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MANAGEMENT DISCUSSION SECTION

Steve Powers
Analyst, Deutsche Bank Securities, Inc.

Good afternoon and good evening everyone I'm Steve Powers. Deutsche Bank's lead US consumer package goods analyst and to close this year's conference, I'm thrilled to introduce and welcome Keurig Dr Pepper to the event, still a young company in its current form, but one with well-established reach that has already proven itself to be able to deliver consistently to ambitious objectives and as I think the current moment demonstrates the company that has built a broad portfolio that's well suited to diverse array of operating environments.

Joining us today from Keurig Dr Pepper, are Chairman and CEO Bob Gamgort, CFO Ozan Dokmecioglu and Vice President of Investor Relations Tyson Seely. Welcome to the conference guys. Many thanks for being here. In terms of format we're going to run today's session entirely as Q&A, so if you're listening via the conference portal, please feel free to submit questions of your own, at the bottom left of your screen and I'll do my best to work them in as we go. But before we begin let's maybe just turn over to Bob to set the stage with some opening comments.

Robert James Gamgort
Chief Executive Officer & Executive Chairman, Keurig Dr Pepper, Inc.

Steve, thank you. Thank you for hosting us today and welcome to everyone who is joining. I'll pick up on your comments saying we are young a company, I agree. We're just about two years old coming up in July, but we've a very experienced management team in the industry both directly in beverages as well as consumer products. And in the past two years, it has been quite eventful, so we have been tested and I feel like we have passed the test nicely. So I know we're going to talk about what's happened in the current crisis over the past three months and we have certainly learned a lot over the past 12 weeks. But I also want to step back and talk about KDP over the longer term because a focus just on the short term is a disservice to the broader story because the reality is we performed well before the crisis, we're performing well during the crisis and we believe we will continue to perform well in whatever this new future looks like. So in the past two years we integrated two companies. We've been very much in line on all of our financial targets that we communicated way back in January of 2018.

Our EPS growth on an annual basis has been about 20%. Our underlying net sales over that same time period has been about 3% per year. Our cash flow is a big part of our story. We generated $3.8 billion from cash flow that we've been able to take our leverage down from 6x to 4.2x. We paid down $2.3 billion of bank debt in doing so and we've done really well in the marketplace backed up by really solid execution at retail, good marketing, great innovation and we gained share in the majority of categories in which compete and on the coffee side, we've taken household penetration up very significantly.

So that happened before COVID-19 hit and it continues. Let me just take a moment before I open up to your questions, how do we think about what's happened in the past 12 weeks. We've said all along and we have had a number of points of contact with investors that we don't view this as a windfall. We are not a pandemic stock. We would have preferred the status quo that we saw in January to continue but we've seized the moment to execute really well and leverage the portfolio that we have, that performed well and we took a number of steps to do that. But most importantly, the management team formed the crisis team chaired by me we began moving very, very quickly to pivot across what we call a big mix management exercise leveraging our portfolio and our channels to be able to drive good performance.

So I'm sure we have more questions to come on that very point, but let me turn it back over to you

QUESTION AND ANSWER SECTION

Steve Powers
Analyst, Deutsche Bank Securities, Inc.

Q

That's great. I think it's probably safe to say that we've got some investors on the call today or listening in via webcast that maybe relatively new to the KDP story or vice versa. Maybe you're just building on what you just said, maybe you can just rewind the clock back those two years, and talk a little bit about the industrial logic behind the merger strategy. And then Ozan, maybe you could remind us some of the financial objectives that you set for yourself at the outset of those three year objectives and where we stand today. But maybe we start with Bob just on the industrial logic

Robert James Gamgort
Chief Executive Officer & Executive Chairman, Keurig Dr Pepper, Inc.

A

Okay. If you go back to 2018, we announced a merger in January of 2018. We brought together Keurig Green Mountain which was the leading single serve coffee system in North America with the Dr Pepper Snapple Group, which is the number three non-alcohol beverage company. And we brought that together as a unified company that we called the new challenger in the beverage industry and one of – but many of our unique elements is that we were the first company to combine hot and cold beverages at scale.

When you peel it back to the next level where it gets very interesting is a combination of a very broad portfolio of brands. The majority of them are leading in their segments to satisfy a wide range of consumer needs in beverages and you match that up with this complementary distribution system when you put Keurig Green Mountain and DPS together, that's very unique and we always talk about, there is seven different ways that we go to market and it's a combination of those two that have enabled us perform well as I said before and we're leveraging now to do well under the crisis and that's because I think we have a couple of elements.

One is we have diversification because diversification is good in a changing environment. We're playing that out right now, but I think we have really smart and targeted diversification because we have a wide range of channel

and portfolio representation, but it's all within the world of beverages. We have seven different ways in which we go to market, I won't go through all of them, but it ranges from direct store delivery to warehouse delivery, all the way to e-commerce which was a Keurig heritage and obviously the direct store delivery and the e-commerce elements right now are serving us really well.

