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Dr Pepper Snapple Group, Inc. (DPS)

Q4 2016 Earnings Call

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MANAGEMENT DISCUSSION SECTION

Operator: Good morning and welcome to Dr Pepper Snapple Group's Fourth Quarter and Full Year 2016 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 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 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 financial and operational performance. These 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 the 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 those non-GAAP measures to GAAP 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'll turn the call over to Larry.

Larry D. Young

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

Thanks, Heather. Good morning, everyone. I'll start by saying how proud I am of our teams for the strong performance they delivered this past year. We continue to operate in a highly comparative environment and notwithstanding CSD headwinds delivered solid results, by remaining laser focused on our integrated communication and execution strategies, developed through our deep consumer insights. We grew both dollar and volume share in CSDs while driving positive pricing mix in the category. We unlocked growth in our portfolio through focused brand communications, and we continued driving product and package innovation across our priority brands to address consumers' changing needs.

I'm excited to say that we announced our acquisition of Bai in November, and closed on the deal just two weeks ago. We are excited to add Bai to our priority brand portfolio and to add Ben Weiss and the Bai organization to DPS. We're working closely with them to accelerate their strong growth trajectory and innovation pipeline.

From a distribution and availability standpoint, we grew or maintained ACV across many of our priority brands and packages in both grocery and C&G. And our fountain team added just under 44,000 new valves across local and national accounts. We continue to drive growth and productivity across the business, as RCI further penetrates the organization.

I'll mention just a few of our wins from several of our 2016 Lean tracks. We closed over 12,000 voids on Dr Pepper smaller CSD packages. Our 7UP Lean track drove significant improvement in the back half trends for the brand, as we experienced 2% growth this past quarter. For perspective, the brand was trending down 10% on a year-to-date basis through the end of the second quarter. This is a great example of the power of RCI and the impact it can have on our business.

Allied brand priority SKU volume was up over 30% as a result of our void closure Lean track. And we reduced our route delivery driver turnover by 14% over the course of the year, improving our sales effectiveness.

And finally, we returned $905 million to our shareholders through share repurchase and dividends. As you saw last week, we raised our dividend 9.4% and our continued commitment to return cash to our shareholders over time and intend to repurchase up to $500 million of our shares in 2017.

Turning to the quarter, bottler case sales were flat on 3 points of positive mix and price. CSD case sales increased 1% and non-carbs declined by 1% in the quarter. Dr Pepper decreased 1% as growth in our bottle and can business was offset by a decline in fountain foodservice due to order timing.

For the full year, fountain foodservice volume was up 2%. Diet Dr Pepper was flat in the quarter, reflecting continued outperformance of the diet category. Our core four brands increased 3% in the quarter, as a 6% increase in Canada Dry, and a 2% increase in 7UP were partially offset by a 2% decline in A&W and Sunkist was flat in the quarter.

For the full year, Dr Pepper increased 1% and our core four brands were flat, reflecting better than category performance across our key CSD brands. Squirt grew 8% in the quarter driven by strong performance in Mexico

and the U.S., and Schweppes increased 7% on growth in sparkling waters and the ginger ale category. Peñafiel grew 1% in the quarter and Crush decreased 1%.

In non-carbs, Snapple decreased 3% primarily on lower promotional activity in a large retailer. Hawaiian Punch decreased 5% on category headwinds and higher pricing on single-serve packages. And Mott's decreased 2% in the quarter as declines in juice more than offset growth in our sauce business.

Clamato increased 13%, and our water category grew 8% on strong growth in Bai, Core Hydration and FIJI in our DSD system. Bai grew by over 100% in the fourth quarter, cycling triple digit growth in the prior year period. We are really excited about the prospects of this brand.

All other non-carb brands declined 10% in the quarter, almost entirely due to our exit of the Country Time business in early 2016. This decline was partially offset by continued strong growth in BODYARMOR, another allied brand, which is continuing to capture share in the sports drink category.

As we moved into 2017, our strategy building our brands, executing with excellence and continuing to embed RCI and Lean management across the organization remains the same.

We will continue to unlock growth in our portfolio by communicating against the needs and demand spaces of our priority brands. Bai is now a priority brand and we work diligently with Ben and his team to maximize the enormous potential of this brand.

We'll continue to deliver solutions to consumers' changing needs through both product and packaging innovation. And our R&D investments will remain targeted at ensuring our brands are addressing specific consumer needs.

Execution is critical in this business. This year, we'll partner closely with our bottling partners to drive additional presence for Dr Pepper in on-premise with both fountain and single-serve bottles. Our DS teams will focus on expanding distribution and availability across smaller CSD packages, Snapple and of course Bai. They'll also focus on growing our single-serve mix of CSDs, Snapple and Clamato in C&G and in higher margin channels.

