Keurig Dr Pepper, Inc.

First Quarter 2023 Earnings Conference Call

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CORPORATE PARTICIPANTS

Jane Gelfand - *VP, Investor Relations and Strategic Initiatives*

Robert Gamgort - *CEO & Chairman*

Sudhanshu Priyadarshi – *Chief Financial Officer*

Maria Sceppaguercio - *Chief Corporate Affairs Officer*

PRESENTATION

Operator
Good morning, ladies and gentlemen. Thank you for standing by. Welcome to Keurig Dr Pepper's Earnings Call for the First Quarter of 2023. 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 the company's Vice President of Investor Relations and Strategic Initiatives, Jane Gelfand. Ms. Gelfand, please go ahead.

Jane Gelfand
Thank you, and hello everyone. Earlier this morning, we issued a press release detailing our first quarter results. Consistent with previous quarters, we will be discussing our performance on an Adjusted basis, which reflects constant currency growth rates and excludes items affecting comparability. The Company believes that the Adjusted basis provides investors with additional insight into our business and operating performance trends. While the exclusion of items affecting comparability and the use of constant currency growth rates are not in accordance with GAAP, we believe that the Adjusted basis provides meaningful comparisons and an appropriate basis for discussion of our performance.

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

Beginning this quarter, we will discuss our performance in accordance with our recently redefined business segments, which were described in an 8-K filed last Thursday, April 20th. This new segment structure is more consistent with how we evaluate the business internally and provides more visibility to our segment performance in the U.S., which is our largest market.

We will also speak about the concept of underlying performance, which removes the impact of non-operational items in the current and prior years. These items include gains on asset sale leaseback transactions, reimbursement of litigation expenses related to the successful resolution of our BodyArmor lawsuit, a business interruption insurance recovery and a change in accounting policy for stock compensation.

And finally, our discussion this morning may include forward-looking statements, which are subject to the Safe Harbor provisions of the Private Securities Litigation Reform Act of 1995. These statements are subject to a number of risks and uncertainties that could cause actual results to differ materially, and the company undertakes no obligation to update these statements based upon subsequent events. A detailed discussion of these risks and uncertainties is contained in the company's filings with the SEC.

Here with us today to discuss our results are KDP Chairman and CEO, Bob Gamgort; our Chief Financial Officer, Sudhanshu Priyadarshi and our Chief Corporate Affairs Officer, Maria Sceppaguercio. I'll now turn it over to Bob.

Bob Gamgort

Thanks, Jane, and good morning, everyone.

We started 2023 with good momentum. Our overall Q1 performance came in largely as expected and demonstrated the resilience of the Modern Beverage Company we have built. We continue to manage well against a dynamic macro environment, with the diversification benefits of KDP's model evident in our results. This morning, we reaffirmed our 2023 outlook and we are confident in our ability to continue to deliver on our commitments as a company.

For the quarter, consolidated net sales advanced a strong 9% versus the prior year and Adjusted EPS grew 3%. Consumer demand remained healthy, driven by successful renovation and innovation, increased investment in marketing and modest elasticities across much of our portfolio. A narrowing gap between inflation and pricing, coupled with increased productivity and favorable mix, contributed to good flow-through to gross profit, though we continue to work through significant ongoing inflation in transportation, warehousing and labor costs. We expect the balance between these operating income drivers to turn more favorable in the back half of the year.

In U.S. Refreshment Beverages, which represents nearly 60% of KDP consolidated revenue, our strong performance in Q1 demonstrated the depth of our capabilities across multiple dimensions, including brand renovation, marketing, distribution and in-market execution, as well as our partnership philosophy and successful track record.

As discussed previously, we create value in U.S. Refreshment Beverages in three ways:

1. By driving growth in core brands through marketing and brand renovation;
2. By filling portfolio white spaces via innovation and external partnerships; and
3. By enhancing the effectiveness of our omni-channel selling and distribution system, including our company-owned direct store delivery system.

The multiplier effect of all three of these elements working in unison was evident in Q1. We gained share in categories representing almost 90% of retail sales, with strong momentum in core brands, particularly Dr Pepper, Crush and Mott's. On the back of the very successful launch of Dr Pepper Strawberries & Cream, brand Dr Pepper recorded the largest market share gain in the CSD category this quarter. In fact, the brand has become the #1 flavored CSD in syndicated data over the past 13 weeks.

For perspective, Strawberries & Cream reached 70% ACV distribution within five weeks of launch, quickly gained a full share point in the CSD category, and continues to experience strong momentum. Driving the early success of Strawberries & Cream is KDP's direct store delivery engine and robust consumer insights and marketing support.

In Q1, we also began to activate our strategic partnership with Nutrabolt, transitioning C4 Energy distribution to our network. Our execution thus far has been smooth and is progressing in line with our plans. As we begin to invest behind the brand, we are securing incremental points of distribution and display, as well as upgrading placements. Though it is still very early days, our partnership with

Nutrabolt is strong and collaborative. We are excited by its potential and look forward to unlocking more value for both KDP and Nutrabolt in the quarters and years ahead.

