Keurig Dr. Pepper

Moderator: Sceppaguercio, Maria
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Operator

Good evening ladies and gentlemen and thank you for standing by. Welcome to Keurig Dr. Pepper's Earning Call for the Third Quarter ended September 30, 2018.

This conference call is being recorded and there will be a question-and-answer session at the end of the call.

I would now like to introduce your host for today's conference, Keurig Dr Pepper Chief Corporate Affairs, Ms. Maria Sceppaguercio. Ms. Sceppaguercio, please go ahead.

Maria Sceppaguercio

Thank you. Hello everyone and thanks for joining us today for KDP's first earnings call. I hope this slightly later start time is more convenient for you.

This afternoon, we issued our press release for the third quarter of 2018, and we previously filed an 8-K containing our historical Adjusted pro-forma quarterly results, both of which are available on our website. As you know, this past quarter was a busy one for KDP with a lot of progress made across the business.

Here with me today to discuss our results of the quarter and our outlook for the year are KDP's CEO, Bob Gamgort, and our CFO, Ozan Dokmecioglu.

Before turning the call over to Bob, I would like to take a moment to

provide some context on the Adjusted pro-forma basis upon which much of our discussion today of financial performance will be based.

As you know, our results start with reported GAAP financials. Due to the merger and unique adjustments required to make year-over-year comparisons helpful, we prepared pro-forma basis that takes these impacts into account.

These adjustments include resetting the transaction date as if it were consummated on December 31, 2016; eliminating one-time merger-related costs and expenses; and normalizing any accounting differences between the two companies.

With these differences accounted for, we then adjusted this pro-forma for items affecting comparability not related to the merger, such as the typical mark-to-market impacts, restructuring expenses, and refinancing costs among others.

The Company believes that the Adjusted pro-forma basis provides investors with additional insight into our business and operating performance trend. While the exclusion of these items is not in accordance with GAAP, we believe that it is a meaningful comparison and an appropriate basis for discussion of our performance.

Details of the excluded items are included in the reconciliation tables in our press release and are discussed in detail in our 10-Quarter, which will be filed shortly.

Finally, our discussion this evening may include forward-looking statements, which are subject to the Safe Harbor provisions of the Private Securities Litigation Reform Act of 1995. These statements are subject to a number of risks and uncertainties that could cause actual results to differ materially.

And the Company undertakes no obligation to update these statements based upon subsequent events. A detailed discussion of these risks and uncertainties is contained in the Company's filings with the SEC.

With that, I'll hand it over to Bob.

Bob Gamgort Thanks, Maria, and thanks to everyone for dialing in.

Before jumping into the results of the quarter, let me take a few

moments to share my perspective on how the integration has progressed since we closed the merger in July.

The integration management team established shortly after the merger was announced in January, successfully transitioned the two companies into one. We announced the new leadership team in June, implemented new decision and governance processes soon thereafter, and have now cascaded our new combined structure throughout the organization.

We've continued the strong momentum of both legacy businesses and have had no disruptions in customer service or systems – an accomplishment that none of us, who are experienced in acquisition integrations, ever take for granted.

Most importantly, the new KDP organization is learning to work together. We are energized by the unique opportunity that KDP represents. That energy and excitement has translated into strong performance in Q3, both financial and in-market, and we look forward to closing 2018 on a strong note and entering 2019 with continued momentum.

Turning to some highlights of the quarter, starting with in-market results, based on IRI. Retail market performance remained strong in the quarter. Our CSD portfolio registered market share gains in both units and dollars, driven by strong performance of Dr. Pepper and Canada Dry.

In addition, we grew our coffee portfolio in the quarter, driven by single-serve category unit growth of approximately 7%, combined with a substantial increase in unit and dollar market share of pods, manufactured by KDP. We also continue to gain share in enhanced flavored still water, and we held share in both shelf-stable tea and juice and juice drinks.

Turning now to the financials, on an adjusted pro-forma basis, net sales were up a solid 2.9% with growth registered in all four business segments, driven by a 3.6% increase in overall volume and mix.

Operating income advanced 14.3% or 240 basis points to 24.4% of net sales, primarily reflecting the growth in sales, continued strong productivity, and timing-related lower marketing expense, which collectively offset inflation and input costs and logistics.

Adjusted diluted EPS advanced to $0.30 in the quarter compared to

$0.21 in the prior year, with a significantly lower effective tax rate this year, benefiting the comparison, along with the cash distribution from Bodyarmor we received as unitholders.

Turning to our segments, I'll start with Beverage Concentrates, which posted solid results in the third quarter. Net sales, which represent our sales of concentrates to bottlers and serves to fountain customers, advanced 3%, driven by growth in both net pricing and volume mix.

The increase in net sales was driven by strong growth of Dr. Pepper, as well as increased sales for A&W and Crush, partially offset by Sunkist.

Operating income for the Beverage Concentrates was even with year-ago, primarily reflecting the growth in net sales, offset by higher performance-based compensation and inflation in input costs and logistics.

