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Dr Pepper Snapple Group, Inc. (DPS)

Q1 2017 Earnings Call

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MANAGEMENT DISCUSSION SECTION

Operator: Good morning and welcome to Dr Pepper Snapple Group's First Quarter 2017 Earnings Conference Call. Your lines have been placed on listen-only until the question-and-answer session. Today's call is being recorded and includes a slide presentation, which can be accessed at www.drpeppersnapple.com. The call and the slides will also be available for replay and download after the call has ended. [Operator Instructions]

It is now my pleasure to introduce Heather Catelotti, Vice President, Investor Relations. Heather, you may begin.

Heather Catelotti

Vice President-Investor Relations, Dr Pepper Snapple Group, Inc.

Thank you, Lori, and good morning, everyone. Before we begin, I would like to direct your attention to the Safe Harbor statement, and remind you that this conference call contains forward-looking statements, including statements concerning our future financials and operational performance. These forward-looking statements should also be considered in connection with cautionary statements and disclaimers contained in the Safe Harbor statement in this morning's earnings press release and our SEC filings. Our actual performance could differ materially from these statements and we undertake no duty to update these forward looking statements.

During this call, we may reference certain non-GAAP financial measures that reflect the way we evaluate the business and which we believe provides useful information for investors. Reconciliations of these non-GAAP to GAAP measures can be found in our earnings press release and on the Investors page at www.drpeppersnapple.com. This morning's prepared remarks will be made by Larry Young, President and CEO; and Marty Ellen, our CFO. Following our prepared remarks, we will open the call for your questions.

With that, I will turn the call over to Larry.

Larry D. Young

President, Chief Executive Officer & Director, Dr Pepper Snapple Group, Inc.

Thanks, Heather, and good morning to everyone. I will start by saying that I'm proud of our teams for staying focused on our strategy of growing our priority brands through integrated communication and execution in the quarter. We outperformed the CSD category and grew both dollar and volume share. The acquisition of Bai which closed at the end of January has unlocked tremendous growth potential in high performing categories and we are providing the team with the resources they need to continue to drive strong growth on the brand. Our allied brand strategy continues to be successful, and is driving meaningful growth for us. And we are continuing to utilize the tools of RCI to drive breakthrough change, enabling us to increase service levels, growth and productivity.

For the quarter, bottler case sales increased 1% on just over 1.5 points of positive product mix and price. Our CSDs grew 1% in a challenging environment, and our non-carb brands declined by 2%. Dr Pepper increased 1%, reflecting continued growth in our fountain foodservice business, partially offset by declines in [ph] tin (3:18). Regular Dr Pepper grew 1% in the quarter and Diet Dr Pepper grew slightly, again outperforming the diet category.

Canada Dry grew 5%, and Schweppes increased 8% on continued growth in the ginger ale and sparkling water categories. Peñafiel increased 5% and Squirt grew by 1%. 7UP and A&W both declined 2% in the quarter. 7UP

grew slightly in the U.S., however, that growth was more than offset by declines in the Caribbean. All other CSDs decreased 1% in the quarter.

In non-carbs, Snapple decreased 6% in the quarter, cycling 4% growth in the prior year as certain promotional activities shifted out of the first quarter of this year and are expected to take place in the second quarter. Mott's declined by 2% as juice declines were partially offset by growth in our sauce business. Bai increased 80% in the quarter, primarily on our acquired volume, as well as on continued growth in our pre-acquisition distribution, which grew 26% in the quarter. This growth was lower than our initial expectations due to timing of certain pre-closing promotional activity. Our expectation for the full year is for growth in Bai of about 40% to 50%. I will speak more about the brand in a moment.

Our growth allied brands increased 33%, driven by continued strong growth across BODYARMOR, Core and FIJI, thus affirming the success and importance of this growth strategy. Clamato was flat in the quarter and our other non-carb brands declined 9%, primarily driven by declines in Hawaiian Punch. Building our brands and unlocking growth with targeted and innovative communication is critical to our strategy. Our summer selling calendar is packed with programs that will connect with consumers, build additional excitement with our bottling and retail partners and highlight our ability to leverage our consumer insights to communicate against the need states of our priority brands.

Dr Pepper will hit the big screen this summer partnering with this year's blockbuster superhero movie, Wonder Woman. On packaged graphics, strong digital media support and merchandising and retailers will help build further excitement around the brand. Pick Your Pepper will return this year, giving millennial consumers a chance to express themselves by picking their favorite bottle or can with a label that represents them. The program proved so successful last year that we are rolling it out to not only single serve bottles, but to take-home packaging as well.

7UP will own the summer social night occasion as the most versatile CSD in the category. Our new campaign including celebrity partnerships, merchandising and point of sale on key packages, as well as strong digital and social media will encourage consumers to mix it up a little with 7UP. Our early results across multiple social platforms reflect strong consumer engagement with this campaign and we are on track to deliver 2 billion consumer impressions this year. So you can see why we are excited about this campaign, and the consumer attention it's bringing to the brand.

Consumers will have the chance to relax harder with Canada Dry and our Relaxing Rewards program where every purchase wins. As the newest addition to the Snapple lineup of flavors, it Takes 2 to Mango Tea will give consumers another great tasting option to take a break with Snapple. Our loss of the Clamato 12 ounce tea bottle will give consumers a convenient solution for an authentic Clamato Michelada when celebrating holidays or just spending time with friends and family.

And Mott's will continue to drive growth in sauce, with updated consumer relevant graphics and a more simplified sauce portfolio, that includes sweetened and unsweetened sauce flavors, and we're launching new 100% juice flavors in convenient pouch and take-home packaging.

As we have said many times, we are very excited about our newest brand, Bai, and its tremendous growth potential. Bai represented just under 4% of our total net sales this quarter, which represents an important shift in our portfolio. If you look across IRI measured channel data, volume growth in the quarter averaged over 40%, and was up over 70% in the highly profitable convenience channel. From an ACV standpoint, while we still believe that

our distribution opportunities for the enhanced water product, particularly in convenience, the more sizable distribution opportunities lie in the other platforms, mainly Bubbles, Supertea and Black.

Bai Bubbles, the sparkling water product, averages in 50% ACV range in large format but only has single digit ACV in the convenience channel. As many of you know, the sparkling water category has seen double digit growth for the past several years and Bubbles is a premium, authentic, great tasting sparkling water product that we believe has great potential for growth.

With respect to Supertea and Black, ACVs range in the single to low double digits for these platforms, and true to the trademark the products capitalize on premium, and better for you and great tasting. The IRI Scan Data also reflects healthy and importantly improving velocities on the brand by channel, highlighting the sustainability of the distribution opportunities. We have recently done some research on Bai and learned that while trial is low on the brand, repeat rates are higher than we have historically experienced giving us confidence in our strategy of driving trial and awareness with consumers.