In-market execution underpins the gains we are making across our U.S. Refreshment Beverages portfolio. The results speak for themselves, but they are even more notable given we – and the industry at large – continue to work through significant inflation. We have supplemented 2022 carryover pricing with some additional pricing actions to start the year, as we protect our profitability and our ability to reinvest for the long-term. The limited elasticities this business has experienced so far are a telling reminder of the resilience of the category, in general, and the KDP portfolio, in particular. Our brands remain important and affordable components of our consumers' everyday lives. Still, as recessionary risks persist, we continue to closely monitor consumer health and sentiment.

Turning now to U.S. Coffee, which represents roughly 30% of our consolidated revenue. This segment experienced a slower start to the year. The performance in pods – which, as you know, is our primary focus and profit driver – was as expected, with brewers softer than expected.

Because this segment's performance in the first half of the year will be difficult to analyze for longer-term trends, let me take a step back and explain what we are seeing in the category and in our own business.

Growth rates in the at-home coffee category, including in the single serve segment, are being temporarily impacted by changes in mobility relative to the prior year. In Q1, the category lapped the surge of the Omicron variant, and lingering pandemic precautions in the year-ago period are expected to continue to affect comparisons through the first half. At the same time, the category is digesting significant cumulative pricing to offset inflation. Importantly, single serve continues to gain volume share in the at-home coffee category in the U.S., underpinning the strength and resilience of the segment and our long-term growth strategy. We also see the environment for small appliances being impacted by the combination of lower consumer discretionary spending and a challenged specialty retailer environment.

Sudhanshu will cover the detailed quarterly performance drivers but let me say upfront:

- We expect the second half to reveal a more normalized picture of the health of the single serve category and our ongoing momentum;
- We are still planning to add approximately two million new households to the Keurig ecosystem in 2023; and,
- We also continue to expect the back half to show strong improvement in segment operating margins.

Short-term noise aside, the Coffee category is vast and growing in the U.S. and globally. Smoothing out the volatility of the pandemic period, we are projecting double digit volume growth for our at home pods in the U.S. from 2019 to 2023, which translates to a mid single digit compound annual growth rate. This is consistent with our previous discussions that eliminating the significant noise over the past three years reveals consistent and healthy long-term trends for at-home single serve coffee. As the leader in U.S. single serve, our overarching growth strategy is to continue converting consumers from brewing coffee by the pot to brewing it by the pod, which we pursue through two primary means:

- First, by driving household penetration for the Keurig system. U.S. single serve adoption remains significantly below that in more developed single serve markets in Western Europe and even in Canada, and we expect household growth to continue for many years to come, as we target adding approximately two million new households annually.
- Second, by increasing revenue and profit growth from our existing 38 million U.S. Keurig households.

Ongoing brewer innovation to address new and changing consumer needs and a focus on expanding brand and variety offerings within the Keurig ecosystem underpin our Coffee growth strategy. We have news on both fronts in 2023.

When it comes to meeting consumer needs, after an initial successful launch with a single customer last year, in 2023 we are expanding our K-ICED brewer platform as well as dedicated ICED pods specifically designed for cold beverages. Cold coffee beverages are growing quickly at coffee shops and over-index to younger consumers. Given our ability to deliver a high-quality cold coffee experience at home for a fraction of the price, we see iced coffee as a growth opportunity for the Keurig ecosystem in 2023 and beyond.

We also continue to add new and exciting brands to the Keurig ecosystem. Today, we are pleased to announce that Philz Coffee, a super-premium brand based in San Francisco, will be available in K-cup pods beginning this fall. Through the new partnership with Philz, as well as the additions of Intelligentsia and BLK & Bold announced last year, we are building a new super premium segment for K-cup pods.

Our International segment, which represents just above 10% of our consolidated revenue, encompasses both our Canadian coffee and beverages businesses as well as our LRB businesses in Mexico and Puerto Rico. Our growth strategy for International leverages enterprise-wide insights and capabilities to grow household penetration in coffee and to drive share gains in LRBs through brand innovation and renovation, whitespace expansion and strengthening our routes to market. We tailor our approach to local tastes and market structures, while exporting best practices and ideas across the whole of North America. In Q1, we were pleased to see broad-based momentum across our brands and categories, including in mineral waters, CSDs and single serve coffee. Our partnership with Red Bull in Mexico continues to build, and we also remain focused on expanding within the no- or low-alcohol category, including through our acquisition of Atypique in Canada. Both opportunities leverage our existing portfolio and distribution assets, including our DSD system in Mexico and our alcohol portfolio and expertise in Canada.

Wrapping up, we expect the operating environment to remain fluid and we see KDP as well-positioned to continue to deliver strong consolidated performance in 2023. We are reaffirming our 2023 outlook for constant currency net sales growth of 5% and Adjusted EPS growth of 6 to 7%. On an underlying basis, this implies Adjusted EPS growth that is closer to 9% -- at the top end of our long-term algorithm.

In addition, KDP has a track record of strong free cash generation and we expect to continue to unlock the potential for incremental shareholder returns through strategic capital allocation. We have evolved our capital allocation approach to better fit our development stage as a company and to respond to a higher interest rate environment. We are prioritizing internal investments, partnerships and M&A,

balanced against returning cash to shareholders through our dividend and opportunistic share repurchases, which we undertook this quarter and last quarter.

