Keurig Dr. Pepper Inc.
2020 Q4 Earnings Call Transcript
February 25, 2021
08:00 AM ET

Operator: Good morning, ladies and gentlemen, and thank you for standing by. Welcome to the Keurig Dr Pepper's earnings call for the fourth quarter and full year of 2020. This conference call is being recorded, and there will be a question-and-answer session at the end of the call. I would now like to introduce Keurig Dr Pepper's Vice President of Investor Relations, Mr. Tyson Seely. Mr. Seely, please go ahead.

Tyson Seely: Thank you, and hello, everyone. Thanks for joining us. Earlier this morning, we issued two press releases, the first announcing that our Board has approved a 25% increase in our quarterly dividend from 60 cents to 75 cents per share on an annualized basis beginning with the second quarter dividend announcement subject to official declaration by our Board of Directors. As part of that announcement, we also indicated that the Board has declared our regular quarterly dividend of 15 cents for the first quarter of 2021. The second press release covers our fourth quarter and full year 2020 results. Both releases are available on our website at keurigdrpepper.com in the Investors section.

Consistent with previous quarters, today, we will be discussing our performance on an adjusted basis, excluding items affecting comparability. The company believes that the adjusted basis provides investors with additional insight into our business and operating performance trends. While the exclusion of items affecting comparability is not in accordance with GAAP, we believe that the adjusted basis provides meaningful comparisons and an appropriate basis for discussion of our performance.

Details of the excluded items are included in our reconciliation tables included in our press release and our 10-K, which will be filed later today. Due to the inability to predict the amount and timing of certain impacts outside of the company's control, we do not reconcile our guidance.

Here with me virtually today to discuss our fourth quarter and full year 2020 results are KDP Chairman and CEO, Bob Gamgort; our CFO, Ozan

Dokmecioglu; and our Chief Corporate Affairs Officer, Maria Sceppaguercio. And finally, our discussion this morning may include forward-looking statements, which are subject to the safe harbor provisions of the Private Securities Litigation Reform Act of 1995. These statements are subject to a number of risks and uncertainties that could cause actual results to differ materially, and the company undertakes no obligation to update these statements based upon subsequent events. A detailed discussion of these risks and uncertainties is contained in the company's filings with the SEC. With that, I'll hand it over to Bob. [2:54]

Robert Gamgort: Thanks, Tyson, and good morning. Before getting started, I'd like to express my best wishes to everyone that you and your families are well. It's hard to believe that we've all been operating under the pandemic for almost a year. And while vaccines are providing hope for a return to normalcy later this year, the spike in COVID cases in January, followed by extreme weather in February suggest that 2021 will be another unpredictable year.

At the start of the pandemic, we put in place our ONE KDP plan, which prioritized keeping our employees safe and healthy, delivering for our customers and consumers and providing for our communities. These priorities have served us well. Additionally, our success in navigating this crisis to date has been aided by using data and technology to leverage the breadth of our portfolio and the unique reach of our distribution network to effectively manage portfolio and channel mix.

In 2020, we delivered at or above the high end of the annual guidance we established at the beginning of the year. And the 2021 guidance we are providing today points to our confidence in achieving the 3-year merger commitments communicated in 2018, despite the macro environment becoming significantly more challenging since that time.

As you saw from our earlier announcement, we are increasing our dividend rate by 25%, starting in the second quarter of this year. This reflects the line of sight we have to continued strong free cash flow, which enables us to simultaneously increase our return of value to shareholders, reach our deleveraging target by year end and invest in expanded production capacity, innovation and technology. In fact, our dividend payout ratio, even after the 25% increase announced today, remains below 50% of free cash flow.

Finally, we're fully committed to deliver both TSR and ESG. In 2020, we achieved nearly all of our aggressive sustainability goals. And in 2021, we have signed up for new and expanded ESG goals, including health and well-being and diversity and inclusion. We will publish specifics for each in our corporate responsibility report in June.

All of this underpins our journey from two separate companies to a combined new challenger in the beverage industry to a Modern Beverage Company with an exciting future. We look forward to sharing our long-term vision and plans for KDP when we conduct an Investor Day in the second half of this year.

Let me take a few minutes to step back and provide key highlights of our 2020 performance. We delivered accelerated constant currency net sales growth of 5% in 2020, with strong momentum exiting the year. Driving that revenue growth, were exceptionally strong in-market results across the business.

In cold beverages, we gained market share in more than 90% of our retail base, including market share growth in excess of one full point in CSDs. This was driven by double-digit consumption growth of Dr Pepper and Canada Dry, our largest CSD brands, as well as A&W, 7UP, Sunkist and Squirt. Dr Pepper & Cream Soda became the number one new flavor in the CSD category in 2020, while Canada Dry BOLD also performed exceptionally well. Canada Dry is now the only CSD brand to achieve volume and dollar growth for the past 14 consecutive years. Strength in cold beverages extended well beyond CSDs, with KDP share growth in premium water, ready-to-drink tea, shelf-stable fruit drinks and Mott's apple juice and sauce.

