Keurig Dr. Pepper Inc.
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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 Fourth Quarter and the Full Year of 2019. This conference call is being recorded and there will be a question-and-answer session at the end of the call.

I would now like to introduce your host for today's conference Keurig Dr Pepper's Vice President of Investor Relations, Mr. Tyson Seely. Mr. Seely, please go ahead.

Tyson Seely

Thank you and hello, everyone. Thanks for joining us. Earlier this morning, we issued two press releases one announcing that we entered into a long-term strategic agreement with Nestlé USA to continue manufacturing Starbucks-branded packaged coffee and K-Cup pods in the U.S. and Canada. The second press release we issued was for the fourth quarter and full year 2019 results. If you need copies the releases are available on our website at keurigdrpepper.com.

Consistent with previous quarters, today we will be discussing our performance on an adjusted basis excluding items affecting comparability and with regard to the year ago period for the full fiscal year. Our financial performance also takes into account pro forma adjustments due to the merger. The company believes that the adjusted and adjusted pro forma basis provide investors with additional insight into our business and operating performance trends.

While these pro forma adjustments and the exclusion of items affecting comparability are not in accordance with GAAP, we believe that adjusted and adjusted pro forma basis provide 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-K, 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.

Here with me today to discuss our fourth quarter and full year 2019 results and our outlook for 2020 are KDP Chairman and CEO, Bob Gamgort; our CFO, Ozan Dokmecioglu; and our Chief Corporate Affairs Officer, Maria Sceppaguercio.

And finally, our discussion this morning may include forward-looking statements, which are subject to the Safe Harbor provisions of this 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.

Before turning it over to Bob, I'd like to share that KDP is hosting a sell-side analyst event on March 19, 2020 which will be webcasted live. As we get closer to the event, we will issue a press release providing more details. But for now please mark your calendars for a 2:00 to 4:00 p.m. Eastern Time live webcast.

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

Bob Gamgort

Thanks, Tyson and thanks to everyone for dialing in. Two years ago, we laid out a bold vision and ambitious financial targets for our new company. We saw significant opportunity to create an organization focused exclusively on beverages of all formats by being the first to combine hot and cold beverages at scale and by harnessing an unrivaled distribution system that can reach nearly all selling outlets using seven different routes to market ranging from direct store delivery to e-commerce.

Since the announcement, we successfully combined our two legacy companies uniting nearly 26,000 employees into one forward-looking organization with a common platform and culture. We also delivered financial results that have exceeded our three year targets invested in the foundation for long-term sustainable growth and have upped our game on corporate responsibility and sustainability.

In 2019, we delivered very strong financial performance with underlying net sales growth of 3.2%, adjusted operating income growth of 10% and adjusted diluted EPS growth of 17%. Importantly, the sales performance reflected growth from all four segments and in-market performance that remains strong as we grew dollar consumption and gain market share in nearly all of our key categories.

And our free cash flow in 2019 was exceptionally strong at $2.4 billion, enabling us to reduce debt by $1.3 billion. As a result, we reduced our management leverage ratio to 4.5 times at year end compared to 6 times at the July 2018 merger close. The strong free cash flow also enabled us to pay down structured payables by $531 million.

In addition to delivering strong and balanced results in 2019 we built a foundation for growth upon which we can drive the business faster and more effectively and we prioritized investment opportunities during that year that we are now beginning to activate. Therefore in 2020, we are investing to drive the top-line and expect net sales growth to accelerate to 3% to 4% while still delivering adjusted diluted EPS growth in the range of 13% to 15%.

Taking the midpoint of that range would place us directly in the middle of our EPS merger target of 15% to 17% through the first two years with robust innovation, marketing and in-store execution driving top-line growth in excess

of our merger targets. We will deliver these targets while remaining focused on the key drivers that can create value for our company.

We create value in cold beverages by renovating and innovating our brand portfolio to leverage our selling and distribution powerhouse and by partnering with emerging growth brands that offer us access to new segments and clear paths to ownership. Productivity provides funding for the continued brand marketing and innovation.

In Coffee Systems, we create value through expanding Keurig system household adoption by converting drip consumers to single-serve. Keurig brewer and coffee innovation combined with effective system marketing drives that conversion. Unique to Coffee Systems, we share some of the productivity we generate with our partners to lower the price of K-Cup pods at retail, further driving consumer growth, while still continuing to expand our margins. And across the enterprise we drive exceptional free cash flow that enables us to delever and offer shareholder value optionality in the future.

As we've said previously, while these concepts are fairly straightforward and simple to understand, when implemented effectively, they are incredibly powerful drivers of value. With that as backdrop, let me take a few moments to emphasize some of the most important aspects of our 2019 results and highlight the areas of investment in 2020 that will drive the accelerated growth we expect.

In 2019, our CSD portfolio expanded retail consumption by more than 3% and grew market share by 60 basis points, with the majority of the portfolio contributing to this growth. In particular, Dr Pepper and Canada Dry posted dollar consumption growth in 2019 of 5% and 6% respectively, fueled by innovation and effective marketing. These results are particularly impressive, given the context of the strong growth these two brands posted in recent years.

We continue to invest in innovation and marketing behind our key brands, including the successful Dr Pepper limited time offer of Dark Berry and the second year of the Dr Pepper Fansville campaign, the latter of which drove outsized dollar and volume performance for Dr Pepper during the college football season.

