Keurig Dr Pepper, Inc.

Fourth Quarter 2023 Earnings Call

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CORPORATE PARTICIPANTS

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Robert Gamgort – *Chief Executive Officer & Chairman*

Tim Cofer – *Chief Operating Officer*

Sudhanshu Priyadarshi - *Chief Financial Officer*

PRESENTATION

Operator
Good morning, ladies and gentlemen, and thank you for standing by. Welcome to Keurig Dr Pepper's earnings call for the fourth quarter and full year of 2023. Should you need assistance, please signal a conference specialist by pressing the "*" key followed by "0."

This conference call is being recorded and there will be a question and answer session at the end of the call. To ask a question, you may press "*" then "1" on your telephone keypad. To withdraw your question, please press "*" then "2." I would now like to introduce the company's Vice President of Investor Relations and Strategic Initiatives, Jane Gelfand. Ms. Gelfand, you may begin.

Jane Gelfand
Thank you, and hello, everyone. We appreciate your attention, recognizing that many of you are also attending an industry conference. Earlier this morning, we issued a press release detailing our fourth quarter and full year results, which we will discuss during this conference call.

Before we get started, I'd like to remind you that our remarks will include forward-looking statements, which reflect KDP's judgment, assumptions, and analysis only as of today. Our actual results may differ materially from current expectations based on a number of factors affecting KDP's business. Except as required by law, we do not undertake any obligation to update any forward-looking statements discussed today. For more information, please refer to our earnings release and the risk factors discussed in our most recent Forms 10-K, which will be filed with the SEC later this morning.

We will also discuss non-GAAP measures of our performance. Definitions and reconciliations to the most directly comparable GAAP metrics are included in our earnings release. We will also speak about the concept of underlying performance, which removes the impact of non-operational items in the current and prior years. These items include gains on asset sale leaseback transactions, reimbursement of litigation expenses related to the successful resolution of our BodyArmor lawsuit, a business interruption insurance recovery, and a change in accounting policy for stock compensation.

Here with us today to discuss our results are KDP Chairman and CEO, Bob Gamgort; Chief Operating Officer, Tim Cofer; and Chief Financial Officer and President, International, Sudhanshu Priyadarshi. I'll now turn it over to Bob.

Bob Gamgort
Thanks, Jane, and good morning, everyone. 2023 was a year of significant progress for KDP, as we: grew share across the majority of our business; entered multiple, high-growth white spaces, such as ready-to-drink coffee and sports hydration, through highly capital-efficient partnerships; began to rebuild margins while simultaneously driving high-quality reinvestment; returned more than $1.8 billion dollars to shareholders, including a 7.5% dividend increase and the opportunistic repurchase of 22 million shares; and delivered our financial outlook while significantly improving the composition of our earnings and strengthening our balance sheet.

Full year constant currency net sales grew nearly 5% and EPS advanced 6%. On an underlying basis, our EPS growth was even stronger and in the double digits, as we largely eliminated the contribution from non-operational gains that benefited the prior year. Pricing actions and a near-doubling of year-over-year productivity savings more than offset continued inflationary pressure, supporting earnings growth even as we funded a double-digit increase in marketing. Our 2023 performance demonstrated the resilience inherent in our broad portfolio, with continued momentum in U.S. Refreshment Beverages and International offsetting short-term pressures in U.S. Coffee.

We also initiated a thoughtful succession process that balances continuity and new perspectives across the company's most senior leaders. Tim and our refreshed executive team have merged seamlessly, are building momentum, and add to my confidence in KDP's future success. Our hard work in 2023 sharpened our strategic roadmap and bolstered our capabilities and financial profile, providing a platform for growth and value creation in 2024 and over the long term.

Moving now to fourth quarter results. A primary focus for us last year had been rebuilding our margin structure. We made impressive gains in Q4, driving the strongest quarterly gross margin expansion in our history and the fastest rate of operating margin improvement in multiple years. This improvement was broad-based across each of our segments and enabled us to deliver EPS above the outlook we shared last quarter, despite the impact of some transitory top-line headwinds.

Q4 constant currency net sales grew 1.1%, with net price realization more than offsetting a volume/mix decline. This result is not representative of our ongoing momentum and was in part weighed down by short-term factors in our U.S. Coffee business that we do not expect to persist. We have good visibility to mid-single digit consolidated net sales growth in 2024, which Sudhanshu will address in a few minutes.

Q4 gross margin expanded 450 basis points, translating to gross profit dollar growth of 10% and helping to fund increased investments. Operating income increased at a high-single digit rate and EPS grew in the double-digits. Notably, normalizing for non-operational items in 2022, our Q4 underlying EPS growth rate was in the high teens.

We continue to enjoy strong momentum in U.S. Refreshment Beverages. Net sales grew at a high-single digit rate in Q4, led by still very healthy net price realization and manageable elasticities, with volume/mix declining only modestly in the period. A redoubled focus on productivity and cost discipline, along with strong C4 Energy partnership execution, translated this top-line to double-digit operating income growth. Q4 segment margins expanded meaningfully, even as marketing continued to grow.