We are investing significantly behind Bai this year as we look to build trial and awareness of the brand. The marketing calendar is a yearlong with national TV, strong digital and social content public relations, and out-of-home advertising in certain markets. We will also emphasize additional sampling and trial driving activities across the country. You may have seen that Bai has recently partnered with a 2017 Tribeca Film Festival to be the official water and enhanced water of the event, and at the same time released their first of four short films under their "Unbelieve" campaign.

Bai has also launched an innovative selling and merchandising strategy called Bai-osphere. Bai-osphere is a concentrated effort to incubate Bai's innovation platforms across their respective categories with very focused and concentrated teams that frequent selected stores. We believe that the trademark has a right to play and win in every beverage category, hence providing consumers with a total beverage solution. We started with a test market and Bai is deploying a dedicated sales team to build partnerships with retailers within a defined geographic radius to create an environment where Bai's innovation platforms that serves as points of interruption throughout the store, enhancing Bai's awareness and penetration across different beverage categories. Early results in our test Bai-osphere market give us confidence to look to expand and scale this strategy to other key markets over time.

Finally, one last comment on Bai. We have recently started selling Bai in the UK. The product is currently being produced in the United States, and shipped overseas. Given that the business is very small currently, as we look to scale the business over time, we'll look for a more sustainable means of manufacturing the product.

And now, I will turn the call over to Marty to walk you through the financials and our updated guidance.

Martin M. Ellen

Chief Financial Officer, Dr Pepper Snapple Group, Inc.

Thanks, Larry, and good morning, everyone. Let me begin with a high level financial summary for the quarter. Sales volume increased 1% with reported net sales up 2%. Somewhat as expected, segment operating profit declined 10%, and core operating income declined 2%. There are several items that are impacting our bottom line results, including our acquisition of Bai that I will speak to as I walk you through the numbers.

However, before I walk you through the line by line results, I would summarize this quarter as reflecting a few noteworthy items. Investments in marketing increased $20 million year-over-year, including $11 million of marketing for Bai for the two months that we owned the brand. Our beverage concentrates and LAB segments

had good overall performance with LAB's results again affected by the weakness in the peso. Results in packaged beverages were impacted by investment in our DSD front line labor, which increased planned expense by about $5 million and by incorporating Bai's results for the quarter. Bai sales were impacted by the timing of certain pre-closing promotional retailer activities and by us having to defer $9 million of Bai's profit on sales to us in the quarter, which should not be a meaningful factor going forward.

Our growth allied brand portfolio, which now excludes Bai, increased net sales by 39% in the quarter, and our CSD performance was, again, better than category performance. Performance in Snapple was weaker than expected and the brand declined as it lapsed certain promotional activity a year ago. Snapple, along with Hawaiian Punch, were the major factors limiting packaged beverages net sales growth.

With that as a backdrop, let's go through the results. Reported net sales increased 2% in the quarter, including the Bai acquisition which accounted for about one percentage point of our net sales growth. Organic net sales growth was driven by just over 1.5 percentage points of favorable product mix and price, along with an increase in organic sales volumes. Net sales growth was partially offset by over one percentage point of unfavorable foreign currency translation and unfavorable segment mix combined. The unfavorable segment mix was a result of our higher proportion this quarter of concentrate sales to finished good sales.

Reported gross margins increased 30 basis points, increasing from 59.5% last year to 59.8% this year. The favorable effect of unrealized mark-to-market commodity changes increased gross margins by 110 basis points. Lower commodity costs primarily aluminum, and continued productivity benefits including those from RCI both increased gross margins by 20 basis points.

The effective mix driven primarily as a result of growth in our allied brands reduced gross margins by 60 basis points and certain increases in manufacturing costs, both inflationary, as well as higher utility costs in Mexico, reduced our gross margins by 50 basis points. Further reducing gross margins by 10 basis points was the negative effect of foreign currency. While our gross margins benefited in the quarter, now that we enjoy the full gross margin on Bai as the brand owner, the benefit was offset by the one-time effect of deferring the recognition of $9 million of gross profit on shipments of Bai product still in our inventory at the end of the quarter. But for changes in our inventory levels of Bai products going forward, this should not be a factor in future periods.

For the quarter, SG&A increased $75 million. The acquisition of Bai added $41 million, including $19 million in transaction and integration expenses. $2 million of these transaction expenses are recorded in our packaged beverages segment. We also added $11 million of marketing investments that included the Bai Super Bowl commercial. SG&A also increased due to an unfavorable $18 million comparison of unrealized commodity mark-to-market activity, increases in certain operating expenses, the additional planned investment behind our DSD frontline labor workforce that I already mentioned and a $9 million increase in planned marketing investments behind our other priority brands. SG&A was reduced in the quarter by lower management incentive compensation expenses and the favorable comparison to a $4 million arbitration award that was recorded in our LAB segment last year.

Depreciation and amortization declined $1 million in the quarter. Other income increased $28 million in the quarter, reflecting the market value increase on our initial equity investment in Bai. We included this gain in our core results, given that our allied brand partnerships are a critical component of our strategy. And we believe that value appreciation from successfully building brands like Bai should be included in our core results. Our guidance increase today includes this $0.10 gain.

Reported income from operations declined by $28 million in the quarter. The impact of Bai, including the transaction and integration expenses contributed $34 million of this decline, which was partially offset by the $28 million gain on our initial equity investment. Let me break down Bai's results, at an operating level there was a loss of $5 million. Included in this loss was the $11 million of marketing investment, including the cost of the Super Bowl commercial.

We then had to defer the $9 million of profit Bai realized on sales of product to us that was not sold through to retailers and were in our inventory at quarter end. But the profit on the product we did sell through was previously earned by Bai before we acquired them. We also recorded $1 million of purchase price amortization and finally and not included in core results were $19 million of transaction and integration-related expenses.

Below the operating line, net interest expense increased $6 million in the quarter, primarily driven by a higher debt balance associated with the Bai acquisition. Our reported effective tax rate was 28.6%, which included an $18 million tax benefit associated with a favorable accounting change related to stock compensation, adding $0.10 to this quarter's EPS, compared to our previous estimate of $0.07. The effective tax rate in the prior year period was 35.2%.

Moving on to cash flow, cash from operating activities was $97 million, down $100 million compared to last year, almost entirely driven by timing of both trades payable and income tax payments. Capital spending was $16 million compared to $27 million last year. Total distributions to our shareholders were $125 million with $97 million in dividends paid, and $28 million in shares repurchased. Recognizing that the market was significantly appreciating on political news in the quarter, we took a conservative approach to buying back our shares, however, we still expect to purchase $450 million to $500 million of our shares this year.

Given our detailed review of Bai and in an effort to allow for sufficient times for your questions, I'm going to refrain from providing a detailed update on our CI today as it's hard to explain all of the activity going on across the company. That said, our 2017 Lean tracks are well underway and here are a few that I will provide updates on later in the year: improving display execution across our priority brands in our DSD network; increasing Dr Pepper fountain and bottles to go distribution in our on-premise accounts; improving display execution on warehouse direct brands and eliminating waste from internal reporting to deliver real time actionable insights across the business. We also have a multi-year major Lean transformation going on across our supply chain.

