them slightly better affordability

options, but we'll be balancing that with investments in premiumization options, whether that be categories or packaging.

And so, as I've talked about in the answer to one of the other questions, we're trying to work both ends of the spectrum here. And I see the need to press harder on both ends as we have done over the last number of years and as we will do in the course of this year.

**Operator:** Our next question comes from Kevin Grundy from Jefferies. Please go ahead. Your line is open.

**Kevin Grundy**

*Analyst, Jefferies LLC*



Great. Thanks. Good morning, everyone. We covered a lot of ground, so a couple clean-ups for me, probably both for John. Can you quantify the impact from hyperinflationary pricing in the quarter from Türkiye and Argentina? I'm not sure if that's a number that you have at your fingertips.

And then broadly, investment levels. I think there would be a view in staples broadly that as gross margin improves, it'll lend itself to some degree of reinvestment. I just wanted to get your thoughts on where the organization is now in terms of its satisfaction with overall investment levels. I think pre-pandemic, we were sort of at a high of 12%, the industry dipped collectively for all of the reasons that we know. If I'm not mistaken, you guys were at 8.5% of sales. Where do you see that going? And then maybe just some broader thoughts on adequacy and how you see this progressing as the cost environment lends itself to a greater degree of reinvestment. Thank you.

**John Murphy**

*President & Chief Financial Officer, The Coca-Cola Co.*



Thanks, Kevin. First question on the hyperinflation. It was about just a little under two points in Q1. I don't have the mirror or sort of the crystal ball for the rest of the year, but you can build that into your assumptions for the rest of the year.

Regarding investment levels, we've been, I think, very consistent over the last three or four years and been clear that we will invest as we need to, to support the portfolio. And on a quarter-to-quarter basis, there are ups and downs on that. We did some really good work in 2021-2022 to be able to do more with less or to do more with the same, so it's not apples-to-apples in that sense.

I think we're getting more value today per dollar of investment than we have ever done before. And so when I take that into account, plus the absolute levels that we're investing, I think we are in good shape overall and I think our markets have what they need. And so we continue to be very much of the mindset to have that as a top priority and where necessary and Q1 is a good example in some cases to invest ahead of the curve. So all in, feel good about the rate and the improving effectiveness of our overall spend.

**Operator:** Our next question comes from Chris Carey from Wells Fargo Securities. Please go ahead. Your line is open.

**Chris Carey**

*Analyst, Wells Fargo Securities LLC*





Hi, everyone. Yeah, just a couple of clean-ups for me as well. Just John, on a total inflation basis, did you see commodities get a little bit worse through the quarter, and perhaps can you comment on total inflation, including freight? So just trying to frame the commodity inflation versus total inflation.

And then from a cash flow standpoint, would you expect free cash flow to be positive in Q2 and any way that you would just discuss the front half versus back half delivery in the context of your full year free cash flow guidance? Thanks.

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**John Murphy**

*President & Chief Financial Officer, The Coca-Cola Co.*

A

Yeah, our commodities portfolio, so to speak, it's a mixed bag in there. On the one hand, we're seeing some moderation in the number of commodities, metals, lumber, for example. We're seeing moderation on ocean and freight in general. But offsetting that for us was, we have a pretty meaningful increase in sweeteners and in juices, so that's one consideration.

The second consideration is we continue to hedge in 2023 and we feel good about the hedges we're putting into place, but they are cycling a set of hedges in 2022 that were more favorable. So I think it's important to keep that in mind.

And then thirdly, as we go into the rest of the year, as we've alluded to in some of the other questions, we do see some further moderation on the overall cost front. But we do have, as a net of all of that, continued view that we'll have a mid-single digit increase for the year 2023.

And on free cash flow, as we said, the first quarter we had a couple of discrete items in there that we had highlighted in February and we've also had a couple of timing items, working capital-related that has affected the net result for the quarter.

Keep in mind that in the second quarter, we will have the transition tax payments going out. And so for this year, I would expect free cash flow as a result of what's happened in Q1 and what I expect in Q2 to be back-weighted towards the second half of the year.

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**Operator:** Our next question comes from Carlos Laboy from HSBC. Please go ahead. Your line is open.

**Carlos Laboy**

*Analyst, HSBC Securities (USA), Inc.*

Q

Yes, thank you. Good morning, everyone. To expand on Steve's earlier question, in the emerging markets, refillables, they drive affordability. But it seems to also help you to increase premium pricing for [indiscernible] (00:56:42) and create premium growth. So my question is, where in emerging markets might you see big opportunities or new opportunities to drive affordability gains in revenue management?

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**James Quincey**

*Chairman & Chief Executive Officer, The Coca-Cola Co.*

A

Yeah, Carlos, thanks. Definitely agree with you on the central idea that if you have a good anchor in affordability options, it allows the portfolio to stretch along the price spectrum with other packaging options and thereby both satisfy more consumers and drive a more – a better, a higher competitive advantage and a more profitable business overall.

Obviously, the – our refillables infrastructure takes time to build, not just from a kind of a manufacturing and distribution point of view, but from a retail and consumer habit point of view. But there's still plenty of opportunity in Latin America, which is obviously one of the big bases. It's still a feature of the German market. How far that then becomes a feature of other markets is going to be developed over time. We've certainly got some activity in Africa and India, but it doesn't, as you know, it doesn't change rapidly overnight. But there's definitely big opportunities to use all the thinking behind RGM and all the new and latest technologies to provide packaging options at good price points across as broad a range as possible.

**Operator:** Our last question will come from Charlie Higgs from Redburn. Please go ahead. Your line is open.

### Charlie Higgs

*Analyst, Redburn (Europe) Ltd.*

Q

Yes, good morning, everyone. Thanks for the question. Just a final one on innovation, please, and I think you've relaunched Sprite Zero in the quarter and also POWERADE. Is there any initial feedback you could give on those brands? That would be very useful. And then also just any thoughts on Coke Zero, which again it grew volumes 8% off a comp of 14%. I guess just how much further do you think that brand specifically has to go? Thank you.

### James Quincey

*Chairman & Chief Executive Officer, The Coca-Cola Co.*

A

Sure. I mean, Coke Zero, the reformulations on Sprite Zero and POWERADE are specific to a number of markets, so this is not a big call-out. They're part of an ongoing program to make sure that we have the best tasting, most effective recipes in any particular market, so see those as examples of continuing to innovate, to stay on the cutting-edge of the formula, whether that's taste and enjoyment or delivery on a functional feature in a category like the sports category.

And as it relates to Coke Zero, we now have many, many years of very strong volume growth behind Coke Zero. I think there's huge and massive ongoing runway for Coke Zero to continue to grow. So – go on.

**Operator:** Ladies and gentlemen, this concludes our question-and-answer session. I would like to turn the call back over to James Quincey for any closing remarks.

### James Quincey

*Chairman & Chief Executive Officer, The Coca-Cola Co.*

So just to summarize, year is off to a great start. We continue to win in the marketplace. While it's still early in the year and the macro environment remains uncertain, we're confident in our plans and our ability to leverage our capabilities to adapt to consumer needs and drive top line-led growth and we have visibility to deliver on our 2023 guidance.

We're focused on the sizable opportunity ahead of us and are managing the near-term uncertainties to build a Coke system for the long term.

Thank you for your interest, your investment in our company and for joining us this morning. Thank you.

**Operator:** Ladies and gentlemen, this concludes today's conference call. Thank you for participating. You may now disconnect.

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