As we observed back in October, though consumers remain largely resilient, value is a key shopping consideration. Many consumers are making trade-off decisions to manage stretched household budgets. As a result, value-oriented channels, such as club stores, continue to outperform, and consumers are inclined to shop more during deal periods, such as holiday weeks.

Our U.S. Refreshment Beverages business model is well suited to a dynamic macro environment. The breadth of the beverage occasions we serve, and the depth of our distribution allow us to spot changing consumer trends with speed. We then flex our plans to deliver on the key tenets of our growth strategy, driving category growth, market share gains, and white space expansion, regardless of the operating environment.

The fourth quarter was no exception, with dollar sales growth and share gains across 85% of our U.S. Refreshment Beverages business. CSDs grew nicely, led by Dr Pepper, which was the largest market share gainer among the top 10 category brands for both the quarter and the year. During Q4, we once again activated our Fansville marketing campaign to fuel awareness and drive demand, and despite Dr Pepper's existing scale, we grew incremental display and ACV for key varieties and pack sizes. Dr Pepper Strawberries & Cream also remained highly resonant, finishing 2023 as the #1 Innovation launch in the CSD category.

In other parts of our portfolio, we leveraged Revenue Growth Management to ensure we are offering consumers continued compelling value across all channels and formats. For instance, in Q4, we deployed more multi-packs and tailored promotional and merchandising strategies by channel for Core Hydration and Evian. As a result, our premium water portfolio grew retail dollars and notched market share gains, overcoming some consumer trade-down to mainstream water.

Our pursuit of white space opportunities continued in Q4, wrapping up a very active year. We exited the first year of our sales and distribution partnership for C4 Energy with momentum. C4 commands less than a 3% share in energy today with meaningful upside ahead, and we have strong commercial plans to add significant further scale in 2024. We also just started shipping Electrolit through the KDP system, which will build our exposure to the fast-growing sports hydration category and multicultural consumers.

A full innovation slate adds to our 2024 excitement. This includes the launch of Dr Pepper Creamy Coconut just in time for the summer season, a Canada Dry Fruit Splash CSD, Snapple mini bottles, the restage of Bai Wonder Water, Core Hydration partnering with Team USA Gymnastics, and the national U.S. roll out of Penafiel, our powerhouse mineral water brand from Mexico.

We intend to leverage continued U.S. Refreshment Beverages top-line growth to drive a balance of reinvestment and bottom-line delivery in 2024. Over the past year, our commercial and supply chain teams have grown increasingly integrated, yielding significant efficiencies. As a result, our productivity savings run-rate step-changed in 2023 and we began 2024 with healthy carryover savings and a robust pipeline of additional projects to support P&L flow-through.

In U.S. Coffee, we continue to "control the controllables" in the context of a still sluggish at-home coffee category. Our Q4 pod shipment trends improved relative to Q3, and we delivered another quarter of strong segment margin recovery and underlying operating income growth. We also ended this year having added approximately 2 million new households to the Keurig ecosystem, in line with our target.

That said, net sales declined 10% year-over-year, as some short-term dynamics weighed on Q4 segment performance. As Sudhanshu will describe in detail, a combination of transient factors accounted for roughly half of the top-line decline, and we expect these to dissipate in 2024.

Bigger picture, volume consumption in the at-home coffee category declined about 3% in 2023 in IRI tracked channels, gradually recovering from a mid-single digit decline in 2022. Q4 category trends were largely consistent with the full year. In both the quarter and the year, single serve coffee continued to grow as a percent of total at-home coffee servings, and Keurig-compatible brewers also gained meaningful share.

In 2023, 4 out of 10 brewers sold were Keurig-compatible and in Q4 that ratio approached 50%. These are clear indications of our ecosystem's ongoing appeal to coffee-drinking households. While at-home coffee category consumption is taking longer than we anticipated to return to growth, the back half of '23 was clearly stronger than the first and we expect the gradual recovery to continue.

Our 2024 U.S. Coffee strategy incorporates a balance between long-term growth initiatives and short-term actions that address current macro realities. We will continue with high-quality, brand- and ecosystem-building activities to drive incremental household penetration, increase pod usage among existing and new households, and accelerate growth in ready to drink coffee. At the same time, we will emphasize affordability through revenue growth management initiatives such as engineering brewers to hit important entry price points and highlighting the relative value of consuming coffee at home versus in coffee shops.

For higher income consumers, we continue to build out super-premium solutions. These actions should support a broader at-home coffee recovery and ultimately help return the single serve category to its long-term growth trend. Even so, we are building our 2024 financial plans around more prudent category growth assumptions.

With more than 50 million coffee drinking households in the U.S. yet to convert to single serve, there is significant runway to steadily grow penetration. We have an ambitious vision of Keurig's future, some of which we will begin to share publicly starting this spring. At the annual housewares show in a few weeks, we will preview an exciting pipeline of disruptive innovation of Keurig brewers, and we will be making a public announcement about these innovation plans shortly before that event.