New partnerships are also an important element of our growth strategy. For example, we tested A-Shoc in 2019 with beverage entrepreneurial Lance Collins, expanding our presence in the energy drink category. A-Shoc was introduced regionally in mid-2019 and is now beginning its national rollout. A-Shoc joined Xyience Energy Drinks which we acquired as part of the Big Red acquisition in 2018. Xyience while small, continues to post impressive growth.

In late 2018, you'll recall that we signed a long-term partnership with Danone to distribute evian water. The launch of this partnership combined with CORE and Bai has made KDP the number two premium water company in the United States and we continue to see areas to build out our presence and drive future growth.

In coffee, K-Cup pods manufactured by KDP were up approximately 4% for the year in IRi U.S. track channels, which, as we have indicated previously, don't capture the accelerated growth we are driving in untracked channels. In 2019, the untracked channels represented about half of the pods we manufacture and we would expect that number to continue to grow.

Our pod shipment growth of 9% in 2019 is consistent with the actual growth we are seeing across all channels. The strong performance of our K-Cup pods was driven by new households that we brought on to the Keurig platform. Specifically, in 2019, we expanded the number of U.S. households regularly using a Keurig brewer by approximately 7%, bringing the total number of U.S. households in the Keurig system to around 30 million at year-end, with an additional 3 million households using the Keurig system in Canada. This growth was driven by robust brewer innovation and the Brew The Love marketing campaign featuring James Corden for the third consecutive year.

Our most recent brewer innovation, the K-Duo, fills an important need for households that want a single machine that can brew both a single cup and a craft. K-Duo has been extremely well received by consumers both in terms of units sold and star ratings.

And finally, on coffee, the long-term agreement with Nestlé announced this morning recognizes the strong partnership we've had with the Starbucks brand for almost a decade. With this agreement completed, along with the long-term master licensing and distribution agreement we recently signed with McCafé in the U.S., we have every major branded player within the Keurig system, committed for at least the next five years.

In 2019, we launched our Drink Well. Do Good. corporate responsibility platform, along with multi-year goals for our supply chain, the environment, health and wellbeing and communities. A significant area of environmental focus for both the industry and KDP is plastics. And in late 2019, in partnership with the ABA and industry peers, we've launched the Every Bottle Back initiative. We are also on track to make every K-Cup pod recyclable this year, after reaching this important milestone in Canada last year.

Finally, in 2019, we rolled out our KDP values and competencies to the entire organization, uniting all of our employees under one common culture, fostering an environment in which everyone at KDP operates with shared purpose and common goals.

As I mentioned upfront, we have good line of sight to delivering sales growth in 2020 above our long-term target range, by investing in a number of platforms across the business. Starting with innovation, which we expect to be a meaningful growth driver for this year.

In CSD, we plan to support our flagship Dr Pepper brand with the first quarter launch of regular and diet Dr Pepper cream soda, which should drive continued growth for the Dr Pepper and increase frequency and volume to the category.

Also launching in the first quarter is Canada Dry Bold, which takes the extremely popular and on-trend Canada Dry Ginger Ale and dials up the flavor impact. We are also rolling out our new lineup of 10-pack mini cans behind many of our CSD brands, including Dr Pepper, Canada Dry, Sunkist, A&W and 7-Up. These mini cans are consistent with the consumer trend to enjoy carbonated beverages while controlling portion size and caloric intake.

While this format has been a significant driver of category growth, until now KDP has not had full representation across its brands. For Bai, we are introducing the first flavor innovation behind the brand since it was acquired in 2016, with the introduction of Bing Cherry, rolling out nationwide as we speak. This is just one of many actions we are taking to support the brand this year and we look forward to sharing additional details during our March 19 webcast.

As mentioned previously, A-Shoc energy drinks will roll out nationally in 2020. Also, as you've likely seen, we purchased Limitless, a lineup of lightly caffeinated sparkling waters early this year. Not only do we plan to build out distribution of Limitless as the year progresses, but we also have developed flavor innovations that we plan to introduce as well. While starting from a small scale both, A-Shoc and Limitless should be solid contributors to growth in 2020.

In coffee, we are in process of launching our next wave of updated brewers, starting with the K-Slim brewer, which is currently available on keurig.com and will be expanded more broadly over the next few months. And just by which is why the K-Slim brewer features an impressive 46-ounce reservoir, a simple user interface and is the first reservoir brewer to feature our next-generation Keurig branding and design. We look forward to sharing more brewer innovation with you as the year progresses. All brewer and beverage innovation will be supported by significant marketing investment throughout the year, behind both existing and new campaigns.

In 2020, we also have plans for increased investment in our networks. This includes CapEx spend and expense behind new manufacturing facilities we plan to bring online in 2020, including our Spartanburg South Carolina facility, which once up and running will be the largest and lowest-cost K-Cup manufacturing facility anywhere.

Also coming online in 2020 is our manufacturing and warehouse facility in Allentown, Pennsylvania, which will produce primarily noncarbonated beverages. Both of these facilities will be significant sources of productivity once they ramp up and will support the future growth of our brands.

Investment in our networks also includes improvements in our routes to market, including our company-owned DSD network. We'll elaborate more on this during our webcast in a few weeks, but at a high level, this means investments

in sales technology and training for our field teams and the acquisition of select independent distribution territories for incorporation into our company-owned DSD. All of this is to ensure that our retail coverage is efficient and effective as possible, allowing us to drive maximum value from this important asset.