Our recent upgrade by Moody's to a stronger Investment Grade credit rating recognizes the inherent portfolio balance of our Modern Beverage Company, along with our capital allocation philosophy and free cash flow profile – all aspects that Sudhanshu will talk more about next.

Sudhanshu Priyadarshi

Thanks, Bob, and good morning everyone.

In kicking off 2023, we made the decision to realign our segment reporting to more closely reflect how we plan, run and evaluate these businesses internally. The new U.S. Coffee segment will also enhance comparability relative to how we speak about our long-term goals, including our 2 million annual U.S. household penetration target. There is also the added benefit of giving you a more refined picture of our operations in the United States, which is by far our largest market. We believe the size, scale and margin profile of each U.S. segment becomes more visible externally, making it easier for you to track and analyze.

U.S. Refreshment Beverages is an $8 billion plus revenue business with a 28% Adjusted operating margin. The U.S. Coffee business is $4.3 billion dollars in revenue – also very large – with an Adjusted operating margin above 32%. Obviously, both are high quality CPG businesses with tremendous scale in the U.S. market. At the same time, our fast growing International segment – at approximately $1.7 billion of revenue and a 24% Adjusted operating margin – is already meaningful and quite profitable.

We are pleased that KDP's portfolio delivered overall Q1 results which were consistent with our going-in expectations, even as performance among the segments was varied. Q1 sales advanced 9% driven by strong in-market execution, particularly in U.S. Refreshment Beverages. Gross profit dollars grew at a similar rate, and we increased marketing investment versus prior year. At $0.34, our adjusted diluted EPS grew 3% versus Q1 last year. Without a five cent headwind from the significant reduction in non-operational items year-over-year, underlying EPS growth in the quarter was in the high teens. As discussed on our last earnings call, we are committed to a step function decrease in the use of non-operational items this year and, as this occurs, the earnings power of the business will become even more visible.

Our actions also continued to reflect our revised capital allocation priorities. In Q1, we saw and took advantage of a value opportunity in KDP shares and bought back 6.6 million shares during the quarter. Combined with the share repurchases we undertook in late 2022, we have now returned more than $500 million to shareholders via opportunistic buybacks over the past two quarters.

Our high-quality portfolio, consistent results, well-capitalized balance sheet and flexible capital allocation approach are being increasingly recognized. As Bob mentioned, Moody's upgraded our credit rating earlier this month, which is especially notable in a weaker macro environment. We believe our strong balance sheet and North American focus represent a safe haven in the current tumultuous financial market.

Let's now take a closer look at consolidated Q1 results. Consistent with the last couple of quarters, our top-line growth was driven by pricing taken to offset inflation and a modest volume/mix decline. Net sales grew 8.9% to $3.4 billion, with pricing up approximately 10%.

Gross margins were stable at 52.7% and primarily reflected the combined benefits of pricing, productivity gains and positive mix, balanced against considerable input cost inflation. Total SG&A as a percentage of sales deleveraged by about 100 bps versus prior year, reflecting continued elevated transportation, warehousing, and labor costs Despite these cost headwinds, we increased marketing investment to support our brand momentum. We also lapped an SG&A benefit of $28 million from a stock-comp accounting change in the prior year period. Q1 Adjusted operating income was $699 million, about 4.5% below year-ago but representing almost 9% growth on an underlying basis. Adjusted net income grew about 1%, aided by flat interest expense, equity method earnings, and a lower tax rate versus the prior year. Lower diluted shares outstanding helped drive additional leverage in the EPS growth rate.

Turning now to segment performance. U.S. Refreshment Beverages sales grew 12.7%, led by 12.5 percentage points from favorable net price realization. The benefit of pricing was sequentially lower relative to Q4, as we began to anniversary price increases we took in early 2022 and have not yet captured the full benefit of pricing actions announced earlier this year. Volume/mix was slightly positive in the quarter, reflecting very limited elasticity impact as well as the contribution from C4 Energy. This volume/mix result speaks to resilient consumer demand, modest elasticities in our categories, and a successful slate of innovations and renovations. Segment operating income increased 11.6%, as we effectively translated top-line momentum to bottom-line results despite inflation in packaging, manufacturing and labor costs.

Our U.S. Coffee segment represents a single serve ecosystem in which our brewers create a platform for high quality coffee experiences through our high margin, consumable K-cup pods. Simply put, we are in the business of selling pods – not brewers. That said, we recognize that quarterly volatility in brewers can sometimes distort the picture. To help you further contextualize brewer trends, we are introducing two additional disclosures: trailing twelve month brewers sold and associated growth rates. You saw both of these in our press release this morning. Going forward, while we will continue to disclose quarterly brewer sales and shipments in our 10-Q, we will focus our remarks in this forum as well as in the press release on trailing 12 month trends, which we believe smooth the inherent quarterly volatility of appliances relative to consumables.