As we've discussed on previous earnings calls, the pandemic required us to manage mix across channels, beverage segments and even pack types to react to dramatic shifts in consumer shopping and consumption patterns. This meant driving growth in multipacks and cans sold in large outlets and eCommerce to offset slowdowns in fountain foodservice, convenience and gas channels and as a result, impulse packs. Our speed in pivoting to these changes was enabled by new uses of data and technology, consistently strong in-market execution, leveraging our

highly developed eCommerce capability and a flexible and resilient supply chain team.

Our coffee business also had a strong year. Consumer purchases of Keurig manufactured K-Cup pods registered double-digit growth, while brewer shipments grew 21%, which reflects a combination of new households entering the system as well as existing households upgrading their brewers. Household expansion of the Keurig system was very strong this year with approximately 3 million new households entering the system. That translates to 10% household growth, nicely above our longer-term pre-pandemic trend of approximately 7% growth per year.

Not surprisingly, the consumer shift to work-from-home meant at-home consumption of K-Cup pods was strong throughout the year, while the away-from-home channel, which is focused on offices, remained a significant headwind. And while we expect the away-from-home business to improve slowly over the course of 2021, we will begin to lap the 2020 declines in the second quarter of this year.

In addition to our strong top line results, our bottom-line performance was also strong for the year, with adjusted diluted EPS growing 15% to $1.40, which represents the high end of our 2020 guidance. This was achieved by offsetting significant mix headwinds and operating cost pressures with revenue growth that was above our targets, continued strong productivity and merger synergies and reductions in discretionary spending.

We also drove strong free cash flow, which enabled us to reduce our indebtedness and improve our management leverage ratio to 3.6 times, while also making significant capital investments, specifically: our new Spartanburg, South Carolina coffee pod facility, which will be the largest LEED-certified manufacturing facility in North America; our Allentown, Pennsylvania cold beverages facility, which was recognized as Plant of the Year by Food Engineering magazine; and our Newbridge, Ireland facility, which represents our second manufacturing location for our important Beverage Concentrates business.
In 2020, we also invested in the expansion of our portfolio and DSD network through multiple transactions, including a long-term agreement we announced with the Honickman Companies that provides KDP with sales and distribution for key brands in the metro New York area, national

franchise agreement with Polar Beverages and other numerous transactions with smaller but strategic independent bottlers to ensure competitive distribution scale for our brands. Consistent with our focus on improving the effectiveness of our distribution system, we exited some nonstrategic SKUs during the year, enabling us to keep our high-volume brands in stock and creating space for new partnerships and 2021 innovation.

In 2020, we also made great progress on our sustainability initiatives. We now responsibly source 100% of our coffee and 85% of our brewers and have improved the livelihoods of over 1 million people in our supply chain. We also completed our multiyear conversion to 100% recyclable K-Cup pods and during the year, we co-founded 2 industry coalitions focused on enhancing US recycling infrastructure. We launched our first post-consumer recycled, or PCR packaging in cold beverages, putting us on track to deliver our goal of using 30% PCR in our packaging across the business by 2025.

This long list of accomplishments would be impressive in any year, but it is even more so against the backdrop of the challenges and uncertainty we faced in 2020. I'm proud of and grateful for the nearly 27,000 team members across KDP who have proven to be our underlying competitive advantage.

Turning now to our outlook for 2021. The guidance we're providing today is consistent with the commitments we laid out at the time of the merger announcement and position us to meet our 3-year merger targets. Specifically, for 2021, we expect constant currency net sales in the range of 3% to 4% and adjusted diluted EPS in the range of 13% to 15%. On a 2-year stack basis, which eliminates any noise from COVID impact, this translates into net sales growth of over 8% and adjusted diluted EPS growth of nearly 29%, both at the midpoint of the ranges.

Our confidence in 2021 growth is supported by both innovation and renovation, both of which will be backed by increased marketing investment. Ongoing productivity savings and our final year of merger synergies will help offset increased inflation. We expect our management leverage ratio to improve by 3 times by year-end driven primarily by our continued strong free cash flow generation.

In 2021, we are rolling out zero-sugar varieties across our CSD portfolio. For most brands, the new zero offerings represent a rebranding of our existing diet SKUs to more clearly articulate the zero-sugar benefit to consumers. For Dr Pepper, the introduction of a zero-sugar variety will be in addition to original Dr Pepper and Diet Dr Pepper. We are also introducing Bai Boost, a new platform with caffeine; and Mott's Mighty, a line of juices and sauces fortified with vitamins and fiber. In addition, we will be launching new flavor varieties across many of our brands.

We've begun the staged rollout of our new Snapple bottles made with 100% recycled PET and featuring new graphics. Also, we are now producing all CORE hydration bottles with 100% rPET.

In coffee, we have another strong lineup of new brewers planned for this year, including our first connected brewer for the broader consumer market. We'll share additional information on this exciting new brewer and other brewers planned as we get closer to launch. In 2021, we expect continued strength in owned and licensed coffee. Last year, we reversed long-term trends by expanding sales and consumption of our owned and licensed brand portfolio. Within that portfolio, we have been able to improve the sales trajectory for the McCafé brand, in partnership with McDonald's, which became a licensed brand for us in the second half of 2020.