As I said before, it's more than just having a wide range of brands, you have to have strong brands that can be supported by marketing and we have that and then what's really building right now and proving itself is the strength of the team and the culture that we're building where we have said from the beginning that speed is our competitive advantage and that is playing out right now. A minutes back with a really strong financial strategy and discipline, and Ozan, I'll let you pick up the story from there.

Ozan Dokmecioglu
Chief Financial Officer, Keurig Dr Pepper, Inc.

A

Exactly. Thanks, Bob. And hello Steve, and everyone. As you would remember at the onset of our merger announcement, which goes back to early 2018. So we have announced publicly three very important metrics on the financial delivery. We said top-line would be 2% to 3% and earnings per share growth over three years is starting from 2019 through 2021, would be also 15% to 17%.

As well as our deleveraging targets, we started more or less as Bob said couple of minutes ago, at 6 times, which is the – we call it as management and multiple on the balance sheet leverage side and we announced and said, we will be at 3 times and lower, following three years into our merger. And then we look to these, let's say a targets where we're at, I'm not going to go into all the granular details, because we shared all the details during our webcast calls, Steve, previously. But the top-line, we are doing pretty well. EPS, we are delivering exactly what we said we would. And on the deleveraging part, as Bob said, our quarter one 2020 financials also came in at 4.2 times, which is all the way down from 6 times that puts us very nicely to deliver at our target being 3 times following the merger three years in 2021. So overall, financial targets are all intact and we are delivering very nicely against that.

Back to you, Steve.

Steve Powers
Analyst, Deutsche Bank Securities, Inc.

Q

Yeah. No, I mean, as you say, you're delivering very nicely into this and have continued to do so as I think consumption data shows, I think your first quarter shows, but Bob you had mentioned at the open about learning a lot these past 12 weeks. When you step back and just look at what you've seen in the marketplace, what you've seen in your organization be able to deliver, how would you summarize those learnings, and what does it tell you about where KDP can go, and does it open up new opportunities and make you challenge some of your own aspirations, either in a positive or maybe in a challenging way?

Robert James Gamgort
Chief Executive Officer & Executive Chairman, Keurig Dr Pepper, Inc.

A

Let me take a minute just to begin, since we've got a broader global audience. Let me just do a really quick recap as to what's happened in the beverage market in the US since COVID hit. And then, I'll get into the specific question that you asked.

Like many places, we saw an initial pantry load in March, it was followed by destocking in April. But we're now settling in at a consumption trend that is well elevated, and I'm talking about total liquid refreshment beverages

running about plus 8% in the latest four weeks, covering all of May. So, that's an elevated growth that seems to be continuing.

When you peel that back, you see very different trends by segment and by channel. Carbonated soft drink juices, juice drinks, mixers for example, are all doing really well. You see weakness in areas like premium water, energy and sports drink, which tend to be more convenience store-centric. Well, that's what's happening on the channel side, growth in large outlets are doing well, e-commerce is exploding.

But as I said before, convenience stores and anything that's away from home or on-premise has been really far down. On the coffee side of the business, we saw a very big growth increase since the very beginning which is driven by two things, new people coming into the Keurig system, I think that work from home mindset caused people to outfit their homes and we did well in that. And then also we saw immediate consumption per machine increasing. And so, in the latest four weeks for example, they were up – the category is up about 16%.

So there are lots of pluses and minuses. And I don't want to minimize the fact that you went and away-from-home coffee business is down dramatically where fountain and foodservice business – services and restaurants is down dramatically. It creates a big hole in revenue and profitability that need to be filled by really pushing the other segments that are growing even harder. And that's the key learning for us out of this is that, we can't land on a single point forecast. We have to talk about ranges and we have to be flexible because the knowledge – with the knowledge that the consumer is going to change and the trends and challenges are going to change. So the minute you land on a forecast and begin to like it. You have to recognize this is going to change again. And so the ability to do that comes from two things that we've implemented. One is we realized the data sources that we were using were almost useless in this environment because they have a lag time, three week or four week lag time, we can't run a business like that in a changing environment.

So one of the first steps that we took was to figure out how to pull together all of the different data sources we had or could acquire to get almost real time data on what was happening in the marketplace and we match that up in the early stages with literally daily management team meetings chaired by me and daily S&OP meetings. We now do it more frequently than we ever did in the past but we're no longer doing it on a daily basis and we were making real time decisions to say demand is shifting, what's our available capacity both in supply chain as well as delivery and how do we pivot to win.