Our 2024 pod program is equally robust. Innovation will span cold and hot occasions and a spectrum of brews and flavors. Along with incremental promotional and marketing support, these new products will directly bolster our owned and licensed brands. Products like refreshers will benefit our indulgent Donut Shop brand, while our high-profile collaboration with Kevin Costner will elevate Green Mountain. This is Costner's first brand campaign in thirty years and will feature the co-creation of a unique set of blends and integrated marketing events to highlight our shared passion for coffee quality and sustainability.

We remain focused on building out the super-premium tier of pods, which reinforces Keurig's reputation for quality and supports premiumization in the category. Our latest activities began in Q4, with the introduction of La Colombe licensed pods, and continue in early 2024 with the conversion of Lavazza to a licensed relationship, which will unlock more growth and efficiencies for the brand. Our ready-to-drink coffee efforts are also gaining momentum. In Q4, we commenced our sales and distribution partnership for La Colombe ready to drink coffee, now with renovated products and packaging.

Wrapping up on U.S. Coffee, while we are not satisfied with our 2023 performance, we are taking steps to support a stronger 2024. We are acting as a category leader to revive long-term category growth, thinking expansively and disruptively, with the vision, capabilities, and willingness to invest in future growth opportunities for ourselves and on behalf of our partners. In other words, we are being open-minded and ambitious, and positioning KDP to benefit from an at-home coffee category rebound, while also planning 2024 in a measured way.

Moving now to our international segment, revenue grew at a double-digit rate on a reported basis and high-single digit rate in constant currency, with a continued balance between pricing and volume/mix. As with our other segments, operating income grew faster than net sales, resulting in significant margin expansion.

Our performance reflected healthy growth across country markets. Our results were led by strong trends across our cold beverages portfolio, primarily driven by Penafiel and Clamato in Latin

America, Canada Dry and Dr Pepper CSDs in Canada, and our continued expansion of our ready to drink alcohol and alcohol alternatives products.

In our international coffee business, we delivered strong household penetration growth in 2023, and this will remain a 2024 priority. In support of that aim, we recently inked an agreement to make Keurig the “Official Coffee Maker of the NFL” in Canada, capitalizing on the sport’s growing popularity. Our international momentum is supported by broad-based capability investments, including in areas such as distribution and consumer insights. As in the U.S., our DSD system in Latin America represents a competitive advantage.

During 2023, we bolstered our reach by expanding our routes and building out more dedicated coolers at retail, and plan to do so again in 2024. Meanwhile, our innovation pipeline marries local expertise and enterprise-wide insights, for instance, the launch of Schweppes Mocktails in LatAm will build on our experience in ready to drink low- and no-alcohol products in Canada, while the upcoming introductions of Dr Pepper Dark Berry in Mexico and expansion of zero CSDs in Canada leverage successful playbooks out of the U.S.

Since merger, we have grown our international business at a strong double-digit CAGR from slightly over $1 billion in annual sales to almost $2 billion. We continue to see outsized growth potential in this segment, and it will remain a meaningful contributor to KDP’s total results in 2024 and beyond.

Wrapping up, 2023 represented another year of delivering on our commitments while also advancing key strategic priorities. The operating environment is, as ever, demanding, but our “all weather” business model and energized teams are up to the challenge. Our focus remains on sustainably and thoughtfully extending our leadership position in the beverage industry, while consistently delivering strong and predictable financial outcomes, including a return to our long-term algorithm in 2024.

On March 19th, we will be hosting a webcasted investor event to dive deeper into our strategy and the multiple value-creation opportunities we see across the business. We hope many of you will join or tune in. I will now turn the call briefly over to Tim, after which Sudhanshu will walk us through the detailed financial results and outlook.

Tim Cofer
Thanks, Bob, and good morning, everyone. After joining KDP in November, I’ve spent the past three months fully immersing myself in the business as Chief Operating Officer and in preparation for the CEO succession later this Spring. My onboarding has exposed me to nearly every aspect of KDP and, most importantly, to its people.

At the top of that list are Bob, Sudhanshu, our Board of Directors, and the broader executive leadership team, with whom I’ve already forged strong and collaborative partnerships. I’ve spent time in multiple KDP locations, from our headquarters in Dallas and Boston, to the front lines of DSD retail, as well as our cold and coffee manufacturing plants. I’ve met with many of our customers and partners and, above all, listened to valuable feedback from our employees. I also had an active hand in developing the 2024 plan that we’re sharing with you today, and I echo Bob’s confidence in KDP’s ability to continue to deliver and create value for our shareholders.

The investor event in a few weeks will be my first opportunity to share a more comprehensive view of my observations on the beverage industry, KDP as a market leader, and our strategy to extend that leadership in the years ahead. I look forward to kicking off a deeper discussion at that time. For now, let me just say that I am equally impressed by KDP's current strengths as I am excited about the company's future potential.

We are a leader in a very attractive industry. We steward many iconic brands that consumers love. Our commercial and distribution capabilities are differentiated. We are a preferred partner and have demonstrated an ability to evolve our portfolio in a way that broadens growth exposure and accomplishes it with capital responsibility.

