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# The Coca-Cola Co. (KO)

Q2 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 Second Quarter 2023 Earnings Results Conference Call. Today's call is being recorded. If you've 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'd 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 Ms. Robin Halpern, Vice President and Head of Investor Relations. Ms. Halpern, you may now begin.

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### Robin Halpern

*Vice President-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've posted schedules under financial information in the Investor 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 re-enter the queue.

Now I will 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. After a strong start to the year, we continued our momentum in the second quarter. Our combination of strong loved brands and an aligned, pervasive distribution system is allowing us to win in many different operating environments. Given our strong first-half results and the resilience of our business, we are raising both our top-line and bottom-line guidance today.

To give you the full picture of our results and our raised guidance, I'll start by discussing second quarter performance and provide perspective on the current business and consumer environment. Then I'll highlight our performance across categories including how we are driving quality leadership throughout our portfolio.

Finally, I'll touch on why we are confident in our ability to deliver our long-term objectives, and then John will end by discussing our results for the quarter and our revised guidance for 2023.

In the second quarter, competing macro forces were at play across our markets. On the positive side, many supply chain pressures eased, concern surrounding the stability of the banking sector diminished and energy prices continued to pull back from record highs. However, global inflation was still elevated and geopolitical tensions continue to exist in some markets. Despite this confluence of factors, we delivered 11% organic revenue growth in this quarter. Volume was flat, and after a slower start, it sequentially improved with June being our strongest month in the quarter.

In the first half of 2023, we delivered volume growth that was consistent with our underlying performance since 2019. More broadly, our industry is strong, and we believe we have significant headroom to grow both volume and value. And we continue to gain share. During the quarter we gained value share in both at home and away-from-home channels. As we look towards the second half, the global inflationary environment is impacting consumers and our business differently across geographies.

In developed markets like North America and Western Europe, inflation is beginning to moderate and labor markets remain strong. Our elasticities continued to be relatively low. However, we have seen some willingness to switch to private label brands in certain categories.

Across the sector, consumers are increasingly cost conscious. They are looking for value and stocking up on items on sale. In these markets, our pricing is largely in place and is expected to moderate as we cycle pricing initiatives from the prior year. It's more important than ever to be consumer centric and to partner with customers to provide affordable and premium propositions which deliver value through basket and incidence growth.

In many developing and emerging markets like Latin America, the Middle East and Africa, consumers are more accustomed to persistent inflation. However, the number of markets with intense inflation has expanded. Five of our top 40 markets are currently experiencing over 20% annual inflation. In these markets, it's equally important to

leverage revenue growth management capabilities to balance affordability with premiumization to be able to take price with local market inflation, which helps offset the currency pressures.

There are, as always, a few markets affected by specific local factors. In China, economic recovery slowed in the second quarter and inflation has declined. Consumer confidence is below pre-pandemic levels. And we continue to monitor our leading consumer indicators and take action to win in the market. In India, business was unfavorably impacted by unseasonable rain and cooler temperatures in the quarter. However, the growth outlook remains intact.

In a world with a wide spectrum of market dynamics from inflation to currency devaluation to shifting consumer needs, our business is proving to be very resilient. We have many levers to pull to manage successfully through different operating environments, and we remain consumer centric and focused on growth. Our recipe for success is unchanged. We continue to deliver on our strategy through a combination of world class marketing and innovation, excellence in revenue growth management and strong execution. We are raising the bar and increasing quality leadership across our portfolio.

Starting with Coca-Cola. We are growing our base of Gen Z drinkers, gaining share and leveraging our scale to drive efficiencies across our system. During the quarter we gained volume and value share by linking Coca-Cola's consumption occasions and engaging consumers through local experiences. A great example is A Recipe For Magic, which was activated in more than 50 markets and celebrates consuming Coca-Cola with meals. The campaign was supported by experiences using local chefs, leveraging approximately 750 influencers globally and was brought to life through social media and recipe-focused billboards.

The Coke x Meals campaign also allowed Coca-Cola to strengthen its local relevance. For instance, in the away-from-home channel in Italy, Coca-Cola has grown instance with pizza, the number one consumed meal with approximately 3 billion pizzas each year, from 10% to 20% over the past four years.

While the Coca-Cola brand is ubiquitous, we tailor our price pack architecture to consumption occasions and are continuing to drive both affordability and premiumization. During the second quarter we grew basket incidence and volume per trip by double digits while increasing price per liter.

Moving on to sparkling flavors. We are seeing strong engagement from consumers across our staple of brands, which includes Sprite, Fanta, Fresca and Thumps Up. At the same time, we have significant headroom to drive further quality leadership across developed and developing markets.

With Sprite, we are driving brand awareness by connecting consumers to passion points and personalized experience at a more granular and locally relevant levels through our global Heat Happens platform.