And as I said right up front, this is a giant mix management exercise. And the reason we're doing well is because we've executed that mix management exercise well, not because we have an inherent portfolio that is just winning because of the trends have moved in our favor because those segments that had to offset trends in our favor that or trends that were going against us. So net, if you look at our portfolio, if you're hearing this conversation, it interestingly has a number of natural hedges built into it and it's just a matter of managing all of those that is the key to success.

Steve Powers
Analyst, Deutsche Bank Securities, Inc.

Q

Yeah. And you guys have always also you've been very clear eyed in your – on your expenses in your line of sight to synergies and savings in general. As you think about what you've been through, what you're going through now, I guess either of you can weigh in on this. Has it opened your eyes to maybe new sources of savings and efficiencies that maybe you didn't see six months ago, but on the flip side, are there new costs that you also now see that might serve as least as a partial offset, how do you think about that?

Robert James Gamgort
Chief Executive Officer & Executive Chairman, Keurig Dr Pepper, Inc.

A

Okay. Ozan, do you want to cover that one?

Ozan Dokmecioglu
Chief Financial Officer, Keurig Dr Pepper, Inc.

A

Absolutely. Steve, you are absolutely right. But also as Bob was explaining because of the integration putting the two legacy companies together we developed an unbelievable detailed visibility to our cost structure which we are seeing huge benefits as we speak. Obviously knowing what we have in greater details provided us amazing levers in terms of pulling and reacting in a very quick manner and seeing the impacts right away in terms of managing our cost base, so all the imaginable details were known to us.

And the second point as we said, we were nicely delivering against our either based productivity targets or the merger synergies which was nothing new to us. And obviously COVID-19 environment created a different working environment that required to do some pull and push which is pulling some of the initiatives that we were planning to execute in the outer months or years for example, and they're doing the vice versa of pushing some of the initiatives that we were planning to implement this year because of the working environment that made it impossible for us either to execute or new priorities popped up.

But the name of the game having a great handle by us in terms of all of our costs structure and this includes all the cost of goods sold as well as the discretionary overheads that we had. And as you know, as a nature of consequence of the COVID-19 working environment and some of the overhead expenses were already down, example, entertainment and travel for example. But because of the visibility that we have developed in the past two years, in fact, if we want to lean on to reduce our cost profile further, we know how to do it and we have the resources, which tells exactly what you said, we are very adapted and flexible in terms of the switch and continue on our journey delivering against our synergy targets as well as base productivities. So we feel very good about it.

Steve Powers
Analyst, Deutsche Bank Securities, Inc.

Q

Yeah, and, I think some of what you just said leads me to another question about – on the outside, we often talk about your business in terms of legacy Dr Pepper Snapple, legacy Keurig Green Mountain. And I guess the question to you is how much of that still pervades how you guys think about the business internally versus now this being as you flex this mix management exercise, Bob, a holistic company, I know you've integrated – the selling organization, you've integrated the warehouse direct business. E-commerce, you talked about as a platform that you spread from legacy Keurig Green Mountain more broadly. So, is this now taking shape in terms of more as a holistic KDP or is there still an element that we're working through of the two legacy businesses?

Robert James Gamgort
Chief Executive Officer & Executive Chairman, Keurig Dr Pepper, Inc.

A

I think there's one element of our business that is distinctive, which is our designing, sourcing and selling of brewers, actually I think selling back, we actually use the same sales organization to do that. We've got the unique element, as I talked about, we produce a huge consumables business hot and cold, and then we're in this very unique position where we manage a system, where we sell you the appliance to drive the consumables.

With the exception of that, entity, which again part of the management teams, part of the financial planning process, still driven by the procurement group et cetera, everything else is much more integrated and harmonized than I think the external world appreciates. And it starts with a common set of consumer insights across beverage. As you point out, it's a combined selling organization that can speak. Now, with clout at the highest levels of retailers with a full category perspective, it's a fully integrated supply chain procurement all the way through to delivery.

Now, there were elements of it that are different, for example, we're not putting pods on DSD trucks, but that's only one part of the way we go to market. And every day, we talk less and less internally, in fact very little about legacy KGM or legacy DPS. And I've had the benefit of working on more than a dozen mergers and integrations, and we have done this one really well so far, and we're staying very focused on making sure that it's not just a combination of companies to drive synergies, but to create a really unique business, and a really special culture on top of it, and we're well on our way to doing it.

Steve Powers
Analyst, Deutsche Bank Securities, Inc.

Q

Great. And I want to get into some of the specific businesses, but I guess just to wrap up this concept of mix management. As you look at what's going on, thinking about the future, I mean your best I guess sort of educated guess at this point, how are you anticipating that mix management exercise taking shape as we approach, as we migrate towards some kind of new normal. What are the variables you're most focused on and how are you allocating resources and anticipating what might come?

Robert James Gamgort
Chief Executive Officer & Executive Chairman, Keurig Dr Pepper, Inc.