Finally, one of our greatest strengths is that we act with a challenger mindset. This is an important cultural element that attracted me to KDP and one which we plan to build upon going forward. Although Keurig Dr Pepper is still a young company, our track record of strong and consistent financial delivery over a historically dynamic past five years is testament to our resilience and potential. I'm honored to build on such a formidable foundation and look forward to partnering with the Board and my colleagues to drive the next chapter of KDP's success.

We have strong alignment in our commitment to deliver value to all stakeholders, including our shareholders. We're fortunate to have many long-term investors who have supported KDP since the merger, and we look forward to delivering for all of you in the years ahead. And with that, I'll turn it over to Sudhanshu.

Sudhanshu Priyadarshi
Thanks, Tim, and good morning, everyone. I will focus my remarks this morning primarily on our quarter four results and the 2024 outlook. Our Q4 performance demonstrated strong execution in a dynamic operating environment. We further rebuilt our margin structure, invested to seed future growth opportunities, and delivered strong EPS growth that was slightly ahead of our outlook.

Fourth quarter net revenue advanced 1.7%, with 1.1% constant currency growth. Net price realization increased 4.8%, which was partially offset by a 3.7% decline in volume/mix. We enjoyed strong momentum across approximately 70% of our business, namely in U.S. Refreshment Beverages and International, but our top-line growth was pressured by temporary headwinds in U.S. Coffee.

Gross margin expanded a record 450 basis points year-over-year, driven by a favorable net impact of pricing, productivity savings, and moderating inflation. We also earned performance incentives related to our strong commercial execution of the C4 partnership, which contributed approximately 100 basis points to gross margin. SG&A deleveraged 170 basis points, in part reflecting a double-digit increase in marketing.

Total company operating income grew 6.5% which, along with modest below the line leverage, drove 10% EPS growth. Excluding the year-over-year reduction in non-operational gains, EPS would have grown in the high teens. In 2023, we essentially eliminated non-operational benefits. We now move into 2024 looking to build on this solid earnings base.

Moving to the segments: U.S. Refreshment Beverages grew net sales 6.8%, led by 7.5 percentage points of pricing. Volume/mix declined a modest 0.7%, with manageable elasticities, broad market share gains, and a healthy growth contribution from C4 Energy. As Bob discussed, in 2024, we will build on our commercial momentum with a robust slate of innovation, though our cadence of launches differs slightly from last year. For instance, our Dr Pepper Creamy Coconut rollout will begin in Q2 and gain steam into the summer, as opposed to the very successful launch of Strawberries & Cream in quarter 1, 2023. While the calendar differences may temporarily weigh on our market share comparisons early in 2024, we remain confident in another great year for U.S. Refreshment Beverages relative market performance.

Segment operating income grew 20.2% in the quarter and margins expanded 360 basis points. This growth reflected the net sales momentum, a favorable impact of productivity net of inflation, and the C4 performance incentives, partially offset by higher marketing.

In U.S. Coffee, we made good progress across multiple dimensions. Share gains for the single serve segment and for Keurig brewers continued, we executed a successful holiday brewer program to end the year with 40 million Keurig households, and segment margins came in at the highest level in 10 quarters. These markers are why we do not view the headline 9.9% net sales decline in quarter four as overly indicative. With pricing a positive contributor just shy of 1%, segment sales were pulled down by a 10.7% decrease in volume/mix. Let me deconstruct the drivers to give you a sense of why we see roughly half of the decline as transient.

Brewer revenue decreased 21%, primarily due to a 14% decline in brewer shipments and reflecting a return of normal seasonal shipment patterns against steadier point-of-sale trends. Looking at the back half in total is more telling, with brewer shipments in line with point-of-sale purchases. As context, full year brewer shipments in 2023 were 13% higher than pre-pandemic shipments in 2019, representing a 3% CAGR.

Pod revenue declined 7% in the period. Even with a continued impact from previously discussed private label exits, pod shipment trends sequentially improved as expected, down 3% in quarter four versus 8% last quarter. Pod revenue in the period was also unfavorably impacted by mix, given a lower percentage of sales from owned and licensed brands relative to last year.

The temporary headwinds in quarter four included the brewer decline, private label exits, and a modest impact of lapping an extra week last year. Though quarter one will continue to reflect still-sluggish category dynamics, we do expect these discrete factors to be less impactful beginning next quarter.

Moving to segment operating profit and margins. Although quarter four operating income dollars declined 2.8% year-over-year, this was entirely due to the impact of lapping more than $50 million in non-operational benefits. On an underlying basis, our operating income grew in the double digits. U.S. Coffee operating margin expanded 260 basis points relative to the prior year. Drivers of this expansion included an improving relationship between pricing and inflation, continuous productivity benefits, and overall cost discipline. In 2024, reinvestment will be an important priority in the segment and will source from these margin tailwinds.