Turning to Packaged Beverages… Packaged Beverages delivered a very strong topline growth with volume and mix up approximately 6%, partially offset by modestly lower net price realization. The decline in net pricing was driven by Bai and Bodyarmor, significantly offset by higher CSD net pricing we began to realize, as a result of pricing actions we initiated during the quarter.

Driving a net sales momentum in the quarter was double-digit shipment volume growth in Canada Dry, reflecting successful innovation and continued growth of the ginger ale segment. Also contributing to the growth were Core, Bai, and Bodyarmor, partially offset by 7UP, A&W, and a modest decline in Dr. Pepper.

Increases in contract manufacturing also had a significant positive impact on the quarterly growth. Operating income declined 16% in the quarter due to inflation of both input costs and logistics, which were not yet fully covered by our pricing actions. Also impacting the comparison was continued investment behind our front-line sales and merchandising workforce.

Last month, we started the new season of our highly successful Dr. Pepper college football marketing and advertising support. This year's campaign called Fansville has a storyline that evolves over the course of the season, culminating in the college football championship.

In addition to TV, the campaign includes digital and social media, print advertising and in-store support, and will be complemented with this

year's 10th anniversary of the Dr. Pepper Tuition Giveaway, which has given -- which has awarded over $10 million to college students and will be presented at the Conference Championship games.

For the holidays, we will again launch our Holiday Green Bottle program behind Canada Dry, 7UP, and Squirt. Thousands of supermarkets across the country will have the familiar holiday display punctuated by fun, festive specific packaging. Additionally, this year the displays will be accentuated with Bai, and its distinctive red caps. Full program is supported by digital and social media.

Now, turning to Latin America Beverages. Latin America Beverages posted a strong third quarter with net sales advancing 2% and operating income more than doubling. The net sales performance reflected higher net pricing of 9%, partially offset by unfavorable foreign currency translation of 6% and lower volume mix of less than 1%. Peñafiel and Mott's were the primary drivers of the net sales growth in the quarter.

Operating income for the Latin America Beverages more than doubled to $27 million in the third quarter, primarily reflecting the growth in net sales and the favorable impact of comparison to the year-ago write-off of prepaid resin inventory. These factors were offset by inflation in both input costs and logistics.

Now, turning to the Coffee Systems segment, Coffee Systems reported a very strong quarter, with modest net sales growth driven by volume mix growth of 2.5%, partially offset by lower net pricing, which continued to moderate significantly on a sequential quarterly basis. Modest unfavorable foreign currency translation also impacted the performance.

The net sales growth was fueled by volume growth of approximately 3% for pods and 8% for brewers as well as higher brewer pricing due to innovation, partially offset by the aforementioned strategic pod pricing investment.

We launched our new coffeehouse brewers, namely the K-Café and the K-Latte that enable consumers to make lattes and cappuccinos at home using any K-Cup pod. In addition, we launched our updated K-Mini brewer platform with new features and a modern sleek design.

Each of these innovations is a reflection of our robust consumer-centric innovation program designed to drive new household penetration of the Keurig system by addressing barriers to adoption. Importantly, each is

performing well in the market with very strong consumer reviews.

We will drive consumer demand for our brewer innovation with a strong investment behind the second year of our Brew the Love campaign, featuring a talented and energetic James Corden as our brand ambassador. The campaign running this quarter highlights the K-Café brewer and its ability to make every house a coffeehouse.

Operating income for Coffee Systems was up a very strong 22% in the quarter, reflecting the net sales performance, strong productivity, and a lower marketing due to timing, despite inflation and input costs and logistics.

Before I turn the call over to Ozan, I'd like to talk about how partnerships remain an important part of our strategy. Since the closing of the merger, we acquired Big Red and agreed to acquire CORE Hydration, bringing these two partner brands into our owned portfolio.

We also added Forto Coffee Shots as a new partner and expanded our distribution relationship with Peet's for ready to drink iced espresso. In addition, just last week, we entered into a long-term partnership to sell, distribute, and merchandise the iconic Evian brand across the U.S. As part of the allied brand reset, Fiji and BodyArmor exited the portfolio.

Partnerships are at the core of the Coffee System portfolio, and we added Tim Horton's, the iconic coffee brand in Canada and Panera, the well-regarded bakery-café brand in the U.S. as new Keurig system partners. We now have more than 75 owned, licensed and partner brands in the Keurig system.

As you can see by these actions, we have significantly reshaped our Allied portfolio in short order with a focus on creating a long-term win-win partnerships that enable both parties to benefit equitably in future value.

We're excited about continuing to drive growth through a combination of partnerships with other leading beverage brands, and by innovating and renovating our portfolio of owned brands.

With that, I'll hand it over to Ozan.

Ozan Dokmecioglu Thanks, Bob, and good evening, everyone.

Let me start with the results of the quarter, which was a very good one

for KDP, and then transition to our outlook for the remainder of the year.