A

On the first quarter call we talked about – we said it was like a chessboard. I used a different term. But it was like a chessboard and I said, think about one axis that is the retail channels and the others our portfolio on segment and those numbers – those intersections are what we're managing how well is our carbonated soft drinks doing in this particular channel and not to make the answer too complicated.

But even within carbonated soft drink, cans are growing and 20 ounce plastic bottles are not right now. So you even have to manage it down to the pack size and SKU level. That is the game board that we're looking at on a constant basis. But I said picking up data allows us to see the changes in trends faster and having the management protocols and disciplines in place to make the changes across the enterprise fast to respond to those. That's how we're going to continue to succeed.

And the reason I answer it that way is I don't think I can predict the future better than anyone else. We don't think we can predict the future better than anyone else. And every time we land on a single point forecast, we've seen that we could be wrong both to the positive and to the negative. So what we talked about is managing across a range of outcomes with a number of contingencies if this happens what would we do if we turn to office happening faster, what would we do. And so we've mapped out numerous scenarios, but haven't locked in on any one of them. And what gives us the advantage to use that management discipline I talked about is really broad portfolio that covers a wide range of needs and a really broad route to market system that allows us to play that effectively, but you've got to manage that actively is a point I keep coming back to.

Steve Powers
Analyst, Deutsche Bank Securities, Inc.

Q

Yeah. Okay.

Robert James Gamgort
Chief Executive Officer & Executive Chairman, Keurig Dr Pepper, Inc.

A

For either of your points, like we believe there's going to be a recession, almost certainly. We thinkthe trends that I described – that we described March, April and May are moderating. People are coming back to restaurants. People will come back to the office. So there's that kind of real high level thing that we could all guess that. But what happens is there's a second wave. So that's why we don't get too locked in on any of these and think that this was a storm that blew through and it's behind us now we're recovering, we're very wary of what else can happen in the future.

Steve Powers
Analyst, Deutsche Bank Securities, Inc.

Q

Yeah. What is your assessment of how the business will perform in a recession? I mean I think there's a more history on the cold side of the business, the legacy Dr Pepper business. But the Keurig business has been around for over a decade, but it's also much more developed than it was then. How are you preparing the overall portfolio for, as you say, a recession that is likely going to come?

Robert James Gamgort
Chief Executive Officer & Executive Chairman, Keurig Dr Pepper, Inc.

A

Yeah. So it does start with the cold side of the portfolio because as you point out there's a longer history. As you know, anything that has a high degree of in-home consumption does well in a recession, we know that CSDs and juices and ready to drink tea et cetera applesauce, those all do very well in a recessionary environment. You might have to get sharper on promotions and you have to think about different pack sizes, but that's really getting detailed on that one.

From a fountain and food service perspective our on-premise business, we tend to skew towards QSRs, quick serve restaurants and they tend to do very well in a recession and we've talked about it before, but again it's worth repeating for this audience, Dr Pepper is the most available carbonated soft drink in QSRs which is a surprising fact to people, it's not the largest, but it's the most available. And so that piece of it – it's again you have a lot of levers to pull to manage your way through a recession depending on how long is it and how deep is it. Hot side of the business, you're right is less – has less history and you could argue is less tested, but it's very well-established right now, hitting about the – approximately a quarter of American households and being in that level where you really embedded. We know that in recessionary times, people move from away from home to in-home. So coffee shops into home will be a benefit for us.

And if you think about the work that we've done on the Keurig system, we now have brewers that are as low as $50 that are very high quality all the way up to $200 and we have consistently and intentionally lowered our price of a pod, even though as you know every quarterly earnings call, we get question about when will the pricing decline stop and our answer is always, but we're doing it on purpose and we have it covered by productivity as you can see in our margin. That's going to serve us well in any recession because in the recent history where it was $0.50, $0.75 early, early days approaching a $1 per pod, you can get a high quality pod in the 30s, you can get a mid-price pod usually in the 50s or even the low end of that, the premium is now in the $0.60 to $0.70 that is no longer the huge premium or a premium especially the low end that it once was, especially given the benefits that consumers get from the system.

So I think we prepared ourselves well to weather through any recessionary storm and those are some of the many things we would do.

Steve Powers
Analyst, Deutsche Bank Securities, Inc.

Q

Okay. And let's talk about those two businesses or the DSD focused business and the coffee business in order in a bit more detail. The DSD business, it's been – the trends have been – I mean clearly there's an away from home headwinds and on premise headwinds but the business as it relates to channels that are open and functioning, consumers are shopping, it's been exceptionally strong based on results that we – what you've reported and based on the consumption data we all see. If your view as to why you're effectively winning at least from a share perspective in this environment and then how you think about the longer term potential of that DSD business as a whole, why was that so attractive back when you brought on Dr Pepper as a strategic acquisition? What is the potential of that from a profit growth standpoint going forward?