Let's now get into the results. In U.S. Coffee, Q1 revenue declined 1.3%, with pricing up 5.3%, but volume/mix down 6.6%. The environment for small appliances was more dynamic than we expected, reflecting the combination of softer discretionary spending and a challenged specialty retailer landscape. These factors primarily impacted brewer shipments, which declined 29% in the quarter. For perspective, Q1 is our seasonally smallest quarter of the year, accounting for less than 20% of brewer shipments. On a trailing twelve month basis, brewer shipments totaled 10.2 million, reflecting a 9.8% decline year over year but strong growth of 25.6% relative to the pre-pandemic period ending Q1 2019. Our goal of adding an incremental two million households in the U.S. in 2023 remains intact.

U.S. pod revenues grew 2.9% and pod volumes declined modestly – down 1.9% in Q1. This was influenced by consumer mobility that was meaningfully different versus the same time last year, when

the Omicron surge led to more time spent at home. There are other factors at play in the category, such as some elasticity in response to pricing and mix shifts to a more normalized level of premium vs. private label exposure. However, we continue to believe that mobility is the largest driver of at home coffee category softness over the past few quarters. It follows that pod trends should improve in H2 as mobility differences relative to last year begin to dissipate. We continue to expect U.S. Coffee volumes in Q2 to remain under pressure, against a year ago period when we successfully executed our Coffee Recovery program and rebuilt partner and retailer inventories after supply disruptions.

Inflation remains a headwind in U.S. Coffee, where segment operating margins contracted 130 basis points in the quarter and segment operating income declined 5.3%. We expect an improvement in the relationship between inflation, pricing and productivity in the back half, which provides good visibility to a strong margin recovery in the segment, leading to a year-over-year improvement in gross margin in 2023. In particular, we are refocusing on productivity in 2023 after much of 2022 was focused on prioritizing customer service.

I want to revert for a minute to Q1 performance as it would have been reported for the former Coffee Systems segment. Constant currency revenue for Coffee Systems grew 1% in Q1, with faster growth in Canada relative to the U.S. Following the segment realignment and reflecting softer-than-expected brewer volume, we now expect U.S. Coffee revenue to grow approximately 1% in 2023, with segment operating income growth of 3 to 4%. This incorporates plans for ongoing marketing reinvestment and the expected back-half margin expansion. Our consolidated outlook for KDP in 2023 – which I will address in more detail shortly – remains unchanged.

Our International segment performance in Q1 was strong and well-balanced. Net sales increased 16.7%, with net price realization contributing 9 points of growth and volume/mix up 7.7% year-over-year. Growth was broad-based and led by LRBs and single serve pods. The combination of net price realization and productivity gains helped to offset inflationary headwinds and, together, led to strong segment operating income growth of 18%.

Turning briefly to cash flow, free cash flow in Q1 was $16 million. This declined relative to last year, reflecting the lapping of certain discrete benefits in Q1 2022 such as the Body Armor litigation settlement gain, as well as a use of net working capital this quarter. For the full year, we expect the rate of free cash flow conversion to approach our long-term target.

This brings us to our consolidated outlook. With Q1 results largely as expected, we continue to expect constant currency net sales to increase 5% in 2023 and adjusted EPS to grow 6-7%. We continue to project currency translation to be a 50 basis point headwind to both top and bottom lines. As Bob said, underlying EPS growth is expected to be closer to 9% -- at the top-end of our high-single-digit long-term algorithm. This basis removes the noise from year-over-year differences in non-operational items, which we still expect to roughly halve relative to 2022 levels.

Despite the recent news headlines about CPI and PPI easing, we continue to see significant cost inflation. Headwinds across realized raw material costs, transportation and labor are sticky and persistent and we still expect mid-single digit inflation in 2023. We are highly focused on offsetting these pressures through a combination of pricing, revenue growth management and productivity initiatives, and we expect the gap versus inflation to reverse as the year progresses.

Our full year guidance for below the line items remains unchanged. We expect:

- Interest expense in a $465-470 million range, which still includes $45 million related to the Nutrabolt investment;
- Equity method earnings from Nutrabolt of approximately $40-45 million;
- An effective tax rate of 22% for the year; and,
- Approximately 1.42 billion diluted weighted average shares outstanding.

As it relates to Q2, EPS is expected to grow in the low- to mid-single digit range. We still expect to have a gap between inflation and pricing and productivity in the quarter, with a more beneficial relationship expected to materialize in the back half. Marketing is also expected to increase in Q2, reflecting incremental investments across both LRBs and Coffee, particularly behind the ICED platform in U.S. Coffee that Bob highlighted earlier.

To wrap up, our overall Q1 performance tracked largely in line with our expectations and we remain confident in our ability to navigate the balance of 2023, which promises to remain dynamic.

- Our recast segments better illuminate the scale of our businesses, with distinct and clearly defined growth pillars in place for each segment.
- Our brand portfolio, renovation and innovation activity, and in-market execution remain very strong.
- We are working diligently to offset inflation and to drive margin improvement later in the year while reinvesting in our brands.
- And, finally, our capital allocation priorities are clear as we look to deploy our strong cash flow against the highest ROI opportunities.

I will now turn the call back to Bob for closing comments.

Bob Gamgort
Thanks, Sudhanshu.