Now, moving to our updated 2017 guidance. We are now expecting net sales growth, including foreign currency translation of about 4%, with 2% of the net sales growth coming from our acquisition of Bai. Our expectation for Bai has come down slightly from our February call and we now see volume growth in the 40% to 50% range, as Larry mentioned. Organic volume growth is expected to be over 1%, and volume growth from our acquisition of Bai is expected to be just under 1%. Our expectation is for slight volume growth in our CSD portfolio, which we believe will be better than the overall category, and for mid single digit growth in our non-carb portfolio, which includes our allied brands. As you can [indiscernible] (21:19) my comments, there's still about 1.5% price mix embedded within our currency neutral organic growth and about 50% basis points of this price mix is the impact of our January 1 concentrated price increase.

Foreign currency translation is still expected to reduce our overall revenue growth by approximately 1%. Our balance of year assumptions for the peso is 21 to the U.S. dollar as we continue to believe that further deterioration could occur. Our revenue growth assumption also now includes the recent loss of our distribution of the Rockstar brand on the West Coast. Rockstar will now be fully removed from our distribution network, and we'll continue to drive our own brand, Venom, which though small has been showing nice growth.

Moving on to cost of goods, given our hedge positions and current market prices for our unhedged positions, we continue to expect packaging and ingredients, excluding the acquired Bai business, to be inflationary by about 50 basis points on a constant volume mix basis. For modeling purposes, remember, that growth of our non-carb portfolio including our allied brands will increase the dollar value of cost of goods and also remember that cost of goods sold is negatively impacted by foreign currency transaction. Collectively, all the factors I mentioned above are expected to result in a full year gross margin increase of about 50 basis points in 2017.

Moving to SG&A, excluding our acquisition of Bai, we are still expecting an increase of approximately $30 million in general cost increases, and expense associated with the investments made in our DSD front line workforce collectively. We also continue to expect an increase of approximately $10 million to $15 million in health and welfare and risk insurance expenses. RCI productivity benefits will help offset a portion of these increases. We now expect marketing investment excluding Bai to increase over $20 million for the year, which is an increase of $10 million versus our previous guidance.

Now, moving below segment operating profit, our net interest expense is still expected to be approximately $170 million, including $50 million associated with the debt to acquire Bai. In other income, we will be lapping a $5 million favorable non-cash gain on our acquisition our Aguafiel joint venture in Mexico and we will also now reflect the $28 million gain on our equity in Bai that was recorded this quarter. Our full year core tax rate is now expected to be approximately 34% which includes the $18 million tax benefit associated with stock compensation that was recorded in the quarter.

We continue to expect strong free cash flow in 2017, with stock repurchases of approximately $450 million to $500 million, subject to market conditions. We also continue to expect capital spending to be approximately 3% of net sales. As I mentioned a moment ago, we continue to expect foreign currency to negatively impact our results in 2017. The combined effect of both foreign currency translation and transaction is now expected to reduce core EPS by approximately $0.07 for the year, primarily driven by our assumption on the Mexican peso. Regarding the effect of the Bai acquisition on expected 2017 core EPS, we now expect the impact to be $0.02 dilutive, including the $0.10 gain on our equity investment recorded this quarter.

Taking all of the above into account, we are now expecting core EPS in the $4.56 to $4.66 range. Now, let me provide some quarterly commentary to help you with your modeling. First, with respect to the acquired Bai business, the performance of the brand is expected to ramp up over the course of the year, and we are expecting heavy marketing investments behind the brand in the second and third quarters. Second, as we move into the summer selling season, our marketing expense excluding Bai is expected to increase by about $20 million in the second quarter. Third, we expect about $5 million of the health and welfare and risk insurance increase to occur in the second quarter.

With all of that said, let me turn the call back over to Larry.

Larry D. Young

President, Chief Executive Officer & Director, Dr Pepper Snapple Group, Inc.

Thanks, Marty. Before we open the lines for questions, let me leave you with a few brief thoughts. We are laser focused on unlocking growth in our priority brands through integrated communication, and aligned execution. We are excited about the growth potential for Bai and the expanded platforms for the brand. Bai represented just under 4% of our total net sales in the first quarter, representing a very positive shift in our portfolio. Our allied brand strategy is working and continues to drive meaningful growth for the company. RCI continues to be our operational platform, and helps us to drive top-line growth and productivity across the business. And importantly, we remain committed to returning excess free cash to our shareholders over time.

Operator, we are ready for our first question.

QUESTION AND ANSWER SECTION

Operator: Thank you. [Operator Instructions] Your first question comes from the line of Judy Hong of Goldman Sachs.

Judy E. Hong
Analyst, Goldman Sachs & Co.

Q

Good morning.

Larry D. Young
President, Chief Executive Officer & Director, Dr Pepper Snapple Group, Inc.

A

Good morning, Judy.

Judy E. Hong
Analyst, Goldman Sachs & Co.

Q

So I guess I had some questions about the Bai sales contribution guidance because it seems like certainly the points lower versus the prior guidance does imply a much more modest contribution in 2017. I think the volume growth of 40% to 50% maybe I think you are expecting something like an 80% or 90% growth before. So can you just talk about what's driving that change? And then from an EPS solutions standpoint, you are including the $010 gain, which I'm not sure if that was included as part of the prior guidances. Can you just bridge the profit guidance versus sort of the sales guidance to the changes that you are making?

Martin M. Ellen
Chief Financial Officer, Dr Pepper Snapple Group, Inc.

A

Thanks, Judy, it's Marty. Let me take both of those – let me start with the latter. So it's – we never had the $0.10 in our guidance. We put it in our results for the reasons I've said and we have taken up our guidance partially to reflect that. We previously communicated I think about $0.11 of dilution. So in essence, without the gain it would be $0.12, so we've lost a further penny.

Let me take your question on Bai to talk about the brand, because to understand the financial performance and what we are expecting this year, you have to understand a little bit about the brand and particularly the channel strategies that have been employed for the brand versus where we collectively with Bai's management think the strategies ought to be adjusted. You may or may not know, we may have talked when we bought the company about their somewhat heavy reliance on the club channel, about a third of their business at the time was in that channel. And if you know that channel, you know from time to time in that channel, they run these heavily discounted MV, multi-vendor, mailings with some pretty deep coupons. Bai built a lot of their business as – as you know club, that's a 15 pack, variety pack, multi-flavor pack. By the way, in this quarter, we missed that activity. The big club channel activities occurred in January this year. Truth be told, in our DSD business, we shipped a lot of that volume in December and of course the businesses we bought from Bai, we didn't have for January. And then I will tell you by the way, the Bai brand in the club channel, based on shipment data, not – it was up 163% but of course it was down in February and March, because the activity a year ago was in that timeframe. So this was really about club timing in the quarter.