Continuing on an Adjusted pro-forma basis, net sales for the third quarter increased 2.9% to $2.86 billion compared to $2.78 billion in the previous year, reflecting strong growth across all four of our business segments. Driving the net sales growth was higher volume/mix of 3.6%, partially offset by unfavorable foreign currency translation of 0.5% and modestly lower net price realization of 0.2%.

Net sales for our Beverage Concentrates segment increased 3.1% to $331 million, driven by higher net price realization of 2.7% and increased volume/mix of 0.7% partially offsetting these positive factors was unfavorable currency translation of 0.3%.

Shipment volume growth for Beverage concentrates of 0.5% was driven by Canada Dry, reflecting innovation and continued strength of the ginger ale segment. Also contributing to the volume growth were Crush and Hawaiian Punch, partially offset by Sunkist and a modest decline for Dr. Pepper.

In terms of bottler case sales, which primarily reflect sales from bottlers to retailers and fountain customers, beverage concentrates reduced their growth of approximately 1% in the third quarter fueled by higher growth of fountain case sales.

Net sales for our Packaged Beverages segment increased a strong 4.9% in the quarter to $1.34 billion as compared to $1.27 billion in the prior year. This was fueled by volume mix growth of 5.7%, partially offset lower net price realization of 0.7% and unfavorable foreign currency translation of 0.1%.

As Bob mentioned, the lower net pricing was largely due to Bai and BodyArmor with the pricing actions we initiated on our CSD portfolio during the quarter, serving as a significant offset.

Shipment volume grew 4.5% in the quarter. Canada Dry led our brand portfolio with double-digit growth fueled by innovation and continued growth in the ginger ale category. Also driving the strong growth were [Core], Bai and BodyArmor, partially offset by 7UP and the modest decline in Dr. Pepper. Increased contract manufacturing volume also had a significant positive impact on the growth in the quarter.

Net sales for Latin America Beverages increased 2.3% to $136 million

compared to $133 million in the prior year. This performance was driven by higher net price realization of 8.7%, partially offset by unfavorable foreign currency translation of 5.8% and lower volume mix of 0.6%.

Finally, net sales of our Coffee Systems segment grew 0.4% to $1.05 billion in the quarter. This growth was led by higher volume mix of 2.5%, partially offset by lower net price realization of 1.7%, which continued to moderate significantly, as expected. Unfavorable foreign currency translation of 0.4% also impacted the performance.

Turning to operating income, in the quarter, operating income increased 14.3%, to $697 million compared to $610 million in the prior year. This performance was driven by the net sales growth, strong productivity, and lower marketing expense due to timing, partially offset by inflation in input costs and logistics.

On a margin basis, operating income advanced 240 basis points to 24.4% in the quarter. The strong operating income growth of 14.3% in the third quarter reflected significant improvement from the slight negative operating income performance through the first six months of the year, bringing our performance through nine months to a positive 4.4%.

Interest expense totaled $168 million in the third quarter of 2018. I would like to spend a few minutes on interest expense, as this is an important metric. On a year-to-date adjusted pro-forma basis, interest expense totaled $517 million.

This amount includes six months of interest expense calculated on a pro-forma basis, meaning it assumes a full merger debt load, starting on January 1st and it reflects only mandatory repayments required under our credit agreement.

Clearly, these assumptions are in accordance with U.S. GAAP and related treatment for the preparation of our pro-forma financial statements. However, in the first 84 days since merger close, we already repaid $550 million in debt, and our original outlook for full-year interest expense remains at approximately $600 million in year one.

Net income increased 39% to $414 million in the quarter, driven by operating income growth and significantly lower effective tax rate due to U.S. tax reform combined with a gain resulting from the cash

distribution from Bodyarmor we received as unitholders. Taking all of these factors together, our adjusted pro-forma diluted EPS increased 43% to $0.30 per diluted share compared to $0.21 per diluted share in the prior year.

As Bob mentioned previously, we got off to a very strong start in the quarter with our $550 million of debt repayment, an area of significant improvement. This performance was enabled by our strong operating profit results and effective working capital management, both of which we expect to continue. In fact, the debt repayment in the quarter is consistent with the de-leveraging outlook and value creation framework we shared at the time of the merger.

And finally, in terms of our outlook for the year. For the full year, we continue to expect adjusted pro-forma diluted EPS in the range of $1.02 to $1.07 per share, after the impact of preliminary purchase price accounting adjustments, which are estimated at $0.04 per diluted share.

For the first nine months of 2018, adjusted diluted EPS totaled $0.74. We continue to expect merger synergies totaling $600 million over the 2019 to 2021 period with $200 million in savings expected each year as well as ongoing productivity across the business.

Our effective tax rate for 2018 is estimated in the range of 26% to 26.5% for the year. For the fourth quarter, we expect our EPS to approximate 26%. In addition, we remain committed to drive significant cash flow generation to enable rapid de-leveraging with a targeted leverage ratio of below 3 times in two to three years from the time of the merger closing.

With that, I will turn the call back to Bob for some concluding remarks.

Bob Gamgort Thanks, Ozan.

