KEURIG DR. PEPPER INC.

Moderator: Robert Gamgort
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Operator: Good morning, ladies and gentlemen, and thank you for standing by. Welcome to Keurig Dr Pepper's Earnings Call for the Second Quarter of 2020. 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 Keurig Dr Pepper's Chief Corporate Affairs Officer, Ms. Maria Sceppaguercio. Ms. Sceppaguercio, please go ahead.

Maria Sceppaguercio: Thank you, and good morning, everyone. Thanks for joining us. Here with me today to discuss our second quarter 2020 results are KDP Chairman and CEO, Bob Gamgort; our CFO, Ozan Dokmecioglu; and Senior Director of Investor Relations, Steve Alexander. Steve is sitting in today for Tyson Seely, our Vice President of Investor Relations, who is home on baby duty as he and his wife just welcomed their second daughter into the family earlier this week. Our best wishes go out to all of them.

I will now hand it over to Steve to cover a few comments.

Steve Alexander: Thanks, Maria, and hello, everyone. Earlier this morning, we issued 2 press releases. The first announced that we have entered into a long-term franchise agreement with Polar Seltzer and the second was our Q2 press release. If you need a copy of either release, you can get one on our website at keurigdrpepper.com in the Investors section.

Consistent with previous quarters, today, we will be discussing our performance on an adjusted basis, excluding 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 is 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 included 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.

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 on 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.

Robert Gamgort: Thanks, Steve, and good morning, everyone. Let me start by expressing my sincere hope that everyone dialed in continues to be safe and healthy and that your families are well. At KDP, we have worked extraordinarily hard since the onset of the COVID-19 crisis to protect the health and safety of our employees, particularly those frontline employees and our supply chain and out in the trade, who play in a central role in ensuring our products are available for our consumers, customers and communities that rely on them.

The results we reported this morning are a testament to the dedication and commitment of our team. And I can't thank KDP employees enough for all that they are doing day in and day out.

As you know, the environment in which we are operating continues to be extremely volatile, with COVID cases spiking again, forcing some regions

into a second phase of shutdowns, all of which impacts consumer mobility and beverage consumption behavior. KDP was performing exceptionally well before the crisis. We have delivered well for all stakeholders during the crisis, as evidenced by the results we're discussing today, and we fully expect to emerge as an even stronger company when we get to the other side. Until there is a widely available vaccine or treatment, we believe the macro environment will be bumpy and uncertain, requiring us to continue to be focused, flexible and responsive.

2 years ago this month, we completed the merger that created Keurig Dr Pepper, which, at that time, we described as the new challenger in the beverage industry. With the integration complete, we believe we have created a modern beverage company with a broad-reaching portfolio of hot and cold beverages, delivered by a diversified route-to-market network that provides unmatched reach and efficiency and with highly unique ecosystems in our coffee business and DSD network that leverage partnerships and technology to create value.

Equally important, we have built a culture that emphasizes excellence in execution and delivery. The COVID crisis is by no means a windfall for KDP. We have been required to focus resources on the areas of our business that are aligned with changing consumer trends such as at-home coffee, multipack cold beverages, large-format retail and e-commerce, to offset significant weakness in away-from-home coffee, on-premise beverage consumption and convenience stores. The impact of these mix changes on margin are significant, which has required us to deliver volume and revenue growth while tightly controlling the cost side of our P&L and still investing in our future. Our executional capabilities have certainly been tested by the crisis, and we're proud of how we've performed to date.

In the 2 years since the merger, we have exceeded our merger commitments for net sales growth of 2 percent to 3 percent and adjusted diluted EPS growth of 15 percent to 17 percent. In fact, in the 8 quarters since our merger closed, adjusted diluted EPS has grown at an average annual rate of 20 percent. In the second quarter, which we believe will be the most challenging environment we face this year, constant currency net sales advanced nearly 3 percent.

Constant currency adjusted operating income grew 11 percent and adjusted diluted EPS was up 10 percent. Further, we have reduced or management leverage ratio to 4x as compared to the 6x ratio at the time of the merger. Ozan will take you through a more detailed review of our financial results by segment in a few minutes.

To bring the concept of a modern beverage company to life, let me use several performance highlights from the latest quarter. The strength of our differentiated portfolio is unprecedented. We were the first company to combine hot and cold beverages at scale, including leading positions in single-serve coffee, flavored CSDs, premium water, juices and mixers.

Our cold portfolio was very strong in the quarter, as we gained market share of total liquid refreshment beverages, with gains in the majority of the category segments in which we compete. Specifically in CSDs, we gained 1.2 share points and moved to the number 2 CSD player in a number of key grocery customers, driven by broad-based core brand strength, strong end-market execution and innovation, such as Dr Pepper & Cream Soda and Canada Dry Bold. In fact, Dr Pepper & Cream Soda is the best-performing innovation in the CSD category so far this year. The Dr Pepper brand has now delivered 17 consecutive quarters of growth at retail, while Canada Dry has done the same for 13 consecutive years.