International segment net sales grew 11.5% in the fourth quarter. On a constant currency basis, sales increased 6.5%, with pricing up 3.6% and volume/mix growing 2.9%. We continued to deliver strong results across markets, despite tough year-over-year comparisons in Mexico from lapping the World Cup last year.

Segment operating income increased a very strong 25.6% on a reported basis and 19.8% in constant currency terms, thanks to pricing, operating leverage, and productivity netting favorably against inflation. As President of our International segment, I see a tremendous multi-year top- and bottom-line growth opportunity across this business, including in 2024.

Moving to balance sheet and cash flow, our ongoing cash generation remains strong. However, we chose to deploy a significant component of our 2023 cash flow to strategically reduce our supplier financing program, a decision that optically weighed on free cash flow even as it strengthened our balance sheet. Put another way, our free cash flow for the year measured just north of $900 million but included a $1.6 billion use of cash from accounts payable, primarily due to our discretionary decisions around the supplier financing program.

Our business remains highly cash generative and, on an ongoing basis, we continue to expect conversion commensurate with other leading beverage players. However, we will be below this long-term level in 2024 due to a continued, albeit more modest, impact from reducing supplier financing.

How we intend to allocate our capital remains very much intact. Our priorities include making organic and inorganic investments to support our growth, further strengthening our balance sheet consistent with our long-term net leverage target of 2-2.5x and returning cash to shareholders through a steadily growing dividend and opportunistic share buybacks. In any given year, we may over-index to one or more of our priorities based on short-term opportunities, but over time, we will take a balanced approach.

For example, direct shareholder returns were a focus area during 2023, representing a cash deployment of over $1.8 billion. We saw value in our stock and repurchased 22 million shares during the year, including more than 8 million shares in Q4. With over $2.9 billion remaining on our buyback authorization, we will continue to be opportunistic. We also raised our dividend 7.5% during 2023, marking our third consecutive annual increase.

Moving now to our 2024 guidance. We expect to deliver mid-single-digit constant currency net sales growth and high-single-digit EPS growth in 2024, consistent with our long-term algorithm. Based on our current FX outlook, we expect reported results to also incorporate a roughly 50 basis point top- and bottom-line currency headwind in 2024.

Our plans reflect continued strong momentum in our U.S. Refreshment Beverages and International segments, while contemplating a relatively muted contribution from U.S. Coffee. New strategic partnerships will contribute approximately 200 basis points to overall top-line growth, which will also benefit from the combination of carryover pricing and selected new price actions, consistent with a more normalized inflationary environment.

We are projecting another year of robust productivity savings to help offset this more normal level of inflation. Even with planned reinvestment in our brands and capabilities, we expect healthy operating profit growth, reflecting net sales growth and full year operating margin expansion.

However, we also anticipate some below-the-line headwinds, primarily in interest expense. This will constrain some of the operating profit flow-through to EPS, though we retain good visibility to bottom-line growth within our high single-digit target range in 2024. Our full year outlook includes the following below-the-line assumptions: interest expense in a $560 to $580 million range; an effective tax rate of approximately 22%; and approximately 1.40 billion diluted weighted average shares outstanding.

From a phasing perspective, we expect our top- and bottom-line momentum to build throughout the year. This quarterly EPS flow is typical for us and accounts for our innovation and investment calendar, as well as building contributions from Electrolit and La Colombe in the back half. Reflecting these dynamics and a slower start to the year in U.S. Coffee, we forecast first quarter net sales and EPS growth in the low-single digits.

In closing, 2023 was a significant year for KDP. We grew share across most of our portfolio, increased gross margins through efficient pricing and record productivity, invested in key growth vectors, improved the composition of our earnings profile, and strengthened our balance sheet. We expanded into attractive white spaces through capital efficient, strategic partnerships, and returned a meaningful amount of cash to shareholders.

Our 2023 performance was the product of hard work and strong execution across our whole organization, which enabled us to achieve a good set of operating and financial outcomes that were in line with our original projections. Our results also underscore our proven ability to deliver consistently and predictably in a dynamic operating environment. We have strong confidence that we will do so again in 2024. With that, I will now turn the call back to Bob to close.

Bob Gamgort
Thanks, Sudhanshu. Five years out from having played a key part in creating KDP, my excitement about its future continues to build. Our performance track record speaks for itself. In the five years since merger, net sales have grown at a 6% CAGR and EPS at an 11% CAGR. We have generated almost $11 billion in cumulative free cash, with roughly half redeployed to bolster the business through transformational capital investments and disciplined M&A and partnership deals, which further enhanced KDP’s growth profile. We returned the other half to shareholders, enhancing our TSR delivery.

We are looking forward to seeing many of you in mid-March and to sharing more about our go-forward strategic roadmap. KDP’s priorities are very clear. They reinforce our role as a disruptive and dynamic force within the beverage industry and lend visibility to continued delivery against our attractive long-term growth algorithm. My confidence is made all the stronger given the refreshed management team now in place, with Tim’s vision and energy already taking root and propelling KDP into its next chapter. Thank you for dialing in during a busy day at CAGNY. We are now happy to take your questions.