In 2020, we will also continue to geo-diversify our brewer supply footprint across Asia. In addition, we have established a center of excellence for brewer R&D and supply chain management based in Singapore. This center which started up in late 2019 locates our teams closer to where our appliances are manufactured, allowing us to move faster and more efficiently.

And finally in 2020, we also plan to make investments behind our sustainability initiatives. As you are already aware, all of our K-Cup pods we manufacture will be recyclable by the end of this year. Recyclability has been a large barrier to adoption for many consumers and we plan to promote this news with stepped-up marketing and in-store support. Also in 2020, we will launch our first 100% post-consumer rPET bottle. We look forward to sharing more information about this later in the year.

During 2019, we received many questions from you on what a future KDP looks like once we move beyond 2021. You're beginning to see a robust pipeline of growth platforms across multiple segments, combined with a contemporary route to market and supply chain infrastructure, all of which point to a compelling future for our company.

Our 2020 outlook represents a year of accelerating growth behind stepped-up investments in our brands, network and people. Some of these investments will produce returns quickly. For example, the innovation of marketing that we are rolling out is expected to translate to accelerated topline growth in the coming quarters, while other investments will take a little bit longer to show results. For example, Spartanburg and Allentown will be significant sources of productivity and capacity for our business, although benefits won't start to flow through until after this year. Most importantly, these are all critical investments to drive sustained future growth and value creation starting this year.

With that, let me now hand it over to Ozan.

Ozan Dokmecioglu Thanks, Bob and good morning everyone. Since our press release provides significant details on our performance, I will touch on our fourth quarter results very quickly and then turning to the larger drivers in our 2019 performance, along with our 2020 guidance. At a high level, the fourth quarter was another solid one for us. Excluding the prior year sales of BODYARMOR in October last year and foreign exchange impacts, net sales increased 4.6% in the quarter with contribution from all four segments. The sales growth along with product – strong productivity, synergies and network optimization drove operating income growth in the quarter of 13% and operating margin expansion of 210 basis points.

We delivered adjusted diluted EPS growth of 17% in the quarter, fueled by the growth in operating income and the lower effective tax rate, partially offset by higher interest expense due to comping last year's benefit of interest rate swaps in the fourth quarter last year.

Turning to full year results. Free cash flow in 2019 was exceptionally strong at approximately $2.4 billion. This translated into an adjusted free cash flow conversion rate of nearly 140%. We also ended the year with $75 million of unrestricted cash on hand. In terms of leverage, we reduced our outstanding bank debt by approximately $1.3 billion in 2019. As a result, our bank debt-to-adjusted EBITDA ratio, which we refer to as our management leverage ratio, improved by nearly a full turn to 4.5 times versus 5.4 times at the end of 2018.

Since the merger closed in July 2018, we have reduced our leverage ratio by 1.5 turns. In addition, we also paid down $531 million of structural payables during 2019, resulting in total payments between debt and structural payables of $1.8 billion. In terms of synergies, 2019 was the first year of our three-year program.

As you will recall, when we announced the merger two years ago, we committed to $600 million of synergies with $200 million per year between 2019 and 2021. We delivered synergies of slightly more than $200 million and we expect to deliver our commitments in each of the next two years.

And finally, before turning to 2020 guidance, let me provide some details on our synergy, productivity and network optimization programs, as they will continue to be important sources of growth and value creation in the coming years.

As we shared at our Investor Day in March 2018, a key part of our strategy is to execute untapped opportunities to drive profitability and cash flow, which enabled us to reduce debt and provide optionality for the business. Our value creation program, which includes synergies, productivity and network optimization, is an important aspect of this.

Examples of progress across these programs that we have already made include the following: the consolidation of warehouses between our two legacy companies; the integration into one sales organization; the organizational alignment of the two legacy companies, including the consolidation of certain corporate functions and elimination of duplicative roles, simultaneously reducing the cost and improving the quality of our brewers through engineering redesign and the harmonization of brewer parts and platforms; optimizing procurement practices, utilizing economies of scale and driving manufacturing efficiencies across the combined network; utilizing asset sale leasebacks on certain facilities, which we will continue to pursue opportunistically; and optimizing our DSD system and processes to reduce the cost to serve our accounts across the country.

All of these actions have enabled us to unlock significant efficiencies and value in our network with many opportunities yet to come. We have a long runway of

value creation in this area and we look forward to sharing these with you in the coming quarters.

Let me now move on to our outlook for 2020. As you saw in our press release, we expect net sales growth to be between 3% and 4% in 2020, nicely above our three-year target range. We have confidence in our expectations given the high-quality areas in which we are making investments.

As I will discuss in a minute, there's a timing component of these investments. Given these investments, we expect adjusted diluted EPS growth to be in the range of 13% to 15% in 2020, representing $1.38 to $1.40 per diluted share. Importantly, over the two-year period ending 2020, we expect to remain in line with our merger target for average annual growth of 15% to 17%. And continue to have confidence, in achieving our target EPS growth, over the three-year merger target period ending 2021.

Adjusted interest expense is expected to be in the range of $530 million to $545 million, with respect -- expectation for continued deleveraging in 2020, given the significant cash flow we expect to generate, in the year, as well as the expectation of a modest benefit, from the opportunistic unwinding of our remaining interest rate swaps.