What's important for our longer-term outlook, however, is the fact that our share expansion of CSDs has been heavily driven by a double-digit increase in new households purchasing many of our brands. We are confident that we will be able to retain a portion of these new households once we emerge from this crisis.

In the hot portfolio, we have a commanding leadership position of single-serve coffee with a combination of owned, licensed and partner brands. And the Keurig brand is ranked by consumers as one of the most relevant brands in the country, not just in CPG, but among all brands.

In the second quarter, our Coffee Systems segment grew pod volume 9.5 percent and brewer volume 11.6 percent. And that's on top of 19 percent

growth in the year ago period, primarily reflecting new households entering the system. These results reflect significant growth in coffee consumption at home, partially offset by the away-from-home channel, particularly our large office coffee business and, to a lesser extent, our hospitality business, which were down significantly in the quarter.

Our share of K-Cup pods manufactured by KDP held steady at 82 percent and retail pricing for the category increased by 2 percent as promotional activity lessened and mix shifted towards premium brands. Further, share trends for our portfolio of owned and licensed brands also improved.

We've previously discussed our 7 distinct routes to market at some length. And today, I think it's relevant to highlight DSD and e-commerce, using examples of their contributions in the second quarter to also illustrate our long-term strategy.

Our DSD network has served us very well during this crisis by enabling the highest levels of flexibility, speed and delivery. We have been able to pivot on a granular basis at both the product SKU and local marketplace level to react to changes in demand, using near real-time data that's simply not available in other distribution systems. We see opportunity to continue to invest to improve our DSD system and look forward to sharing more with you on this topic in the future.

As you've seen across many categories, e-commerce has been the real star this year. The COVID crisis has accelerated consumer adoption of e-commerce for food and beverage, and we see no evidence of this trend slowing when the crisis abates. If you recall at the time of the merger, we emphasized Keurig's first-mover advantage in this space, dating back to the launch of keurig.com 16 years ago and how we plan to leverage that competency across our full portfolio. Today, we believe we are the leader in e-commerce in food and beverage, if not FMCG. E-commerce now represents more than 10 percent of KDP total retail sales, and it continues to expand rapidly. While our online business is weighted towards brewers and K-Cup pods, we also have a strong presence on the cold side, especially with Bai, CORE, Mott's and Dr Pepper.

Upfront, I mentioned the concept of ecosystems in our DSD and coffee business. Let me explain that important concept further, demonstrate its power in the most recent quarter and for the future and announce several exciting developments.

Our DSD networks, which gives us national reach and the ability to be in retail on a daily basis, is an attractive asset to start-up or expanding beverage companies. While we have stated that we have no interest in renting out our system as a distributor, we're willing to partner with beverage brands that fill white space in our portfolio through a range of structures. Recent examples include our long-term partnership with Danone for the evian brand, our investment with a path to ownership in A Shoc Smart Energy and our licensing agreement with Peet's Coffee for ready-to-drink beverages.

This morning, we announced a long-term franchise agreement with Polar beverages for their Polar Seltzer brand. Polar Seltzer is the third-largest branded flavored sparkling water in the U.S. despite being available in less than 35 percent of the country. The brand is also the highest-velocity sparkling water where distributed. We currently have a long-standing and successful franchise agreement with Polar beverages to distribute key KDP brands throughout their network in New England, and we are excited to announce a similar arrangement for their flagship brand to be in our system in expanded geographies. We look forward to rapidly scaling Polar to national distribution.

We've also made a seed investment with a path to ownership in (Don't Quit), a clean label meal replacement protein drink line created by Jake Steinfeld of Body by Jake. You'll hear more about this partnership and Don't Quit as the brand launches in a couple of weeks.

Our coffee ecosystem is built on innovation, technology and partnership. While common in the technology space, this structure doesn't exist anywhere else in CPG. That means when a consumer makes the conversion from brewing coffee by the pot to coffee by the cup, our branded partners, our retail partners and we, all benefit, which puts us all on the same page with regard to ensuring the Keurig ecosystem remains healthy and growing.

In March, we were scheduled to unveil our Keurig innovation pipeline and latest growth strategy during an investor meeting in Texas. While COVID required that meeting to be canceled and the conversation since then have been dominated by the crisis, we have maintained internal focus on progressing our pipeline for launches in the third and fourth quarters and strengthening the Keurig ecosystem to the benefit of all stakeholders.

Our lineup of K-Duo brewers launched in late 2019 performed exceptionally well in the quarter. And our case K-Slim brewer introduced earlier this year is off to a good start. In August, we are launching the (K-Supreme) and (K-Supreme Plus), filling out our product range at the mid to higher end of our portfolio. These new brewers priced from $139 to $189 feature our new industrial design and most importantly, are the first of our next generation of brewers to include multi-stream technology, which increases coffee extraction by using a new 5-pronged needle system to deliver a more favorable and aromatic cup. These brewers also offer greater consumer control over strength and temperature. We intend to cascade this technology to more of our brewer lineup over time.