In North America, Sprite celebrated Hip-Hop's 50th anniversary with the launch of Sprite Lymonade Legacy and sponsorship of concert tours, exclusive experiences and collaborations with prominent artists. We partnered with local pop stars and a grammy producer in China using our global Sprite Limelight music program for Gen Z drinkers across 1,500 college locations. And in South Korea, the Sprite WaterBomb Festival similarly generated strong results.

In India, the Joke in a Bottle promotion allowed consumers to scan packages and receive customized and localized jokes through WhatsApp to beat the heat. In June, Sprite was awarded most resilient brand by Kantar for adding the greatest number of new households in 2022 of any FMCG brand.

Turning to water, sports, coffee and tea, we are segmenting the broader opportunities and using our refreshed resource allocation capabilities, prioritized markets and subcategories that offer the highest return on our investments. We are building our edge through consumer centricity by accelerating the speed to market our innovation, measuring results in real time and scaling successes.

We continue to build excitement for Fuze Tea through the rollout of green tea in Mexico, summer limited edition in Türkiye and expansion of Zero Sugar offerings across Europe. Early results show promising velocities, and Fuze Tea grew volume double digits during the quarter.

Vitaminwater is another example. During the quarter, we relaunched vitaminwater zero in North America with a new sweetness system of monk fruit and stevia, which generated value share gains.

We are capitalizing on consumer need for rapid hydration, a fast-growing subsegment within sports drinks, with the launch of BODYARMOR Flash I.V. in the US and Flashlyte in Mexico. While it's still early, both saw strong consumer interest during the quarter and have demonstrated promising initial results.

Our juice, value-added dairy, and plant-based beverages have delivered nine consecutive quarters of double-digit top line growth, and gained both volume and value share during the quarter. We continue to innovate to drive premiumization under the Simply trademark. Simply Mixology, which provides consumers with great-tasting mixers and ready-to-drink mocktails, kicked off an experiential campaign that celebrated the start of the summer and its national rollout.

Also, fairlife had another exceptional quarter as both Core Power and fairlife nutrition plan continued their strong momentum. In May, we announced a \$650 million investment to build a state-of-the-art production facility to help drive the next wave of growth.

Finally, we are encouraged by what we're seeing across alcohol ready-to-drink beverages. We continue to take a measured approach through exploring and applying our learnings. While still early, Jack & Coke has shown promising results. In the Philippines, the combination of Jack & Coke and Lemon-dou delivered strong share gains. The Schweppes Mojito rollout in India is also off to a good start, and these examples illustrate how our marketing transformation is coming to life.

The strength of our total beverage portfolio gives us further confidence that we can continue to deliver by providing consumers beverage choices for every occasion. Our purpose is to refresh the world and make a difference, and we remain committed to building a more sustainable future for our company and the planet as we strive to grow our business. We continue to pursue progress toward our vision of a circular economy for packaging through innovation and partnerships.

For example, in the US, we recently partnered with Republic Services to ensure we have an adequate supply of recycled plastic for our packaging. At the same time, we are embracing refillables. We recently kicked off a program with customers in four US cities to test refillable fountain cups with plans to expand elsewhere.

We successfully navigated the first half of the year, which supports our decision to raise guidance for the full year. And instead of trying to predict the many directions things could take, we remain focused on delivering our key objectives that we outlined in February. In other words, number one, pursuing excellence globally and winning locally through relentless consumer centricity to drive top line momentum; two, investing for the long-term health of our business and raising the bar across all elements of our strategic flywheel; and three, generating US dollar EPS growth.

Our system has never been stronger, and our global network model is allowing us to quickly adapt to changing environments. We believe we are well positioned to deliver our updated guidance and objectives thanks to our incredible system employees around the world.

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

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## John Murphy

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

Thank you, James, and good morning, everyone. We are pleased with the momentum of our business and our strong second quarter results.

Starting with the top-line, we grew organic revenues 11%. Unit cases were flat. As James said, volume for the second quarter got off to a slower start, but ended on a positive note.

Concentrate sales were one point ahead of unit cases for the quarter, primarily driven by the timing of concentrate shipments. Price/mix growth was 10% for the quarter, driven by carryover pricing coming into the base from last year along with some new pricing actions across operating segments, including the impact of hyperinflationary markets.

Comparable gross margin for the quarter was up approximately 40 basis points, driven by underlying expansion and a slight benefit from bottle re-franchising, partially offset by the impact of currency. Comparable operating margin expanded approximately 90 basis points for the quarter. This was primarily driven by strong top line growth and the impact of re-franchising bottling operations, partially offset by an increase in marketing investments and higher operating costs versus the prior year as well as currency headwinds. Putting it all together, second quarter comparable EPS of \$0.78 was up 11% year-over-year despite higher than expected 6% currency headwinds.