Our strategy of partnering with select allied brands is contributing to our growth and we'll look to add new partners as time progresses. These partnerships allow us to rapidly participate in growth in emerging and fast growing categories where we don't currently have a brand presence. Finally, we'll continue to evolve RCI into our daily management process, driving breakthrough change in our business to support GOAL deployment, will further integrated Visual Management across the business to drive GOAL metrics and we'll look to key business leaders to drive Lean tracks and business-led RCI initiatives across the organization ensuring that we're building a sustainable operating culture.

Building our brands remains a key component of our strategy and we've got some great plans in 2017 to drive excitement with our consumers and our retail and bottling customers. Dr Pepper will return to the big screen in the spring, partnering with this year's blockbuster superhero movie Wonder Woman and we'll have consumers craving the taste of regular Dr Pepper with our new media campaign. Once again, superstar L'il Sweet will let consumers know, there's no better option for a sweet tasting reward than Diet Dr Pepper.

Many of you know that coupled with our 2016 Lean track, focused on execution for 7UP, we have also been working diligently towards the new consumer messaging. And I'm pleased to say, the new campaign has just started airing. We're reintroducing consumers to 7UP, the most versatile CSD in the category. The new campaign

will encourage consumers to mix it up a little, by showcasing the versatility of the brand, whether drinking it straight, using it as a mixer or an ingredient for cooking. We'll let consumers know that you can do a lot with 7UP.

With nearly 2 billion consumer impressions, the campaign will feature national media, including television, digital and social media, as well as strong shopper marketing and retail activation programming across the year. We'll continue to leverage strong growth in the ginger ale category, with our new Canada Dry campaign, Relax Harder, encouraging consumers to take relaxation to the next level, with the real ginger taste of Canada Dry.

We've got new news on Snapple with the launch of our Takes 2 To Mango Tea. The newest addition to the Snapple line will be supported with national media and national [indiscernible] (11:06) and stronger shopper and retail activation.

Mott's is helping kids develop healthy eating habits, early on with [ph] peachable taste (11:16), a resource complete with recipes and tips to help kids, the fundamentals of eating healthy, while cooking with their parents. We're also launching 100% Juice and pouch packaging for convenience, launching new flavor extensions of our 64 ounce based 100% Juice, and repositioning our applesauce line to simplify our sauce portfolio into three platforms, regular, unsweetened and organic. And for the first time ever, Clamato [indiscernible] (11:46) nationally during key Hispanic holiday timeframes, as we look to turn the authentic Clamato Michelada into the next margarita.

I'm sure you'll agree, we've got a full calendar of activity planned for the year. And we couldn't be more thrilled as a company to welcome the Bai team and the brand into the DPS family. We've had a strong relationship with Bai over the past three years, and we're looking forward to providing them the support they need to continue the strong growth trajectory, they've been experiencing. I hope, all of you've got to see the Bai commercial during the Super Bowl featuring Justin Timberlake and Christopher Walken. It garnered a tremendous amount of positive attention on social media and undoubtedly drove awareness of the brand.

As I mentioned back in our November call, this acquisition made a tremendous amount of sense for us, given our history, with them and the knowledge of the brand, but importantly it solidifies our position in the enhanced water category with the fastest growing premium brand. The brand has an outstanding portfolio of products, with the enhance waters as the base. The brand has also expanded into the carbonated water category with Bubbles, the coconut water category with Cocofusions, the premium tea category with Supertea, and most recently the CSD category with Bai Black and this is just the beginning. The pipeline of integration is long.

Now let me turn the call over to Marty to walk you through our 2016 financial results and our 2017 guidance.

Martin M. Ellen

Chief Financial Officer, Dr Pepper Snapple Group, Inc.

Thank you, Larry. Let me begin with a high level financial summary. In the fourth quarter, sales volumes increased 1% with reported net sales up 2%. Currency neutral net sales were up 3%. As expected, core operating income declined 1%. Certain cost increases including health and welfare and insurance were incurred in the quarter. We also invested in our frontline, increasing labor spend to reduce turnover and enhanced sales effectiveness, something we began to do earlier in 2016. Also, we invested more heavily in marketing against several of our priority brands.

Core EPS were up 4$ in the quarter, and excluding both foreign currency translation and transaction, core EPS were up 8%. The negative foreign currency transaction impact was primarily driven by Mexico, as they source certain inputs in U.S. dollars. For the year, sales volume were up 1%, with reported net sales up 3%. Currency

neutral net sales were up 4%. Core operating income was up 5%, yielding an operating margin of 21.5%, up 60 basis points from last year. Core EPS for the year were up 9%. Excluding foreign currency translation and transaction impacts, core operating income was up 8% and core EPS were up 12% for the year, some very solid results for 2016.

Now let me provide some further details on the fourth quarter. The reported net sales increase included 2 points of favorable product and package mix, 1 percentage point of price realization, and a 1% increase in sale volumes. Reducing this net sales growth was 1 point of foreign currency translation and 1 percentage point of unfavorable segment mix. Reported gross margins declined 20 basis points in the quarter, from 60.5% last year to 60.3% this year. The impact of mix, mostly from our allied brands, as expected, reduced gross margins by 50 basis points.