Additionally, in the third quarter, we are introducing a limited edition K-Mini brewer created by the renowned home furnishings designer, Jonathan Adler. This brewer represents the first step into a new platform for Keurig with limited edition and/or custom-designed brewers, targeting consumers who are attracted by kitchen style and aesthetics. Look for more to come on this topic in the near future.

Retailer interest for these new brewers and across the entire Keurig brewer lineup for the upcoming holiday season is strong and follows a very successful Mother's Day, which experienced a noticeable e-commerce retail shift.

In our last earnings call, we discussed how we were using real time points-of-consumption data through our Keurig connected panel of 10,000 households to guide our decisions during the crisis. Harnessing what is one-of-a-kind technology in CPG, we've been able to navigate the volatility caused by

COVID, making near real-time decisions to drive strong in-market execution. We also make connected panel data available to all Keurig partners.

Today, I'm pleased to report that our first smart brewer will be available for sale to consumers on keurig.com between now and our next earnings call.

The K-Custom Smart will deliver our most personalized, flavorful coffee experience ever, powered by our smartest technology. This brewer represents the next step toward having connected and intelligent brewers across our line. The K-Custom Smart is compatible with existing K-Cup pods and has the capability to recognize the specific brand, variety and roast for any owned, licensed or partner brand made by Keurig and brewed to the specification of its master roaster to bring out the fullest flavor. The K-Custom Smart can be controlled from a smartphone, set to turn on with your morning alarm and brew your favorite cup of coffee from bed. It can also be customized to consumers' favorite temperature and brew preferences and can automatically reorder pods, having tracked how many the consumer has brewed since their last order. More specifics will be available in the press release at the time of its official launch.

Finally, earlier this month, we began selling McCafe as a Keurig-licensed brand in the U.S. across K-Cup pods, bags and canisters, further emphasizing our ability to create win-win partnerships across the portfolio. We look forward to working with McDonald's to drive growth for the brand in the U.S. as we've done in our partnership with McCafe in Canada, which began earlier this year.

Before I turn it over to Ozan, I want to mention 3 important points regarding sustainability. Again, while most of our conversation over the past 4 months is focused on the COVID crisis, we've also continued our progress toward delivering our sustainability commitments. First, we are fully on track to convert 100 percent of our K-Cup pods to be recyclable by year-end. As of today, approximately 95 percent of the K-Cup pods being produced are recyclable.

Second, in the next quarter, we are targeting to introduce our first PET bottles made with 100 percent postconsumer resin. As you'll recall, we are committed to using 30 percent postconsumer recycled material by the end of 2025. And this is an important first step towards realizing that goal.

We also recently announced our founding sponsorship and position as the largest funder of the Recycling Partnership's Polypropylene Coalition. This industry collaboration is designed to increase and improve the recovery and recycling of polypropylene, the plastic used in K-Cup pods and many other food and consumer products. We have already begun using postconsumer resin in the production of our Keurig brewers.

Finally, we have received the good news that our Spartanburg, South Carolina production facility for K-Cup pods will be LEED-certified, making it the largest LEED-certified production facility in North America and the second-largest LEED facility of any kind.

With that, let me hand it over to Ozan.

Ozan Dokmecioglu: Thanks, Bob, and good morning, everyone. I will briefly review our performance for the second quarter, which our press release provides in significant detail. The second quarter was another good one for us. On a constant currency basis, net sales increased 2.9 percent, with growth in 3 of our 4 segments. Packaged Beverages and Coffee Systems were particularly strong in the quarter.

On a constant currency basis, adjusted operating income increased 11.1 percent in the quarter, driven by revenue growth, productivity and merger synergies as well as a significant reduction in discretionary spending. As Bob noted, we believe that we have struck the right balance of continuing to invest in areas such as innovation, technology and sustainability that provide competitive advantage, funded in part by reduced marketing, given the low return on investments in the quarter and dramatically lower travel and entertainment expenses given the limitations in travel. These drivers were partially offset by negative segment mix, inflation, higher operating costs

associated with increased consumer demand and certain costs related to COVID-19 that were not treated as items affecting comparability.

Let me pause here for a moment to discuss these COVID-19 costs. In the second quarter, pretax operating expenses directly related to COVID-19 totaled $75 million. Of these, $63 million were recognized as items affecting comparability and consisted of temporary and unusual compensation increases and incentives for frontline employees as well as incremental safety and sanitation expenses across our business. The balance of the COVID-19-related costs in the quarter, which totaled $12 million, consisted of inventory write-downs and bad debt expense and have not been treated as items affecting comparability. Therefore, they are included in our adjusted results.

Adjusted diluted EPS advanced 10 percent in the quarter, fueled by the growth in adjusted operating income and an increase in nonoperating income in the quarter. These growth drivers were partially offset by increased interest expense due to lapping the benefit of an interest rate swap in the year ago period and the higher effective tax rate due to lapping favorable discrete tax items in the year ago period.