I will tell you in all other channels, in terms of shipment data, the brand was up 43% in the quarter, across the three months, forget for a moment when we acquired them, just in terms of the performance of the brand. As Larry said in his prepared remarks, and this is really important, trial in the brand is low. The repeat rates of purchase once tried are about as high as we and maybe others have seen on any brand, which informs our strategies on what to do in channels. And as you can imagine that means maybe not so much as in the past emphasis on a 15 pack, multi-pack, with a very high basket rate, okay? So part of our reduction, if you will, from – you are right about 80% year-over-year growth to say 40 or 50 is this view that we got to go back and think about how we build the brand sort of more one bottle at a time and get the trial going so we can get the repeat purchases. So embedded in that is really what we think is a thoughtful change in channel strategy.

I will also tell you that Bai Bubbles, which maybe all of you have seen or not seen a sparkling version of the base product. It's being repositioned. If you have seen it, before you have seen it bundled up with the enhanced product on the same shelf, line price. But as Larry said in his remarks, this product can really go after the sparkling water category. There are some incumbents in that category that we think have weakened and we think are deserving of a pretty much frontal attack by us and that's where we're going.

Supertea and Black, new products. These are great products. Early receptivity in terms of retailers has been really good. They are just getting off the ground now. So it's a little hard for us to think about what those brands may or may not do. We don't have a long history with them. We have tried to do a conservative job, I would say, at this point in thinking about what those brands can do over the balance of this year.

And while I have Bai in front of me, let me just quickly again talk about the financial results. I want to make sure everybody understands what happened this quarter. As I said – as we said, the volume contribution was about 40% of our 1%, Bai added net sales this quarter of about $21 million that includes $11 million from the third party distributors, about $10 million through our DSD systems. And I talked about $5 million operating loss if you – if you think about it, $11 million in marketing, a major portion of that was the Super Bowl commercial. Interestingly, they paid for it in January, before the closing, this was in flight before we bought the company. They tried to pay for it in January. We expensed this in February. That's just the way it works, okay? We inherited on their balance sheet and then the $9 million of profit elimination.

I mean, you have to understand that in essence we bought a company and we are the two-thirds customer as opposed to buying a company that has all external customers which means whatever we had in our inventory at the time we bought and we sold on was great for us. It's in our profit. The profit they made was before we bought them. The stuff that they reshipped to us, it was still in our inventory, in our company, related party, we can't recognize it, so in essence the profit that they would have made on their side from shipping to their largest customer for the most part, they couldn't recognize. This is a one-time event. It sort of remains there subject to that inventory level fluctuating up or down. And that's a real important point. So those are the two key takeaways for Bai. I will say the spending on the Super Bowl which was not insignificant, the $9 million of profit elimination which hit in the quarter, we shouldn't continue.

I hope that helps everybody understand where we are with Bai.

Judy E. Hong
Analyst, Goldman Sachs & Co.

Q

That certainly helps a lot, Marty. Just one follow-up. So your existing Bai distribution sales were up 26% and you talked about the total Bai kind of all channel being up, I think, 43%. So why is there that disconnect? Is your – is Bai sales in non-DPS distribution territory is actually doing better than your distribution territories?

Larry D. Young
President, Chief Executive Officer & Director, Dr Pepper Snapple Group, Inc.
A

Principally, Judy, because the January activity in club we shipped in December. It was in our December sales.

Judy E. Hong
Analyst, Goldman Sachs & Co.
Q

Got it. Okay. All right, thank you.

Operator: Your next question comes from the line of Laurent Grandet of Credit Suisse.

Laurent Grandet
Analyst, Credit Suisse Securities (USA) LLC
Q

Good morning, everyone.

Martin M. Ellen
Chief Financial Officer, Dr Pepper Snapple Group, Inc.
A

Good morning.

Laurent Grandet
Analyst, Credit Suisse Securities (USA) LLC
Q

Hey. I will follow up on Bai, if I may. I mean, you said the trial was very low, but how was it? I mean, could you share with us some numbers? And also, I mean, what is the outcome of the Bai Super Bowl investment in terms of brand KPI and actually in terms of trial or awareness. That would be interesting for us to understand.

And lastly on Bai, I was intrigued by the expansion out of the U.S., and UK manufacturing. Could you explain a bit more what you are planning to do there? What is the timing and are you planning to expand to more countries in Europe? Thank you.

Martin M. Ellen
Chief Financial Officer, Dr Pepper Snapple Group, Inc.
A

Let me take a few of those in unrelated order. Let me just – as Larry mentioned, in the UK, we are just getting started. We have a major customer there in the drug channel, product I think just went on the shelf in April. We are making the products here for obvious reasons. Volumes are too low to even think about having it contracted out in the UK at the moment which means of course that the profitability won't be that great. So, look, we had it in market less than a month. We've got a sales partner over there. We have a contract pack partnership, we just used them, but at this point, we are not going to go that route, and so it's too early to make a call on it. I do know they shipped their second container load of product over, so – but I don't want to speak too much at this point, but we'll update you on it as we go.

In terms of the Super Bowl commercial, here's what we would say, it was planned by Bai's management team in flight before we closed. To be honest, look, it got great GRPs. I mean, obviously, they were off the charts. I was told the Bai website actually, in their words, blew up during the game, meaning there were so many people trying to access it. So the brand got lots of exposure. I would say from our end, given it was sort of planned, I will say a little hurriedly and probably did not allow for the best retail execution planning and in store activity that maybe we would have done differently if we had had our hands on this thing completely from inception of planning on through retail execution.

I apologize, what was the first part of your question?

Laurent Grandet
Analyst, Credit Suisse Securities (USA) LLC
Q

Well, the first question was how low is the trial? You have been saying it's low. So how low is it if you can share that with us?

Martin M. Ellen
Chief Financial Officer, Dr Pepper Snapple Group, Inc.
A

Well, I'll tell you, it's low single digit but I see repeat numbers as high as 50%, which is really high.

Larry D. Young
President, Chief Executive Officer & Director, Dr Pepper Snapple Group, Inc.
A

Which we haven't seen in a long time on anything.

Laurent Grandet
Analyst, Credit Suisse Securities (USA) LLC
Q

Okay. Low single digit on trial, though?

Larry D. Young
President, Chief Executive Officer & Director, Dr Pepper Snapple Group, Inc.
A

Yeah.

Laurent Grandet
Analyst, Credit Suisse Securities (USA) LLC
Q

Okay. Thanks.

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

Dara W. Mohsenian
Analyst, Morgan Stanley & Co. LLC
Q

Hey, guys. I'm just a little bit puzzled on Bai here because the revision for the full year, it's a really significant revision from 80% plus to 40% to 50%. So I'm just trying to understand, have underlying assumptions changed at all? Is it just the club channel timing that you mentioned and the promotional issues? Because it seems like there's got to be something beyond that particularly with the Super Bowl advertising that you just talked about. So I'm just trying to get more comfort on it, because it seemed like you guys were very bullish in mid-February and some of these issues should have been understood then. Has something changed? What level of visibility do you think you have on the updated 2017 outlook here?