To summarize, the third quarter represented a strong start for KDP. In a very short period of time, we made progress across the business from organization structure to integration planning to delivering a strong first quarter as a combined company.

During this time, we also reshaped and strengthened our partnerships across both our hot and cold businesses, and set the stage for a strong finish to 2018.

We will now open the lines for your questions.

Operator Ladies and Gentlemen, at this time, if you would like to ask an audio question, you may do so by pressing star then the number one on your telephone keypad. Again, that is *1, to ask an audio question.

Our first question is from the line of Lauren Lieberman from Barclays.

Lauren Lieberman Great, thanks hi everybody.

Bob Gamgort Hi Lauren

Lauren Lieberman I was curious if you guys could talk a little bit about Evian, just kind of the role that you see it playing in the portfolio. It strikes to me as maybe there is bit of like latent brand equity there, little bit under-representative in terms of distribution.

So, you didn't talk about some of the opportunities for that brand specifically, why it was a right answer for you, as you talk about going after that kind of value-add or higher end water category?

Thanks.

Bob Gamgort Sure, the water category in total, as you know is very much on trend and growing. You can look at water and segment it, depending on how you look at it into somewhere between 6 and 8 different sub-segments of water, premium, source stillwater is a very attractive segment, both in terms of its size and growth.

Evian was the original premium bottled water. It really does show the power of the brand needs to be met with power of distribution. When they lost their previous distribution agreement, they were actually the largest premium sourced water brand at that time.

And the brand that the legacy DPS business was carrying Fiji was much smaller and you could see there is a complete reversal in trends at that point in time. And so we are really excited to be able to bring full distribution back to Evian.

Danone is a terrific partner. They love this brand. This is the largest premium water brand in the world. It is a flagship brand in their portfolio, and they are very excited to invest in marketing and

innovation, now that they have confidence that the distribution and merchandising base will be back up to where it needs to be for a brand of this stature.

So it's a perfect complement to our portfolio. It's a gap that we wanted to fill, and we are excited about the growth prospects in getting it back up to where it once was as the leading premium water brand in the country.

Lauren Lieberman That's great and if there is a room for second question, I know Bob you've reminded everybody that Allied Brands are only 5% of total company sales and profit.

But I just saw it in the form it might be helpful if you could recap how you're updating the [progen]. You went through the changes made in the portfolio, but more how you put yourself in a better position to capture value you are creating for your partners, and sort of, avoiding hits down the road.

Bob Gamgort Yeah, just a recap on where we are, only a few short months into the combined business, on the Allied portfolio. We've added Evian, Peet's Iced Espressos, and FORTO Coffee Shots, which are shipping now.

We acquired Big Red and Core. We are excited about those. Fiji and BodyArmor exited the portfolio. And then we continued on with no change in distribution agreement for Vita Coco, High Brew and Neuro. And so the Allied portfolio has settled out nicely in a fairly short period of time.

As we said, we feel that with all the pluses and minuses of that, there is no change on our earnings or EPS. When we think about 2019, which we'll talk about, there may be some slight headwinds to a onetime reset in growth, because you're taking some big businesses out, like Fiji, that actually weren't growing very much, and you're replacing them with some smaller but faster growing businesses.

So that's really just a one-time adjustment, has zero impact on our profitability, and we think we're at a really good starting point, but we want to do more. And the go forward position on Allied brands is we're targeting those that fill a gap in our portfolio, because we want to make sure that it's an incremental volume generator by its nature.

And the partnerships that we are looking for are those that are very long term in nature. They have an equity investment component to it, in

most cases, Evian being a situation where it doesn't make sense, and they would have a path to ownership, assuming that we both hit milestones.

And that avoids, which you're alluding to, helping drive a brands' great success and then you're really have, at that point, no advantage, versus any other company, in owning that brand once you have contributed to its success.

We don't see that as a successful path going forward, given all the value that we create. As you have seen in the business, the value creation has been proven time and time again. So that's the evolution of the allied brand portfolio.

Lauren Lieberman Great okay, thank you so much.

Operator And our next question is from the line of Bryan Spillane from Bank of America.

Bryan Spillane Hey, good afternoon everyone.

Bob Gamgort Hey Bryan.

Maria Sceppaguercio Hey Bryan.

Bryan Spillane Just two quick ones for me. I guess one just a clarification, Ozan in terms of the $600 million of interest expense in year one that's I guess second half of '18 through the first half of '19, right? So the first four quarters.

Ozan Dokmecioglu Yes, that's right. It's a one year--yes, that's right.

Bryan Spillane Okay, and then second question I guess for you Bob is just, can you just -- in the quarter, you had very good margin expansion in coffee systems.

And I think there's been a lot of focus on the price reductions in pods and I think people have been concerned a little bit about the ability to grow margins and have pricing come down.

So if you could walk us through where you stand in that process, and the drivers of margin expansion, I guess, in coffee systems as we look forward.

Bob Gamgort

Let me talk about the growth side first and where we stand on that, and then I'll talk a little bit about the margin side. We were very happy with the performance that we put in for coffee systems during the quarter.