In 2021, we will launch Green Mountain Coffee Roasters Brew Over Ice pods, which taps into the growth of cold coffee. The majority of our brewers launched since 2018 also have a Brew Over Ice option. We are expanding our highly successful Original Donut Shop One Step Lattes introduced in 2020 into One Step cappuccinos. Last year, The Original Donut Shop brand registered double-digit consumption growth and market share expansion on the strength of the new One Step offerings and a new marketing platform.

Before turning it over to Ozan, I'd like to recognize the entire KDP organization for their tireless efforts in delivering such strong and well-balanced results. Because of their success, we have confidence in our 2021 goals, and we look forward to sharing our longer-term outlook at an Investor Day later this year. I'll now hand it over to Ozan to take you through the specifics of our financial results. [16:57]

Ozan Dokmecioglu: Thanks, Bob, and good morning, everyone. Continuing, on an adjusted basis, I will briefly review our performance for the fourth quarter, which our press release discusses in significant detail, and then turning to our full year 2020 performance and our 2021 guidance. In the fourth quarter, constant currency net sales increased 6.6%, fueled by higher volume/mix of 6.3% and favorable net price realization of 0.3%, with our Coffee Systems, Packaged Beverages and Latin America Beverages segments, all posting growth.

Adjusted operating income increased 5.5% in the quarter, driven by strong net sales growth, continued productivity, merger synergies and lower discretionary spending, which includes marketing. These drivers were partially offset by the unfavorable comparison to a 30-million-dollar gain in the prior year on the sale-leaseback of 3 manufacturing facilities, higher operating costs in the current year associated with increased consumer demand and inflation in logistics. On a constant currency basis, adjusted operating income grew 5.7%. Adjusted diluted EPS grew 11.4% in the fourth quarter, driven by the growth in adjusted operating income and lower interest expense and lower effective tax rate.

Let me turn now to our full year results for 2020. Constant currency net sales increased 5%, driven by higher volume mix of 5.6%, partially offset by lower net price realization of 0.6%. Adjusted operating income increased 10.4% and adjusted operating income margin expanded 150 basis points to 27.5%. This performance was driven by strong revenue growth, continued productivity, merger synergies and lower discretionary expenses. These drivers were partially offset by higher operating costs associated with increased consumer demand for our products, inflation in logistics and certain other COVID-19-related costs.

On a constant currency basis, adjusted operating income grew nearly 11%. For the year, pretax operating costs directly related to COVID-19 totaled 150 million dollars, of which 128 million dollars were recognized as items affecting comparability. These costs consisted of temporary and unusual compensation increases, incentives for frontline employees, incremental health and safety measures across our employee base and enhanced sanitation expenses for our facilities. The remaining 22 million dollars of costs represented inventory write-downs and bad debt expense that were incurred in the first half of 2020 and included in adjusted results.

Adjusted diluted EPS advanced 15% to $1.40 for the year. This strong performance was fueled by the growth in adjusted operating income, lower interest expense as a result of continued deleveraging and a lower effective tax rate.

Turning to our segment performance for the year. Coffee Systems constant currency net sales increased 4.8%, driven by higher volume mix of 7.2%, partially offset by lower net price realization of 2.4%. The volume mix performance reflected pod volume growth of 6.3%, driven by double-digit at-home consumption, partially offset by the significant decline in the away-from-home coffee businesses. The strong 21% increase in brewer shipments for the year was fueled by continued expansion of households coming into the system and existing households upgrading their brewers, continued brewer innovation, marketing investments to grow household penetration and a very successful holiday season.

Adjusted operating income for Coffee Systems increased 7.9%, and adjusted operating margin grew 110 basis points to 34.2%. This performance was fueled by the net sales growth, continued productivity and merger synergies and lower discretionary spending. These drivers were partially offset by the unfavorable margin mix related to the very strong brewer shipment growth for the year.

Packaged Beverages constant currency net sales grew 8.5% for the year, driven by strong volume mix of 8.2% and higher net pricing of 0.3%. This performance reflected particularly strong growth in our company-owned DSD operations and our warehouse direct business, driven by very strong execution that drove market share expansion across the portfolio, including carbonated soft drinks, premium unflavored water, ready-to-drink tea, shelf-stable juice drinks, apple juice and apple sauce.

Adjusted operating income for the segment increased 30%, and adjusted operating margin expanded 320 basis points to 19%. This performance reflected the strong net sales growth, continued productivity and merger synergies and lower discretionary expenses, partially offset by higher operating costs to meet strong consumer demand and inflation in logistics. On a constant currency basis, adjusted operating income increased 31%.

Beverage Concentrates constant currency net sales declined 6% due to unfavorable volume mix of 5.8% and lower net pricing of 0.4%. This performance reflected the impact of COVID-19 on the fountain foodservice business, which primarily serves the restaurant and hospitality sector. Adjusted operating income for Beverage Concentrates decreased 2% due to lower net sales, partially offset by lower discretionary expenses, while adjusted operating margin advanced 310 basis points to 70.8%.