Martin M. Ellen
Chief Financial Officer, Dr Pepper Snapple Group, Inc.
A

Yeah, we had to put – that's a great observation of where to put that into, I think two major buckets. I would say it's both about timing and emphasis on club channel versus other channels. As we just said with those repeat rates, we've got to get trial up. If we get trial up, it's hard to do it with a big basket ring, like you find in a [ph] club

multi-pack (38:05). So that's about channel strategy. Second, we would say a little bit less aggressive on expectations for rolling out innovation. Okay? That's – we may have been too overzealous in both Bubbles, Black product. We didn't talk about today, anti-water which is in the process of being relaunched and new packaging, some new marketing behind it. You may or may not know they had a product in the market, called anti-water. And again, we probably had more volume in there in our earlier expectations.

We have now just completed a relaunch plan for that, as I said, involving all the piece of marketing – from price bracket, promotion, placement. If I had to say two things, it would be club channel and just our sort of sharpened pencil view of how best to phase in the innovation, but no real change in expectation on the core business.

Larry D. Young
President, Chief Executive Officer & Director, Dr Pepper Snapple Group, Inc.

A

Yeah, Marty is exactly right. We want to be laser focused on the execution of our innovation. We had a lot of stuff out there and we looked at it and we said, let's line them out and let's figure out what we're going to do with each one of them. Let's start and get the Bubbles going. We see tremendous opportunities with the Bubbles. Let's get the Superteas out there. I'll tell you what, if we can get the Superteas out and get someone to taste it, that's what it's going to take. So we got to do a lot of trial there, a lot of sampling. We are putting plans together for that right now, but we have laid out a much more laser focused execution strategy that makes it more possible for the teams in the field to go out and make these brands a huge success.

Dara W. Mohsenian
Analyst, Morgan Stanley & Co. LLC

Q

Okay. And when you originally did the deal, you laid out your expectation for us, obviously this year you've just outlined today. But as you think at least conceptually about this second year, has the growth potential changed at all year two, ignoring sort of any issues this year as you guys think conceptually about the business at this point?

Martin M. Ellen
Chief Financial Officer, Dr Pepper Snapple Group, Inc.

A

I mean, if we are right on the innovation, which we have to – in terms of how it will succeed, it's really just timing and plus 40% this year and plus 40% next year tells us the brand doubles in two years. So it hasn't really changed, maybe a little bit in timing if I said for rollout of innovation and as Larry said, for the most part. And then the channel is where do we want to be in club? What is the role of the club channel? Don't forget, we are just getting started in convenience. And I think – I think it's fair to say that channel can sort of disrupt us a little bit in terms of up and down the street customers. We prefer to sell to those customers directly and not have them purchase a 15 count box and break it open out of club. So there's some strategy you have to think about across those channels.

Larry D. Young
President, Chief Executive Officer & Director, Dr Pepper Snapple Group, Inc.

A

And our strategy has always been to pursue profitable channels and so we've done a deep dive on that and we've looked at it and say, yup, maybe a little less volume. But that's going to pay off in the long run.

Dara W. Mohsenian
Analyst, Morgan Stanley & Co. LLC

Q

Okay. Thanks.

Operator: [Operator Instructions] Your next question comes from the line of Steve Powers of UBS.

Stephen R. Powers
Analyst, UBS Securities LLC

Q

All right, thanks. Good morning.

Martin M. Ellen
Chief Financial Officer, Dr Pepper Snapple Group, Inc.

A

Hey, Steve.

Stephen R. Powers
Analyst, UBS Securities LLC

Q

Just a cleanup on the Bai conversations. I guess I just want to make sure that all incremental innovation that you do plan is in your outlook. Because I thought and maybe I'm wrong, you can correct me, but I thought things like Black at least were not in your original outlook. That was sort of incremental upside as you just were a little bit cautious about how to think about the rollout of that innovation this year. So it sounds like from your comments today this updated outlook embeds everything. I just wanted to confirm that. And then...

Martin M. Ellen
Chief Financial Officer, Dr Pepper Snapple Group, Inc.

A

You're...

Stephen R. Powers
Analyst, UBS Securities LLC

Q

Okay, go ahead.

Martin M. Ellen
Chief Financial Officer, Dr Pepper Snapple Group, Inc.

A

[indiscernible] (42:03) You were right, it was – some of those were not in, but the one that was in that we backed off on is the water product.

Stephen R. Powers
Analyst, UBS Securities LLC

Q

Okay. Okay. Okay. That's very helpful. And then I guess just two other kind of – two other questions, I guess, which I'm already violating the one question rule. I apologize.

But the incremental $10 million in Amp, if you could – it sounds like that's not Bai related, just a little bit of clarity as to where we should expect that to go. And then, this is – you've said we talked about it before, but obviously BODYARMOR and the other allied brands were, again, strong which is great. But the other side of that coin is the same discussion we were having around Bai pre-acquisition and I guess just in the context of the Rockstar distribution loss, just how you are thinking about the risk to that allied brand portfolio and the sustainability of it.

Martin M. Ellen
Chief Financial Officer, Dr Pepper Snapple Group, Inc.

A

Okay, Steve, now I will handle questions two and three.

Stephen R. Powers
Analyst, UBS Securities LLC

Q

Sorry about that. Thanks.

Martin M. Ellen
Chief Financial Officer, Dr Pepper Snapple Group, Inc.

A

The additional $10 million in marketing is unrelated to Bai. We are thinking about it in our fourth quarter this year and it's simply because as we've said before, we'll do whatever we think we can properly execute on that has a return. We've had some other things come up across our brands and we want to spend on them. And we want to do the right thing for those brands. So we're going to add $10 million and it's going to occur in the fourth quarter. And that's spread across a couple of different brands.

And second part of the question, remind me again.

Stephen R. Powers
Analyst, UBS Securities LLC

Q

Just it's – as we've talked about before, the BODYARMOR, allied brands.

Martin M. Ellen
Chief Financial Officer, Dr Pepper Snapple Group, Inc.

A

Allied brands, correct. Okay, look, so nothing has changed. They are doing great and I think we've picked some really good partners, shows we are picking categories that can really grow. BODYARMOR, just what a great example of brand, entering into a category dominated by one big player and being fought hard at with another big player and something we would have never done on our own and now we are capturing great growth.

But as we've said and you can say Rockstar is an example. We lost the brand principally years ago. We had in the West Coast distribution and now we've lost it. We've always said there's a risk we don't control these brands. But now we control Bai. And yeah, I know we paid $1.7 billion for the brand but now it's 4% of our portfolio and we control it. There is – the alternative for us is to simply not do what we are doing, to close down our distribution system, gen up as much innovation as we can internally. Whatever that might cost us, and we do it ourselves. That's sort of the choice. Close the system down, have it there for owning your own brands. We have chosen maybe a little bit different than others to leverage our system, pick the right partners, recognize that at some point there we could lose one or more of these. It seems like every time we lose we only pick one up and there's just so much happening in the space, so much happening across the categories. So many great innovation ideas that come through this door every week of every month pretty much and give us a choice to pick. But I can't, Steve, argue that at some point the successful one could end up being taken away from us. It's just a fact.