Turning to our segment performance for the quarter. In Coffee Systems, constant currency net sales growth of 5.8 percent was driven by strong volume/mix growth of 8.3 percent, partially offset by lower net pricing of 2.5 percent. The volume/mix performance reflected higher purchases of K-Cup pods and brewers for at-home consumption, partially offset by a significant drop-off in the office coffee and hospitality businesses. Constant currency adjusted operating income increased 10 percent in the quarter to $363 million.

In Packaged Beverages, constant currency net sales grew 6.3 percent due to strong volume/mix growth of 6.6 percent, partially offset by modestly lower net pricing of 0.3 percent. This performance reflected increased at-home consumption and market share growth due to strong in-market execution, enabled by excellent supply chain management and exceptional collaboration across our frontline teams during the crisis. This growth was partially offset by a decline in the convenience and gas channels due to limited consumer

mobility. Constant currency adjusted operating income increased 41.6 percent in the quarter to $269 million.

In Beverage Concentrates, constant currency net sales declined 16.2 percent due to a significant drop-off in the fountain foodservice business, which serves restaurants and hospitality, and lower net price realization of 4.8 percent. The lower pricing related annual adjustments to prior year customer incentives, partially offset by customary concentrate pricing that we took in January. Importantly, as the second quarter progressed, we saw improving month-over-month trends in this business, and those trends have continued into July. Constant currency adjusted operating income decreased 9.3 percent in the quarter to $222 million.

And finally, in Latin America Beverages, constant currency net sales grew 1.4 percent, reflecting the strong pricing of 6.1 percent, partially offset by lower volume mix of 4.7 percent due to limited consumer mobility in Mexico. Constant currency adjusted operating income increased 30 percent to $23 million in the quarter due to continued productivity and lower marketing expense.

While the current environment has proven the power of our brands, it has also made evident the importance of simplification. To meet heightened demand and drive efficiency during the crisis, we focused our production and delivery on the highest-priority products with great success. Through this process, we have performed a detailed review of the offerings in our system to ensure we deliver on our customers' needs while ensuring we were efficient. We will continue to focus on this as the best practice coming out of this crisis and going forward.

In terms of our ongoing productivity and merger synergies, we continue to execute on these opportunities aggressively. In the current environment, we are delaying certain planned value-capture projects due to COVID-19-related safety concerns. And in other cases, we are accelerating certain projects to offset delays. We remain committed to delivering our value-capture commitments through both productivity and merger synergies and fully expect to deliver our planned merger synergies of $600 million by the end of 2021.

Now moving to cash flow and liquidity. Free cash flow in the quarter was strong at $524 million, translating into an adjusted free cash flow conversion rate of approximately 112 percent. In the quarter, we reduced bank debt by $274 million and structural payables by $78 million, and we ended the quarter with almost $150 million of unrestricted cash on hand.

In terms of leverage, our bank debt to adjusted EBITDA ratio, which we refer to as our management leverage ratio, improved to 4x compared to 4.5x at the end of 2019. This improvement was driven by continued reductions in outstanding debt balances and continued growth in adjusted EBITDA. Since the merger closed, we have reduced our leverage ratio by 2 full turns.

Turning now to CapEx. We continue to support the business with necessary CapEx investment, but some projects will be delayed primarily due to COVID-19. For example, our new Spartanburg port production facility is delayed approximately 6 months resulting from equipment supplier delays, and our new cold beverages production facility in Allentown is also delayed about 3 months for similar reasons. We have always expected both of these facilities to primarily be contributors to our business in 2021. And these minor delays do not significantly change our expectations, which brings us to our guidance.

In terms of full year, we continue to have confidence in our ability to manage through what is likely to be a bumpy road in the second half, much as we have done to date. Our outlook for adjusted diluted EPS growth remains unchanged at 13 percent to 15 percent. This outlook reflects our expectation for constant currency net sales growth in the range of 3 percent to 4 percent; continued strong management of discretionary costs across the business while maintaining investment in innovation, technology and sustainability; expected higher marketing investment in the second half of the year relative to the second quarter, given the expectation for an environment in which consumer receptivity to marketing and marketing return on investment improves.

It's important to note that if we experience accelerating growth in our categories in the second half, we would likely increase our brand investment

to drive mid to long-term growth while still delivering our adjusted EPS guidance for 2020. We also have confidence in our deleveraging targets and continue to expect our management leverage ratio to be between 3.5x and 3.8x at the end of the year.

Operator: And at this time, if you'd like to ask a question, please press "star" followed by the number "1" on your telephone keypad. Again, that is "star" "1" for any questions. We'll pause for a moment to compile the Q&A roster.

Our first question will come from the line of Bonnie Herzog with Goldman Sachs.

Bonnie Herzog: All right. I kind of want to just ask, overall, your business has done quite well in the at-home economy that we're all experiencing right now. So just hoping you could talk a little bit more about how you expect your business will perform maybe in a more normalized environment. I guess I'm wondering if you see any risk at all in possible pullback in demand for your products, maybe as consumers return to some of their pre-COVID routines. Just really, how do you think about this? And how sticky do you expect your business to be as maybe things return to normal?