Certain expected inflationary cost increases and increased depreciation decreased gross margins by another 50 basis points. But RCI was our weapon of choice to completely offset these cost increases. Positive net pricing added another 30 basis points. Foreign currency reduced gross margins in the quarter by 30 basis points.

And finally, a favorable comparison of unrealized mark-to-market commodity price changes, and lower commodity costs together increased gross margins by 20 basis points. For the quarter, reported SG&A excluding depreciation rose by $7 million, after a favorable mark-to-market comparison, lower fuel costs and a $6 million foreign currency translation benefit.

We experienced certain inflationary cost increases, including health and welfare and insurance costs, as we lapped favorable trends. And as I already said, we incrementally invested in additional frontline labor cost in the quarter. Marketing, as planned, increased $7 million reflecting new priority brand creatives across several of our trademarks.

Depreciation and amortization declined $1 million in the quarter, reflecting our continued focus on managing capital. Other operating expense decreased by $4 million on a favorable comparison to a $7 million impairment charge on our Garden Cocktail brand that was recorded in the prior year.

Below the operating line, net interest expense increased $14 million, driven by $12 million of mark-to-market activity, related to certain interest rate swaps and amortization expense associated with a bridge facility related to the acquisition of Bai. Our reported effective tax rate was 35.4% in the quarter, compared to 36.4% in the prior year.

Moving on to cash flow, cash from operating activities was $939 million, down $52 million compared to last year, primarily due to a $35 million multi-employer pension plan payment and certain income tax prepayments. Capital spending was $180 million compared to $179 million last year. For the year, total distributions to our shareholders were $905 million, with $519 million in shares repurchased and $386 million in dividends paid.

Fourth quarter share repurchases were substantially less than previously anticipated, as we were in negotiations to acquire Bai. This impact on outstanding shares would have lowered 2017's core EPS expectations by about $0.03, before considering our detailed 2017 factors.

With that said, now let me move on to 2017 guidance. Coming off our solid 2016 performance, we entered 2017 with a lot of momentum, and we expect another solid year of business performance. We're expecting net sales growth before currency translation of about 5.5%, with 3% of this growth coming from our acquisition of Bai.

In essence, we've acquired Bai's sales to all of the other bottlers, distributors and channel partners. Underlying this revenue growth is 1% organic volume growth and 1% for the acquisition of Bai. Our expectation is for flat volume 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. As you can infer from my comments, there is about 1.5% of price mix embedded within our currency neutral organic growth of about 2.5% and 50 basis points of this price mix is the impact of our January 1, concentrate price increase. Foreign currency translation is expected to reduce our overall revenue growth by approximately 1%.

Moving on to cost of goods. Given our hedge positions and current market prices for our unhedged positions, we expect packaging and ingredients, excluding the acquired Bai business to be slightly up by about 50 basis points on a constant volume mix basis. Because we were already the major distributor for Bai, representing about two-thirds of their sales, our cost of goods sold will now benefit as we enjoy the full gross margin as the brand owner rather than the distributor.

This higher gross profit margin, along with the gross margin on Bai sales to other distributors will fund Bai's marketing investment of about $80 million, and about another $90 million in SG&A which is primarily in selling expense as are retaining the Bai sales organization and also maintaining Bai headquarters. For modeling purposes, remember, that growth of our non-carb portfolio and allied brands will also 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're expecting an increase of approximately $30 million in general cost increases and additional increased investment in our frontline people collectively. We're also expecting an increase of approximately $15 million in health and welfare and risk expenses in 2017, excluding our acquired Bai business. As always, RCI productivity benefits will help offset a portion of these increases.

We expect marketing investment against our base business to be about 7.5% of net sales in 2017, which implies a year-on-year increase of over $10 million. And as I just mentioned, we're expecting about $80 million of marketing investment behind Bai.

Now, moving below segment operating profit, our net interest expense will be approximately $170 million, including $49 million associated with the debt to acquire Bai. In other income, we'll be lapping a $5 million favorable non-cash gain on our acquisition of our Aguafiel joint venture in Mexico.

Our full year core tax rate is expected to be approximately 34.5%, which includes a favorable accounting change associated with tax benefits related to stock compensation. We expect strong free cash flow in 2017, allowing for our recently announced 9.4% dividend increase, and stock repurchases of approximately $450 million to $500 million subject to market conditions. We also expect capital spending to be approximately 3% of net sales. As I mentioned a moment ago, we are expecting foreign currency to negatively impact our results in 2017. The combined effect of both foreign currency translation and transactions is expected to reduce core EPS by approximately $0.11 for the year, primarily driven by the Mexican peso.

To give you some further insight and to help you with your modeling, the Mexican peso averaged MXN 19.83 to the U.S. dollar in our fourth quarter, and we are now planning on an average rate of MXN 22.53 for all of 2017, representing 14% depreciation and about 10% weaker than current spot rates.