Stephen R. Powers
Analyst, UBS Securities LLC

Q

Okay, yup. Thanks. Fair perspective. Thank you.

Operator: And your next question comes from the line of Kevin Grundy of Jefferies.

Kevin Grundy
Analyst, Jefferies LLC

Q

Thanks, good morning, guys.

Martin M. Ellen
Chief Financial Officer, Dr Pepper Snapple Group, Inc.
A

Good morning.

Kevin Grundy
Analyst, Jefferies LLC
Q

Not to belabor the Bai issue, but I guess I will. But, Larry, just curious if you can provide more color now on the interaction with Bai's management team and how you plan to run this asset. Because I mean it seems somewhat apparent here that the tone is just different. Marty, you made comments like if we had our hands on it, if we had a sharpened pencil sort of view. So I'm just trying to ascertain here and we've talked about some of the channel strategy. So you don't need to repeat that, but just any further operational risk here as it pertains to running the business and then potentially Bai's management team. Because before it seemed like we kind of had this rocket ship and we were just going to let Bai's management team continue to do what they are doing but the tone certainly seems different now.

And then, Marty, just a follow-up on a comment you made before. It seems like the soft guide on 2018, and I know you guys don't like to give product line guidance. I respect that, but this is also pretty consequential to the growth trajectory of the business. It seemed like there was a soft guide of about 40% to 50% looking out the next year. Is that kind of where you guys are now from a financial planning and analysis perspective? And then any sort of comments beyond that would certainly be helpful I think for the market. Thank you.

Martin M. Ellen
Chief Financial Officer, Dr Pepper Snapple Group, Inc.
A

I will let Larry talk about it. But there's no soft guide. It's too early for us to call 2018. We're not planned out there yet.

Larry D. Young
President, Chief Executive Officer & Director, Dr Pepper Snapple Group, Inc.
A

Yeah, we don't have three full months in yet. But back to the questions on Bai, Bai management, we stayed very closely align with them. They are – Ben Weiss and his team is definitely running the business. We give them the resources that they need. A lot of good insights as we shared with them our strategy, how we work, they were in full agreement that we needed to look at some of this innovation and make sure we do it properly, that we take it – we don't distill it out, we don't run it through the club channel, that we put a strategy together that we are going to go out and get it sampled. If we talked about the trial, we got to get that trial up. Because any time you got 50% repeat, you want all the trial you can get. You want every person tasting that. The team is enthusiastic. We were there last week. We spent a day and a half with them. We did a lot of planning. The alignment was unbelievable. I couldn't believe what we got done in less than an eight-hour day on what we were going to be doing going forward and the team is pumped and we are thrilled to death that Ben Weiss and his team is running. We are here to help them.

Martin M. Ellen
Chief Financial Officer, Dr Pepper Snapple Group, Inc.
A

Kevin, it's Marty. Don't read my comments about sharpening our pencils. I mean, the Super Bowl thing, as I said, I mean, we were separate companies. If we – the one thing we do is we look back at everything we do in an effort to improve and if we look back at the Super Bowl, the one thing I think we would have tasked ourselves to have done better with their team is to plan retail activity better. That's just...

Larry D. Young
President, Chief Executive Officer & Director, Dr Pepper Snapple Group, Inc.
A

Needed just a little more time for the retail activity to communicate with the retailer.

Martin M. Ellen
Chief Financial Officer, Dr Pepper Snapple Group, Inc.
A

And my communication I've changed in channel strategy if you had not just coming for us. I mean, they acknowledge it as well. Their team has looked at this as well. So this is not coming from us. And by the way, Larry talked about Bai-osphere this very interesting way they are approaching the sort of targeted focus on stores and are driving the stores and these targeted areas to improve weekly case throughput like by 3x. That's Ben and his – that's Ben's idea and his team's idea and we are very supportive of it. It's sort of an innovative way to think about particularly for a new brand a very much more sort of hands on in-store focused effort. We are really intrigued by this as a model, as an adjunct to almost marketing and creating awareness for new growing brands. So don't – they are at work every single day, running as hard as they did before and I would say we're trying to do everything we can to keep up with them.

Larry D. Young
President, Chief Executive Officer & Director, Dr Pepper Snapple Group, Inc.
A

And the enthusiasm is contagious they have. I mean, it's a – it's a group when you go ahead and work with them, spend a day or two with them, you come out pumped up ready to go.

Kevin Grundy
Analyst, Jefferies LLC
Q

Larry, just as a follow-up, if I may, quickly on the international strategy. How many other markets are potentially viable and how quickly can those come on? That's it for me. Thank you.

Larry D. Young
President, Chief Executive Officer & Director, Dr Pepper Snapple Group, Inc.
A

So, like we said, we just started in the UK, so, I mean, we just started on this. So way too early to comment. We have got a team looking at across the different countries as we know each one of them has different regulations. So we have got to make sure we understand those. We just sent our second container. So we have got to see how that sells, what kind of a take rate, what the trial is, what's the repeat. Then that gives us something to go talk to a contract packer about. You don't want to go in and do a contract pack agreement when you don't even know what you are going to sell. I mean, that becomes very dangerous. I spent a lot of time in Eastern Europe and Europe, Central Europe doing this for Pepsi back when I was on that side. And so we are going to take it slow. We are going to understand what's there, and we're going to make sure that when we do it, that it's going to be sustainable and that it will be profitable in the future.

Kevin Grundy
Analyst, Jefferies LLC
Q

Okay. Thank you very much.

Operator: Your next question comes from the line of Bonnie Herzog of Wells Fargo.

Bonnie L. Herzog
Analyst, Wells Fargo Securities LLC

Q

Good morning, guys.

Martin M. Ellen
Chief Financial Officer, Dr Pepper Snapple Group, Inc.

A

Good morning.

Larry D. Young
President, Chief Executive Officer & Director, Dr Pepper Snapple Group, Inc.

A

Hey, Bonnie.

Bonnie L. Herzog
Analyst, Wells Fargo Securities LLC

Q

Okay, I'm not going to ask you a question on Bai. I actually have a question on your packaged beverage margin. So they contracted a fair amount in the quarter. I guess I was hoping you could drill down a little further on some of the drivers of that, such as mix impacts, raw materials and then what your expectations are for these margins for the remainder of the year. And then in terms of your OpEx inflation in the quarter, could you just give us a little bit more detail on that and whether you expect those expenses to continue? Thanks.

Martin M. Ellen
Chief Financial Officer, Dr Pepper Snapple Group, Inc.