Robert Gamgort: Yes. Sure, Bonnie. It's a great question, something we think about a lot. I think we step back at 100,000 feet, and then I'll drill down deeper into your points. We look at – there are companies that fall into roughly 3 buckets. There were those that may not have been doing well prior to the pandemic and are doing really well during the pandemic because suddenly, something was off-trend became on-trend. And it would cause you to say, "What's going to happen when things turn to normal?" Which is where you're going.

There's another set of companies that were doing really well prior to and are struggling in this environment. And in that case, you kind of have to hope for a return to a future that looks a lot like the past.

We're in a very unique situation here. And I think there are very few companies in this situation. That is, we are performing very, very well prior to the crisis. So we said a number of times, we don't see this at all as a windfall for us. We've been able to perform very well since the crisis, but we've had to

work really hard to do that. And I think you'll see from the comments that we made earlier that it is quite a mix management exercise where we've had to push some areas of our business really hard. But I'll remind you, there are areas of our business that are large and profitable that have taken a significant hit in this crisis that we've had to offset. And if things were to return more to normal, we get the bounce-back on those immediately.

But we don't expect the future – we don't expect it to continue the way it is indefinitely, but we also don't think that the future is going to look exactly like the past. And so we have the tools and the levers to pull to be able to create a company that does even better in the future. And that's reflective of all of the innovation that we continue to invest in and we're continuing to launch. And we're getting great retailer receptivity on all of that as well because they're bullish about that future as well.

So we're confident in where we are, and we continue to be confident in how we will deliver till the end of the year, as we talked about in our guidance and our commentary, but we're not planning on a future that returns back to normal. If it did, it would actually be good for us. But we're planning on future that's going to look quite different, and we're navigating the company to be even stronger and stay ahead of the game.

Operator: Your next question comes from the line of Bill Chappell with SunTrust.

Bill Chappell: Just looking at the kind of the brewer household penetration. And is there any way to kind of gauge – so how much those sticks? And then I know we don't talk about attachment rate anymore, but certainly, the attachment rate is going to a new higher level. Any kind of idea of where that is and where that's a sustainable level? I mean I imagine a lot of us are dusting off our Keurig machines and using them all the time, but a certain amount people had never used them before and will start using them on a regular basis. So just kind of any sense on how the whole platform has changed over the past 3, 4 months?

Robert Gamgort: Yes. And remember, we have really good insight into this internally because we have this household panel of 10,000 homes. We can see minute-by-minute consumption. And so we've been able to track the attachment rate change

from the very beginning of the crisis. And we don't – we haven't talked about attachment rate in the past because, as we said, when you guys have tried to model that, it's really steady. So the whole game is really about household penetration. And we've also said that volume growth in the category is a good proxy for household penetration because attachment rate is even.

We're getting 2 benefits right now. We're getting new people coming into the system. And to answer your question, that sticks. And we've seen that for years now that when somebody decides to move from brewing coffee by the pot to brewing coffee by the cup. Or in the case that we have right now, people who weren't making coffee at home, making it at home now using a Keurig machine, that's incredibly sticky. The dropout rate from the system is very, very low.

The attachment rate, as we look forward, our belief is we'll capture some of that increased attachment rate going forward because people who weren't making coffee at home or were making it at a lower frequency recognize that – A, it's easy to do; that the quality has improved dramatically over the past couple of years. So for those that had a perception of quality, they're now getting a firsthand experience that the quality is better. And you heard from our innovation pipeline and that will continue to go up.

And I think the third part of it is significant cost benefit to making coffee at home. And I think a lot of people, if you look at the research that we do, but also social media and articles that are written, there are a lot of people saying, "I really like this. This is easier than I thought, and I'm saving a lot of money on top of it." So we don't model going forward that we're going to keep all of that attachment rate, but we know we'll keep some of it. But the household penetration gains, we're very confident we'll keep the great, great majority of that.

Bill Chappell: That's great. And just one follow-up on that. Have you seen any real change to – or trade down to private label or lower-priced brands as we've been in a quasi-recession? Or is it just kind of too early to tell or see?

Robert Gamgort: Yes. I'll talk about both of them. On the cold side of the business, no, we're seeing actually pricing on average up as promotions lessen, and we're seeing no move away from brands to private label. In fact, in many cases, you're seeing the larger brands benefit. And clearly, we benefited significantly from a share of total liquid refreshment beverage. And then we gained, as I said in the prepared remarks, 1.2 share points in CSD. So the brands at – our brands in particular are doing very well in this environment.

On the coffee side of the business, you're actually seeing a skew towards more premium brands in this environment. And I believe that's because as people trade-off from making – or purchasing coffee outside of the home to making it in home, they want to take their brands with them and the coffee shop brands that they can get now in our system skewed towards the premium end. So that's very bullish.