Free cash flow was approximately \$4 billion year-to-date. This was largely attributable to strong underlying operational performance and working capital benefits, partially offset by a \$720 million transition tax payment that was made during the second quarter as well as M&A-related payments.

Our balance sheet is strong, and our net debt leverage of 1.6 times EBITDA is below our targeted range of 2 to 2.5 times. Our capital allocation priorities remain the same, and we continue to invest to drive long-term growth.

As James mentioned, we are encouraged by what we are seeing in the marketplace. While we continue to spin our strategic flywheel faster to generate top-line-led growth, we've also progressed on our margin agenda as demonstrated by our consistent track record of offsetting cost headwinds to sustain steady gross margins. We have numerous levers available to drive top-line growth and improve the effectiveness and efficiency of our spend over the long term.

Our all-weather strategy, coupled with the great plans that we have in place to continue to create quality leadership across our portfolio, give us good visibility to deliver on our raised 2023 guidance. This is comprised of organic revenue growth of 8% to 9%, which includes positive volume growth while continuing to be led by price mix. There are a few considerations to keep in mind. We expect pricing in developed markets to moderate through the year as we cycle pricing initiatives from the prior year.

In developing and emerging markets, we aim to take price with local market inflation. To the extent that intense inflationary markets drive elevated price mix, the impact is oftentimes offset by currency as it is frequently difficult to hedge our exposure. Due to our reporting calendar, there will be one additional day in the fourth quarter.

We now expect comparable currency-neutral earnings per share growth of 9% to 11%. Based on current rates, our hedge positions, we are updating our currency outlook of an approximate 3- to 4-point headwind to comparable net revenues and an approximate 4- to 5-point currency headwind to comparable earnings per share for full-year 2023.

Inflationary pressures are beginning to moderate in some ways, including freight rates, that are favorable compared to last year. That said, several commodities that are prevalent in our basket like sugar and juice remain elevated, and we have some hedges that we will be rolling off to less favorable rates. 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.

Our updated underlying effective tax rate for 2023 is now 19.3%. All in, we are updating comparable earnings per share growth of 5% to 6% versus \$2.48 in 2022. We continue to 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.

If you exclude the transition tax payment made in the second quarter and various payments associated with M&A transactions, 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.

As we enter the second half of the year, we continue to build a culture that emphasizes raising the bar in every aspect of how we do business. Thanks to the tremendous ongoing commitment of our system employees around the world, we are confident in our ability to deliver on our guidance for 2023 and drive value for our stakeholders over the long-term.

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



## QUESTION AND ANSWER SECTION

**Operator:** [Operator Instructions] In the interest of time, we ask that you please limit yourself to one question. Our first question comes from Bryan Spillane of Bank of America. Please go ahead. Your line is open.

**Bryan D. Spillane**

*Analyst, BofA Securities, Inc.*

Q

Hey. Thanks, operator. Good morning, everyone. I guess I have a question about just as we kind of look into the back half of the year and looking at organic sales, the implied organic sales guidance, which I guess is in the 5% to 6% range in the back half of the year. Maybe, James and John, can you just talk a little bit about how maybe the just the macro environment or the operating conditions are today versus what you were thinking at the start of the year?

And given that there's more of these markets where, countries where hyperinflation is an issue, is price a little bit more of a driver in terms of the organic sales comp in the back half of the year relative to volume, again, versus kind of what you were thinking at the start of the year?

**James Quincey**

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

A

Yeah. Good morning, Bryan. Let me try and unpack that a little bit. I think the headline part of the answer is there's a little more pricing in Q2 and in the downhill than we had expected at the beginning of the year principally around that basket of countries where inflation is high, above 20%, and a little more persistent. That's the short answer.

But the longer version of the answer is, look, we're executing the strategy we've talked about consistently over time, and again, in CAGNY, the real focus on upping the bar on marketing, upping the bar on RGM, the commercial strategies and the execution in the marketplace, all with the intent about delivering a good, strong, top-line-led growth algorithm. And, obviously, that we've talked historically that in normal -- normal times that 5% to 6% would be split between volume and price on a roughly equal basis.

And so, what you're seeing in the back half of the year, which I think is important to note, is we're expecting volume to be consistent in the second half with the way it was in the first half, which in the end is running on a trend, if you like, a CAGR versus 2019, similar to what we did last year. So, we see sustained positive volume growth coming out of 2022. And we're looking for volume growth in the second half in a very similar way to the first half whether you're comparing to prior year or to 2019. So, we want a business that is growing consumer base for all the right, appropriate strategic reasons.