And it very much represents the execution of the strategy that we talked to you guys about for a while now. If you take a look at the pod category, and this is per IRI, but its good proxy for even what we see in some of the unmeasured channels, Pod category grew 7%. We grew share of manufactured pods, those pod manufactured by KDP, and therefore, our consumption in the quarter on pods was plus 9%.

Now, there's a little discrepancy when you take a look at the shipments during the quarter, because you see +3% for pods. That's really simple – It's just a year ago comparison to a shipment timing where a year ago, we were implementing SAP and so there were advanced shipments in the third quarter, that we're bumping into again.

But the fact that there was 9% growth of consumption during the quarter really speaks to the robust growth that we're seeing in the total system. As you know from a pricing standpoint, we've been very strategic in taking price down. We've done that for a couple reasons. We've done it to address the number one consumer barrier to entry two years ago, that's now largely gone away, which was pod pricing.

And we also want to compete on a different level and attract the right partners into the system based on price, quality and service. And we attracted Tim Horton's to come into the system, which is the leading coffee brand in Canada, that's further evidence of that.

We clearly have been able to offset those pricing concessions by very robust productivity, and that productivity is across the entire supply chain of the business, and on the procurement side on our conversion and logistics. And we also have productivity that we've been able to generate on the brewer side of the business.

And so there are a lot of moving parts, but I think the proof is in fact that we're able to reduce price and yet still significantly expand margin. A lot of hard work behind that. But it's good delivery of the productivity.

And then the last point, to make sure I covered everything you wanted, last point is pricing. When you take a look at the average pod price in the category, if I look at it on a 52-week basis, it was $0.51. If I look at it on a 12-week basis or four-week basis, it was $0.50.

So we said $0.50 is about the right price point, in the category. It's not exact, it's based on all of the research that we've done. And you see the moderation there going from about $0.51 to $0.50.

And if you look at it for our business because we have more premium brands on KDP manufactured, we're going from $0.54 to $0.53.

That's the moderation that we're really pleased to see. And if you compare that to history, you will see that that's a significant change in slope.

So very much on track with the strategy that we talked to you guys about over the past six months, and absolutely thrilled with the performance in the quarter.

Bryan Spillane Okay Great, thank you.

Operator And our next question is from the line of Judy Hong from Goldman Sachs.

Judy Hong Thank you, hi everyone.

So I guess first question is just on the DPS side, the packaged beverage division. I know the margins there have been under pressure, just given a lot of the input cost inflation that a lot of the industry players are facing, obviously.

But it seems like pricing went through and maybe that a little bit of a delayed pricing, but I guess I am just wondering how much of some of these input costs inflation you're expecting to recoup in the fourth quarter and 2019?

And then there's been a little bit of maybe choppiness around how some of the leading CSD players are taking pricing in the marketplace, some with a little bit of a delay.

So how do you think about the competitive dynamics, as you're taking

more pricing in that category?

Bob Gamgort Yeah, so if you go back to the release that we issued for the second calendar quarter of the year, we put results out for DPS and KGM essentially separately because we weren't running the business at that point in time. But we did allude to the fact that we were seeing inflationary pressures, which everyone in the industry is facing right now. And the fact that we were, at that point, in need of putting pricing in place and that's what we were really clear that we were going to do.

If you take a look at what's happened in the marketplace, and I'll just use IRI as an example. On year-to-date basis, our price is up across our portfolio of CSDs about 1.9%. In the latest 13 weeks, it's up 3.3%. That still lags the category, but we're now catching up.

And that's what's required for us to close that margin gap on the PB side of the business. And so while it's being implemented, not a lot of that hit during the quarter. So the benefit to your question will really hit us in Q4 and then roll over into 2019.

Judy Hong Got it, okay, and then just a follow-up on the margin or the process improvement at KGM side, so I think you also called out lower marketing expenses.

So of the 22% increase in operating profit, how much was the lower marketing, and is this more timing that hit the fourth quarter?

How should we think about that?

Bob Gamgort It's really timing related because it's some nuances around when you want to spend around the holiday season versus year ago, and it was not a significant driver in the profit improvement in the quarter.

It was one of the smaller contributors to it and it's nothing to signal other than just when do we want to time marketing around the holiday.

And we're really happy with the advertising that we have on air right now, with James Corden featuring the new brewers, it looks great, and getting great consumer response to it.

So we're happy to invest in that in the fourth quarter.

Judy Hong Got it, thank you

Bob Gamgort Okay thanks Judy.

Operator And our next question is from the line of Brett Cooper from Consumer Edge Research.

Brett Cooper Hey guys, question for you on the innovation side, specifically on the legacy DPS business.

I was just wondering if you could offer your thoughts on, or your perspective on where you take innovation as you go forward relative to prior DPS. And then relative to the coffee business where you had a longer lead-time to get innovation out.

How long do you think into the innovation cycle that you feel is representative of what you can do going forward?

Thanks.