Our management leverage ratio is expected to be in the range of 3.5 to 3.8 times, at the end of 2020. Cash outlay for capital projects is expected to step-up, as previously communicated to approximately $550 million to $600 million, in 2020, given the ongoing projects we have underway to support future growth in our business.

Importantly, 2020 represents the key cash-out a year, in the three years following the merger. We currently expect CapEx, over the three-year period to be in the range of $1.4 billion to $1.5 billion.

While we are not providing guidance by color, we do expect net sales growth, and adjusted EPS growth versus 2019 to be tempered in the first half of 2020, due to several factors.

Specifically, the investments we are making this year that Bob mentioned previously, will be weighted to the first half, versus the second half. Productivity and synergies are expected to be lower, in the first half, versus the second half, as programs build throughout the year.

Based on our current input cost coverage, we expect inflation to be the highest, in the first half of the year, specifically in the first quarter. And then, moderate over the balance of the year.

Partially offsetting these timing factors is a gain of $39 million, we realized in January of 2020, related to additional asset sale leasebacks, of four properties. Consistent with the value creation framework, I laid out earlier this gain

primarily affects, Packaged, Beverages, with the remaining benefit in Coffee Systems.

In addition, in Coffee Systems, we are anticipating the highest tariffs, in the first quarter and marketing investment is also expected to be elevated. Coffee will also be lapping, the full launch of the highly successful K-Mini brewer, in quarter one 2019.

In Beverage Concentrates, the timing of synergy capture and volume initiatives, are weighted toward the back half of the year. Given these discrete segment impacts, while we do expect solid performance from Coffee Systems and Beverage Concentrates, in 2020, they will start slowly and ramp-up as the year progresses, particularly Coffee Systems.

And with that, I will hand it back over to Bob for some closing remarks, before we open it up, to your questions.

Bob Gamgort

Thanks, Ozan. We've covered quite a bit of territory in our remarks today. And look forward to providing more details, during our March 19 webcast. We're excited about the progress we've made in the past 18 months, to build a foundation for our company that we can now leverage to drive accelerated growth, beginning this year.

The strong results we have delivered since the merger closed, demonstrate the strength of our strategy and team. And we are confident in our 2020 guidance. And remain committed to delivering the three-year merger targets, we established, more than two years ago.

I will now hand it back over to the operator, to open it up for your questions.

Operator

Thank you. Ladies and gentlemen, at this time if you would like to ask a question please press star then the number one on your telephone keypad. Again, that is star, one to ask a question. If you would like to withdraw your question, press the pound key.

Please hold while we compile the Q&A roster. Your first question is from the line of Bryan Spillane with Bank of America.

Pete Galbo

Hey guys. Good morning. It's actually, Pete Galbo on for Bryan. Thank you for taking my question.

Bob Gamgort

Good morning.

Maria Sceppaguercio Good morning.

Pete Galbo Bob, I just wanted to get your thoughts around, supply chain, particularly coming out of China with a lot of the disruption, we've seen at ports. And how you're thinking about that, in terms of brewer growth particularly maybe in the first half of the year?

Bob Gamgort Yeah. So I mean, first of all, you're talking about the supply chain. I think, it's important to talk about there is no demand impact on our business. Because the great majority of our business nearly all of our business is in U.S., Canada and Mexico.

So, that's why you get to the supply chain side. We've done a couple of things that have served us well. I mean, the first thing that we did was, geo-diversified our supply chain for our brewers, outside of China.

Our original catalyst for doing so was tariffs. But that served us well in this current situation. We just came out of our peak selling season during the holiday, with spectacular selling results.

And as we go into this year, we're in a lower seasonality period, which allows us to build some inventory. And so, we really at this point in time, we're really shaped from a supply standpoint. We'll watch it very carefully. But we don't anticipate any disruption at all.

Pete Galbo Got it. Got it. That's helpful. And then maybe just on free cash flow, obviously very impressive in 2019 that $2.4 billion. Just want to get some thoughts around sustainability of that in 2020 and 2021?

Ozan Dokmecioglu Sure. I mean I believe we have demonstrated quite a bit of ability to drive outsized cash flow from variety of sources. For example, we have -- and as we've just announced our core free cash flow conversion ratio to net income was 140%. And it would be obviously, we will continue our programs in order to generate still outsized cash flow. For example our business is quite highly cash generative.

Second we have a strong working capital management programs in place, as well as we tap into other initiatives, if we see opportunity in order to unlock the cash generation using our asset base. For example asset sale leaseback was one of the initiatives. Therefore we do expect to generate outsized cash flow and turn our free cash with -- in excess of 100% in the upcoming few more years.

Pete Galbo Great. Thank you.

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

Peter Grom Hey good morning everyone. So I just wanted to ask a couple of questions on the revenue outlook. So first, I guess would it be possible to break out your expectation for what is organic in the 3% to 4% target for 2020 as I know you guys get a benefit from McCafé in the back half of the year?

And then just more broadly you reiterated your long-term EPS guide this morning, but didn't mention anything around long-term net sales growth. And maybe I'm reading too much into this, but should we expect faster growth beyond 2020 as a result of this increased investment ?

Bob Gamgort Yes. I mean let's start with 2019 for a second right? If you look at -- there was a lot of noise in 2019 as we talked about numerous times about the ins-and-outs of Allied Brands. I am very happy to say that's all behind us as we go into 2020. So there is no concept of underlying net sales as we go into 2020.