Then what's going to happen to revenue in the second half is we're going to see the impact of three buckets of price/mix. The first bucket is the carryover of pricing from prior year. Obviously, there was more cost inflation last year. But logically, that is a set of numbers that is going to tend to zero by the end of December. And so that is going to stick down as we go through Q3 and Q4. So bucket one, carryover. That's going to step down.

Bucket two is price increases we've made so far this year that are leaving aside the large inflation countries, look much more like a normal year in terms of what we've taken this year, both in terms of timing, number of price increases and relative level of price increases [Technical Difficulty] (00:24:57-00:25:22)



**Operator:** Ladies and gentlemen, we are experiencing technical difficulties. Please stay on the line.

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**James Quincey**

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

A

When did I stop? Operator, do you know when the line cuts on my answer?

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**Operator:** Unfortunately not, sir. Our next question will come from Lauren Lieberman from Barclays. Please go ahead.

[indiscernible] (00:25:44)

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**James Quincey**

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

A

Operator? If you let me just finish the other question. I'm just going to back up.

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**Operator:** Certainly.

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**James Quincey**

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

A

Apologies to everyone for the technical trickiness. I'm just going to back up, and if I'm repeating something I said, apologies. And if there's a gap in the logic, apologies again. I think we talked about volume, second half similar to first half, whether you're talking prior year or 2019.

Pricing, three buckets. The bigger piece of the pricing of the three factors, which is the carryover, is obviously stepping down through the year towards zero by the end of the fourth quarter, the new pricing that's coming in 2023 being very consistent with the kind of normal level of pricing that we would see. And it's kind of in place already for the year, and that obviously then continues at the same rate through the rest of the second half.

And the third piece, which is about a quarter of what's happening on at PMO at the moment, this bucket of higher inflationary countries. And as I said earlier, there was a little more inflation from those countries in the second quarter than we had previously expected. Obviously, that then comes back around in a little more forex headwind. We are assuming that some of those inflation rates will moderate in the balance of the year in the second half and likewise moderate in the forex, although it's very uncertain. So, we'll have to see what happens. But that's basically the composition of how to think about the effect of our strategy delivering good top-line growth in the second half.

Next question, operator.

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

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**Lauren R. Lieberman**

*Analyst, Barclays Capital, Inc.*

Q

Hi. Can you hear me okay? Because like my line has got crackly now.

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**James Quincey**

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

Yeah.

A

**Lauren R. Lieberman**

*Analyst, Barclays Capital, Inc.*

That's okay. Okay. Great.

Q

**James Quincey**

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

Yeah. We got you, Lauren.

A

**Lauren R. Lieberman**

*Analyst, Barclays Capital, Inc.*

Cool. Good morning. Okay. Wanted to ask a little bit, actually, about Costa and coffee overall in light of the resource allocation model and identification of key profit pools and so on. Not mentioned in the prepared remarks but definitely called out in the press release this morning with particular strength in the UK. So, I guess broad question would be how coffee overall is kind of fitting in on this thought process and resource allocation models, if they are getting a particular differences by geography fits for different emphasis on the category by different bottlers. And then specific to the numbers called out in the release saying Costa UK, should we think about that as recovery with mobility, COVID or tweaks or adjustments to the strategy you've made that are beginning to come through in performance? Thanks.

Q

**James Quincey**

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

Yeah. Sure, Lauren. Let me do it in reverse order. The Q2, I think, is more recovery than new stages of growth. Having said that, the Express machines have continued to expand numerically in terms of numbers of placements all the way through COVID and including, so far, this year.

A

So, the Express business, the B2B business in the UK is – has been strong, remains strong, and still growing, so gaining share. The retail – the store numbers are much more about a recovery, kind of completing the play on mobility, perhaps, and have gained share a little bit. And, obviously, we're focused on how to drive growth going forward, and we see plenty of headroom in the UK market. But I would characterize year-to-date more on – more of a biased recovery on stores than new, and the bias in Express on new.

Internationally speaking, in – if you just break it down into – there's a couple of different buckets. The ready-to-drink bucket, we've made some good progress in China. We made some good progress in Japan with launches of ready-to-drink Costa, in the case of Japan, complementing Georgia. And actually, Japan had a pretty good start of the year growing both Georgia and Costa, so kind of a full coffee strategy in the ready-to-drink looking good. And that's still the most important ready-to-drink coffee market for us.

And then the B2B, which is a mix of Express along with kind of we're serving, so providing machines and beans, starting to see that getting some traction in Europe with the bottling partners there. And starting to kind of find its feet in the US, too. And those are the ones I'd call out as the most – as at the front of the program in terms of geographic expansion.

**Operator:** Our next question comes from Dara Mohsenian from Morgan Stanley. Please go ahead. Your line is open.

**Dara Mohsenian**

*Analyst, Morgan Stanley & Co. LLC*

Q

Hey. Good morning. So, I just wanted to...