And the other point that's worth emphasizing is that the cost of pods today, in general, whether it's at the premium, mid-price or the value or entry-level price point, are all down significantly versus where they were 3, 4, 5 years ago. And that's intentional. That was part of our strategy that we talked about. We set off with the ambition of lowering the price of pods to increase household penetration and attachment rate, and that's exactly what we're seeing. So I would have thought actually that, given the – some of the financial strain, you might see some trade down, which I would emphasize we're OK with because we produce the great majority of private label as well. But we're actually seeing the reverse right now. And although I can't predict anything in the future, it makes sense to me with the change in behavior from out-of-home to in-home.

Operator: Next question comes from the line of Bryan Spillane with Bank of America.

Pete Galbo: It's actually Pete Galbo on for Bryan. Bob, I was – just wanted to dig in a little bit on Beverage Concentrate. Obviously, Bob, you kind of mentioned, it seems like you're through the worst of it or through the trough and July trends improving. But also just wanted to touch on your concentrate volumes were pretty significantly behind bottle or cases in the first half. I think it's

something like 350 basis points. Just how should we think about catch-up there in the second half of the year? And I have a follow-up as well.

Robert Gamgort: Yes. Let me start, and then Ozan, feel free to jump in at the end if you have something you want to add to this. The BC areas where you see the fountain foodservice business, that's servicing restaurants, and clearly, that's been impaired. But it's improved throughout the quarter. And so I think that the gap that you're talking about between shipments sometimes and concentrate shipments and bottle or case sales, that happens from quarter-to-quarter. So there's always a catch-up, but we are seeing great improvement in the FFS business throughout the quarter due to a rebound in restaurants.

And I'd emphasize that we're particularly strong in QSRs. And in fact, we are the – Dr Pepper brand is the number 1 most available CSD in QSRs. And so as the drive-through business seems to be improving in particular, that's very bullish for us going forward. But you're seeing in the BC segment the hit that came from restaurants shutting down, especially in the early part of the quarter. Ozan, anything to add to BC?

Ozan Dokmecioglu: No. I mean actually, you covered all the points. I mean there is always a gap and lag between our shipments to our distributors and the bottlers and their shipments to the retailers. And as Bob said, always and always within the time frame, catches up.

Pete Galbo: Got it. No, that's helpful. And maybe, Ozan, just a quick one. You detailed some of the COVID costs for 2Q. Anything we should be expecting kind of in the back half of the year that you'd call out at this point?

Ozan Dokmecioglu: Well, I mean, maybe I can use this opportunity to expand a little bit on the FX as well. And as you have heard in our prepared remarks, first of all, the costs we excluded from adjusted results are unique and temporary impacts resulting from the crisis. So they are not normal ongoing cost of business. This is consistent with our long-term standing treatment of extraordinary and onetime costs. So I mean these costs are clearly and not only defined as the significant expenses to provide temporary financial incentives to frontline employees, which represented more than 70 percent of the cost and the

balance for the extraordinary measures that we undertook to protect employee health and safety, including, obviously, enhanced benefits for them and their families.

And we also said there was a portion, approximately $12 million, of COVID-related expenses that we did not add back and we kept in our adjusted results. Therefore, first and foremost, the health and the well-being, safety of our employees come as number one. Therefore, depending on the crisis and depending on how the pandemic is going to evolve, we will adjust our programs accordingly. Having said that, we also believe quarter 2 was the highest in terms of us incurring the COVID expenses. Obviously, time is going to show us what will be the reality, but that's our expectations at this point in time.

Operator: Our next question will come from the line of Robert Ottenstein with Evercore ISI.

(Yutong Zhou): This is actually (Yutong Zhou) on for Robert. So you mentioned a new product called Don't Quit. Could you just talk about what gets you excited about that brand? How does retailer interest look? And how are you thinking about sales and profit potential?

Robert Gamgort: Yes. So we're just getting a teaser on that today, and there will be appropriate press release from them because we're investing in this business, in the next couple of weeks because it's already teed up to go for sale in August. It's going to be available on – right now, it's about 2,500 retail outlets and growing traditional retailers, as you might imagine, as well as e-commerce.

What's exciting for us, big white space in our portfolio, protein drinks, we don't want to launch a Me-Too protein drink out there. And so this one, we think, is highly unique. It's targeted to a baby boomer population, which is growing and underserved in this space. And we think that all the new entries are going for a much younger population. We saw this as very unique with a very unique person behind it who speaks to that group uniquely. The structure is unique in the marketplace, but not for us. It's very similar to the deal that we did with A Shoc, where we put a relatively modest seed investment upfront.

We help them with this business, although this business won't initially go through our DSD network, it will go through warehouse direct. And as it proves itself out, we will put it in our DSD network where it's appropriate. And it's got a prenegotiated path to ownership. So we have the option to buy it at a point in time in the future if we choose at a multiple that makes sense. And so it's the combination of all of those things that has us excited.