But if you go back and look at 2019, our underlying net sales was 3.2%. In the fourth quarter it was 4.6%. And if you wanted the discount underlying our reported was 4.3%. So you saw an acceleration throughout the year in 2019. And that continuation into 2020 is why we have the confidence of taking our revenue targets up for 2020.

With regard to organic versus additional really the only thing that wouldn't be organic in your definition would be McCafé as you point out and a couple of points out on McCafé. I mean one, we participate in revenue of McCafé now because we produce the pods. And so we're picking up some incremental difference particularly on the premium bag business, but we already participate in the revenue on pods.

So there's not much change there. It's a partial year impact and a lot of the reports out there that quote numbers that I've seen are really looking at retail numbers not manufactured sale numbers.

So to answer your question, the great majority of what we're talking about on the increased revenue in 2020 is by your definition organic. In terms of sustainability of that beyond 2020 which is where, I think you're getting at clearly we're not going to sit here and guide beyond 2020.

But you can see the investments that we're making are not short term in nature. They're very much long term in nature both in terms of the foundation that we're building that drives our business day in and day out, renovation of our existing brands, launch of new businesses whether we're doing it completely on our own or in partnership with others.

And all of that combined suggests that we have a lot of runway in front of us as we talked from the very beginning to improve the operations of our business and

fill in significant white space in our portfolio. And that's why we're giving the outlook that we are today.

Peter Grom Thanks. That's very helpful. Pass it on.

Operator Your next question is from the line of Lauren Lieberman with Barclays.

Lauren Lieberman Hi, good morning.

Bob Gamgort Good morning.

Lauren Lieberman So I just wanted to talk a little bit about maybe opportunities that you have uncovered since closing the deal, sort on a full year in but just -- two years in but vis-à-vis like in particular the network optimization program and some of the things that you started to hint out and promise us we'll hear more in a few weeks.

But I was just curious kind of what is sort of incremental discovery as you've gotten closer and deeper into the business versus things that you may be contemplated when the merger first came together? Thanks.

Bob Gamgort Sure. Let me -- I'm going to break them into three buckets of areas that we've learned. I'm going to talk about portfolio expansion in the white space, I'll talk about our selling and distribution capabilities. And then I'll ask Ozan to talk about the cost side of the business and also some cash I think would be important, right?

Because you go in -- as you point out, you go into these mergers with a hypothesis and a merger thesis, but the reality is how can you deliver against that once you're up and running. And so now 18 months into running this business what have we learned? I think our ability to fill in white space in our portfolio and expand into higher-growth segments is very much intact and as evidenced by the fact that we're taking up our target on growth.

And you could see where we're targeting to fill in our white space. Water -- premium water is a very attractive segment. We're now the number two premium water company. And through a combination of the Bai business that was there; the partnership that we have with Danone on evian; the acquisition of CORE at the end of 2018, which we really were able to accelerate in 2019; the recent acquisition of Limitless, which is small, but we'll ramp up this year; and some of the other opportunities that we take a look at in water. We see significant growth coming out of that segment and we see more opportunity to fill in additional white space within water.

Energy is another one. And energy as we talked about is more -- you have to be more thoughtful about how you want to approach that segment, because of some of the big players that exist. But a combination of business that we acquired

along with Big Red and Xyience now growing rapidly and the partnership that we're scaling up with Lance Collins on A Shoc are all good examples of how we're able to access some of these very large and attractive segments in unique ways.

The one point I would make on top of that is, that's all important as long as your foundation, your core business continues to grow and that is 100% what's happened. What's interesting that didn't really -- hasn't really come up and I see a number of the reports is, again, KDP outpaced the CSD market. We were up 3.2% for the year the market was up 2.5%, and Dr Pepper just had its 15th straight year of growth and outpacing the CSD category with growth of nearly 5% and Canada Dry at 6%. So being able to add all of these new segments on top of a really strong and robust core is the key to our success.

On the route-to-market side, there are a number of things that we're doing. And again, it's hard to cover it on a call, so we'll just say we're previewing that for our discussion in March when we have you all in, but it's a combination of investing in technology, investing in our people, but also being very targeted and going after some of these independent distributor markets where we think we can do a better job through our own company-owned DSD. We've already begun to do that, which will show you when we get together and we have plans to do more of that.

And what we're seeing is part of the strength in our core is not only coming from marketing and renovation, it's coming from strength in our selling and distribution capabilities. And so both sides of that are not only intact, but we feel stronger about them than we did going into it, which is again why we're taking up our growth outlook.

Ozan, why don't you talk about the cost side of the business, because we've learned quite a bit on there as well?

Ozan Dokmecioglu Sure. On the cost side, let me start with the value capture. As we did defined and shared with you as well comes in two pieces, which we call as base productivity programs as well as the synergies. And as we guided and announced several times, we had the target of delivering $600 million of deal synergies starting -- over three years starting 2019 through 2021.

And we just also announced that we talked of actually both of the metrics. In fact on the deal synergy side, we delivered a little bit more than our original plans. Therefore, the things went well in those two buckets in terms of delivering overall value capture and topping off those numbers, which in fact gives us the unique opportunity as Bob laid out a couple of minutes ago to continue to invest behind our business from the -- either the brand investment side or the distribution routes or our manufacturing capability that will further fuel and satisfy our growth as well as further drive the base productivity as well as the synergies.

Therefore, there's no surprise. In fact, we have maybe a little bit positive surprise in those two buckets, which unlocking the investments that we have laid out.