We have previously not been in the business of currency forecasting. So, including this additional currency depreciation for the balance of 2017 in our guidance is a departure from our past practice, but we believe warranted under the circumstances. For your reference, the peso has been recently trading around MXN 20.50 to the $1. Should this rate hold for the balance of 2017, our core EPS could increase by about $0.05 from our current guidance. We will certainly update this throughout the year.

Furthermore and somewhat related, because of the present economic uncertainty in Mexico and its potential impact on our consumer, we lowered our core EPS expectations by another $0.04. We'll clearly have a better feeling for this as we progress through the year.

Regarding the effect of the Bai acquisition on expected 2017 core EPS, we now expect the impact to be $0.10 dilutive, solely as a result of the application of purchase accounting. It is important to note that the expected operational performance of the business is expected to be stronger than we communicated in November. However, we're now expecting approximately $33 million to $36 million in non-cash purchase price accounting adjustments for the year, the majority of which will be recorded in SG&A.

Taking all of the above into account, we're expecting core EPS in the $4.44 to $4.54 range. I know that's a lot to digest, but let me also add a few quarterly phasing items. First, with respect to the acquired Bai business. The performance of the brand is expected to ramp up over the course of the year, as we continue to build distribution across new innovation. Note also that about $8 million of the aforementioned purchase accounting adjustments relates to a write up of the value of the opening inventory, so, we will earn no margin on those sales in the first quarter.

Second, as we're currently launching our new 7UP communications strategy, along with several other new priority brand creatives, our marketing expense is expected to increase by about $10 million in the first quarter.

Third, we expect the majority of the incremental investment behind our frontline to occur in the first half of the year. And, finally, we expect the tax accounting change benefit to be recorded primarily in the first quarter.

With that, 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 as we start the year. We remain focused on unlocking growth across our priority brands through integrated and aligned communication and execution, and relevant innovation. We're excited to now call Bai one of our own, great brands and will be focused on providing the team the resources and support they need to continue their strong growth trajectory.

We'll look to selectively add to our allied brand portfolio to take part in rapid growth across emerging beverage categories. Rapid continuous improvement will continue to be the foundation with which we operate on a daily basis. And importantly, we remain committed to returning excess free cash to our shareholders over time.

Operator, we're ready for our first question.

QUESTION AND ANSWER SECTION

Operator: Thank you. [Operator Instructions] Our first question comes from the line of Vivien Azer of Cowen.

Vivien Azer
Analyst, Cowen & Co. LLC

Q

Hi, good morning.

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

A

Good morning, Vivien.

Vivien Azer
Analyst, Cowen & Co. LLC

Q

So, on Bai, certainly encouraging that you have a more optimistic outlook for 2017. Just kind of circling back to our conversation in November around the acquisition, what is it informing that is it more about distribution opportunity or are you seeing a pickup in velocity, in particular, perhaps because of the Super Bowl advertising that you did which was quite good?

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

A

So, Vivien, it's Marty. Good morning. All of the above. I mean the base business is just performing so well and there's still so much distribution opportunity. Larry, in his prepared remarks talked about innovation. We may have talked in November about Bubble, their sparkling version of the base product that was in everybody's view really underrepresented in the market. So there's a big push on Bubbles. It's doing well. There's some new packaging on it. Their Bai Black, which you should now see beginning in the marketplace, which is in essence their product in traditional CSD flavors. You saw in the slide, sort of an interesting sort of billboard, dear soda: welcome Black. We're really excited about.

So, we have taken up together with, of course, Bai, now that we work closely with them, we've taken up both sales and profitability expectations for 2017. And you could probably backward engineer what all that means based on our original $0.03 dilution versus $0.10 now with about $0.11 or so of purchase accounting adjustments.

Vivien Azer
Analyst, Cowen & Co. LLC

Q

Got it. And as you think about the portfolio on Bai, clearly a lot of initiatives underway. Seemingly they all have a place under the brand umbrella. But what are you going to be watching out for, just to make sure that you're not extending the brand too far, too fast?

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

A

No, no. We definitely look at – with the base business, the Bai still water, there's still tremendous opportunity there. So, we track that really close, and as we rollout the Bubbles we've seen Bubbles and Black together kind of

give us a – we've got the still and we have the sparkling, so it makes a really good play off of each other, especially whenever we get promotions out on displays.

So, we'll be very cautious on what we roll. We make sure that we have current innovation at a certain level of ACV before we go to something else. But as we've said in the prepared remarks, the pipeline is very attractive.

Vivien Azer
Analyst, Cowen & Co. LLC

Q

Terrific. And last question for me, I give you guys a lot of credit for even trying to handicap the Mexico risk under the current administration. Just so I understand, the $0.04 reduction to your core EPS outlook, on balance like how much of that is the currency expectation that you laid out in the prepared remarks versus any kind of softening in terms of underlying fundamentals in that market?

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

A

Vivien, what I'd tell you, so the $0.04 is unrelated to the $0.11 of FX, but you can say a piece is related. For example, there was a 17% or 18% fuel increase by PEMEX January 1, because Mexico imports so much of its refined product, you could argue that was a result of the depreciation of the peso. And, of course, that goes directly to our transportation cost. We use fuel in our business, of course, that's $0.02 of the $0.04.