And finally, Latin America Beverages constant currency net sales grew 3.8%, reflecting strong net pricing of 5.8%, partially offset by lower volume mix of 2%, due primarily to the impact of COVID-19 in Mexico. Adjusted operating income increased 32%, driven by continued productivity and lower discretionary spending, partially offset by the impact of foreign currency transaction expense and inflation in logistics. Adjusted operating margin increased 620 basis points to 21.7%. On a constant currency basis, adjusted operating income grew nearly 43%.

Turning to synergies. We delivered approximately 200 million dollars in 2020, bringing total merger synergies to approximately 400 million dollars over the past 2 years. Free cash flow in 2020 was again exceptionally strong at approximately 2.2 billion dollars. This translated into an adjusted free cash flow conversion ratio in excess of 110%. We also ended the year with 240 million dollars of unrestricted cash on hand. Our strong free cash flow performance enabled us to reduce outstanding bank debt by more than 950 million dollars and structured payables by 170 million dollars, for a total reduction in financial obligations of 1.1 billion dollars in 2020.

Due to our reduction in bank debt, growth in adjusted earnings and cash on hand, we improved our management leverage ratio by nearly a full turn to 3.6 times in 2020. Since the merger close in July 2018, we have reduced our management leverage ratio by an impressive 2.4 turns. As Bob discussed earlier, the KDP Board of Directors has approved a 25% increase in our annualized dividend rate from 60 cents per share to 75 cents per share beginning with the second quarter dividend, which is paid in the third quarter and subject to the Board's official declaration. This new rate will drive a 12.5% increase in dividends per share in 2021 and another 11.1% increase in 2022.

Importantly, despite the sizable increase, our dividend payout ratio remains below 50% of free cash flow. Highly cash-generative nature of our business as well as our strong profit growth is expected to enable us to continue to de-lever to 3 times or below by the end of 2021.

Let me now move on to our outlook for 2021. We expect 2021 to be another good year for KDP, which, as Bob mentioned, will drive exceptional results on a 2-year stack basis. Before jumping into the full year outlook, let me provide some context for quarter one.

As indicated previously, we exited 2020 with a strong top line momentum, and we expect to benefit from that in the first quarter. On the cost side, you will recall that we will be comping a 42-million-dollar gain in the first quarter of 2020 on sale-leaseback transactions and another 20-million-dollar gain in the year ago quarter from unwinding interest rate swaps. We believe this context will be useful to you as you build your models for 2021.

The specifics of our 2021 outlook include: on a constant currency basis, we expect net sales growth to be in the range of 3% to 4% for the year, which continues to be above our 3-year merger target of 2% to 3%. This strong growth is expected to be driven by higher year-over-year investments in innovation and marketing, the benefit of recent partnerships and ongoing in-market executional strength.

Adjusted diluted EPS growth is expected to be in the range of 13% to 15%, representing $1.58 to $1.61 per diluted share. Importantly, over the 3-year period ending 2021, this performance will position us to achieve our merger target for average annual growth of 15% to 17%. We again expect merger synergies of approximately 200 million dollars in 2021, delivering on our 3-year target of 600 million dollars. Adjusted interest expense is expected to be in the range of 505 to 515 million dollars. Our adjusted effective tax rate is expected to be in the range of 23.5% to 24% for the year. We expect our management leverage ratio to be at or below 3 times at the end of 2021. With that, I will hand it back over to the operator for your questions. [31:27]

Operator: Ladies and gentlemen, as a reminder, to ask a question, you will need to press star one on your telephone. To withdraw your question, press the pound key. Please stand by while we compile the Q&A roster. Your

first question comes from the line of Bonnie Herzog with Goldman Sachs. Your line is open.

Bonnie Herzog: I had a couple of questions on your pod business this morning. First, wondering how we should think about attach rates this year and then into the future. When I look at your brewer household penetration and how much it increased in 2020, but then I compare that to the pod attach rates, they seem to lag a bit. So, I'm just trying to understand if there's some type of timing effect we should be aware of or should we assume that attach rates will be slightly below historical levels going forward, especially at this higher base of brewers?

And then could you please confirm if your new pod manufacturing facility is already up and running? Or if not, when it will be? And really how we should think about the potential margin lift on your pod business from this new facility? Thanks.

Robert Gamgort: Yes. Okay. I'm going to take the first one, and then I'm going to turn it over to Ozan to talk about Spartanburg. Coffee attachment rates have been very steady for years and in the past, we've talked about the best proxy for household penetration growth is actually pod volume growth because of attachment rate being so stable.

In the early part of the shelter-in-place, we saw an increase in attachment rates, as you would expect. Obviously, we got some benefit from that in the early part of this, but we've seen it normalize over time and our expectations going forward is that it does normalize over time. So, we did get a short-term benefit from that, but remember, that was offsetting a significant hit that we were getting to our office coffee business. So, all of the guidance that we put out there for 2021 does anticipate a more normalized attachment rate. Ozan, you want to talk about Spartanburg.

Ozan Dokmecioglu: Absolutely. We already started our test runs at our Spartanburg facility. And obviously, it's a multiyear ramping up the production facility given the huge size and the volume that will come out, but all we can say at this point in time, we are 100% on track in terms of continuing month-in, month-out ramping up of our facility. As you said, we do expect to further lower our cost of production in the pods.