Before moving to Q&A, I want to take a moment to thank Maria, who is retiring in July, after a distinguished 40-plus year career. She will remain with KDP as an Advisor through year-end. I know that most of you hold Maria in the highest regard, just as we do at KDP, where she has been a valued member of the Executive Leadership Team for the last five years. Maria and I have worked together for over a decade, spanning two companies and countless deals, including an IPO. She has built a very strong Corporate Affairs team for KDP, and we are pleased that she will stay on as an Advisor to support the transition to her successor upon hire. We will all miss working with Maria and wish her the very best in this next – and well-earned – chapter.

I'll now turn the call over to the operator for questions.

QUESTIONS AND ANSWERS

Operator
We will now begin the question-and-answer session. To ask a question, you may press star then one on your touchstone phone. If you're using a speakerphone, please pick up your handset before

pressing the keys. To withdraw your question, please press star then two. And in the interest of time, please limit yourself to one question. At this time, we'll pause momentarily to assemble our roster.

Our first question comes from Andrea Teixeira from JPMorgan.

Andrea Teixeira
Thank you, everyone, and good morning. So I wanted to go back, Bob, you spoke about the brewer shipments and I understand the volatility that allowed you to change the reporting ways and merging the two. I was just wondering, embedded in your commentary as well, you spoke about second quarter still being challenging and all the mobility aspects of the category. So if you can talk about a little bit of what are you seeing as we exit the quarter and as you lap the Omicron or pandemic benefits for the in-house or at-home consumption?

And then at the same time, I understand you don't disclose what is out-of-home, but there is some out-of-home component of the pod, so how should we be thinking about that as well as pantry destocking or retail destocking? Thank you.

Robert Gamgort
Yes. Okay, Andrea. Thanks for your questions. It's really three components, particularly on brewers. I'll talk about mobility-related to pods and then I'll add in the last point about what is the away-from-home business impact on our pods business.

So first of all, on brewers, I always need to go back and say what we said essentially every quarter is, we don't see brewer sales as a good predictor of household penetration, and our primary focus is driving household penetration. And just so we're clear, we said that in quarters where brewers were plus 60% or plus 35%; we felt the same way.

There is an inherent volatility in selling small appliances that is fundamentally different than selling consumables. And that's why looking at it on a quarter-by-quarter basis makes that metric even less helpful. And if you look at this quarter in particular, you're seeing a lot of disruption in retail. I'm thinking about one of our original retailers for the Keurig business that actually went bankrupt. So there's movement in inventory, there's movement across retail channels on the brewer side, so it's particularly volatile.

Having said that, we don't believe it impacts household penetration. Just for perspective, we sell about ten million brewers per year, and we add two million households. So there's a significant difference there that is representative of upgrades or replacement, and that's the piece that I think people always forget.

The reason that we're talking about brewers on a trailing 12-month basis is because that at least takes some of the noise out of it and gives an accurate picture. But, of course, we didn't change the metric. We're just talking about that, and we're still reporting the quarterly metric as well, so we'll give you both.

With regard to mobility, that has been the single biggest driver of at-home coffee consumption. And as we talked about on the last call and still true today, we're seeing the exact same trend globally. As it stands right now, mobility, the run rate, if you want to think about it that way, on mobility is pretty steady. And what's happening now is we begin to lap year-ago numbers that also are more normal. That will happen in the back half of the year and we've been saying that for a while. Everything seems to be on track for that. And other people around the globe who are in the coffee business are seeing the same kind of trends and saying the same thing. So I think there's a common view of what's happened with the consumer.

The biggest driver of consumption of coffee at home is time spent at home. It's that simple. And so that's what we're seeing happening right now. And with regard to away from home, when you see the total pod number, as you point out, it's a combination of at-home and away-from-home. And a lot of people do that calculation for attachment rate and they divide the total pod number divided by the number of brewers, that embeds the away-from-home number, which is really nothing to do with an attachment rate.

That away-from-home business, which was down, almost gone, in the early days of COVID, has rebounded, but we think it is clearly lower than pre-COVID and we think that's the way it's going to stay for a while. So I don't think there's good news to come on the away from home. I also don't think there's bad news to come. I think it's pretty stable right now, but it has been a significant drag on the business over the past couple of years. But if you were to calculate that and its impact on the attachment rate I described, it would give the impression that attachment rate is down just simply because away-from-home in total is smaller than it once was.

Operator
The next question comes from Bryan Spillane from Bank of America.

Bryan Spillane
Thanks, operator and good morning, everybody. Maria, congratulations. It's been a pleasure working with you. You'll definitely be missed.

Maria Sceppaguercio
That's so nice, Bryan. Look forward to seeing you soon.

Bryan Spillane
Okay. I guess you stayed for more than just a cup of coffee.

Robert Gamgort
We were waiting for that.

Bryan Spillane
You teed it up. So actually, my question is for Sudhanshu and just around your comments around cash flow. Working capital was a pretty negative swing in the first quarter. And I think, if you can clarify for this, that this is partly just reducing the size of your factoring program? So A), if you can confirm that.

And then the second is just how you get to approaching 100% free cash flow conversion because you're starting from a pretty big hole in the first quarter? So if you can kind of clarify how close you think you get to the long-term target? And again, just how that evolves over the course of the year, given the impact on cash from operations in the first quarter?