And then, the question is what happens? In all of this what happens to the Mexican consumer? Obviously, I just indicated fuel for example is a real cost increase to the Mexican consumer. What happens overall given all the uncertainty about NAFTA, the wall and the economy, which is ultimately what this all goes to and our consumer. We obviously don't know, the world's changed a lot the last few months clearly, and so we've tried to, as you say, handicap those last $0.02 and we'll update everybody as we look at our business at the end of the first quarter. But it just felt in the current world today we ought to give some recognition to the uncertainty in our guidance.

Vivien Azer
Analyst, Cowen & Co. LLC

Q

Totally fair. Thanks a bunch.

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

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

Q

Hey, guys. So, a couple of things, one is on first, the 2016 and certainly the Q4. The Q4 number obviously was a miss versus consensus and it's the first one, at least versus consensus over the past kind of four years or so. And I understand that, if you do the bridge, at least to our numbers look, operating expense is a little bit tougher that we had modeled. And I'm just trying to understand better kind of why in quantified bucket, so is there anything to do with RCI winding down?

Is there some possibility that there is distraction on your core business given all this excitement about Bai? And you can see the Snapple number is a little shaky and [indiscernible] (33:07) were a little bit shaky overall. So, can you characterize any of the distraction and characterize a little bit of, is RCI still going strong, given that Q4 was certainly a miss versus consensus?

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

A

Ali, thanks for the question. Look, I appreciate all that. Let me just step back and say, we delivered $4.39 for the year. The top-end of our guidance was $4.40. And fair enough to everybody that follows us that we've had this history of exceeding our own guidance and as a result many have set consensus expectations above, what we've said, we would do. So we'd like to say, look, that's why I said in my remarks that what came in terms of some of the higher spend, marketing included frontline investments, was all as expected by us. We did say in other words $0.04 of currencies, but I don't know what all of you had in our models, it's not so relevant to us and no disrespect there please.

So we're actually where we think we should have landed and still a strong increase over prior year. So shares could have been a factor. I haven't even looked at the impact. For example, we brought back, if you saw very little I think $56 million, $59 million or something in the quarter, as we're pretty much blacked out, it's possible that could have had an effect. I never really went back and even looked at. It wasn't so relevant to us from an operating point of view.

No, don't and please RCI is – I mean there is so much – you saw how much we said we offset just in productivity and cost of sales. It's enabling us actually to make some really important investments in the business and be able to offset them and in essence turn waste into real value investments. So we couldn't be more encouraged about where we are with RCI.

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

A

Yeah. And there was no distraction at all on the other brands. I mean, in my prepared remarks, I mentioned that Snapple was down 3%. That was one large retailer on promotional activity which we'll see a difference there in the first quarter. 7UP, for the first time grew 2%. I mean there's a reason that we keep Bai a separate business out there. That way we don't get distraction. The Bai guys are out there. I mean they're kicking butt on their own out there and our guys are out here I mean doing the same thing with 7UP. You saw what we did with Dr Pepper. The only thing that was down on Dr Pepper was our fountain and it was due to timing. So I thought we had a great quarter and we came right where we thought we'd be on everything.

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

Q

And just to build on that, and particularly the history of kind of beating the guidance, if I look at 2017 from implied organic sales growth and you mentioned the kind of 2.5% to 3% excluding FX and excluding just the benefit of that third-party – kind of the third of the Bai businesses out there that was with third-party and taking that in. So you caught 2.5%, 3% organic sales growth, which is slower obviously than what you've delivered this past year. So what are you seeing? You mentioned Mexico, if you can expand on that a little bit and what that 3% would have been without your Mexico views? But also is there any Vita Coco in there? Is there anything else that suggests a slowdown that you'd expect of about 1 point and 1.5 point versus what you delivered so far and what we delivered in 2016, organically?

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

A

Yeah, Ali. Okay. So let me remind everybody, yourself included, so in terms of guidance into 2017, I think everybody knows we assume and we never assume pricing on CSDs. And even though there's some modest inflation because we don't really control the category if we weren't so competitive. So we tend to get a little bit if

everybody else is taking it, the market is that competitive, but you should walk away understanding that we have none in.

I want to step back and talk about maybe 2017 in a little different context. As we've talked to many of you and our investors over time, we've said on a more normalized basis, we'd look for about 7% EPS increase in the long term given our model of organic growth et cetera. This year we got tax benefit coming. If you put 7% on our $4.39, you'd be around $4.70. I'm taking the liberty of starting with our $4.39 and not the Street's number which is couple of pennies higher. You'd be at $4.77, but in a normalized FX mode and you subtract $0.11, Bai is a complete overlay against that algorithm for its first full year with its $0.10 and you'd probably land around $4.56, again a couple of pennies higher than the top end of our guidance. Then you can think about what we said about possible uncertainty in Mexico and that potential impact on our business. So, we think that dots connect really pretty well in terms of our long-term algorithm.