As we communicated previously, Spartanburg facility, as we go into the year, especially second half of 2021 and beyond, will be one of the base productivity sources to improve our efficiency in our manufacturing facility with regards to the pods, but not only that, we also have several other programs that will continue to help us to deal with the management of our overall per pod cost going forward at the same time. So, the things are on track. [35:00]

Operator: Your next question comes from the line of Bryan Spillane with Bank of America. Your line is open.

Bryan Spillane: Just a couple of quick ones for me. First, maybe if, Ozan, can you give us a little bit more color and insight in terms of just how we're thinking about inflation in total for KDP this year and maybe more specifically in Packaged Beverages, with fuel costs likely to go higher? Maybe packaging -- just specifically in Packaged Beverages, how you're thinking about managing inflation?

And then maybe just one last one. If we've done the math right, it looks like you undershipped in Beverage Concentrates shipments lagged consumption for the full year in 2020. So, as we're kind of thinking about modeling 2021, will there be any sort of disconnect the other way? Will concentrate shipments maybe exceed consumption in 2021?

Ozan Dokmecioglu: So, on the inflation point, yes, we expect 2021 to face higher inflationary pressure than 2020 and we have built that into our guidance for the year, obviously, and we are very confident that we can manage the exposure. Primary areas of inflation in 2021, as you also alluded, Bryan, would be in the logistics as well as corn-related products. While other areas, such as coffee, for example, that we contract for yearly, not months, will also serve as a partial offset.

It's basically the umbrella of the commodity and the input cost management that we always do and when the opportunity presents itself, we also hedge ourselves in order to manage our cost profile. Therefore, we believe we have a good balance right now. It is true. We are seeing, as I said, on a couple of line items, cost pressures increasing in 2021 versus 2020. At the same time, second point is -- the answer for your question with regards to the Beverage Concentrates. It is true, when we

look in a closing, like a month or 2, we may see some lagging with regards to our concentrate shipments in Beverage Concentrates as well as the finished product shipments from our bottlers or the distributors, but when we take a medium to a little longer-term perspective, they always catch up, and that's what we are going to see in 2021 as well. [37:48]

Operator: Your next question comes from the line of Kevin Grundy with Jefferies. Your line is open.

Kevin Grundy: Great. And congratulations on a strong year, particularly in this environment. Just to stick with the guidance and the outlook for both of you. So, guiding to 13% to 15%, which is great, but [38:10 missing words] -- and just to pick through some of the items, the revenue outlook is better, which is encouraging, right, particularly given the inflection of the coffee business. You're getting 1 to 2 points of help from a lower tax rate. Synergy, you're wrapping that up this year. That's a major contributor. The financial pacing with respect to the balance sheet deleverage is in line with expectations. To Bryan's question a moment ago, commodity is more of a pressure point than I'd imagine you expected.

What else is that? Is advertising and marketing moving up? Maybe you could comment on that. What are some of the other pressure points that are driving a below algorithm year, at least for the 3-year target for EPS growth with the top line outlook so strong?

Robert Gamgort: Yes. I mean a couple of things. I mean when we put our algorithm out there, we didn't say we were going to achieve 15% to 17% every year and the guidance we just put out there puts it nicely within that range, in that 15% to 17% despite what we all agree is a world that is very different than it was in 2018.

The one comment I would put is we are restoring marketing in 2021. We've said all along that any opportunity to restore marketing to drive growth, we would do so. In fact, on our Q3 earnings call, I think we were really clear on our intentions and when we provided our guidance, and we said that we would be in the 13% to 15% range for 2020, we also said any opportunity to over-deliver would be reinvested back in our business for growth, which is exactly what we did. We came in right at the high

end of our guidance. We reinvested back into growth, and we achieved 6.6% revenue growth in the fourth quarter.

So, we look at our outlook for 2021 to be incredibly strong and, more importantly, well balanced because the results that we've delivered are not driven by anything that would hurt us in the long term by driving the short term. In fact, quite the opposite. We've invested in brand growth and innovation, in new plant capacity. We've invested in technology and that's why we're able to do things like grow share on 90% of our portfolio and add an extra 1 million households into the Keurig system. [40:27]

Operator: Your next question comes from the line of Lauren Lieberman with Barclays. Your line is open.

Lauren Lieberman: Great. I was curious -- I guess, two things. One is the dividend increase is sizable and, I think, unexpected, which is great, but I was also curious how that fits into your thoughts about overall capital allocation and the outlook for acquiring brands outright or continuing to make investments in new brands. So that was one question.

And then the second is, you've had tremendous market share gains all year in the cold side of the business, as you've talked about. We've also made all these route-to-market changes. And so, I was just curious, kind of at a very high level even, what you're hoping to get out of those changes, right? Is it accelerated growth? Is it better efficiency? Again, because the share performance in the existing footprint, if you will, had already been as strong as it was, particularly in 2020.

Robert Gamgort: On the dividend side, we know that dividends are an important part of shareholder return in this space and we saw an opportunity to provide more return to our shareholders by increasing the dividend 25%. We do that while simultaneously sticking to our deleveraging target and also investing heavily in the business. All I would say on that one is it's reflective of the very strong confidence that we have and line of sight to continued strong earnings and strong free cash flow. Even with that substantial increase in dividend rate, our payout ratio is still below 50%, which is well below just about anyone else in this space.