**James Quincey**

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

A

Good morning.

**Dara Mohsenian**

*Analyst, Morgan Stanley & Co. LLC*

Q

...follow-up on Bryan's back half question. You did mention a weaker start in April post the Q1 call, and then the stronger June volume performance, obviously, on this call. Is that engendering additional confidence internally around top-line? And the reason I'm asking is it sounds like, conceptually, you're not necessarily guiding to the June volume strength continuing in the second half. I'm just trying to understand that. Is that more just prudence, given the inflationary environment you mentioned and consumer volatility, or are there other factors there?

And as we think about your full-year organic sales growth guidance range as part of that question, was that just the upside in Q2? Was some of it maybe some upside from Q1? Did you change expectations at all from the back half within that full-year organic sales growth guidance raise? Thanks.

**James Quincey**

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

A

I think, Dara, you might get the prize for the most questions in one question. Look, clearly in the second quarter as we had anticipated in the previous call, April had started softly. But then, things kind of normalized towards the end of the quarter and June was a good solid month of growth.

But I think the easier way to think about is, take the whole of the first half, because you're always going to have some good months and some bad months. April happened to concentrate some price increases in developed countries and bad rains in India. Look, that will always happen on any given month.

I think what is a question of what gives us confidence in the back half of the year, if I just take January to June, with its combination of good, middling and bad months, the growth rate in the first half, what we're expecting is a similar sort of growth rate in the second half whether you compare it to 2022 or to 2019. And so, we think the momentum is there. We think, in the developed markets, we've got through the pricing that needed to be taken in 2023. We don't foresee substantive new pricing in the downhill. But we think this is going to be a well setup run-through in the second half. And as I called out on that other answer with Bryan, the uncertainty factor is really around the concentrate in a few of these more inflationary marketplaces.

Guidance going up, I guess there's obviously some flow through. We had a good first quarter, obviously, versus consensus; a better second quarter. We clearly feel confident in our outlook for the full-year, which is why we're taking it up. So, there's some flow through. Obviously, there's some timing factors in the relative performance in Q2.

And as we've talked on previous calls, given the nature of our business and where we sit in the supply chain relative to final sales, I think it's always good to take a multi-quarter average to the way of thinking about volume or pricing or even the flow through to EPS. And I think that's kind of something that we always think about. Otherwise, you can get too distracted by the ups or downs on any given quarter.

So, we're going up in the guidance. We feel confident about the second half. There will always be some puts and takes, but we think we have a great strategy and a great plan to execute for the rest of the year.

**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. I guess – I had a question on your Asia-Pacific operating margins, which were pressured again this quarter. And then, James, you touched on a couple of markets that are still facing pressures. But just hoping you could share a little bit more color on some of these headwinds in the region, and then any key initiatives you might have implemented to mitigate some of these pressures? And, as a result, how should we think about your op margins trending through the remainder of the year in the region? Thanks.

**James Quincey**

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

A

Sure. As it relates to Asia-Pacific, what we – there's obviously a set of things that happened in Q2 that were specific to Q2. There was some destocking in the China operating unit that was kind of a significant piece there. And there was some strong demand for some of the juice businesses in China and India. And those are two kind of atypical factors that happened that depressed on a timing basis, the margin in Asia-Pacific.

It is worth noting that there is a sort of structural headwind when seen specifically just at the Asia-Pacific region level. And what I mean by that is that we have a very big business in Japan, which is an excellent business and has a good operating margin. But then Asia-Pacific concentrates a set of fast-growing emerging and developing markets; India, China, some of the southeast Asian countries. And given the nature of how fast they grow in their emerging profile, i.e., they have price points that are lower than Japan, they create a negative geographic mix effect to the Asia-Pacific reporting segment. That's been a feature for an extended period of time. In other words, you have to sell one point something cases in India and China to make up, to kind of compensate the mix effect relative to that.

So that's kind of structural headwind is always slightly there. Obviously, our objective is through our strategies, our marketing, RGM, execution, and the way we invest to try and offset that headwind. So, if you look back over time, you'll see that whilst the margin fluctuates up and down, it has kind of had a certain stability when you look, for example, at 2019 versus 2022.

And so, I close by saying don't over-rotate to one quarter in the case of Asia-Pacific, given some of the issues. But I would also point out that this is not a region seen on its own where operating margin is likely to grow over time because of the structural mix effect. But when seen at the company level, we obviously manage it as part of the overall portfolio so that it is a piece of the puzzle in looking at our total strategy of, as we've talked about, using the levers to hit that top end of the revenue at 5 to 6 with a little bit of aggregate operating income margin expansion for the total enterprise. And we understand the role of each segment within that equation.

**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.*



Hey. Good morning. Thank you. Actually, I want to squeeze in two topics. But I want to pick up first on, James, what you were just talking about in the broader total company context.