On the cash flow side, absolutely, there's no surprise. We laid out a deleveraging program, and we are 18 months into it and definitely have delivered exactly what we said we would. We did deliver outsized cash flow in 2019 and we have very solid programs intact and in place both 2020 and 2021 that will get us to the deleverage targets that we put out there. And the more opportunities we find definitely we will put into service as we have been doing.

Bob Gamgort So I think, I mean the net of all of that is we were really confident going into this merger. 18 months later, we're even more confident with what we know. And the one thing we didn't mention in any of that was we did everything we just talked about on top of delivering a home run of the year for Coffee Systems, and our outlook on that is as robust as ever. So we're sitting out here 18 months into this feeling good as you can tell.

Lauren Lieberman That's great. Thank you so much.

Operator Your next question is from the line of Steve Powers with Deutsche Bank.

Steve Powers Hey, great. Good morning. Two questions if I could. I guess the first one just building as quickly enough for Ozan. It looks like outside of a couple hundred million dollars in asset sales in the fourth quarter your free cash flow would have actually come in a little light of the full year target. And I guess that was probably planned on your part. But I guess can you just give us a little bit more insight to what was sold? And as we think about the path the future free cash flow, is that a driver there? Is there a line of sight to similar sales in the future?

Ozan Dokmecioglu Well, first of all, I mean, we delivered $2.4 billion of free cash flow. And that equates Steve to 140% of the conversion -- cash conversion percent free cash flow to net income, which is best-in-class and best in our industry, so obvious number. Therefore, we did planned a potential asset sale lease. In fact, we did plan during the deal types of those numbers, because we always look to our opportunities in a very holistic manner.

And therefore we just delivered the mid part of our guidance that we put out there. Therefore, probably it will be a little bit unfair to say that we are short in absence of flows, let's say a couple of asset sale leaseback that we did. In fact, once we release our 10-K today you will find further details. The sale – the asset sale leaseback operation that took place in December, which we did, planned as such by the way, in 2019 was on the three manufacturing units that we had. And obviously we have a very long-term lease contracts in place even the options on us to be able to renew two terms further after the first expiry of the lease period. And therefore that was within our algorithm. And whenever we find

opportunities to unlock the untapped opportunities, either on the profit side or the cash side, definitely we will go after.

So what matters is if you take a holistic look to our cash flow generating, again, we have very solid programs in place with regards to continue expanding our working capital. This business including our EBITDA generation is very cash generative. And there are ample other opportunities that will enable us to continue to deliver outsized cash flow.

Maria Sceppaguercio Yeah. The one thing that, I would add in all of that, this is Maria – is that, if you look at our results for the year there's a fair amount of noise in it. And any time you put two large companies together you're going to have that. There are things that are positive and things that are negative. One, I would venture to say, if you look at 2018 and 2019 and you make a list of them and the vast majority of that stuff is disclosed you will see that we had more benefit in 2018 than we did in 2019. So, on a year-over-year basis, our growth if you strip all the noise out would actually be higher than what we reported. It would be north of 17%. So there is some work that has to be done to kind of get to that, but the reality is that the underlying performance was really good.

Steve Powers Okay. Yeah, that's helpful. Thanks for the clarity. I guess, second question, if I could for Bob. And I guess this builds on what you were just discussing in response to Lauren's question, your ability to leverage legacy DPS distribution platform assets to expand accelerate new brands. That's always been a big part of your longer-term strategy and the industrial logic of taking on DPS in the first place. But I guess, are you removed from the merger 18 months or so? As strong as legacy Keurig and core DPS have been it looks like that part of the value proposition maybe a little bit just lagging, if I could. I mean, clearly, you're excited about 2020, but you've spoken in the past about some of Bai's challenges and the slower ramp of Allied Brands. I think Allied Brands' contribution were supposed to turn positive in the quarter. I'm not sure, if that happened. So I guess just can you give us a little bit more clarity on – or color on how you're thinking about it and the system's ability to develop smaller underpenetrated brands in the future? And as it relates to – and maybe some of that relates to your comments about plans to acquire new territory because that too seems like an evolution from some of your comments in the past. So just some further wrap-up there would be great. Thanks.

Bob Gamgort Yeah. I think you're referring to our PB segment which is where our company-owned distribution resides. I mean, first of all, just to reiterate because I know our – there's complexity around our routes to market. But we have the ability to reach 100% of the U.S. with direct store delivery. Approximately 75% of that is through company-owned DSD and the remainder is through long-term partnerships with independent distributors. So we have the ability to take any new brand and get it to every store in the U.S. through our – through a DSD

system, which is really powerful. I mean, there are only a few companies that can do that.

Within the PB segment you have to remember to Maria's point on noise that is the noisiest segment with regard to the movement in and out of Allied Brands. And that was disruptive, but I think we managed through it really well. And if I just take a look at the quarterly trends on the PB segment in the first half of the year, we were – our underlying growth was around 1% to 1.5%. In Q3, it was plus 3%. In Q4 it was plus 4%. So you're seeing an acceleration after cleaning up some of the noise of the Allied Brands through our own company-owned DSD system.

And yeah, the Allied Brands some of them were a little bit slower to ramp up that we talked about before and there are always brands that you have to work on. We talked about Bai, we talked about Snapple tea. But everybody who has a big portfolio always has a group that is growing rapidly a group that's growing nicely and a group you have to work on. The key is you have the balance right. And again our total company growth in the fourth quarter underlying was 4.6% and our PB segment was plus 4%. So yeah, we feel great about where we are with this one. We just always have a few things we have to work on that you can pick out. But net-net, everything is going in the right direction and that's reflective in the targets, we put out there for 2020.