It doesn't change our outlook at all on our ability to participate in M&A. We've said all along that, even with our commitment to rapidly de-lever, we would be able to participate in the M&A space in a number of different ways. With CORE, for example, we used shares to make that acquisition, and that acquisition has been very value-accretive to us in terms of being able to drive growth both on the top line and earnings. We acquired Big Red with cash. We had a very unique transaction with the Honickman Companies to be able to secure our brands in the metro New York area. We've entered into other deals that are more partnership.

Then I'm going to segue into your next question because it's related. If you take a look since 2019, we've done about a dozen transactions in the route-to-market space, and nearly all of those were paid for right out of our cash flow. So, it tells you that we have incredible cash flow visibility that allows us to do all of this activity while de-levering, while increasing our dividend payment and also investing in plant infrastructure and technology. So, it's just another opportunity to reward our shareholders.

With regard to the route-to-market space, you asked what our goal is. It's all of the above. So, we look at our business market by market and as we've joked with you sometimes, but it's not far off, ZIP code by ZIP code. Our situation is very different across the market. In aggregate, we control the distribution, or we have DSD coverage that covers somewhere slightly north of 75% of the US population, but for those of you that know the business intimately, you know that it's very different brand by brand.

So, it's a two-pronged approach. We invest heavily in our brands through marketing and innovation and renovation. And then we need to make sure that market by market, we have the most competitive distribution system for those brands and that has led to all of the transactions that I just talked about and the couple that you highlighted. And what does that do for us? It's a long-term play, not a short-term play. It gives us access to both growth through better execution and also gives us access to efficiency through consolidation of inefficient retail distribution. [44.35]

Operator: Your next question comes from the line of Dara Mohsenian with Morgan Stanley. Your line is open.

Dara Mohsenian: So, the 28% brewer growth in Q4 was very striking. It even came a few quarters into COVID when, theoretically, a lot of new households had already purchased brewers in response to COVID. So, I was just hoping you could be a bit more specific on the key drivers behind the Q4 brewer strength, how sustainable that might be as we look forward into 2021. And then also, just taking a step back and looking more at the full year. Clearly, the 3 million household penetration increase is above that typical 2 million pace. So just how do you think about that incremental 1 million households? Does a lot of that sort of come out in 2021? Or do you think that 2021 household increase could be similar to the historical range pre-COVID-driven 2020, in theory?

Robert Gamgort: Yes. Great questions. Let me start with the last one, which is household penetration and then talk about brewer growth. Because as we said all along, brewer growth is not a great predictor of household penetration. And while there is a correlation between the two, not necessarily year in and year out. So, let me start with household penetration.

You're correct that our most recent run rate has been about 2 million net new households per year. That increased to 3 million households. We don't believe that's a pull forward from 2021. We don't believe that that's actually material in the grand scheme of things because the best way to look at this business is to look at it over a longer period of time. Definitely not quarter-to-quarter, and even year-to-year isn't particularly helpful. Why I say that is, in the past 5 years, so if you take a look at the 5 years since Keurig was taken private and then merged with KDP, that's a good time frame. We've increased households from 21 million to 33 million. That's an increase of about 9% per year. It's a compound growth of 9% per year. It's 12 million new households and if you recall back in 2015, 2016, the word out there was that household penetration had flattened and the market was saturated, and we've increased our household base by more than 50% since then.

With all that growth, if you go back to the Investor Day presentation that we laid out in great detail in 2018, and with the remaining universe of households, there's still another 60 million households that ultimately should be converted from brewing coffee by the pot to brewing it by the cup. And Keurig, obviously, has the lion's share of that. And so, we've got years and years of runway ahead of us at the growth rate that we're at.

So when you look at 2 million to 3 million year-over-year, it looks material. When you look at going from 21 million to 33 million in 5 years with 60 million households a go, 1 million is a blip in all of that. Having said that, let's be careful on the year-over-year comparisons, which everyone will report on. So, if we went back to our normal 2 million household penetration growth, that would look like 6% growth in 2021. I'm not projecting them, just keep going through the illustration and people will write that there's a deceleration in household penetration, which would actually be a real misleading conclusion.

Let's talk about brewer sales. Brewer sales are a combination of things. They're a combination of new households entering the system, people upgrading their brewers as we introduce new models with benefits and features that didn't exist before. We're seeing more upgrades and also, we see replacements of brewers that over time fail. So, we shipped 11 million brewers last year. That was a record number.

In addition to the strong household penetration growth, we saw a record number of upgrades. People were investing in their work-from-home situation. We've got all these great brewers that were just introduced in the past couple of years, and so we saw people lean in and upgrade. As I always point out, while that doesn't have a material impact in the year, that's yet another household recommitting to the Keurig system for the next 3, 4, 5 years. So, it's all incredibly bullish.

Going into this year, we wouldn't expect to see that number in 2021. We don't need 11 million brewers to support a 2 million or even a 3 million household penetration growth. We have no idea how many people are going to upgrade. That's something that we can't predict. So, I think as you look at 2021, a flat number on brewer growth would be extraordinary. A decline in brewer growth would be very normal and would support great household penetration growth, but again, watch for the headlines that are going to say how brewer sales are down and it's a concern about the Keurig system in the future.