In the quarter, the top line was obviously strong. But I think relative to external expectations, we saw a bit more margin flow through and SG&A leverage than was expected, especially in regions like North America where the margin was exceptionally strong relative to history. So, I'm curious in terms of how to think about the balance of managing top-line growth versus continued margin expansion as you think about the back half, but then also more broadly, just in the context of your top-line-led algo. Is there maybe more cost efficiency opportunities that we should be thinking about longer term? Or is what we're seeing in the quarter maybe more just a matter of timing?

I also, John, if I could just want to loop back to a question I asked last quarter on below the line dynamics. You came into the year talking about below the line leverage, interest expense and so on. But we haven't seen that again this quarter, especially with the lower tax rate. So, I'm just curious if that has changed in the full-year and if that factored into the full-year guidance range. Thanks for both.

**John Murphy**

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



Steve, let me take the second piece. First, it's fairly straightforward. In the quarter we benefited from higher equity income and from interest that we earned on our overseas cash, which was in both cases ahead of what we had assumed when we guided at the start of the year. And from the second half of the year, I don't expect either of those two to be as strong. So, I just think we have little bit of deleverage in the second half of the year, but modest, not a significant variable for your consideration in the second half of the year.

**James Quincey**

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



Cool. Yes. Back to the margin element of the question. North America, in a way, [ph] is the flip side (00:41:05) of what we just talked about in Asia-Pacific. Obviously, the results came in very strong in North America on the top line and on the margin. Again, there are number of timing factors that kind of flatter the second quarter margin structure in the case of North America, including, for example, a bit like the Costa UK, bit as it was a much faster growth rate in the away-from-home than the at-home in the North American marketplace. And, obviously, that's margin accretive. That should be seen as, in a way, more completing the play of the recovery versus COVID. So, the completion of the reopening of restaurants, cafes, theme parks, et cetera, et cetera. And so that channel mix, if you like, flatters the operating income in the short-term. There's a number of timings of other things that impact that, BODYARMOR integration, et cetera.

I think the way to think about margin going forward by segment and most importantly for the company overall, is firstly not to over rotate on any one quarter. Remember that there are number of expenses, items and deduction items that we accrue on the basis of sales curve, not just what actually happened in the quarter. So timing is a feature. And that's why I'm very strong on let's take four quarters in a row and look at that relative to history. And when you do that, whether it would be North America, Asia-Pacific or more importantly the company overall, what you're going to see is us sticking to our strategy, which is to drive the growth from the top line and then to look for

modest or moderate increments of the operating margin which we deliver not just by effective strategies to allocate resources, whether they be marketing or operating expenses, so that we are efficient and get a little bit of leverage there. But the design of the portfolio itself and the RGM strategies also is a component in creating sales that inherently have a little more gross margin. So, we use all the levers to try and deliver.

And so, don't take these segments' over or under deliveries as a sign of something new and radical happening, if they are features of our business model. And the big overall idea is top-line growth with small increments of operating margin expansion.

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

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**Robert Ottenstein**

*Analyst, Evercore Group LLC*

Q

Great. Thank you very much. James, I'd like to talk about the global system. Recently there's been a lot of interesting developments in some of the bottlers. You had CCH buy Finlandia. You've had a lot of your bottlers, particularly in Latin America and elsewhere, talk about B2B platforms that they're developing. And so, my question is, how are you thinking about these developments? Are there new models, revenue-earnings sharing models? And how do you make sure that the bottlers stay focused on those products that drive the most value for The Coca-Cola Company? Thank you.

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**James Quincey**

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

A

Sure. Let me start just by headlining. Actually, we've just come off last week we had a global bottler meeting in Atlanta. I think it's been 30-plus years since we had that meeting in Atlanta. But we had it in Atlanta last week with the majority of the biggest bottlers in the Coke system. And I think it was a very clear meeting on our collective will and ability and interest in investing in this business and our overall level of alignment on what's important and what should we drive individually and what needs to be driven collectively. So I actually, you guys all go around and talk to the bottlers as well. And I think you'll get it reflected back from – there is a very high degree, not just of alignment on what needs to be done, but enthusiasm on the opportunities ahead of us to drive the business, our collective business forward.

On some of the specifics, clearly, you've got in that basket – there are things that happen around the world that are local and obey a set of dynamics that are important and relevant and not necessarily projectable around the world. The case of CCH and the distribution and now the ownership of Finlandia, I think, is one of those. The B2B platforms which progress very nicely in Latin America are a feature of the business in multiple other countries. We've been testing and exploring and developing individually and collectively B2B platforms with the principal objective of enhancing the system, and most importantly, the bottler's relationships with the retailers.