Bob Gamgort Yeah, I think we see a lot of opportunities to expand into white space and new territory within our portfolio on both sides of the business. As we talked about on previous occasions, the Allied brand or partnership strategy is an important part of it, but it's not the exclusive approach.

And we think there's a big opportunity, both in terms of innovation and renovation. I'll give you a good example of this, Canada Dry. Canada dry, great segment, good solid marketing behind it, and then the introduction of Canada Dry with lemonade this year.

That business -- if I take a look at it on a year-to-date basis, that business is up about 16%. It's up actually stronger than that in the latest four weeks. So, I think that is a really good proof point of how some strong marketing and some nice renovation, on top of an existing business, can really generate growth. And so our perspective is it will be a balanced approach across all of those as we all try to ramp up the growth side of the business. And one last point, as you imagine, that's very profitable growth to be able to add topspin to a brand like Canada Dry, 16% growth on a CSD, is I think surprising to most people on the outside who talk about CSDs being flat to declining, and it gives us encouragement that we can really ramp that business up.

Brett Cooper Great thank you.

Bob Gamgort Okay

Operator And our next question is from the line of Stephen Powers from Deutsche Bank.

Stephen Powers Hey guys, good evening, thanks.

Bob Gamgort Hey Steve.

Stephen Powers So just to start a couple of just clean up clarification questions, I guess. On the guidance, I get the EPS has been reiterated; just want to confirm that you're also reaffirming the 7% to 8% EBITDA growth.

Second on the A&P, I think you did a good job of clarifying the timing related. Just as we think about the full year pro-forma. Are you net investing in A&P, or is A&P down, is it a source of profit growth in the year?

And then last on the synergies. Just any benefits to 2018 because obviously we're not carrying the executive management team at DPS any longer, I think as of a couple of weeks ago, there has been a pretty sizable restructuring done in Plano.

So I just want to understand if there is synergy benefit to '18?

Bob Gamgort We'll divide and concur on this one. I'll do the marketing because it's the easiest one. The marketing will not be down year-over-year, it's not a source of profit for us. In fact, we look to generate productivity to invest more behind the brands, which is something that we expect to see going forward.

And again, the evidence that we have on the Dr. Pepper business growing and Canada Dry business growing, the Keurig system growing, I think are-- for us gives us very confidence that if we've got the right marketing vehicles, we are certainly not shy to invest in them.

Ozan, why don't you talk about the synergy piece? If you want to talk about how do we think about the synergies and any impact on 2018 and then I'll ask Maria to talk about our targets.

Ozan Dokmecioglu Absolutely, in fact, the synergies that we are going to see in 2018 would be quite a bit immaterial. And we already knew it was related to

a handful of executives with regards to the severance. The consequence of the synergies that we had already planned is literally quite a small number.

That's why we did not change our outlook, neither for 2018 nor for 2019. And we basically say, as I said during a 10 minutes ago readout that we are committed to deliver our synergy number of $600 million over three years, starting with $200 million in 2019 onwards.

Bob Gamgort And Steve, your question about the recent restructuring we announced, that was pretty -- pretty much -- right on schedule from what our original plans were.

And the timing of that is late in the year and by the time people actually leave, et cetera, it's almost no impact in '18, but it puts us in good position, along with other synergies, for '19.

Maria, you want to talk about target question?

Maria Sceppaguercio Sure, I know you asked about EBITDA, let me just start with Sales. We disclosed net sales and that's going to be in the +1% to 2% range for the year.

Originally, we were talking about EBITDA in the 7% to 8% range. We've since gone to EBIT because as a public company, we think EBIT is far more important or operating income, it's much easier for other folks to track. But the difference between the growth rates is insignificant.

We're still looking at 7% to 8% growth in operating income. And Ozan already talked about $600 million in synergies, which was another important metric.

Bob Gamgort Starting in 2019.

Maria Sceppaguercio Yeah, so we are holding our guidance and all of the important elements of that guidance we have no change in.

Stephen Powers Okay thanks, that was a very impressive tag-team, thank. If I could just ask one more question and I guess as a follow on from this-- we think about the synergies, culturally down in legacy DPS.

There had been a big move over the last five, six, seven years to implement what was referred to as RCI, rapid continuous improvement. I was just curious as how you guys have engaged with the DPS team, what you've encountered with regard to that program, do you expect that to live on, and just any reactions to that and how we should think about that as playing a role going forward?

Bob Gamgort Yeah, I think, clearly, productivity has been a big part of both companies' cultures. There are different approaches to it, different names behind it.

Looking at the Keurig productivity delivery prior to the merger with DPS. If we saw the before and after picture, when it was private and then public again, you saw that there was a very significant amount of productivity driven.

I think it’s great that we are all working together towards the same goal. These are both organizations that have an appreciation for the fact that the way to control your destiny in CPG today is to make sure that you've got robust productivity that you can invest back in the brands and into your organization where needed.

And so that part has been, I would say, fairly seamless in terms of the cultural fit.

Operator And our next question is line of Kevin Grundy from Jefferies.

Stephen Powers Okay, thank you very much.