QUESTION AND ANSWER

Operator
We will now begin the question and answer session. To ask a question, you may press “*” then “1” on your telephone keypad. If you are using a speakerphone, please pick up your handset before pressing the keys. To withdraw your question, please press “*” then “2.” At this time, we will pause momentarily to assemble our roster. The first question today comes from Peter Grom with UBS. Please go ahead.

Peter Grom
Thanks, Operator. Good morning, everyone. So, Bob, you mentioned that you're building your '24 operating assumptions based on category growth expectations that are more prudent. Can you maybe just unpack that a bit more? And I would be particularly curious on what your expectations are for the U.S. coffee business. It sounds like 1Q is still going to be sluggish, but it does also seem that you need the category growth to improve in order to kind of hit your organic sales outlook. So just any thoughts on specifically when you think that inflection will happen would be helpful. Thanks.

Robert Gamgort
Sure, Peter. Thanks for the question. All three of us on the call today have been very involved in the development of the 2024 plan. I think as we said right up front, there's no expectations in the

plan of any significant change in the macro environment. And we talked about our expectations around coffee being quite muted as we think about 2024.

We focus our energies really on what we have in our control, which we've talked about a number of times. I think given that Tim will be taking over in Q2, and he's been very much involved with the team in developing AOP, it may be helpful for you guys to hear from Tim about why we have conviction on the outlook that we provided today.

Timothy Cofer
Yeah. Thanks, Bob. Good morning, Peter. As Bob said, I think we do have good visibility into the mid-single-digit net sales growth '24 outlook that we've shared with you today, and it really reflects three primary elements, and I'll start with Refreshment Beverages. We had a strong '23 and expect to continue positive momentum into '24. I think it will be characterized by a more normalized pricing environment that includes both some carryover and select targeted new actions. That will drive a more balanced price and vol mix equation.

We've got a strong innovation lineup again, and Bob referenced some of those initiatives earlier in the prepared remarks, all supported by strong digital marketing and in-store activation, and we will benefit from our recent expansion into higher growth of white spaces, including electrolyte in sports hydration, which is fully incremental, and the continued scaling of our C4 platform and energy space in partnership.

Second, we think we have continued significant runway in international. And we've demonstrated a double-digit CAGR since the merger. As Bob mentioned earlier, it's a much bigger part of the mix. We've nearly doubled the business since merger at almost $2 billion. And we expect that solid momentum to continue in '24.

And that brings us to coffee. The two first elements really give us time for U.S. coffee to recover on the top line. And so, the overall mid-single-digit sales guidance reflects relatively muted contribution expectations from U.S. coffee. We expect coffee vol/mix recovery. We expect sequential improvement throughout the year.

We've got some good programming and good new ideas, partnerships, La Colombe, Lavazza conversions on the premium side, new marketing campaigns on Green Mountain and Original Donut Shop, some strong innovation, including refresher and extension in our iced platforms, all the while in this economic environment, reinforcing our quality, a variety and importantly, our strong value proposition relative to coffee shop alternatives.

Operator
The next question is from Chris Carey with Wells Fargo. Please go ahead.

Christopher Carey
Hi, good morning. Just following up on coffee, can you maybe just help frame the visibility that you have on operating profit and operating profit margins and the vision if the top line remains muted as you expect? I would assume that's in line with your expectations, but it has been quite a volatile experience over the last several years. So, what if things get worse? Do you have enough buffer to be able to invest behind maintaining the sequential improvement even if still muted in 2024, while maintaining your profit expectations for the year? So, any context there would be helpful.

Robert Gamgort
Yes. Chris, let me just give you just a bigger picture context on the top line, and then I'll ask Sudhanshu to talk to you about the margins. And it's all under that umbrella of controlling the controllables. We have good visibility on the margins. If you look at the very long-term trends on at-home coffee and single-serve in particular, you talked about it as volatility. It was a situation where the category went straight up during COVID due to time spent at home and then it moved down from that peak.

So, it's been slow moving. We talked about it quarter-to-quarter. It actually hasn't been that volatile. It's just been slower in recovery than any of us expected. Just to reiterate a couple of comments about the category, we're not happy with the pace of the rebound, but it is sequentially getting better. It is interesting that we're seeing this trend globally in nearly every developed market. And the other trend that seems to consistently hold up is that the single-serve segment outperforms all other forms of coffee.

And so, we're seeing this gradual improvement. The untracked channels perform better than the track channels. And given that the pace of that, while sequential has been gradual, that's why our planning expectations going forward, we think, are quite reasonable and prudent. Now, that's an area we don't fully control, but we influence it through our innovation and marketing. We do have a lot of visibility and control of the margins. So Sudhanshu, you want to talk about that side of the equation?

Sudhanshu Priyadarshi
Thanks, Bob. And Chris, as you saw this in second half, that gives you a proof point of how we have rebuilt margin. First half, we were at 30% operating income margin. In Q3, we did 33%. In Q4, we did 36%. And we said that it took us multiple years to come down from the peak margin, it will take us multiple years to get the margin to build back. But at the same time, in 2023, we took structural action to support our prior U.S. coffee margin.