And we've enjoyed high growth in Bai as their distributor, of course, that's helped our allied brand portfolio and of course now, since from time-to-time we talk about the mix of our business within allied and base, the allied piece goes down a little bit, maybe instead of 4.5% to 5% now it falls to 3% or so of our volume, okay, giving us more of that growth in our own portfolio. Yeah, it may [ph] tug (38:21) over time as we move on beyond 2017. We'll see how the brand is doing. We talked back in November about doubling in a couple of years. We still think that's really in the cards. So, we'll talk about growth in 2018, but I think the algorithm pretty much holds pretty firmly for 2017 and that's why we feel so optimistic about the year.

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

Q

Okay. And, just my last one. In that optimism, I guess, your $450 million to $500 million of share repurchase is lower than you guided to over the past couple years, but the dividend obviously is healthy 9.4%. Can you just talk about that decision and particularly on the share repurchase being lower? Thanks, guys.

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

A

Ali, actually that's a little incorrect. Prior to last year, would have been about $400 million. You may recall that we actually borrowed an incremental $250 million of 30-year bonds at the end of 2015. So, in essence, the $650 million of guidance we went into in 2016...

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

Q

Yeah.

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

A

...was actually an increment borrowed with cheap 30-year debt. So now we're really actually coming back down to a number that is still stronger than pre-2016, if that makes sense.

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

Q

Well, 2015 I thought was $500 million to $550 million, but maybe I have that wrong.

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

I don't recall. We were in the $400 million to $450 million range, but the increment and clearly the step up in 2016 was solely around the December 2015 $250 million bond offering.

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

Understood. So going back to slightly below 2015 nothing major to report. Okay, thanks.

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

Yeah. Thanks, Ali.

Operator: Your next question comes from the line of Mark Swartzberg of Stifel.

Mark Swartzberg
Analyst, Stifel, Nicolaus & Co., Inc.
Q

Oh, thanks. Good morning, everyone.

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

Hi, Mark.

Mark Swartzberg
Analyst, Stifel, Nicolaus & Co., Inc.
Q

A couple of questions, one relating to one brand that Ali just touched on, of course, an important brand, Snapple. Larry or Marty, when you think about the performance you actually generated for the brand in 2016, is it fair to say it disappointed? And irrespective of whether it did disappoint, how are you thinking about the trajectory for that brand going forward?

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

Yeah, anytime they're down, there's a disappoint. I mean, that's what I'm here for. But that was the fourth quarter. We can explain the fourth quarter. It was flat for the year, but with the fourth quarter being down, we know exactly where it was. One retailer, we've already taken plans – we have plans in place, that we're going to correct that. So, we're not sounding any alarm bells on Snapple at all.

Mark Swartzberg
Analyst, Stifel, Nicolaus & Co., Inc.
Q

And as you think about that particular retailer, in the larger portfolio, I've seen some encouraging things with the portfolio in my own trips to the store. But how are you thinking about the pace, if you will and the nature of an improvement for that brand?

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

The improvement on the promotion will go into effect, first quarter.

Mark Swartzberg
Analyst, Stifel, Nicolaus & Co., Inc.

Q

Got it. And do you think that translates into growth for the brand this year from a volume perspective?

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

A

Yes.

Mark Swartzberg
Analyst, Stifel, Nicolaus & Co., Inc.

Q

Great.

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

A

And especially with the innovation we have out there. I think the Takes 2 To Mango is going to – our distributors and all of our partners out here, the retail trade are very excited about it, bringing more news to Snapple.

Mark Swartzberg
Analyst, Stifel, Nicolaus & Co., Inc.

Q

That's great. Okay. And then, you're taking what seems to be a more constructive approach in the way this new entity Bai is actually managed. And by that I mean we're seeing some of the competition over the years Bai, a growing business and integrate its management into the larger company and the consequences that that business performs poorly relative to what was projected.

So, my question is really kind of the next layer, if you will. Is it correct to think that the management incentives for someone working for Bai are substantially different than those for someone working for kind of legacy DPS? Or how are you trying to take it to the next level so that these individuals working for Bai really deliver on the objectives you have vis-à-vis the money you've laid out?

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

A

No. I think, if you look – they're very similar to how we go across the entire organization with our pay structure and bonus structure. I mean in every part of our business we look at – I mean, we don't have a template out there. I mean it depends on what that person can manage is how we reward that person.

And so, these guys are, I'm going to tell you, you talk about an excited team. Marty and I meet with them and talk with them every day. You've never seen guys so engaged in your life that are out there. I mean they love to win, and we like to win with them and we're going to make sure they have everything they need to win even more.

Mark Swartzberg
Analyst, Stifel, Nicolaus & Co., Inc.

Q

Great. And when you think about the ACV gains for Bai versus the per store gains, and the spending you're going to be doing on the brand, can you give us some sense of how much of that is going against incremental accounts,

truly new distribution versus how much is focused on improving per store rates of growth either through Bubbles or some additional SKUs?