Operator And our next question is from the line of Kevin Grundy from Jeffries.

Kevin Grundy Thanks, good evening everyone.

Maria Sceppaguercio Hey Kevin

Kevin Grundy I wanted to start with the KGM business and come back and build on Bryan's question, and then I have a question on working capital.

So Bob, just to come back to the pricing dynamic and you sound relatively comfortable with that. Have we flattened out at this point? So in other words, are you comfortable modeling flat pricing looking out

to '19.

And then as it pertains to that, when the deal was announced, the expectation was at least at the time the KGM gets back to 2% to 3%, or, yeah, 2% to 3% type growth in '19 and beyond, things certainly getting better sequentially each quarter this year, but not-- certainly not at that 2% to 3% level.

What's your confidence that you can deliver on that 2% to 3% looking out to next year?

And then I'll follow-up with the working capital question.

Bob Gamgort Look, I think, we still have some pricing to go here. I wouldn't -- we're talking about it moderating, but I wouldn't use the word flat right now.

And I think that that's the prudent planning approach to take. It forces us to make the right decisions from the perspective of productivity to cover that from a margin standpoint.

And it puts us in a very competitive position because, as I said before, lowering prices attracts more consumers into the system, as well as satisfies our partners.

So the targets that we put in place back in the beginning of the year when we announced the deal are very much intact, as Maria talked about before, and I think all the elements of the KGM strategy and KDP as a combined company are coming together nicely.

Kevin Grundy Okay, so 2% to 3%, but then more volume weighted and you guys can offset the lower price that you're still confident with that. Is that correct?

Bob Gamgort I think that's the way we think about it. We play around -- we have the ability to play around with different pricing and volume, levers to cover pricing, but I think we're fine from that standpoint.

Kevin Grundy That's helpful and then quick follow-up for Ozan on working capital. There is clearly a healthy level of working capital improvement based on your leverage guidance looking out, but not to the degree that you're able to achieve on the Keurig side.

Now that the deal is closed and you've spent quite a bit of time now with the operations, do you see potential upside for working capital at this point or is that something that you can comment on?

Ozan Dokmecioglu Sure, absolutely, and as you said, we have successfully developed our playbook working capital in the past doing a healthy job in the legacy KGM.

And basically we are applying the same playbook, using even the larger [balance sheet]. And we feel very good about in terms of the working capital generation levels, and why these will turn into cash based on what we have found out so far in DPS legacy.

So we feel very good about it.

Kevin Grundy Yes, I mean more explicitly—I'm sorry-- and then I'll pass it on. So if I am not mistaken, you went to negative 15% of sales on the Keurig side.

Is that something that's attainable on the legacy Dr. Pepper side?

Ozan Dokmecioglu Yes, we will be pretty close to that number somewhere around, as you said, -12% to -13% is within range. And we have already started to deliver on the trajectory based off the working capital improvements that we managed to do in the past 84 days.

Kevin Grundy Okay, thanks for your time guys. Good luck.

Operator And our next question is from the line of Robert Ottenstein from Evercore ISI.

Robert Ottenstein Great, thank you very much and congratulations on a terrific start. First question, I was wondering if you could just give us a little bit of more background in terms of color on Bai, what strategy is there. You're taking a little bit of price reductions.

What's going on there in terms of volume, penetration, distribution, velocity, anything to give us a sense of what's going on with that brand please?

Bob Gamgort Sure, if you take a look at Bai now, it is a-- it's made a transition from a small but rapidly growing brand to a good-sized brand. So it's in the $400 million range right now and on a year-to-date basis growing at

15%.

So the good news is it's large, but the reality of that is brands don't grow at 40% or 50% forever, as you know, especially once you get into that near half a billion dollar range.

Having said that, we see a tremendous amount of upside on the business over the long term; a lot of distribution still to be gained on that business, particularly in small outlets.

If you take a look at some of the IRI numbers, in particular, around some of the smaller outlets, as much of that as you can get, there's still quite a few distribution gaps that I think that will continue to drive growth on that brand, going forward, once closed.

So we're happy with how the brand has progressed. It's really a nice addition to the portfolio, and it's delivering meaningfully in terms of both revenue, and is a nice profit contributor as well.

Robert Ottenstein And what's the pricing strategy?

Bob Gamgort Well, that's the pricing you're taking a look at? There was some negative pricing. It's really just a quarterly timing of promotion. There's no -- it's not a conscious strategy, as we talked about on Keurig pods, for example, to say we're going to roll back pricing. This is just timing of promotions that impacted.

Robert Ottenstein Terrific, and then second question I'm hearing through the Grapevine that there's been some supply issues for cans, aluminum cans. Is that anything that you are seeing, or hearing, or affecting you in any way?

Bob Gamgort There has been some bumpiness in aluminum can supply across the industry, nothing that has reached the level where it would show up in our results, and we know there's inflation as well, which is part of what's driving some of the pricing actions in the industry.

Robert Ottenstein Great, and then my final question, I'm also hearing that there is out there a second increase on 20-Ounce PET, the Coca-Cola Company is trying to lead in c-stores.