My last -- because it's a good point of time for me to say this. I think my last point is, as we think about 2021, you guys are going to have to do this across the board, just make sure you take a look at 2-year stack numbers, not just year-to-year numbers. So as I put in my script, when you look at the total KDP basis, a 2-year stack basis, which takes out all

that noise, in 2021, if we hit the midpoint of our guidance, we're going to be 8% revenue growth over 2 years and 29% EPS. So, I think that's the way we're going to have to look at the world in 2021. [50.06]

Operator: Your next question comes from the line of Nik Modi with RBC. Your line is open.

Nik Modi: I was looking at some of this Numerator data, and it's showing how more and more of the pods are being sold online, regardless of the brewers, bought online or in a brick-and-mortar environment. So, I was just hoping you can share with us the implications of that from a P&L perspective, margin-wise, consumer insight, visibility, right, because it's not as easy to track just from a retail consumption standpoint. So, any clarity around that would be helpful.

Robert Gamgort: Yes. So, it's a great insight. We've been really proud of the development that we have in eCommerce. When we launched the company in 2018, we talked about one of the seven routes to the market being eCommerce, and that we believe that we were the most developed food and beverage company in that. 2018, I don't think anyone really cared much about eCommerce and beverage, but today, we all care. We talked last year about more than 10% of our total company sales going through eCommerce. And obviously, that's an area that's accelerating dramatically.

On coffee, in particular, coffee pods, we get to the consumer through eCommerce two ways: We go through retailer.com and amazon.com, but we also go through Keurig.com. I know it's more challenging for you guys to have visibility of that. We've talked about pods, in particular, that an increasing percentage of our pod sales are not visible through traditional syndicated data, but we have a really good handle on what goes on in eCommerce. And to your point before, we also, in many cases, are able track it down to the individual consumer who's buying this. So, we have a much more targeted marketing program as a result of all of that.

As far as margins and all of that go, it's great. There's not a concern here. It's more challenging, as you can imagine, to ship liquids. I think the future of eCommerce and liquids is much more in the click-and-collect

mode or home-delivery mode, not shipping it through traditional FedEx and UPS, but Keurig pods are high value, lightweight, long shelf life, don't damage. It's almost an ideal item to ship through traditional eCommerce channels, and that's why it's been really attractive. So, it's going to be an increasing part of growth in our business.

One of the things we'll talk about in 2021 is the launch of the first connected brewer for broad-scale consumer use. We're excited about that. We'll talk to you about that in the future, and I think that's going to accelerate more of the eCommerce attractiveness for the Keurig business going forward. [53:05]

Operator: Your next question comes from the line of Andrea Teixeira with JPMorgan. Your line is open.

Andrea Teixeira: So, my question is on the competitive environment. And Bob, you mentioned the investments and also innovation that you're putting for both Packaged Beverages and coffee. So, are you seeing the need to increase A&P investments in light of what some of your competitors have announced, particularly in flavors? And the second part of this question, if you can also talk about pricing for Packaged Beverages and the coffee pods in the context of your outlook for 2021?

Robert Gamgort: Yes. Our reason for restoring marketing is because we have an objective to increase our marketing as a percentage of sales over time and we know what happened in COVID across the board. We're really proud of the fact that despite the fact that we had to pull some of that marketing and some of it, it was just a bad environment to invest in advertising. And they're certainly in the early and mid parts of the year. And other parts of it was because of the great mix headwind that everybody in the industry faced. We were proud of the fact that we did that, but we got really efficient in where and how we spend our marketing. And my best evidence of that is the market share gains across our portfolio that suggest that we were able to still balance brand growth, investments in innovation, with a more restricted marketing budget.

Every opportunity that we get, we will invest in marketing and innovation. That's what we're doing in 2021. It's not a reaction to competition at all. It's an investment in the great pipeline of brand ideas

that we have. As you can tell from all of our conversation here, we are building this business for the long haul as I referenced before, when we looked at the fourth quarter, and we knew that we were trending very strong for 2020, we were very explicit in saying any over-delivery would be reinvested back into brand growth, and that's exactly what we achieved in Q4. So, that's our ambition, is to build a very healthy brand portfolio for the long haul.

With regard to pricing, I think this industry is incredibly rational in pricing and we don't discuss what our specific outlook is for pricing in a given year, but we have our eye on inflation, as does everyone, and I think that the beverage industry has shown that it's been able to recover inflation through a combination of productivity and pricing, and I wouldn't expect that would change going forward. [55:41]

Operator: Your next question comes from the line of Rob Ottenstein with Evercore. Your line is now open.

Robert Ottenstein: Great. And again, congratulations on a terrific year in very challenging circumstances. So, as you look out on 2021, I think a lot of the shelf changes were postponed or didn't happen in 2020. What are the shelf sets look like for the spring reset? Do you get a sense that you're gaining shelf space? And maybe give us an update on some of the new brand initiatives: Don't Quit, A Shoc, Polar. So that would be the first question. And just the second question, just a detail, if you could give us a reminder of your investment in BODYARMOR and if, in fact, that gets sold, how to look at proceeds to KDP?