Steve Powers Okay. Thank you.

Operator Your next question is from the line of Robert Ottenstein with Evercore ISI.

Robert Ottenstein Great. Thank you very much and congratulations on a strong year. Two questions. First you talked – and it went fast, but it sounds like it looks like you're going to be pushing mini cans much harder than the past. And it's obviously, obvious why you would do that but that does represent a change in strategy certainly from prior management. And if I recall and correct me, if I'm wrong I think it may have been a change in strategy from your initial views on the business due to supply chain costs and complexities. Is that correct? And what kind of -- how are you thinking about dealing with those changes to the supply chain to execute on that effectively? So, that's question number one.

And question number two, obviously gaining some really nice share in the cold drink segment. Can you say what channels that you're seeing those share gains? Or is that pretty broad? Thank you very much.

Bob Gamgort Sure. So, we keep talking about why we're so bullish on our business going forward is the amount of opportunity we still have in front of us that we haven't yet accessed. I mean we talked a lot about segments that we're entering that we didn't have great participation in that we are now able to access.

Its -- mini cans falls into that same category. You know, it's been a big growth driver for the industry. It's not only a driver of revenue growth, but it's good profit as well and we just haven't participated in it for a number of reasons. There's no change in our thesis on this. We've always wanted to do it.

It's just a matter of gearing up our supply chain and getting the can supply to be able to do that. And now we're able to do that in a broad way -- in a big way going into 2020, which is another source of incremental growth and profitability. The industry has access to that we're underdeveloped. We'll be able to close that gap, because we need to make sure that our brands are available in a format that consumers want.

With regard to where we're seeing share gains, it's really across the board. It's no particular channel. That's the great thing about this business is that we have access to every customer and every channel. And when we're able to drive growth and share gains through great marketing through innovation or renovation or through new segments, we get the benefit of that across every single channel.

Robert Ottenstein Terrific. Thank you very much.

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

Kevin Grundy Hey, good morning, everyone, and congratulations on a strong year.

Bob Gamgort Thanks.

Kevin Grundy Bob, can we pick-up on Coffee Systems? So the household penetration was up nicely this year, and then also reflective in strong brewer volume growth of 8%, which is great. Can you put some context again on -- just revisit where you think household penetration can go? I think there's been some context around mid-60% household penetration in parts of Europe. Maybe just some updates on your targets here. And then how quickly you think you can achieve them? And then what that potentially means as we think about growth in this segment?

Bob Gamgort Yeah. Let me get -- let me just give the real headline numbers on how we see the Coffee Systems' number in 2019, because as you know, there's a lot of -- when it comes to reporting, there's -- I think there's still an over-reliance on the IRI numbers, because they're available, but they don't really tell the whole story.

When I look at the key metrics for 2019 on Coffee Systems, we see household penetration of 7%. We see pod shipments of 9%. We've always said over time shipments and household penetration will equal each other. We see brewer shipments of 8%. But if you take a look at NPD, which is a good source of brewer sales, they were up 9.5% for the year.

And in the fourth quarter, which was -- which benefited from the introduction of the K-Duo launch, NPD was up 15.5%. So that's why I said, it's a home run of the year on Coffee. And not to mention we expanded our margin by 90 basis points at the same time we did all of that.

In terms of household penetration, we're sitting at around 23% household penetration. All of the work that we've done going back to the launch of the merger, and we showed you in our first Investor Day, we said that we believe that household penetration should be north of 50%.

There is -- every piece of evidence has suggested that number is still very much the target something north of 50%. And we're just chipping away at it every year, and at a pace that we're looking at growing that at 7%. You could do the math and figure out when we would get to 50%, but the good news is it's a long way off. And so that speaks to our ability to continue to drive outsized growth in Coffee Systems for the foreseeable future.

Kevin Grundy Okay. That's helpful. And then just a follow-up to Robert's question. So, specifically around Beverage Concentrates, so the volume number there has been strong, and it's been strong for the past two quarters. So, Bob maybe just talk about the disconnect between what we're seeing in the Nielsen data. You alluded to some stronger growth in track channels -- in non-track channels, excuse me.

But I'm just trying to understand the sustainability of the wide gap that we're seeing between the Nielsen data and then what we're seeing in volume growth in Beverage Concentrates. Talk about the emphasis in non-track channels, but specifically I think it would be helpful that the magnitude of the gap that we're seeing, is this just sort of the first half, you picked up distribution in the first half of 2020, we should see this -- that gap close? Or do you think this is sustainable we should see this gap higher? And if so why?

Bob Gamgort So, I think if you -- are you talking about -- just for clarification, are you talking about in the months of January, February? Or are you talking about fourth quarter?

Kevin Grundy I'm talking about fourth quarter Bob, but I'm also talking about third quarter. So, if you look over time, there's been a tighter gap between the volume numbers in Beverage Concentrates versus what we see in the Nielsen data, and that gap has widened in 3Q and 4Q. So the question is sort of premised on that.

Bob Gamgort I think there's a couple of thing. I think one is you don't see everything in the Nielsen IRI data. So, for example, a big part of our business that shows up in Beverage Concentrates is what we call fountain and foodservice. So that is our sales to restaurants across the board. And remember, Dr Pepper is the most available soft drink across all restaurant formats.