Sudhanshu Priyadarshi
So hi, Bryan, it's a great question. So you see Q1 operating cash flow is down versus a year ago, but last year, we had a lot of one-off items. So it's lower, mainly driven by those things, but also there is some timing of supply chain financing, we call it factoring. And this program was great in the beginning when the interest rate was low, but we have a lot of options of our cash. You saw our leverage target is 2.0x - 2.5x. So we make the right optimal financial decision, whether it's interest rate, factoring also takes care of some interest rate is impact our P&L. So we're making a lot of those decisions. Those are dynamic. But from where I sit today, I still expect that we should be pretty close to our long-term target

of cash conversion. I don't see an issue here right now, but we will be making these dynamic trade-off decisions every month, every quarter, and we will update you more if we see something different.

Operator
The next question comes from Lauren Lieberman from Barclays. Please go ahead.

Lauren Lieberman
Great, thanks. Good morning. Very much appreciate the conversation on trying to effectively smooth out the conversation on brewer sales in particular and also on pods across multiple quarters. But I was wondering why the comparison is being made to trailing 12 months ending the March quarter of '19 because that's basically comparing to 2018. I wouldn't think that with the pandemic starting as it did that there was any big real acceleration in shipments. There may have been takeaway at retail, but shipments wouldn't have changed very much in those last weeks of March 2020. So why compare it to effectively 2018 rather than to 2019?

Sudhanshu Priyadarshi
Lauren, this is Sudhanshu. The reason we did it to give you a more clear picture. In Q1 2020, you'll see that China started having to locked down and then we saw the late March, there was some retail. So it was more to give you the visibility, that's the reason we did it. It's more because Q1 2020 had more noise, so we just wanted to have a pre-COVID number. But we'll continue to give you a trailing 12 months' decline. As you can see, this time, we declined 9.8%. So you will always have this metric, but that's the reason because Q1 2020 had some noise, so we just wanted to be more clear.

Robert Gamgort
Yes. And just to build on that one, one of the points is if you take a look at how we're expecting sales for brewers to play out in 2023, it's going to be up nicely versus 2019 or you could pick a date prior to 2019, all of which were years in which we added 2 million or more households. So one of the points we're trying to make on this is there were a number of upgrades and replacements that were accelerated during the pandemic cycle. You had people spending more time at home, people were spending money on their home and also there was government subsidies as well.

But in the end, we sell brewers as part of household penetration. Actually, household penetration is what drives brewer sales primarily. And if you go back and you compare it to '19, '18, '17, the 2023 numbers, no matter how you look at it, are going to be up nicely versus that and we added 2 million households in all of those years. And that's the point we're trying to make.

Operator
The next question comes from Chris Carey from Wells Fargo. Please go ahead.

Christopher Carey
Hi, good morning. Can you just comment on the coffee margin in the quarter? Just given the volume decline I actually think it came in a little bit better. What are some of the drivers? What are you seeing from commodity inflation? What are you seeing from transportation? What are you seeing from volume deleverage in the quarter? And then also, what are you seeing from a productivity standpoint? This is a key kind of debate for investors. And again, I just want to understand some of the components that came in, in Q1 and maybe helping build confidence on what you expect for the full year, including the back half recovery. Thanks.

Sudhanshu Priyadarshi
So Chris, there are three things that impacted Q1. One was there's a narrowed gap between pricing and inflation. There was mix between pod and also the brewer sales. If you see brewer declined 29%, it

helps the margin and productivity benefit was there too, but that will ramp up more towards the second half.

If you look at our U.S. Coffee guidance, we said roughly 1% top line growth and 3% to 4% profit growth. So you're seeing leverage will come more. It will be more second half, but we believe that the margin improvement driven by relationship improving between inflation and pricing, productivity and mix will help us deliver the full year number. So Q1, all those things impacted, but you will see this benefit more in the second half.

Operator
The next question comes from Steve Powers from Deutsche Bank. Please go ahead.

Steve Powers
Great. Good morning, thank you. So on the resegmentation, I definitely appreciate the simplicity of it. And I think over time, it will become shorthand for all of us. And I think the incremental disclosures you have been speaking to on Coffee Systems pods versus brewers will help. As I'm thinking about it, my question is really on the refreshment beverages side because just the economic differences, both revenue mix implications and margin mix implications of the former beverage concentrates versus packaged beverages business, I think there's a big spread there.

So as you're talking about that business going forward, we're thinking about forecasting that business going forward, how should we think about that? What information may be in the Qs and Ks going forward that will help us tease out those potential mix implications? I'm just trying to think through that.

And also on refreshment beverages because I don't know if you're going to give this or not, but just the Nutrabolt contribution to growth in the quarter and expected over the year just so we can frame sort of the underlying versus the all-in revenue growth? Thank you.

Sudhanshu Priyadarshi
So Steve, this is Sudhanshu. The reason we did this resegmentation, we didn't do it since we merged. When we merged, we were running the business the same way. But internally, this is our second chapter of KDP growth and we run the business, U.S. Refreshment beverages, U.S. Coffee and International, so that's the reason we're required to report results to you the way we run the business.