Robert Gamgort: Yes, sure. Let me start with the shelf changes. A more normal year in 2021 than 2020 when innovation was more challenging to get on the shelf. We got a good head start with Dr Pepper & Cream and also with Canada Dry BOLD. And as you know, we have a long list of innovation and renovation that we launch every year, so I'm not going to mention them all.

I think 2021 looks more normal in access to the shelf. We've got a really strong lineup of innovation across the board. We talked about some of it in the prepared remarks, but again, we have much more than that. And so

we stand in a really good position to get that strong innovation and renovation on the shelf quickly.

And our speed to market as a company has improved every single year and we're very proud of the distribution system that we're building, a combination of our company owned DSD as well as our independent partners. And through a combination of strength of ideas, better joint planning with our partners and our customers, we've been able to improve our reach to shelf and so that's going to continue.

You mentioned some of the seed investments that we have in brands like Don't Quit and A Shoc. All in early stages, all very promising, too small at this stage for us to report, but I would expect that when we do our Investor Day midyear, we'll give a more comprehensive update on all of the start-up investments.

And that's just one of many tools that we employ, where we've said before that we can launch something on our own. We can partner with somebody in a joint distribution manner as we've done with brands like Evian. We can make seed investments as we did with Don't Quit and A Shoc, and we can acquire things outright, as we did with CORE.

Polar is off to a great start. It's a terrific brand and really our play in the sparkling water, flavored sparkling water segment. We're ramping that up right now. The ACV for Polar has already improved by about 20 ACV points nationally. So, it shows the strength of our partnership with them. And obviously, you can tell by the comments here that we're very bullish on driving that brand to a national leader in the not-too-distant future.

And then the last one, BODYARMOR. It's publicly available. We have 12.5% ownership stake in BODYARMOR. If and when that business is sold, then we would receive payment just like any other investor would receive payment at that time and we don't know anything more than what's been publicly reported to date. So, I think I covered all of your territory there. [59:36]

Operator: Your next question comes from the line of Sean King with UBS. Your line is open.

Sean King: When we think about your three-year synergies coming to an end this year, have you identified savings opportunities amidst the pandemic, like some of your large US peers that can carry the margin expansion story beyond the 3-year guidance?

Robert Gamgort: Yes, I'm going to turn this over to Ozan for more specifics. Our initial focus is to make sure we deliver those synergies because there were some questions on day one. Could we really achieve those? And obviously, we have a line of sight to do that, but we also know that synergies are always a short-term situation and we made sure that we had line of sight to productivity beyond, but also we used it not just to drop to the bottom line, but to invest heavily in our business during this mode. Ozan, do you want to pick up from there and talk about how we think about productivity beyond synergies?

Ozan Dokmecioglu: Absolutely. So, let me step back and look at it. As you said, three years ago, 2.5 years ago, to be precise, we said that we expect to deliver 600 million dollars of deal synergies, starting 2019 through 2021, 200 million dollars every year. As we just spoke, during our script, we are very happy to share with everyone that, after two years, we have delivered successfully 400 million dollars of synergies, and we expect to deliver another 200 million dollars in 2021. That would complete the 3-year cycle of the merger synergies that we put out there.

Now, we also said and shared publicly that overall efficiencies, we look at it in two big buckets: One is the merger synergies that I just spoke and the second one, as we define and call it, base productivity programs, which obviously, base productivity programs will continue, including 2021 and beyond.

When we step back and look at it holistically, we have several programs and initiatives that actually either we are executing now, or we will be starting to execute to continue to fuel the base productivity programs that we have. For example, when you look to what's happening in the Coffee Systems, we are building a state-of-the-art K-Cup facility in Spartanburg, South Carolina. As I said, I think, 10 minutes ago, we are at the early phase of having, let's say, test runs over there. And we expect to ramp up the facility for the remainder of the 2021 and beyond 2022. That will be a good source of base productivity programs for us.

When we look to Packaged Beverages, for example, at this year, we are also building and will be put into service Allentown in Pennsylvania and again, in a state-of-the-art aseptic systems lines, for example. That will continue to drive down our costs.

On the Beverage Concentrates side, for example, we are building the second concentrate plant in Ireland and besides the continuity of our business will be secured, given we only have one facility now in St. Louis, we'll also have some financial benefits at the same time. And these are, for example, the three big programs that we have, but on top of this, we always look for efficiencies, and we have several other programs that we are implementing as we speak. Therefore, we feel very confident that beyond 2021 that our overall efficiency programs will be intact and will help us to drive further profit growth and margin enhancement.

Operator: Thank you. And that concludes the question-and-answer session. I would now like to turn the conference back to Tyson Seely.

Tyson Seely: Thank you, and thank you, everyone, for joining us this morning. I know it's a busy day for many of you, but as usual, the IR team, myself and Steve are around for any follow-up calls, so please feel free to reach out to us. Stay well and be safe. Thank you, everyone.

Operator: Thank you, presenters, and thank you, ladies and gentlemen for joining Keurig Dr Pepper Fourth Quarter 2020 Earnings Conference Call. Have a wonderful day. You may now disconnect. [1:04:03]