And so, that's an area where we continue to see very strong growth behind demand in our brands. And that -- what's the demand driven by? Great marketing because those are really the core brands limited number of SKUs. And so that's when you see core Dr Pepper or Canada Dry doing really well in those segments behind good marketing.

That probably explains the biggest difference in the gap there. The other thing I thought you were alluding to is when you take a look at the IRI or Nielsen numbers that's been reported, and you see somewhat of a slowdown in the fourth quarter and a little bit into this year that's really a category driven piece that comes in from lapping of pricing in the fourth quarter and the previous year.

Our differential performance, KDP versus the category though has held up really nicely. So the category slowed down as would be expected when you lap pretty aggressive pricing. You're seeing the price impact being lower, but the volume impact higher. But most importantly, we continue to outperform the category and that hasn't slowed down at all. Does that get at your question?

Kevin Grundy I think so. I mean, the way I'm seeing just -- not to put words in your mouth, but it seems like you picked up some distribution in foodservice. That's what's driving the disconnect in 3Q and 4Q, which would suggest that that gap remains the same or roughly the same in the first half of 2020, but then maybe normalizes in the back half of 2020. Is that fair?

Bob Gamgort I wouldn't take it all the way on to 2020 because it's more than just picking up distribution. We're seeing an increase in velocity on our brands in same stores in the fountain and foodservice channel. It's not just we picked up…

Bob Gamgort …if you got a number -- because reality of it is, if we are the most available beverage out there, there aren't many more places we can go. So really this is driven by velocity. I mean, if you take a look at again the really strong marketing behind our flagship brands Dr Pepper in particular, you see it in the retail channels and you see it in the fountain and foodservice channels, we're getting good velocity increases on that brand.

Kevin Grundy Okay. Thanks, Bob. I'll pass it on.

Operator Your next question is from the line of Brett Cooper with Consumer Edge Research.

Brett Cooper Good morning. At the outset of the deal you guys said, you wanted to get pod pricing to about $0.50 and I think you ended 2019 at $0.49 in measured channels. You also said that consumers found $0.30 pod pricing a bargain. I think private label pricing is in the mid-30s in measured channels. So first I'm just wondering if you see any I guess change in volume pricing as you go forward now that

you've gotten those targets. And is it possible with the South Carolina plant to get a partner to $0.30 pod pricing? Thanks.

Bob Gamgort Yeah. I think look, part of Brett what we've talked about along the way is you're looking at IRI pricing. So remember when you take a look at IRI pricing, it reflects partners and/or retailers who can choose to compress their margins if they wish, because it's still a very attractive segment from a growth and profitability standpoint. And so some of them choose to compress margins and obviously that has no impact on us nor do we control that.

With regard to what we said back at the deal launch, I think that's a good place to start. If you go back to the March 2018 Investor Day that we had here in Burlington, we talked to you guys about the current situation on coffee. And as you pointed out at that point in time, pricing was coming down. Volume was growing but it wasn't enough to offset the pricing and we saw negative revenue.

And what we projected at that time is that volume would accelerate, pricing would moderate and margin would continue to expand. And we said that revenue would grow to somewhere between 2% to 3% by the combination of all of those factors. That has come a 100% true. You're seeing our pricing this is -- forget about IRI for the reasons I talked about, look at our pricing that's in our 10-K, you'll see that it's still declining but moderating over time.

Our net sales, which were negative in 2017, were flat in 2018 up slightly. Remember I said 2% to 3%? Our revenue was 2.8% up in 2019. So right on where we forecasted it back almost two years ago to be. And the most important part of it that I think is far more important than pricing, which everybody on the outside tends to focus on is our margin continues to expand. So we were up 90 basis points in 2019, despite making those investments.

And what that tells you is that as we said all along, we have line of sight to strong productivity and there's still a lot of productivity left to come. And you just pointed out one of those examples, which is Spartanburg coming online, which will be another step change in the pricing of our pods. So I can't totally forecast where pricing is going to go, although we continue to see it moderating. But we do have line of sight to the increased growth in our business and our increased operating income margin and we feel good about both of those. And I think those are actually the most important metrics.

Operator Your final question is from the line of Sean King with UBS.

Sean King Hi, thanks for question. Can you elaborate on any implications, I guess if any of the Starbucks agreement in terms of margins versus dollar revenue or dollar profit reporting? Or is the real value of this agreement just locking in a powerful brand for years to come?

Bob Gamgort It's really the latter to us. I mean, it is a really important brand for the system. It's now the number one brand within the system and it brings a premiumness to the overall category and our business in total. Obviously we're really important to them. If you look at how big K-Cup Starbucks business is and the profitability behind that, we're important to each other. And I think that's reflected in the fact that we entered into a long-term agreement with them because it's a win for both of us. So I think it's really about that and not a material impact on anything other than we continue to grow the household penetration of the system and Starbucks continues to participate in that growth with us.

Sean King Great. Thanks a lot.

Operator That's all the time we have for questions. I will hand the call back over to management for final remarks.

Tyson Seely Thanks everyone. This is Tyson. I know you all have busy days today, but the IR team is around to take your questions. So feel free to give myself or Steve a call and we'll talk to you later. Thanks.

Operator This concludes today's earnings call. Thank you for your participation. You may now disconnect.