And as we said when we did the A Shoc deal, we would like to do more of these. We see this as, again, part of this ecosystem that we've created, where we can create these win-win structures, help entrepreneurs and start-up companies to get up and running and buy an option on them for the future and get rewarded for the help that we're able to provide to make them successful. So more to come on that.

Operator: Your next question comes from the line of Kevin Grundy with Jefferies.

Kevin Grundy: Congratulations on a – congrats on a great first half here so far. So Bob, question on M&A, which is going to become an increasingly – I think for investors, a bigger part of the story, particularly as we sort of look out to next year. Can you talk a little bit about the M&A philosophy? Maybe share some of the governors around areas of interest, fully understanding you don't want to front run anything that you're potentially looking at, looking out. We totally get that. But maybe put some governors around where the Board and where you're going to be looking.

And maybe even just comment, there's some increasing discussion about another company in the beverage space looking in non-alcohol that is looking in the hard seltzer category. Maybe you can comment on the company's openness to moving outside of non-alcohol as well. And that'll do it for me.

Robert Gamgort: Yes. We look at white space in our portfolio, and we could define white space very broadly. And again, I don't want to tip our hand in any way on that front. But just like you heard us talk about energy in the past with A Shoc, we just talked about (Don't Quit) in protein. I'm just using those examples, although they're relatively small at this point. That we're very clear as to where we have white space in our portfolio. And I think we're very creative in thinking

through how do we access that white space in a way that's a win-win, meaning we don't want to just be a distributor. We've said that multiple times.

And so when you look at the arrangement that we have with evian, which was a space that we couldn't access on our own. And then you look at the deal that we announced today on Polar, which is very significant because it's a big category, rapid growth, white space, we could try to invent it ourselves. We could try to acquire somebody in that space. But look, Polar is a family-owned business. It's a great brand, it's not for sale. And to be able to sit down with them, we've had a long and successful relationship with and come up with this win-win scenario, says that we can move forward in these spaces without having to necessarily buy something outright. And we get all the benefits from it. And then if you take a look at Polar, they get the benefits of maintaining ownership of the brand and experiencing now what will be a national brand for them.

And with regard to specifically M&A, just a couple more things that we've talked about before that I would emphasize. We are very wary of acquisitions of highly developed businesses or rapidly growing businesses that have reached threshold that are at very high multiples. We've said this before. We've studied every one of these. We cannot find one that has created value in the industry. It's happened within our own house, right? We've talked about it on Bai. It's good learning for the future. We love the brand, but the multiples don't make sense. And so we are not going to fall into that trap. And so we look at the possibility of filling our white space through the arrangements that we talked about earlier, which are seed investments, long-term partnerships, franchise agreements. We also look at M&A, but I would tell you what's off the table is going out there and making a very large acquisition on a huge multiple because those values always get written down in the future.

Operator: Your next question comes from the line of Peter Grom with JPMorgan.

Peter Grom: So just a couple of questions on net sales guidance. So first, maybe a bit more of housekeeping, but could you maybe break out what we should expect in terms of the benefit from McCafe but also Polar in the back half? And then second, I know the environment continues to evolve. But as you mentioned,

Q2 is hopefully going to be the most difficult, but – so the extent that you're willing to share kind of the underlying assumptions embedded in guidance for the back half from an operating standpoint. Do you expect a continued reopening sequentially? Is it kind of based on where we are now? Just anything around that topic would be helpful.

Robert Gamgort: Yes, yes. On – with regard to McCafe, that was announced in the beginning of the year. So that was always part of our 2020 guidance. And I would say that everything is on track there. So no new news. So that's embedded in the guidance.

Polar is something that will be up and going, but it's really a benefit towards 2021 rather than 2020. Both McCafe as well as Polar, they're investments that are required in the first 6 months to a year, so there's almost no profit impact on either of those. And again, we said that before in McCafe. So I look at those as more of a 2021 impact. And the story that comes out of that is we are managing our way through the COVID crisis really well and holding on the guidance. And we're doing that with what we have in hand, but we're continuing to invest in innovation and new partnerships. And we talked about a lot of innovation today as well as these new partnerships, which really set us up for continued growth. This is not a short-term phenomenon. This is something that we will invest in over the long term.

Your question about the back half of the year is a really important one because we're one of the few companies that have provided guidance. And we do not think for a second that we can predict the future better than anyone else. And if you look at the Fed's comments yesterday, and they have better access to the economy than we do in terms of the data, they put a lot of caution out there on the second half. So I think the important thing for you to take away from this is that we're not operating off of a single-point forecast. We tested our second half plans against a number of macro scenarios. And despite the fact that we think it's going to be bumpy and volatile, we feel like with that, that testing that we've been able to put out there that we have confidence in our ability to continue to deliver really strong revenue and EPS growth.

So it's not just a matter of holding on the guidance, I'd like to point out to people. It's guidance for 13 percent to 15 percent EPS growth and 3 percent to 4 percent revenue growth for the year in a year that is unprecedented in terms of its challenges. It's because we're working against a range and not a single point.