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

A

I mean, the biggest push we're going to have is the up and down the street business. I mean, that's where it's very profitable. You can see, we look great in large formats in the clubs, I mean, we've got a lot of product there. C&G has got a great opportunity for us, up and down the street, but the big one is Bubbles. I mean, as we get Bubbles building it in, tying in the Black with it, Cocofusion, I mean, we've got a lot of opportunities there. And the Supertea has just started. I mean, Supertea right now, 2016, was sitting at about 11% and we're looking at tripling that, so by 2018. So, there's where all the opportunities are on the Bai products.

Mark Swartzberg
Analyst, Stifel, Nicolaus & Co., Inc.

Q

Great. And then finally, Larry, it's a new year. We have obviously a lot going on in the country that's different due to the decision for who our President is. None of us on this call is getting younger. So, can you give us any sense about how your board is thinking about management succession for the success that you've had, continuing if you will? And I don't know what you can share with us, but this is what boards do. And as I said, none of us on this call's getting younger, so I'm just trying to get a sense of where the board is on this subject?

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

A

No. We discuss at every board meeting and we've got a fantastic board, and that's one of the major responsibilities I have, making sure we have the right team in place. I think they're pretty fortunate that I need to go to 72 to maximize my social security now. [indiscernible] (45:07) to go for a while. But I love what I'm doing. I couldn't see myself not doing it. So, the board looks at it. We've got a bright young team under Marty and I. We've got a lot of people with a lot of runway, a lot of stretch, and we've worked on that everyday making sure that in case, that dreaded hit by a bus happens, we've got some good people in place.

Mark Swartzberg
Analyst, Stifel, Nicolaus & Co., Inc.

Q

Yeah. And I appreciate it. I see where you are coming from [indiscernible] (45:37) but I'm more interested in the non-hit-by-a-bus scenario, and how your board's thinking about that? And maybe the question is when might we hear more about that?

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

A

Oh, I don't know when we'd hear about it. I mean, I'm probably the youngest 62-year old guy you'll ever meet in your life. Marty is the same age with me, so I mean we have a lot of energy and we go hard. There's, like I said, no plans for me to do anything. But even with that said, I mean we have to have a succession plan in place, which we do. I mean there is the hit by the bus, that is the long-term. It's [ph] who's in (46:18) development for two years, three years, five years. So it's very typical on that market. We don't spend a tremendous amount of time on it, but we do cover it in every board meeting.

Mark Swartzberg
Analyst, Stifel, Nicolaus & Co., Inc.

Q

Fair enough. Great. All right. Thank you, Larry.

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

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

Hi, good morning, everyone.

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

Good morning.

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

Marty, just a question on higher elevated marketing spend for Bai. I mean clearly, you're spending at a much higher level this year. And normally, I would have expected that to come down next year, but given what Larry just said, there's lots of opportunities for you to spend. Is it possible that marketing spend for Bai, as a percentage of sales remains little bit elevated next year as well?

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

Of course. Look, this is about investment now. This is really a balanced investment and balanced growth to both get the top line growth that this brand deserves to get as well as the bottom line.

I'll now tell you, actually we might even spend a little more, but again we looked at all the different activities. We've said this a lot before. What can we realistically together with them and it's really about them, manage well and over what timeframe.

And that gave us a lot of insights into where to put the marketing dollars. But the Super Bowl commercial, I will just tell you. I don't know, what it means, but I was told within minutes, their website just about went down. It was so inundated with people looking at the brand. So we'll get some returns on that Super Bowl commercial like we do. We've talked about with some of you marketing return on investments over time. We'll get some feedback. We'll look at some data to see how well it worked, it didn't work. But so far early returns are good.

This is the time to invest in this brand. This is the time to educate the consumer, create this enormous pull. Mark, asked about ACV versus velocities, velocities keep going up. You have still lots of ACV and as all of you know some of the innovation there we have to be careful to make sure, we've got the right level of distribution before we turn on the pull. That's sort of basics in our business. We understand it, they understand it. I can't predict where the marketing budget's going to go in 2018. And we're getting ahead of ourselves we go there. But this is something – this marketing investment is going to have high returns we believe and we're very happy and happily spending that money.

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

Got it. And then given that Bai is much more penetrated online than the rest of your portfolio, is there anything you are doing to perhaps leverage that position to bring some of the other brands into the online channels or they are on separate tracks at this point?

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

A

Absolutely. We're learning as much from them as we can. We're teaching each other. We're growing together. Like I said, it's only been two weeks since we closed, but we're learning from the online, we're learning also, I mean, they're fabulous in digital. I mean, they understand digital. And so, we're not only thrilled about the brand, we're very thrilled about the team we have that we work together with and can learn from each other.

Amit Sharma
Analyst, BMO Capital Markets (United States)

Q

Got it. And just one more for me. Larry, your points about Bai not a distraction for the other brand, that's well taken. And going beyond that, just if you look at holistically your portfolio, and as Bai comes in and perhaps, some of the other faster, more contemporary allied brand come into the portfolio, do you look into your portfolio and see as an opportunity to maybe consolidate some of the brands that may not be so much on par where the consumer is going or thinking of?