Are you guys following that? Do you have any sense or color on what's going on there?

Bob Gamgort I mean that's not something that we could comment, which would be future pricing that's rumored. That would be inappropriate for us to talk.

Robert Ottenstein Understood, thank you very much.

Operator And our next question is from the line of Vivien Azer from Cowen and Company.

Gerald Pascarelli Hi, this is Gerald Pascarelli on for Vivien Azer. Thanks very much for taking the question.

So my first question has to do with the coffee systems. The 8% volume growth that you delivered in Brewers.

I guess, what percentage or how much did the new innovation from K-Café, K-Latte drive the growth relative to your more core offerings?

Bob Gamgort I have to look that one. I don't have that off the top of my head. It's really just started shipping during the quarter. It's going to hit mostly in the fourth quarter.

And that's where you will see much more and we will clearly have that answer on our next call, but I think it's the Mini, the Latte, and the Café that are really going to be a big drivers in the fourth quarter, not as much so in the third quarter.

Gerald Pascarelli Got it, helpful and my next question has to do with Canada Dry. I know that Ginger Ale, strong performance in Ginger Ale was a call out in the prepared remarks. But I guess where does Sparkling Water fit into the growth profile and into the brand's overall performance here as you continue to deliver these strong trends?

Thank you.

Bob Gamgort We think that Sparkling Water, under both Canada Dry and Schweppes brand, have been a big growth driver. It's not something that shows up in a lot of these numbers nor have we talked a lot about it.

It's a relatively small business overall, but there are regions in the country where it's fairly large. But again when you think about our go

forward strategy, that's a segment that really would be a good addition to our portfolio in a broader way than we have played right now with Canada Dry and Schweppes.

But there are pockets of country, particularly in the Northeast where it outsells other sparkling flavor waters, and I think it's something that we haven't leveraged well enough.

Gerald Pascarelli Got it, very helpful thank you very much.

Bob Gamgort All right, thank you.

Operator And we have time for one last question from the line of Nik Modi from RBC.

Nik Modi Yeah good afternoon, or evening.

Bob Gamgort Hi Nik

Nik Modi Hey, how are you doing Bob?

Bob Gamgort Well.

Nik Modi The question is really on M&A. You obviously have made some moves on brands. But I'm curious how you think about acquiring different go-to-markets because it does seem like just looking across the entire beverage landscape, distribution is starting to become more of a focus just as companies try to get closer to the consumer.

So, maybe you could just provide some context around that?

Bob Gamgort So you're talking about--just to clarify, are you saying acquisitions related to distribution versus brand?

Nik Modi Yes, go-to-market -- exactly. Go-to-market, asset purchases versus actual just brand purchases or maybe there's both, right? Maybe there is--

Bob Gamgort Yeah okay, I get the question. I think, look, anything is fair game as we think about optimizing our business. As we talked to you about our

strategy, it's a combination of broadening our portfolio and making sure that our distribution and merchandising is best in class.

When we think about a portfolio side, as I've said before, a combination of innovation, renovation, as well as partnerships and M&A. On the distribution side, we're thinking about things, I think, more towards optimization of what we have right now. We've got number partnerships right now in the distribution space where we also think that we could have conversations that are more strategic in nature as well.

I wouldn't rule that out what you're talking about, but it's certainly not on our short-term hit list of priorities because we think that we can get a significant amount of improvement in the system by optimizing what we have and maximizing the relationships that are in place right now.

Nik Modi Great, and then just a follow-on to that, when you think about your algorithm that you put out there. I'm just curious how much partnerships -- additional partnerships or Allied brands is part of that algorithm, or is that just what you have in your existing portfolio?

Bob Gamgort I think as we talked about that-- those targets, which we go back awhile, we put those out there at the time of the announcement of the merger before we knew exactly what Allied brands would look like.

And as we said a number of times, that's why you guys have us navigate through all of these complexities to make sure that we're able to land in a very good place, which is exactly what happened and where we stand today with Allied brand portfolio. And I talked before about how we think the impact on the business, going forward.

We like partnerships, so we will continue to do those, and we will continue to add through acquisition as well. And if it got to a point where it was such a material addition to us, that it would change our outlook, we'd have that conversation.

But we feel like we're in good position right now with the partnerships in place and the portfolio that we have to deliver well against the targets that we talked about all the way back to January.

Nik Modi Great, very helpful, thanks Bob.

Bob Gamgort Okay.

Operator And at this time, I am showing that we have no more time for further questions. Presenters, I turn it back to you for any closing remarks.

Maria Sceppaguercio Hi, this is Maria. I just want to thank everyone for joining us tonight. I know it's getting late. We will be around. So if anyone wants to reach out to me, certainly feel free to do so.

Steve Alexander is also here, so reach out to him as well. And thank you for participating and we look forward to continuing the dialog.

Take care, everyone.

Operator Ladies and gentlemen, this does conclude our conference call. We thank you greatly for your participation you may now disconnect.