Robert James Gamgort
Chief Executive Officer & Executive Chairman, Keurig Dr Pepper, Inc.

A

Yes. So the DSD system just to describe it real quickly to everybody, our DSD system allows us to reach 75% of the US with our company-owned equipment and employee – and company employees and the remaining 25% approximately is handled by long-term relationships with independent distributors and the combination of the two allows us to reach 100% of the US population in a cold single bottle, single can merchandising format which is really powerful.

What attracted us to it at the time of the merger was the fact that we were getting – we'd be able to get access to one of the three systems of scale in the country that could do what I just described. So there's a scarcity value on that, but we also said that we didn't plan to just buy it and hold it we plan to invest in it and improve it. And that's exactly what's happening right now as you're seeing a combination in the marketplace of the management discipline and protocols that I've talked to you about before and our ability to move quickly between demand and supply and delivery on a real-time basis.

But, you're also seeing in these numbers, just the fundamental improvements that we've been making in our DSD system through investments in technology and people and process. So, it's a combination of those two working right now, and I think it's hard to predict the future, but we're very pleased with the performance we've seen in the past three months. And we're pleased with the trajectory that we're on both from a performance and a cost standpoint. But, we don't feel like we're anywhere near finished on that, we felt like we were really in the early days of this performance improvement when the crisis hit. So, it's been a really interesting space for us.

Steve Powers
Analyst, Deutsche Bank Securities, Inc.

Q

And as you parse that – the recent successes, have you been able to demonstrate that you can leverage the improvements that you've put in place in your own company-controlled territories and also essentially export those learnings and best practices to your partners' such that the whole system is kind of uplifting equally or is it skewed to where you have control or how's that laying out?

Robert James Gamgort
Chief Executive Officer & Executive Chairman, Keurig Dr Pepper, Inc.

A

It's an excellent question. So, our performance goes well beyond just where our company DSD is. And again, that comes from a number of things including strength of our portfolio. If our brands are strong, Dr Pepper is very strong, it'll perform across all systems in which there's distribution assuming that there's reasonable execution, but we've been working hard over the past two years to really build the relationships with our independent distributors, sharing a lot more of what we're doing, building trust and anything that we think that

is in our DSD system that would benefit one of our independent distributors, we're not shy to share that with them or offer them those resources. And so, again, I think we've built a lot of trust, and I think we're in a stage now of rolling that out, but again, in very early stages, but they are absolutely critical to our success.

Steve Powers
Analyst, Deutsche Bank Securities, Inc.

Q

Great. The other thing that has been an ongoing topic with your DSD business is the concept of the allied brands and leveraging that system to grow brands that may today be under scale but tomorrow could be the promising brands of the future. You guys have approached that with a different, kind of exciting framework relative to how DPS in the past managed that business, it used to be in my view sort of a way to fill capacity, there was basically excess whereas you guys have pivoted and said this is a strategic lever of growth that we can take this third system in the country and offer it up to promising entrepreneurs and be able to capture that growth. The sample size is still small, but there's been some mixed successes on that. Is your confidence, as you've now run this for a couple of years, is your confidence the same, is it greater, has it raised questions, what's been the experience?

Robert James Gamgort
Chief Executive Officer & Executive Chairman, Keurig Dr Pepper, Inc.

A

Yeah. So the allied brand model that you described that the DPS team ran proved the strength of its system because there are a large number as you know well-established brands that are out there that are successful that were born in the DPS system. The problem is a very large number of those brands are in somebody else's system right now.

And so that is the challenge of that strategy and the structure that they created which is they didn't get rewarded enough for the sweat that they put into to build these brands. And so our point of view is we're open for business, if we've got whitespace in our portfolio, we want to partner with entrepreneurs and we will work our tails off to make their brand successful, but we want to be rewarded for that.

We want to be credited for the value that we create and so what we've said is, if you want to come into our system at an early stage and we mutually build a great success, we want a pre-negotiated path to exit for you. We don't want to be in a situation where we've been wildly successful, built the brand and then have somebody else come in and pay a much higher price for that. And that's the difference.

To your point, it's very early. Remember in the first year of our merger, we had to clean-up the existing allied brand portfolios. We bought some brands, some left, some came in and we needed to stabilize all of that for about a year, it's actually a little more than that to get that up and going, get Evian ramped back up in our system again.

And we felt like we were in a really good place. And now we've brought in our first of – these experiments, if you want to call it that, in A Shoc which is the energy drink partnership with Lance Collins. Hard to read where we are with that one because that was just scaling up when COVID hit, and as I mentioned before energy has been a challenged segment. So we don't really know although we're getting good distribution. You wouldn't want to read anything off of that.