We talked about renegotiating partners' contract. We made progress on Spartanburg. And in 2024, we expect for the full year, coffee margin progress on an annual basis, but I wouldn't rely on second half margin as an ongoing margin for coffee. And we also need to factor in the balancing between two priorities. One is supporting category and top line recovery, but we feel good about coffee margin expansion for 2024.

Operator
The next question comes from Brett Cooper with Consumer Edge Research. Please go ahead.

Brett Cooper
Thank you and good morning. A question for you on LRB brand partnerships. I was hoping you could speak to the evolution of your capability to onboard brands, I don't know, maybe using recent additions versus those that you started earlier. Any tangible evidence you have with respect to those benefits you get on your own brands to bring those on? And then, just the environment for partnership additions that we sit in today. Thanks.

Robert Gamgort
Sure. So, we've got good experience now in onboarding a number of brands. And I'm not going to recite all of the ones that we've had over the past four or five years, but the most recent additions, which have happened or are in process of being onboarded right now, of course, C4 La Colombe ready-to-drink coffee, and Electrolit.

As we've developed--as we've brought brands on board, we've learned quite a bit about how to exit them out of their current distribution system quickly and efficiently, and then how to onboard them both into our national account planning process all the way down through our inventory planning and merchandising and delivery at a store-by-store level. So, we've developed a playbook that we use. It's the same team who has onboarded all of these brands.

And when we are in a position where we have an agreement with a partner, we bring all the commercial teams together, we spend a couple of days, and we have this down to really a science. The tangible evidence of that, I would point to C4 where you could see there was not only zero slippage in terms of its performance during an onboarding, which is a fear in most situations where you're transitioning from one distribution system to another, we picked up immediately and improved the performance as soon as it came into our system.

And you can see that in terms of increased availability, both breadth and depth of availability. You can see it in the merchandising quality, and you can also see it in the display and promotional activity. And obviously, those are all the leading indicators. The lagging indicator that's critically important is the share gain.

So, we have the same bullishness as we're bringing La Colombe up to speed right now. And as I mentioned in my prepared remarks, Electrolit just started shipping through our system is going incredibly well right now. So, I think we've got a great example--many good examples of how we get better and better at that.

In terms of what does the environment look like, the track record we have now of every brand--partner brand that has come into our system that has seen a marked improvement in performance and growth and even brands that have been in our system for a very long period of time, our longest partner brand is Vita Coco and the fact that they continue to grow as well has created a great sense of attraction for other brands who are outside of the system to try to get in.

That puts us in a position to be very thoughtful and disciplined about where we want to do this, and also to be able to construct deals that are truly win-win over the long term. And we think the hallmark of this is that, from an investment and growth perspective, is that we're able to leverage the strength of the business improvement that we can offer partners to construct deals that are highly attractive to us, very capital efficient, give us exposure to higher growth segments, and the proof in terms of the benefits to the partner are in the results that I just talked about.

Operator
The next question comes from Dara Mohsenian with Morgan Stanley. Please go ahead.

Dara Mohsenian
Hi. Good morning. So, Bob, I just wanted to return to top line in the at-home coffee category in the single-serve segment. You obviously covered 2024, but just can you take more of a look backwards at 2023 and some of the recovery being weaker than expected? Is it just the COVID drop-off you referenced earlier or are there other factors that drove some of that softness? And then just turning to the long term. So, any perspective on if anything structurally changed here in the single-serve coffee segment, how do you think about the growth opportunity post-2024?

Robert Gamgort
Sure. Dara, good morning. Thanks for the question. We've felt a lot of time studying the coffee segment since the COVID peak and then the anticipated recovery since then, I think Chris mentioned before that there was some volatility in the top line. As I was thinking about his

question, the volatility was really driven by our expectations of a rebound and are not happening. If you look at the actual trends underneath it, they've been pretty steady, unfortunately, on the upside, much slower than we had originally anticipated.

I always start with the total at-home coffee category because single-serve mirrors that, except it just performs better than total at-home coffee. So, there's nothing fundamental about single serve. It's really in the context of total coffee. This is an interesting category and similar to many I have worked on in my career. It's a universal product. It's a very high frequency consumption pattern. And in situations like that, you can see that minor changes in consumer behavior can really move the needle. And again, we're not talking about volume changes of plus 10%, minus 10%, we're talking a much smaller ranges within. But given the size of that business to us, it has an impact on us.

Mobility was clearly a factor that's not debatable. But if it was all mobility, we would have seen a faster rebound than that. And so, as we go through this process of understanding it and our peers do the same globally, and you can listen to their insights from their calls as well, you can see that there's really no single issue. It's a lot of little things that have contributed to it. And I think the best news in that is that as all of us in the coffee industry have done the deep-dive diagnostics to understand, is there something structurally that's changed? Is there a significant consumer behavior or perceptual change? I'm happy to tell the answer is no, that the equity and beliefs around coffee and the attractiveness of coffee even to the younger generation is as good as it's ever been.