To the extent that we can complement, and here we're largely talking the fragmented channel, because the relationship with the modern trade is already set on electronic platforms anyway. We're talking about the fragmented trade and the majority of almost 30 million customers we visit as a system is to enhance that relationship, to make it no longer hostage to the visit of the Coke sales rep, but to make it a 24/7 opportunity to enhance relationship to all the product, to ask for service call, to get a new cooler, to put some umbrellas up, or to add to an order that's already about to be delivered.

And that is certainly when we have evaluated how those customers where the B2B platforms are available. How they're doing versus where it's not yet rolled out, there is clearly an improvement, not just in the relationship,



however, you want to measure it, but also in the sales. So, there's a lot going on in the system. And I think the last thought there is you should take it also as examples of the willingness of the system to experiment and try and be on the front edge of what drives value in the marketplace.

**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*

Q

Hi. Good morning.

**James Quincey**

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

A

Good morning.

**John Murphy**

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

A

Good morning.

**Chris Carey**

*Analyst, Wells Fargo Securities LLC*

Q

You made a comment on some private label switching happening in certain markets. Can you just expand on where you're seeing this specifically and geographically and perhaps by category. And the playbook that you'll be deploying in these markets – the sorts of development that you'd be looking for to respond to these actions ahead? And I ask that a bit in the context of, clearly, some of your ingredients are still quite inflationary and whether you see any potential risks to being able to price against that inflation in some of these markets going forward. Obviously, you have a playbook with a lot of different levers, and I'm just curious to hear your thoughts on where these developments seem to be happening and how you think about responding to these a bit more specifically. Thanks.

**James Quincey**

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

A

Sure. So private label switching is principally a feature, firstly, in Europe, and then, to some extent, also in the US. If you were to include price brands or B brands, you might see some of that also in Latin America, depending on how you want to define it. But very specifically on private label, that's, number one, a European effect, and number two, a US effect. And it's, in our view, highly related to the strength of the brands in any specific category. So, we see it more, in terms of beverages, happening in water and juices rather than soft drinks, and certainly less when you get to colas.

The strategy on top of what we need to do in terms of our marketing and continuing to make the brands relevant to the consumers and executing in the marketplace is, of course, the RGM strategy. Yes, premiumization remains an opportunity, but we need to keep an anchor and continue to evolve and adapt our strategies on affordability, whether that be refillables, whether it be affordable small packs, or affordable future consumption packs, that has become something that is a tested strategy in inflationary environments; well learned in Latin America, for example, but now applied – has been for a number of years in Europe and in the US.



And we have more things we can do in both marketplaces that have an anchor in both affordability and premiumization. And that's a playbook that we're rolling out and executing in those marketplaces.

As it relates to the inflation and the COGS coming through, obviously, some of that, whether it be juice or sugar and corn syrup, affects different markets. The most of the inflation is in the set of markets where we do price to local inflation. And in a way, the higher inflation gets, the more likely it is you're just – you're going to follow inflation. And so, the risk to not following is not really there as it goes up. The risk actually appears on the volume side. But this is a select group of markets.

So, if it were to [ph] err (00:52:07) towards the more inflation in the back half of the year, we think it's manageable. If it were to [ph] err (00:52:12) to the less inflation, that would be good. But we think it's in a bucket of manageable things.

And as it relates to the total company relative to some of those input costs, we have very long-term relationships with most providers and long-term hedging programs, which allow us to kind of – they don't avoid inflation, but they smooth it, but then makes it much more manageable from a pricing and packaging point of view.

**Operator:** Our next question comes from Filippo Falorni from Citi. Please go ahead. Your line is open.

**Filippo Falorni**

*Analyst, Citigroup Global Markets, Inc.*

Q

Hey. Good morning, everyone. Can you guys talk a bit more about your alcohol strategy broadly, particularly with the Red Tree Beverages subsidiary? And specifically, in terms of like new innovation, any other subcategories or areas where you are looking to expand within alcohol? I know you're experimenting, but just any color on the future plans will be great. Thank you.

**James Quincey**

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

A

Yeah, thanks, Filippo. Look, the Red Tree entity that we stood up in the second quarter is more of a technicality than some new big step forward. It isn't a change of strategy and it's not a vehicle to distribute in the US. It allows us a better platform to engage with the partners that we're working with in the US, in terms of coordinating and influencing the marketing, and allows us a better separation of the alcohol versus the non-alcohol band. So, it's more an optimization of the model and how we want to execute things rather than a different thing.