So I would say we're going to stay disciplined with our strategy because, Steve, from our standpoint, we'd rather build our system off of a level of volume that is predictable rather than go out rent some volume bring it in, build somebody's business and then have to pay a disproportionate price and I guess my last point that I'm leading to it is, we've shown this in the past, we've studied the major beverage acquisitions, those that are a high multiple of

sales and I'll just mention one that's in our system, right Bai was one of those, I won't mention anybody else's.

And we couldn't find one that ever-created value. And so, from day one, we said that's just a game we're not going to play and we're not going to put ourselves in a position where we are forced to pay that kind of multiple, we'll pay a fair multiple, but we want to be rewarded for the brand value that we create. So, time will tell how that strategy plays out, but in our opinion that's a far better strategy than going out and paying a very high multiple.

Steve Powers
Analyst, Deutsche Bank Securities, Inc.

Q

Thanks. Yeah. Perfect. So, let's maybe pivot over to the coffee side of the business. It's almost a similar dynamic in the near-term where you've got, the away-from-home part of that business that is clearly having headwinds. But the, at-home business is on fire, I think one of the most exciting parts of that is just what I perceive to be not just accelerated consumption, where there are already brewers in households, but also incremental household penetration activity. Can you talk about the movement you're seeing on that in the current environment and then, what's the longer-term vision for folks who haven't heard you articulate, what's the vision of the penetration opportunity over time?

Robert James Gamgort
Chief Executive Officer & Executive Chairman, Keurig Dr Pepper, Inc.

A

Yeah. So, as I said, we're just under 25% household penetration right, it's a number we talked about and we said we will talk about that at the end of the year, so I'm just pulling the number that we talked about at the end of last year on our earnings call, and we said we'd update that on an annual basis.

But we believe that there's upside to be well north of that, and there's an Investor Day presentation at March of 2018 that really shows the significant amount of upside that we have on household penetration. It describes not only the absolute number, but the target of people – opportunistic target of people who should be coming into the system.

And then we even took a step further and when we describe what were the barriers of those people coming in. And what you've seen since then is that our innovation pipeline and our marketing efforts have been very targeted against the right individuals solving those barriers to come into the system, and so we've seen a really steady, but high level of growth in household penetration.

It's too early to tell and it wouldn't be appropriate for me to talk about it on this call, because it would kind of violate how we've talked about these things in the past. But if you look at for example NPD data or some other publicly available data, you're seeing a lot of interest in brewers in total, as people have outfitted their home and also in Keurig brewers specifically. And so, the difference as you said the category is way up, it's a combination of household penetration growth and what we call attachment rate which is usage per machine.

And I would remind people that we have a 10,000 roughly household panel where we get real-time consumption on Keurig brewers and we could actually see hour-by-hour as people were told to work from home, we could see their coffee consumption going up in their homes. And we know when they return to work that that number will come down.

But we also have a sense that it'll land at a slightly, if not meaningfully higher number because people have kind of rediscovered their machine. But the people who've come in for the first time, the good news about them is they stick for a very, very long time. The dropout rate once somebody comes into the system is very low. So we'll give

more detail on that, you'll see it in our Q2 earnings which will be coming up and then at the end of the year we'll provide an update to our household penetration number. But the macro trends are certainly in our favor right now.

Steve Powers
Analyst, Deutsche Bank Securities, Inc.

Q

Yeah. And you had mentioned that the pricing discussion that often comes with this business and I guess the – I think you've done a good job articulating as to why you perceive that strategy and the benefits that it's had. The question that I think lingers for longer term investors is, does the need to hit specific price points today; while it's good, does it communicate a lack of longer term pricing power? Right now, it's doing benefits and coffee costs are favorable, but over time is there some inherent ceiling on pod pricing that will inhibit longer term growth and how do you respond to that?

Robert James Gamgort
Chief Executive Officer & Executive Chairman, Keurig Dr Pepper, Inc.

A

Sure. We have talked about it that way, again I'd reference it back all the way to that same investor deck that has a lot of detail on this. We talked about pricing over time. We said it would decline for a period of time because we were driving the decline and then we said over time, we expect that it would moderate.

And we actually are seeing moderation, before the crisis. Now, during the crisis you actually see prices go up. And the reason is because when you're selling at this rate and retail is having trouble with keeping in stocks, they want fewer promotions. That's the real reason why that's happening. And you're also seeing something very interesting, as people trade from away-from-home to in-home; the growth in premium pods is higher so they're trading their coffee shop purchase to in-home. They want that brand and they're willing to pay slightly more for it because it's still a great value versus what they've been able to get.

So, there's a lot of interesting dynamics happening on the pricing point, my comments really are focused on the fact that we have long-term agreements with our partners. And when we signed the agreement with Nestlé, which we announced earlier in the year, for the Starbucks brand, we said that we now have all of our branded partnerships locked up for a very long time.