We also feel that U.S. Coffee, people will get a lot more visibility because we talk about two million households, people look at IRI and channel data. So it will help more clarification and people can relate to what internal numbers and external numbers are.

Regarding refreshment beverages, you have the 3-year margin and sales. So you can see from there that we will continue to disclose the key drivers of that performance, but that's the way we run the business. It's U.S.-focused. We're also taking noise from Forex before it was Canada and U.S. combined. So a lot of those things will help you simplify it, and we will aid you if you have any questions on building your model.

Nutrabolt this quarter was minimum but it did help us. But for the year, as we say, depending on the interest rate we pay, interest cost and also the equity pickup it will take, it's marginal. It will see more improvement or accretion to our EPS in 2024.

Operator
The next question comes from Brett Cooper from Consumer Edge Research. Please go ahead.

Brett Cooper
Good morning. Congrats to Maria as well. A question for you on distribution system. There's been a lot of change in the marketplace. And I think you're in a unique position given that your non-distributed volume goes through Coke or Pepsi route to market. And given that perspective, I was hoping you could offer your thoughts on the potential for distribution relationships and partnerships as a means to enhance scale capabilities and economics and then obviously, ultimately, brand performance in the years to come.

Robert Gamgort
Yes. Brett, just to clarify for everyone, a portion of our Dr Pepper volume goes through Coke and Pepsi as well as our own trucks, and then some other brands like Schweppes and Crush. Outside of those brands, everything goes through our distribution system, and we cover about 75% of the U.S. population. And then the rest of that is covered by a network of independent operators, most of whom we've had long-term relationships with.

And so we have always stated that we want to be a catalyst for consolidation on the distribution side of the business. We think it is what retailers are going to want over time. We believe it's highly cost efficient. We also think from an environmental impact, taking miles off the road is a smart thing to do. Our way of doing that has been to consolidate overlapping territories where our company-owned routes match up against independent operators. And we've done about 25 transactions over the past couple of years to make that happen.

We think that consolidation will continue over time. We think that there are all the macro drivers that we just talked about, and we stand ready and are driving our role as a catalyst to continue to make that happen. So, a lot more to come there.

Operator
Our next question comes from Kevin Grundy from Jefferies. Please go ahead.

Kevin Grundy
Great. Good morning, everyone. I want to extend my congratulations to Maria as well. I want to come back to Nutrabolt, and the C4 brand, Bob, you sounded pretty bullish, both near term and long term. A few questions related to that. Just one, maybe comment on how quickly you think you can ramp that brand from a distribution perspective. Some color on the spring shelf space resets and where you think that brand is possibly gaining share?

And then Sudhanshu, to follow up on Steve's question, I think there would be some interest in the revenue contribution. I think the guidance for equity earnings is helpful, but the revenue contribution on the distribution agreement that would have gone through the old PB segment, is that something you're willing to provide with respect both to the quarter and to the full year in terms of what's embedded in your outlook? Thanks for all of that. I appreciate it.

Robert Gamgort
Sure. Early days on C4, we're in the mode of transitioning from their current distribution system into ours. I can tell you that that's gone very smoothly so far. And if you look at the syndicated data, you can see that the points of distribution are on the rise, which is really what our initial objective is. And it's more than just the quantitative increase in distribution. It's also the qualitative increase in terms of quality of placements, distribution -- on merchandising and placements. So all of that is very much going on track. And the good news is you'll be able to track our progress on both the distribution gain and you'll be able to monitor velocities through syndicated data. So you'll be able to track our progress.

You want to talk about the growth contribution?

Sudhanshu Priyadarshi
Yes, Kevin. So C4 contributed to volume in U.S. Refreshment beverages in Q1 and which we expect to continue for the full year. But similar to other distribution partnerships, we are not quantifying the top line contribution. As Bob said, we will call this out as a driver and you can track our performance in the scanner data.

It is very small, if you look at our $8 billion U.S. Refreshment beverages, it's very small. But we'll call that out as a driver for you. And then once it becomes big enough to really meaningfully impact our revenue and profit, we will start thinking on how do we disclose it.

Operator
Our next question comes from Bonnie Herzog from Goldman Sachs. Please go ahead.

Bonnie Herzog
Thank you. Good morning, everyone. I just had a couple of questions on your U.S. Coffee segment. Bob, I understand your point about brewer volumes versus household penetration, but I'm trying to understand your expectations for brewer volumes this year, especially that's a pretty big driver of your top line as well as impacts on margins since they're just slightly profitable.

So how should we think about brewer volumes for the year, especially given how elevated your inventory levels still are? Is it fair to assume your volumes will likely now be down more than you originally thought? And then if so, is that also a key driver of why you're expecting margin expansion in the second half? Any color there would be appreciated.

Robert Gamgort
Sure. Sure. On our last call, we set the expectation number for 2023, that brewers would be down modestly. When you take a look at it on a trailing 12-month basis, you see those kind of trends that we described here, down 9.8%. This quarter, as we said in the prepared remarks, was softer than expected, and I don't take a look at any one of these quarters and project it as a long-term trend. And there's a lot of volatility in this quarter compared to a normal quarter of brewers, which has volatility. And part of that, as we talked about, is retail disruption with regard to some of the specialty retailers being really challenging and one of them going bankrupt.