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

A

No, because we've talked about this before that tremendous amount of our brands are very regional and they'll play very strong in certain parts of the United States. As a whole, they don't look like they're that big, but they're major players. Vernors up in Michigan and Ohio. We've got Sun Drop in the Southeast. We've got Cactus Cooler in the Southwest that are very strong brands. Our guys are masters at handling these brands, SKUs, knowing the right package to have in there. So, we're very pleased with how our portfolio looks like right now and really no changes.

Amit Sharma
Analyst, BMO Capital Markets (United States)

Q

Got it. Thank you so much.

Operator: Your next question comes from the line of Robert Ottenstein of Evercore.

Robert Ottenstein
Analyst, Evercore Group LLC

Q

Great. Thank you very much. Can you talk a little bit about any plans to take Bai international? What that may look like? Any thoughts on timing? And then as a follow up on Bai, a little bit of color on where you thing Bai is taking shelf space? Thank you.

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

A

Okay. Robert, it's Marty. I'll handle the first part. The answer in terms of international opportunity is yes, there is a geography that they and now us are working on. I don't want to comment on until we actually have something to comment on. We've been making some efforts of trying to do some similar work with Snapple in Asia and other parts of the world. There may be opportunities now to put some of these brands together, so that we can offer

distributors and other partners maybe a little more to go and sell to retail. But I don't want to get ahead ourselves at this point. It's work in progress and when we have something we will certainly talk about it.

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

A

Yeah and on the shelf space, where it's coming from, you notice where it's positioned that in our accounts, it's in the waters, the sparkling waters, in more of the new age territory. As we know, there are so many that come in and out of there and the brands that are strong and repeat, it's not that hard a work. The grocer understands it, he knows it and we get the space in that territory. So, we keep it there. The space [ph] gains (52:23) have been good, but the biggest segment that we go after that excites us and our major focus is displays and points of interruption. Get it into other places of the store, get it upfront in the cooler and the money we're spending on it, we want it to be top of mind. Being top of mind, we have to have it close at hand.

Robert Ottenstein
Analyst, Evercore Group LLC

Q

Great. Thank you very much.

Operator: Your final question this morning comes from Laurent Grandet of Credit Suisse.

Laurent Grandet
Analyst, Credit Suisse Securities (USA) LLC

Q

Yes, hello. Good morning, everyone. I like to understand in term of organization, what do you do to maintain Bai kind of startup profile in the organization and not being really fully included into the core business, so that's my first question. The second one is about Dr Pepper. You said, sales were impacted by timing in fountain food service performance. Could you please explain a bit more and should you recover these in Q1 2017?

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

A

Laurent, it's Marty. Let me try to handle this and Larry can add any comments. I think the first part of your question goes to just the Bai organization. I think, Larry covered this with Mark. They are running separately together with us. That team is very passionate about the brand and maybe you've heard Ben talk about in the past, total beverage solution, which really is his phraseology for using the penetrating the brand and lots of these other categories that Larry mentioned, as appropriate, when appropriate in due course.

They're just very passionate about continuing, in essence, to have a real impact in the way people drink that's their point of view. We support that point of view. We don't want to do anything to harm that point of view at all, because actually we think they're on the right track. And so we're running this differently.

As opposed, in my comments, this isn't about taking every dollar of cost out. By the way, that should be clear, I mean, they've got a great sales organization run by a fellow, Ken Kurtz. That organization is staying in place. There is a reason. We want them focused on Bai. We don't want to get it diluted in anyway by combining it with our sales organization. Why would we want to interrupt all the great success that they're having and we think they're going to have in 2017. So we just love – got this thing set up and we really love the team there. And as Larry said, they've not missed a beat around just the closing of the transaction, meetings, discussions with us, activities are just, if anything I would say, maybe they push us sometimes faster than we're used to being pushed and that's okay, that's good.

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

A

Absolutely.

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

A

Brand Dr Pepper, look, it's fountain. It's a Dr Pepper brand and Diet Dr Pepper outperforming the category, the football program, college football, Larry Culpepper, you guys know the whole media platform. It's just a big home run for us. And on the quarter, okay, fountain was a little weak because we've got one big fountain customer that doesn't always order their product in the same quarter, and so, we get some timing between the quarters. But look, up 2%, that's a fine performance for fountain for the year. So, Dr Pepper is a real bright spot for us at the moment, and we expect that to continue.

Laurent Grandet
Analyst, Credit Suisse Securities (USA) LLC

Q

Well, thank you very much for this.

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

Well, thank you for joining the call today and for your continued interest and investment in Dr Pepper Snapple Group. Thank you.

Operator: Thank you. That does conclude Dr Pepper Snapple Group's fourth quarter and full year 2016 earnings conference call. You may now disconnect your lines and have a wonderful day.