So, for us, we keep doing what we're doing, which is driving the category through innovation and marketing. And as I mentioned, again, in my prepared remarks, we're going to be debuting some real breakthrough innovation in the near future. We look forward to being able to do that. And we're also making sure that we are targeting affordability in the short term. We know that there's quite a bifurcation in U.S. households. The higher income households are increasing their consumption of premium products. And so, it's important for us to have premium brewers and a super-premium coffee line because we want to be attractive and competitive with that segment.

But we also know that the mid- and lower income consumers have become more value seeking. Therefore, we're very much focused on ensuring that we always have an entry-level price point brewer or two out there. We focus on the cost per cup and talking about that more overtly in comparison to the price benefit we offer versus away from home coffee and, of course, being more selective in targeting promotions and price pack architecture. So, we're happy to see the improvement we wish in the category, wish the pace was faster. We've taken very prudent--a very prudent approach to our assumptions for 2024 to let that happen naturally and be able to deliver good results as it does.

Operator
The next question comes from Andrea Teixeira with JPMorgan. Please go ahead.

Andrea Teixeira
Thank you. Good morning. So, I appreciate the explanation on, perhaps, volume and the shift that you mentioned, Bob, but can you comment more about the price mix for the coffee pods? How much of that was, from what you just said, you want to focus on affordability or is that a fact of life that you have been seeing more of a structural shift from own to partner brands? And related to that, what should investors expect in terms of the cadence of the pod recovery or perhaps becoming as bad as we progress through the year? Thank you.

Robert Gamgort
Yes, I'll answer the last part first in terms of the cadence. You're seeing it happen, right? You see the sequential improvement there. We don't have anything that would indicate that the continuation of that is anything but a good assumption.

I think when you take a look at mix. Mix, just remind you, mix gets very noisy when we analyze it quarter-by-quarter. There are a couple of factors in mix. On the brewer side, we had a mixed scenario where we sold more of entry-level lower-priced brewers. We're indifferent from a household penetration perspective, but it does have an impact on the revenue side as you--we say a zero impact on the profit side of the business.

If you take a look at it within pod, you do see that the owned and licensed pods were lower as a percent of total sales during the quarter and that the unlicensed pods have a higher revenue contribution. In our last earnings call, we talked about that the category had gotten a bit more promotional. It's not a surprise when the category consumption is soft. You can expect to see individual players promote more to try to gain a share advantage.

Remember, we are really focused on category growth because we have about 80% of the category. So that's not as big of a focus for us. But when the price gaps become so far out of line, we have to address them on our owned and licensed portfolio. And we said that we were going to do that in the fourth quarter, which is what we've done, and it just takes time for that to catch up. But our expectation is that the promotional and marketing activity and the innovation activity that we put in place on owned at license will bear fruit for us in 2024.

Operator
Our last question today comes from Filippo Falorni with Citi. Please go ahead.

Filippo Falorni
Hey. Good morning, everyone. Just wanted to go back to assumptions for category growth, but on the U.S. refreshment beverage side. Clearly, we've seen normalization in pricing and volumes have been a little bit weaker to start the year. Can you give us a sense of what you're assuming for refreshment beverages for your core business, excluding the partnerships? Thank you.

Robert Gamgort
Sure. When we take a look at 2024, we're coming off of a couple of years of incredibly strong category growth that was driven by unprecedented levels of pricing and really healthy elasticities in the face of that pricing. That's not a good expectation for the long term. So, when we think about 2024, we think of reverting back towards the long-term patterns that we've seen for LRB in the individual segments. And that means more balance between price and volume mix.

Two specific things to call out when you think about our business with regard to 2024 and why we have confidence in our guide, and Tim went through that in great detail, but with regard to U.S. refresh and beverages, I would call out that partnerships are an important part of our growth engine. And you can expect those are contributing about 200 basis points towards growth as we think about 2024.

And then, the only other comment I would make is the phasing of the growth in U.S. refreshment beverage is slightly more second half focused, and that's driven by two things. The timing of Dr Pepper innovation is a bit later this year. And you know that Dr Pepper innovation has a material impact on our growth for our LRB.

And then the other part, too, is the ramp-up of Electrolit, which is happening right now, and we'll pick up steam as we move throughout the year, but that's already a very substantial business that will be coming fully into our system. And as we've been able to do with C4 and other partner brands, we expect to be able to work with them to step up the performance to an even higher level.

And so, as that builds, that will have a much more significant impact on our growth rate in the second half of the year. But as I said, on a category basis, I think you should start thinking towards the longer-term trends that we saw pre-COVID and pre the inflationary time period to be a good guide for how we think about the category.

CONCLUSION

Operator
This concludes our question-and-answer session. I would like to turn the conference back over to management for closing remarks.

Jane Gelfand
Thank you, Betsy, and thanks, everyone. We appreciate your time and attention this morning. And as always, the Investor Relations team is here to answer any follow-up questions you may have. Have a great day.

Operator
The conference is now concluded. Thank you for attending today's presentation. You may now disconnect.