And then, in terms of progress, look, it's still a small part of the business. And as I talked about, I think it was CAGNY, it's great and there are lots of runs on the board. Jack & Coke has got some really promising nice results, including in the US. Simply Spiked Peach is performing very nicely in the US. If you want to look for a really bright spot, you can head to the Philippines and Jack & Coke and Lemon-dou, which is an alcoholic lemon drink, got well over 30% share of their RTD category. All of this is very encouraging as we continue to take a measured approach to this, and to kind of learn and apply our learnings. All of this needs to generate belief that it can be material for the Coke company, not just a nice business; and that we're still in the process of driving towards. But certainly, so far, we're pleased with what's taken place, and we're encouraged about the next steps that we have to take.

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

**Andrea Teixeira**

*Analyst, JPMorgan Securities LLC*



Thank you. Thank you for squeezing me in. James, on your volumes commentary – and I appreciate that. On your four-year CAGR, I think if our math is correct, is 1.7% unit case for total company, which is obviously remarkable. That said, I think EMEA was a bit softer in the quarter. I understand your commentary about Russia. And what is actually happening in EMEA ex-Russia? And how should we be thinking going forward?

And related to that, since your comment that the US was very strong out of home, and Europe is – a big percentage of Europe is out of home, on the comments about June, how we should be thinking not only about Europe, but the performance of on-premise against off-premise globally? Thank you.

**James Quincey**

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



Hang on. I'm trying to process all the questions. I think you've beaten – was it Dara, I think you've beaten there? EMEA was a bit softer. Yeah. I think on EMEA, we are – it was even though – so on EMEA, we're expecting EMEA to be positive in the second half. And so, there was a rump effect from the withdrawal from Russia in the second quarter. So Europe was in pretty good shape. Actually, Europe ex-Russia, if you take the first half, Europe ex-Russia was positive. So, we are feeling that now it's dropped out of the base numbers in the second half, that actually Europe and EMEA will be in good shape.

Obviously EMEA has got a couple of the hyper-inflationary countries like Türkiye and like Pakistan. So EMEA could get other effects. But if you concentrate where Russia is, which is Europe, which is the biggest impact, actually Europe had a positive volume in the first half if you take out Russia. And so, we're feeling good about Europe as we go into the second half. And I think the question really is the trade-off between pricing and volume in a couple of countries, particularly Türkiye and Pakistan, and for those that want to go deep down the rabbit hole, Zimbabwe as well.

Now the next part of the question was about away-from-home versus at-home. Yeah. It wasn't just June which was the strength in the US basically the first half. You've seen the out-of-home growing ahead of the at-home and the recovery. And I think that's the way to think about it is we're seeing the back end of the recovery in the away-from-home. Similarly, in Europe, in fact, globally transactions were ahead of volume, which tends to imply smaller packages are growing faster than bigger packages from a mathematical point of view. So as a global feature, there's a little more on-premise consumption or little more small package consumption than large package consumption, which helps as well. But I don't think we should see this as a new secular trend, more kind of the last bit of renormalization post-COVID.

**Operator:** Our final question today will come from Peter Grom from UBS. Please go ahead. Your line is open.

**Peter Grom**

*Analyst, UBS Securities LLC*



Thanks, operator, and good morning, everyone. So, James, maybe just two quick follow-ups; one just on Chris's question around trade down and improving affordability. Do you expect any changes in the promotional environment, particularly in North America? It doesn't sound like that's the shift you expect but just wanted to be sure. And then just following up on your response to Andrea's question, I would be curious how you see channel mix evolving as consumers seek more value in some of these developed markets, particularly just given the strength from away-from-home that you just alluded to. Thanks.

## James Quincey

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

A

We see the US pricing and promotional environment as pretty rational. We have a set of strategies in place to try and balance our premiumization, regular and affordability strategies in the US, which includes a little more promotion than the first quarter. But basically, promo levels are very similar to prior years and not as stepped up. And we think that we have the right balance of premiumization and affordability plays to be able to continue to gain, as we did in the second quarter, volume and value share in the US. So, we think the environment is rational. We think our strategy works for us because we gain volume and value share. and we've got the right mix of, roughly the right mix of, promo and price. And, obviously, we're going to continue to push the affordability and the premiumization play.

And then the channel mix question. Do we think we'll see in developing markets I think – I think the principal feature is a renormalization post-COVID. I don't think it's kind of recessionary or inflationary or that. I think it's just been we've kind of seen a renormalization of the channel mix. We have talked over prior years about how big an impact on price mix and margin structure, the shift in channels were with what seems ages ago, the lockdowns. That is now largely played out, which is another way of saying we don't expect channel mix to be a major feature of the discussion in quarters and years to come. Thanks.

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

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## James Quincey

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

Yes. Thank you, operator. So just quickly summarize. Second quarter results, I think, demonstrate the momentum we have in the marketplace. We are navigating a broad set of dynamics in the local markets while driving scale and maintaining flexibility at a global level. We are confident in our ability to deliver on our 2023 guidance and our longer-term objectives. Thanks for your interest, your investment in our company and for joining us this morning.

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

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