A

Okay, Bonnie, it's Marty. I would tell you the key things to think about, in packaged beverages and, of course remember, it includes Bai, and so we couldn't recognize all of the margin, as I said on Bai in the quarter, and that was dilutive. And the other thing was their increase in their front line labor that I called out in my prepared remarks. And quite frankly, we've talked a lot about other people in the industry, have talked a lot about turnover and open positions and in our business when it comes to customer service, whether it's deliveries, merchandising, et cetera, we actually through an RCI guide and with our front line team concluded that there were some areas we needed to add some resources and we did that.

And for the most part, the other factor which I mentioned, and we haven't talked about in the Q&A yet is just the impact of Snapple being down impacted.

Bonnie L. Herzog
Analyst, Wells Fargo Securities LLC

Q

Right.

Martin M. Ellen
Chief Financial Officer, Dr Pepper Snapple Group, Inc.

A

That's a negative mix factor to them. That too was promotional activity, also in club. That activity is coming back in the second quarter. But for Snapple to be down 6%, it's a pretty high margin product and that creates – we don't want to trade off Snapple mix if we can go for better CSD mix, even though we like our CSDs being up. So a combination of negative mix for them, swallowing some of these effects of Bai and making the investment that we think will pay tremendous dividends in that segment are really the three factors.

Bonnie L. Herzog
Analyst, Wells Fargo Securities LLC

Q

Okay. Thank you.

Operator: Your next question comes from the line of Amit Sharma of BMO.

Amit Sharma
Analyst, BMO Capital Markets (United States)

Q

Hi. Good morning, everyone.

Larry D. Young
President, Chief Executive Officer & Director, Dr Pepper Snapple Group, Inc.

A

Morning.

Amit Sharma
Analyst, BMO Capital Markets (United States)

Q

Marty, just to continue Bonnie's last question. So if you are able to strip out Bai from the packaged beverages segment, what will be the underlying margin, if we can get a view on that? And then as you look through the rest of the year, some of these one-time-ish type things go away. Can you talk about that a little bit?

Martin M. Ellen
Chief Financial Officer, Dr Pepper Snapple Group, Inc.

A

Yeah, I would say if I look at the major pieces of Bai that were in packaged beverages, I have about 250 basis points in margin.

Amit Sharma
Analyst, BMO Capital Markets (United States)

Q

Got it. And then on Bai itself, you're talking a lot about maybe reducing the lines on the club channel and then pushing on trial a little bit. Can you talk about the margin implication of that? If you think about the profitability, how great does club rank in that versus other channels? And as you are pushing on trial and sampling, is that included – or how much of that is in included in the dilution guidance that you updated today?

Martin M. Ellen
Chief Financial Officer, Dr Pepper Snapple Group, Inc.

A

Well, so the tradeoff is and when you sell a lot of volume in club and the big club period, you are also doing that on a discounted basis, right? So we preferred not to overly do that, however, other trial programs are also going to come with some level of promotion because we have got to get the product in people's hands. So on balance, there's been no sort of view necessarily of a big shift and how much we're going to spend what we will call in trade, but how it gets allocated across different channels and different programs will change.

Amit Sharma
Analyst, BMO Capital Markets (United States)

Q

So is it fair to assume that over the longer term, as you reduced the lines on club, that could be a positive for Bai's standalone margins?

Martin M. Ellen
Chief Financial Officer, Dr Pepper Snapple Group, Inc.
A

Absolutely. It absolutely could. As I said, one of the things we also want to protect against is not letting leakage out of the club channel into the much higher margin up and down this convenience. So there's an element of strategy that we have to be aware of for that, which would enhance our margins.

Larry D. Young
President, Chief Executive Officer & Director, Dr Pepper Snapple Group, Inc.
A

Yeah, we want to make sure that we get it out where the product is close at hand. I mean you've heard me talk before on any brand it's got to be where people are working, where they're playing, where they're dining, where they can try one. Not very many people are going to go buy 15 to try something. If you get them out there having one of them, that's also at a much more profitable channel. You are going to have much more success. And we're also tying into it, we've got a lot of success on ACV getting it on shelf but we want it off the shelf. We want that thing on displays, points of interruption. That is how you move a product, not just setting on shelf space.

Amit Sharma
Analyst, BMO Capital Markets (United States)
Q

Got it. Thanks so much.

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

Lauren Rae Lieberman
Analyst, Barclays Capital, Inc.
Q

Great, thank you. Just to clarify on Snapple, so you said you expect it to improve from here was the major downdraft from the quarter similarly timing on club promotions or is it something else that changes through the balance of the year? And then also just on Clamato, just looks like that was relatively weak. So could talk just a little bit about incremental marketing plans there and kind of what has changed – if anything's changed on the perspective on growth for that brand this year. Thanks.

Larry D. Young
President, Chief Executive Officer & Director, Dr Pepper Snapple Group, Inc.
A

I'll take the Snapple. On the Snapple it was club channel and we had a major activity last year in January, February. This year that activity hits in May. So, it's just a matter of timing right there. And then also on – you heard me talk in the fourth quarter that we had some activity coming back into the first quarter and that came in towards the end and we will see more of that in the second quarter.

Martin M. Ellen
Chief Financial Officer, Dr Pepper Snapple Group, Inc.
A

And look, Clamato which was flat in the quarter, which I would say that's – that brand is extraordinarily profitable. So when it's not up as it has been that hurts the margin a little bit of packaged beverages as well. That's a holiday issue, Lent and Easter for its consumer. We are not concerned about Clamato. Nothing has happened in that red juice category at all that weakens or threatens Clamato. So it was – it's just a little bit of holiday timing.

Lauren Rae Lieberman
Analyst, Barclays Capital, Inc.
Q

All right. Thanks so much.

Operator: Your next question comes from the line of Ali Dibadj of Bernstein.

Ali Dibadj
Analyst, Sanford C. Bernstein & Co. LLC

Q

Hey, guys. I do want to go back to Bai a little bit for maybe three things. One is although you've kind of put a spotlight on club and talked about that being part of the issues there, if you look at the Nielsen data which includes some club but not Costco as an example. There too you are seeing a massive slowdown in Bai, right? So the 43% that you mentioned. That's what you see in the Nielsen data too. So I guess I don't know why to distinguish club versus others besides the strategy of the pack basically versus the trial. So the growth trajectory, I'm not seeing that differently.

The second thing with Bai is you mentioned about two points of your guidance for this year is Bai. I just want to clarify, is that the third party coming in so that you kind of one-third coming in or does that also include the underlying? And if it doesn't include the underlying by growth, can you just give us a sense of underlying for organic and inorganic Bai growth what that drives the overall guidance for top line growth this year?

And on repeat rates of 50%, so if we're sensing that there's different repeat rates on the different products, kind of the core product that's out there, the Bai five that we all probably know and we've all I think trialed, the pomegranate and the blueberry, that core stuff that's a 50%, right? But it really goes to very, very low and the lack of success actually with Bubbles with I think just thinking about Black with water, et cetera. So can you kind of differentiate those repeat rates in these different launches because it does suggest that the future launches beyond the core are actually getting worse, I guess for lack of a better word.