Those partnerships contractually have agreements on what our pricing are, so whatever the pricing is going to be which I'm not projecting for anybody right now, we know what it is and that's for the majority of our business. And the reason we had confidence in doing what we did which was a pretty bold move is because when we did that household penetration analysis and the barrier work, that I described earlier when we took the company private. By far the number one barrier was the price of pods. And when we took a look around the world at what Nespresso pods in Europe looked like, we realized that we weren't at equilibrium. We weren't even close to equilibrium.

And so we had a strategic choice to try to protect the pricing that was in place at that time which would limit our household penetration or drive massive productivity and efficiency through investment and lower the price and we chose the latter route. I know it's challenging for somebody on the outside trying to build an external financial model when they see a negative number on pricing. They're just not used to seeing that. But as I always point out, look at the volume growth; look at now the revenue growth which we hadn't seen until recently. And then also really importantly look at the margin expansion because it tells you we have great visibility on what we're doing here.

Steve Powers
Analyst, Deutsche Bank Securities, Inc.

Q

Yeah. You have – and Ozan has spoken to this at the top, you've given some pretty clear financial objectives to the market and set for yourselves as to what you want to deliver through 2021. For investors who were coming to the story now and they're trying to think about the three-year horizon from today as opposed to from the starting point, how do you how do you advise them to think about it because I think a lot of what we talked about today paints a picture of where the top line can go and what the addressable capital market opportunity is. But from a productivity standpoint, when synergies reach their conclusion at the end of 2021 assuming the current schedule holds, what are the levers of top line leverage and profit growth and how should longer term investors think about that looking out longer term?

Robert James Gamgort
Chief Executive Officer & Executive Chairman, Keurig Dr Pepper, Inc.

A

Ozan, do you want to pick up the first part of that?

Ozan Dokmecioglu
Chief Financial Officer, Keurig Dr Pepper, Inc.

A

Yeah.

Robert James Gamgort
Chief Executive Officer & Executive Chairman, Keurig Dr Pepper, Inc.

A

And then I'll come and talk about beyond 2021.

Ozan Dokmecioglu
Chief Financial Officer, Keurig Dr Pepper, Inc.

A

Absolutely.

Robert James Gamgort
Chief Executive Officer & Executive Chairman, Keurig Dr Pepper, Inc.

A

Or you could cover that as well?

Ozan Dokmecioglu
Chief Financial Officer, Keurig Dr Pepper, Inc.

A

Absolutely. So let me start, so Steve I mean first of all as we discussed many times, right, it's great to reiterate again. We remain on track for our 2020 and 2021 financial targets to deliver despite the pandemic COVID-19 working environment due to several reasons as we have been discussing now, due to several economic uncertainties. So, we have been delivering, since the merger, and we have another 18 months to go on our target. We should not forget that.

So, if I want to make a quick summary, strong top line growth with 2020 outlook ahead of the target that we put for ourselves 2% to 3% that we announced in greater detail during our quarter one call as well as the year end call that we announced 2019 results.

Our earnings per share growth stays intact despite the pandemic-driven economic conditions. We delivered the first wave of synergies with the remainder to come through the end of 2021. And as we discussed many times, when we say synergies, we should not also forget the strong base productivity programs that we had, and we have been implementing very successfully against them, that is nothing do with the deal synergies and we see them to continue for the foreseeable future.

We didn't discuss, but I think, it's very important to note that we generated free cash flow of $3.8 billion since the merger, and as we announced, when we look to the strong cash flow strong generation, clearly, it's best-in-class, for example, at the end of 2019, our conversion ratio of net income-to-free cash flow was in excess of 140%, and the same metric at the end of quarter one 2020 was in excess of 115%, which clearly demonstrates our ability to generate a strong and high level of free cash flow and we expect this strong delivery to continue.

And with that, we are also continuing to deleveraging our balance sheet as a critical part of our value creation. As we said, we started approximately 6 times and at the end Q1 2020, we were at 4.2 times which puts us nicely on the trajectory that we put out there to be at 3 times following three years into the merger. Bob, would you like to top it off?

Robert James Gamgort
Chief Executive Officer & Executive Chairman, Keurig Dr Pepper, Inc.

A

Yeah. And I think about it, everything you said is perfect and it takes us through the end of 2021 which is still 18 months away so to have that line of sight towards those kind of returns for another 18 months is unique. And then beyond that just thinking about where we go our leverage will be below 3x, it gives us a lot of optionality. Significant CapEx investments that we have been and are making right now will pay off in return but also will slow down in terms of cash flow needs.

And then we still have considerable whitespace in our portfolio with a number of different ways to get there. So I think we have clearly in interesting play for the next 18 months and a very interesting play beyond that and as we move forward that's an area we'll be talking about more and more.

Steve Powers
Analyst, Deutsche Bank Securities, Inc.