Operator: Your next question will come from the line of Vivien Azer with Cowen.

Vivien Azer: I was wondering if you could expand a little bit on your outlook for CORE in the sparkling water category more broadly. It's certainly been outperforming still water pretty considerably for a couple of years, more than a couple of years now. So where do you see the share today? Where do you see it going forward? And are there any international benchmarks that you're using to inform that thinking?

Robert Gamgort: Yes. I don't – unfortunately, in this category, there's not an international benchmark that's very helpful. I think what you're seeing is that people love carbonated soft drinks. I put that in the broad category. People like bubbles. And there are full-calorie versions of them. There are low- or no-calorie versions of them using a variety of sweeteners. And then there are unsweetened flavored varieties in there. And we're seeing growth right now across all of them. But the area that's really emerged in recent years and continues to be strong through the crisis has been this unflavored – excuse me, unsweetened flavored sparkling water. And I don't see any signs of that slowing down because it's representative of a shift in consumer preferences towards healthier, but also just less flavor, less sweetness in general. And we see that in a number of categories.

I don't know how high is high. But again, when you're looking at the growth rates, Polar in the past 6 months grew at like 25 percent. You're seeing explosive growth. And we, as I said before, could have come at this by an acquisition. We could have come at it by trying to develop our own brand. And we thought this was the best way to go. This is the highest-velocity brand in the category. They have one challenge, and that is they're only in about 1/3 of the country. We can help them with that challenge. And so we think taking

that brand in partnership with them and making it national is the best way for us to leapfrog in this category and end up in a leadership position.

And I would also point out that we've got some other smaller positions in this category. Canada Dry and Schweppes are in there. Canada Dry, by the way, in the Northeast corridor, is a very strong brand in unsweetened flavored sparkling water. But we really are emphasizing Canada Dry and its ginger ale credentials, and you see that it has had 13 years of growth with a lot of innovation behind it. And so that's always going to be the focus on Canada Dry. We're not going to pivot that to a sparkling water brand.

And we made an acquisition last year that we didn't talk a lot about of Limitless, which is more of a functional sparkling water. And I would just say more to come on that one. We haven't really put our game plan in play on that, and we'll be happy to share that with you in the future. And we think that, like many large, in growing categories, the best way to access them is through multiple plays, but be clear, the Polar play is our lead one, and we couldn't be more excited to partner with the fastest-selling brand in that category.

Operator: Our final question will come from the line of Sean King with UBS.

Sean King: A question for you on the, I guess, the strong brewer number. Is there any kind of color you can provide, I guess, on the cadence of that through the quarter, like by month? And could that number have actually been higher given the closure of a lot of the traditional retail channels through the quarter?

Robert Gamgort: Yes. Very good question. That has been strong and steady with no signs of slowing throughout the quarter. So it's not an issue like we saw in some of the other categories like fountain foodservice, where it was incredibly weak in April and we saw a recovery by July. This has been strong from the start and persistently strong, we're happy to report.

In terms of your point, which is very true, which is a lot of the traditional brick-and-mortar retailers were impaired. We saw a very significant shift to e-commerce during the quarter. And that's a combination of traditional e-commerce players. The brick-and-mortar retailers that you referred to, some of them did a fantastic job of pivoting to e-comm. And then, of course, we

have keurig.com. And in the case of our e-commerce capabilities, which I would point out, again, we're – e-commerce now represents more than 10 percent of our total company retail sales. We have such strong capabilities there that we were able to step in and actually fulfill shipments for e-commerce retailers who weren't able to catch up with demand. So think about the pressure they were under in the early parts of this crisis. Our brewer sales could have been higher in the early stages if they were able to fulfill. So we actually stepped in, and in a large number of cases, fulfilled on their behalf. And were able to satisfy the consumer demand that was there and continues to be there.

And the last point I'd make on this is, nobody knew what Mother's Day was going to be like and that's a – it's one of those classic holidays, and we always think, do we play in this one. We had a very strong Mother's Day. It was an e-commerce shift. People shifted towards things that they could get through e-comm and also that were predictable, reliable. They knew that they were safe in terms of people would like them. And also, there was a real shift towards more functional gifting.

I think you're going to see the same thing at Christmas. Whenever there's a situation like this and people are also feeling financial stress, they tend to move away from gifting that's more extravagant to that which is more known and functional. And the fact that we're going to be out there with a full lineup of brewer, our best lineup we ever had, and some really good innovation on top of it, is the reason why I said in my comments that retail or receptivity around our innovation pipeline and then total lineup for the – for Q3 and Q4 has been remarkably strong.

Operator: I will now turn the call back over to management.

Steve Alexander: Thank you very much. This is Steve. The IR team is around all day. If you have any questions, please reach out to us, and we'll follow up with you. Thanks so much for joining today.

Operator: Ladies and gentlemen, that will conclude today's call. Thank you all for joining, and you may now disconnect.