Larry D. Young
President, Chief Executive Officer & Director, Dr Pepper Snapple Group, Inc.

A

I will start with the Bubbles. I will let Marty kind of go through some of the questions. But you're talking about the failure of Bubbles we have got accounts where Bubbles is larger than the base business. Bubbles is just a matter of getting it out there. And the Bai-osphere where we talk about, Bubbles is number one. So I mean that's a tremendous opportunity for us there and that's one of them where we saw that the trial and the repeat gave us tremendous opportunities. So having the Bai-osphere gave us an opportunity to focus on it and we saw that it paid very big dividends.

Whenever we talk about the base business, you named off pomegranate, you named off the blueberry, there's a bunch more out there. The other flavor lineups, we have got to get them – get trial on those, get people to pick those up because they are all tremendous flavors. Ben and I tell everybody. We don't tell anyone what our favorite brand is, what our favorite flavor is. We had one but we're not telling anybody. We want them to try all of them. Same thing with Cocofusions. Everybody is trying the base coco, coconut. The other Cocofusions are fantastic. We got to get people sampling, people trying them. So that's where we are looking at getting the trial and repeat that gives us the growth we'll be looking for.

Martin M. Ellen
Chief Financial Officer, Dr Pepper Snapple Group, Inc.

A

Yeah, Ali, I'm not – and the other thing I'll add and we didn't [indiscernible] (60:52) guys can get it from either Nielsen or our IRIs is velocities. I mean, if you look at the velocities and the growth in velocity, it's like 50% or 60% growth. So this stuff is turning which supports the high level of repeat purchasing and I'm sure you guys can get

that data off of those services because we get it. I'll go back to channels again. It's – let's go back to Q1. Again, club was up 163%, between our packaged beverage business which delivered into December and the fact that we didn't own the rest of the biz. We were just out of that in the first quarter. We did not necessarily have that timing well planned in our initial guidance.

We – the other channels in the quarter, up 43% and pretty consistent growth, convenience is all opportunity. The trial repeat that I quoted was principally for the base product, but there's no reason to believe it's not everything – all the initial data we've seen on the innovation, particularly on Bubbles which is going to get a lot of emphasis shows it to be strong. And as I said, Bubbles needs to be repositioned into the sparkling water category. It's been – that smaller can has been like priced along with the base product in the enhanced water section. There is an element of change in merchandising strategy here that we think is really important for that SKU, for that product.

We're very confident in the growth that we now planned for the brand. We are confident in the timing for the rollout of the innovation. We are confident about channel strategy. I mean these are all things you have to think about and go through to build a brand. It doesn't mean maximized sales in 2017. It means build a brand

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Larry D. Young
President, Chief Executive Officer & Director, Dr Pepper Snapple Group, Inc.

A

Right. And we found like to Marty's point when we unbundled the base in the Bubbles is that's when we saw the Bubbles take off. So I mean, that's when you look at it and understand while we talk about a total beverage solution, we unbundled the Bubbles and they grew. We unbundled the Black from the Bubbles and it grew. So I mean, that's where we get the total beverage solution. We have it at different parts of the store, we have points of interruption, we get it off the shelf, we get it upfront cold where people can try it and that's when it takes off and runs for us.

Ali Dibadj
Analyst, Sanford C. Bernstein & Co. LLC

Q

And so just that number if you can on inorganic plus organic for Bai as your guidance for this year in terms of top-line growth.

Martin M. Ellen
Chief Financial Officer, Dr Pepper Snapple Group, Inc.

A

The brand growth for us is simply looking at the brand year-over-year, full year 12 months, forgetting the fact that it's 11. I don't know what would be organic versus inorganic. If you talk about our system growth...

Ali Dibadj
Analyst, Sanford C. Bernstein & Co. LLC

Q

Well, for the two points – sorry, I apologize. The two points that you mentioned, that's inorganic plus organic, or that's just taking in the sales from the distribution you didn't have? That's what I'm trying to get at. Because if that's just the kind of taking in the sales what's the overall impact of Bai on your growth for the year? Does that make sense?

Martin M. Ellen
Chief Financial Officer, Dr Pepper Snapple Group, Inc.

A

Oh, yeah. What you are asking us is really the piece we acquired the third party bottler piece which originally was going to be about three. That's – yeah, that's just the acquired piece.

Ali Dibadj
Analyst, Sanford C. Bernstein & Co. LLC

Q

So two is just the acquired piece which was three and now it's two, and what's the underlying growth piece? That's another two. It sounds like the stuff is growing 40% plus and 4% of your volume; is that right?

Martin M. Ellen
Chief Financial Officer, Dr Pepper Snapple Group, Inc.

A

Yeah, about right. I think the 4% is about right.

Ali Dibadj
Analyst, Sanford C. Bernstein & Co. LLC

Q

Okay. So about four points of overall growth is coming from Bai organic plus inorganic.

Martin M. Ellen
Chief Financial Officer, Dr Pepper Snapple Group, Inc.

A

Right.

Ali Dibadj
Analyst, Sanford C. Bernstein & Co. LLC

Q

Okay, okay. I know you didn't mention RCI. I don't know if I want to give update [indiscernible] (64:39) RCI. You mentioned just very, very briefly. But as we look at the margins, we were hoping for more even if you try to strip out Bai, which you gave us some more data in this column. I will try to go back and do that some more granularity, but no signs. I know you are going to say no but I really want to emphasize this, no signs of RCI slowing down? No signs of RCI kind of low hanging fruit disappearing and trying kind of reaching a little bit higher? You are still as confident as ever that it continues to motor on?

Martin M. Ellen
Chief Financial Officer, Dr Pepper Snapple Group, Inc.

A

Absolutely. And, Ali, I'm sorry I couldn't give color because I knew Bai was going to get a lot of attention on the call before we went over. I would tell you 20 basis points in gross margin we can specifically identify with RCI projects. I rattled off all sorts of activities including the thing we are doing in supply chain with – is now up like 31 kaizen events and lots of – just lots of good things happening. But actually, no, look, we are building a culture around improvement, we're focusing on service levels and quality levels and all those things, and cost just takes care of itself. And it's – the team has expanded. We got more activity than we've ever had and I just couldn't fit it in into this morning's call.

Ali Dibadj
Analyst, Sanford C. Bernstein & Co. LLC

Q

I appreciate that. Got it. Thank you.

Operator: We have reached our allotted time for questions and answers. I will now return the call to management for any additional or closing remarks.

Larry D. Young
President, Chief Executive Officer & Director, Dr Pepper Snapple Group, Inc.

I would like to thank you for joining the call today and for your continued interest and investment in Dr Pepper Snapple Group.

Operator: Thank you for participating in Dr Pepper Snapple Group's first quarter 2017 earnings conference call. You may now disconnect your lines.