Q

Perfect. Thank you. Yeah. Now there was news today, your largest shareholder announced its intent to distribute about 143 million shares, about 10% of the current shares outstanding. Maybe just some comments on that as an effort to increase liquidity in the stock and just you've got some other strategic investors in terms of Mondelez, et cetera, so maybe just some comments on that for those who aren't as close to it.

Robert James Gamgort
Chief Executive Officer & Executive Chairman, Keurig Dr Pepper, Inc.

A

So we've talked about JAB you're referring to...

Steve Powers
Analyst, Deutsche Bank Securities, Inc.

Q

Yeah.

Robert James Gamgort
Chief Executive Officer & Executive Chairman, Keurig Dr Pepper, Inc.

A

...and their intent to work with us and it was actually at our request to increase our public float. And so we, in a very organized fashion, we've worked with them to sell some shares to put float out there and we're sitting about 24% public float and the stock trades much better when the float is higher than it was when it was very restricted, it's actually very interesting. If you pull it apart and say of the public float, how much is held by the top 10 shareholders, how many of them are net buyers, you can see that our effective trading float was too small. So that's been really effective.

This is something that's really different today. What this is, is we always talked about JAB and their partners. Well now we're talking about their partners. Everything always is a headline of JAB. What is happening is the partners that are a part of this deal are receiving a distribution of shares. So this is not new equity. They're not selling the shares right now. They're receiving some of the equity that they own right now in the holding company in the form of shares and those shares, as you said about 10% of total public float, 50% of them are locked up for six months and then the other 50% are locked up for a year.

And at that point they're fully tradable if those partners choose to trade them and so there's no immediate impact on the effective float in the marketplace, the first, any impact would be six months from now if they decided to do that. And the way I described this is, this is very common within the world of private investing. So these are players who go – whose investment go all the way back to the take private of KGM and so giving them the option for some liquidity five years into their investment is very typical; and so all three of the minority partners that are in the press release today have been with the KGM and now KDP since 2015. So this is pretty normal stuff.

You asked about Mondelez, Mondelez was not involved in this at all. And I know they're – honestly we don't have any indication of what their intentions are that's something that they would be willing to share with you that they don't talk to us about. But hopefully that clarifies what the event was today. It was very interesting because one of the first headlines that went out there was that JAB is selling 10% of the company which couldn't be further from the truth. So it's nice to have an opportunity to clarify exactly what this is. But actually if you read the press release, it's pretty clear within there

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Steve Powers
Analyst, Deutsche Bank Securities, Inc.

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Yeah. Okay perfect. We're at the end of our time, but I want to close, just in terms of getting a sense for the biggest success factors for you. Clearly we know what the objectives are for you financially, the outputs so to speak but I guess in terms of inputs, how do you want to deliver those results? What is – do you assess when you look back six to nine months from now on what transpires from here to there, what do you want to be able to say to investors you were able to achieve?

Robert James Gamgort
Chief Executive Officer & Executive Chairman, Keurig Dr Pepper, Inc.

A

Okay. On the coffee systems piece household penetration is always the most important driver of success in the long-term. And we've mentioned before that there is not always a correlation especially quarter-to-quarter between brewer sales and household penetration. I won't go into that long conversation, but it's really household penetration that is the key indicator of success in the coffee systems.

On the cold business, market share performance within our categories; yeah it's great the categories are growing faster like they are now but that we don't always control that but we do have a strong influence over our market share performance and I always think of that as a really important metric.

How we're getting those results is something that you should all look at, which is the quality of innovation on consumables and on brewers, and the quality and the investment in marketing that we're making behind those over the long-term. There's going to be fluctuations time to time on that, but that's an important quality driver of results over time.

And then the last one is where I started somewhere in an earlier question you had is, we don't expect the environment going forward to be stable and predictable and return back to the way it was. And I said internally to our organization, I don't think January of 2021 is going to look a lot like January of 2020.

And so those are – the metrics I just gave you are really the core metrics, but the real driver of success will be doing what I just described in a way that's flexible and nimble, and we're not wed to any one path and that we're willing to shift course if we see the environment change, that's ultimately the only way to succeed in an environment like this.

Steve Powers

Analyst, Deutsche Bank Securities, Inc.

Excellent. And we're going to have to leave it there, but it's a good note to end on.

Robert James Gamgort

Chief Executive Officer & Executive Chairman, Keurig Dr Pepper, Inc.

Yeah.

Steve Powers

Analyst, Deutsche Bank Securities, Inc.

On behalf of Deutsche Bank and all of the investors who attended the conference or listening to. Thank you, Bob. Thank you, Ozan. Thank you, Tyson for joining us. Thank you Keurig Dr Pepper. Be well, everybody and stay safe. Thank you.

Robert James Gamgort

Chief Executive Officer & Executive Chairman, Keurig Dr Pepper, Inc.

Thank you.