Having said that, other retailers will pick up the consumer slack and the consumer demand, and we will certainly be there in all those retailers. We have distribution everywhere. And a lot of this is moving online where we are very, very strong. And so as I said before, just like in quarters, we're plus 60%, we said don't project this quarter out anywhere that's the inherent volatility, I'm saying the same thing about this quarter.

With regard to inventory, it's not an issue from our standpoint. We manage that very, very well, so it's not a negative.

And with regard to second half margins, expected reduction of brewers is not a driver of our margin assumption in the back half of the year, that's not built into any of our assumptions.

Operator
The next question comes from Peter Grom from UBS. Please go ahead.

Peter Grom
Thanks, operator, and good morning, everyone. And Maria, congrats as well.

Maybe just two questions on coffee, maybe one just housekeeping. Bob, you mentioned Bed Bath & Beyond, how impactful is that to the business? I'm assuming it's embedded in the outlook, but just wanted to understand if there's something we need to think through as we model the growth from here.

And then I just wanted to follow up on Chris' earlier question around operating margin in coffee, but more from a long-term recovery perspective. I understand you expect improvement in the back half of the year, but how would you frame the long-term opportunity? And maybe more specifically, how quickly can you get back to operating margin in the mid- to high 30% range? Thanks.

Robert Gamgort
The disruption from any particular retailer is not a major factor over the long term. The consumer demand remains. They just shift their demand to other retailers. And I said before, we have great relationships and great availability across the board, including e-commerce.

We always try to work with retailers even when they're challenged. And so in a given quarter, it causes some disruption based on shipments versus a year ago, etc. But like I said, it has no impact on household penetration nor does it have any impact on the long-term outlook that we have or even the annual outlook that we have.

With regard to margins, Sudhanshu gave you the reasons why margin was on the right trajectory. If you continue to look forward, I'll give you a couple of factors, one is the narrowing of pricing versus inflation as we talked about on our contracts with our partners. We have long-term contracts. We said a number of times that there is a lag in being able to secure the pricing versus inflation. So as time goes forward, we're able to do that.

And the other part that we talked about is productivity. Productivity, a year ago when we were in a supply chain rebuild mode, was a very, very low focus for us. In fact, there's no focus. We were just trying to get supply out there to rebuild inventories. Now that we're way ahead of the game from a manufacturing standpoint, it allows us to focus on productivity.

And then, of course, we talked about big structural productivity projects like Spartanburg, and we said that we view that, it has been a delay, which has been challenging in the past 12 months and currently. But as you look forward, think of that one as deferred productivity still to come. So again, this is all about the narrowing of our cost structure, which is inflation minus productivity versus pricing and they continue to get more favorable as we move forward.

Operator
Our last question comes from Rob Ottenstein from Evercore. Please go ahead.

Robert Ottenstein
Great. Thank you very much. First, just a point of clarification, then my real question. The clarification is, I just want to make sure I heard it right, that the pod sales in the second quarter will be affected by Omicron last year? And please remind me on the guidance on that. And then the main question is, wondering if you could give us an update on your digital initiatives and e-commerce? Thank you.

Robert Gamgort
Sure. Just to clarify on the pod conversation, the primary driver of pod volume is the mobility and it's, as I said before, time spent at home is the biggest driver of coffee consumed at home. No big surprise there, but it's a very direct relationship there.

The run rate that we're seeing on mobility is relatively stable over the past couple of months, and we continue to expect that going forward. It's the lap versus year ago that becomes more neutral/favorable as you get to the second half of the year. And that's why we're saying in the second half of the year for all forms of at-home coffee would look better on a volume perspective.

The unique element in your comparison to Q2, in addition to the mobility comparison, is we were rebuilding inventory after the late, it was Q4, Q1 supply chain issue. And so we out shipped ourselves in the second quarter of last year and we were really clear when that happened and that was the rebuild of inventory. So that's why when we talk about Q2 being more challenged on a comparison basis, it's the combination of still the rebound in the mobility versus a year ago with this unique situation in Q2, which is the inventory build.

With regard to digital, we don't have a lot of time to talk about that right now. I think it's a conversation for another day. We have initiatives across the board in terms of the way that we plan to run the business as well as the way that we identify and optimize our consumer marketing.

With regard to direct-to-consumer, we've talked before that we believe we are one of, if not the leader, certainly in the food and beverage world in terms of direct consumer sales. And the technology that we continue to build on the Keurig side of the business, which is the connected brewers with the ability to understand consumption on a real-time basis, translating that into a smart auto reorder program is very exciting as we continue to move forward and build the number of households that have a smart brewer. So a lot more conversation on that point to come. I can't really do it justice in this period of time, but appreciate the question.

CONCLUSION

Operator
This concludes our question-and-answer session. I would like to turn the conference back over to Jane Gelfand for any closing remarks.

Jane Gelfand
Thank you, Jason, and thank you, everyone, for joining us on a busy morning. The IR team is available to answer any questions you may have. So please do reach out. Thank you again.

Operator
The conference has now concluded. Thank you for attending today's presentation. You may now disconnect.