Keurig Dr. Pepper

Moderator: Maria Sceppaguercio
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Operator: Good morning, ladies and gentlemen. Thank you for standing by. Welcome to Keurig Dr. Pepper earnings call for the fourth quarter and full year of 2018.

This conference is being recorded and there will be a question and answer session at the end of the call. I would now like to introduce your host for today's conference, Keurig Dr. Pepper, Chief Corporate Affairs Officer, Ms. Maria Sceppaguercio. Please go ahead.

Maria Sceppaguercio: Thank you. And hello, everyone. Thanks for joining us. Earlier this morning we issued a press release for the fourth quarter and full year of 2018. If you need a copy, you can get one on our website at keurigdrpepper.com in the investor section.

As you will recall from last quarter, the discussion of our Q3 performance was largely on an adjusted pro forma basis due to the merger. And our discussion here today will be consistent with that. The company believes that the adjusted pro forma basis provides investors of 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 the adjusted pro forma basis providing meaningful comparison and an appropriate basis for discussion of our performance.

Details of the excluded items are included in the reconciliation table included in our press release and are discussed in detail in our 10-K, which will be filed later today.

So with quite an exciting 2018 now in the record books, our attention turns to driving another year of strong performance for KDP in 2019. Here with me today to discuss the results in 2018 and our outlook for 2019 our KDP Chairman and CEO, Bob Gamgort; and our CFO, Ozan Dokmecioglu.

Also with us today is a recently hired Vice President of IR, Tyson Seely who some of you already know. Tyson will be on the IR team here at KDP reporting to me. For those of you who don't already know Tyson, I'm certainly you will enjoy working with him.

And finally, our discussion this morning may include forward-looking statements, which are subject to the Safe Harbor provision of 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. And with that, I'll hand it over to Bob.

Robert Gamgort: Thanks, Maria, and thanks to everyone for dialing in. We are very pleased with the strong results delivered in Q4 and for the full year of 2018. And we're especially proud of the progress we have made in creating our new beverage company. We expect to create sustained shareholder and stakeholder value over the long term.

We have largely completed our integration, bringing together 25,000 employees under a unified culture and harmonized processes. And we have established a singular focus to capture growth across the majority of beverage occasions in North America.

Most importantly, our in-market business momentum never lost a beat while we are in progress of integration, a real testament to the quality of our team members and the strength of our integration program.

We drove growth across the majority of our portfolio on 2018. Our on track to deliver our synergy goals and our in-position to deliver the overall value creation targets we communicated at the time of the merger even in an environment that has become much more challenging over the past year.

Let's talk specifics for 2018 before we speak to our expectations for the coming year. I'll begin with in-market results based on IRI.

Retail market performance was strong across most of the business. Our CSD portfolio registered market share growth in both units and dollars, with strong dollar performances for both Dr. Pepper and Canada Dry, and to a lesser extent, A&W, Squirt and Schweppes.

Outside of CSDs, we gain share in multiple cold beverage segments such as enhanced flavored still water, premium unflavored still water, ready-to-drink coffee, apple juice, vegetable juice and mixers.

Our coffee portfolio also delivered strong results in 2018, driven by unit growth approximating 10 percent for pods manufactured by KDP, out pacing category growth of approximately 8 percent. In dollar terms, KDP manufactured pods grew over 4 percent and a category that advanced approximately 3 percent. As a result, the dollar market share of pods manufactured by KDP advanced to 82 percent.

Turning now to total company financials… on an adjusted pro forma basis.

Net sales were up 2.3 percent for the year with strong revenue growth registered for all segments, except Coffee Systems, which was up in volume but essentially flat in dollars, due to our previously discussed strategic pod pricing investments.

Operating income advanced approximately 7 percent to $2.6 billion, with double-digit growth in the second half of the year, more than offsetting flat performance in the first half. For the year, the profit contribution from growth in net sales and continued strong productivity was partially offset by increased inflation in input costs and logistics. Further, the operating gains from

changes in the Allied brands portfolio in 2018 were less than those realized in 2017.

Adjusted diluted EPS advanced 22 percent to $1.04 for the year, squarely in line with our targets, reflecting the growth in operating income and lower interest expense as well as the benefit of non-operating income recorded in 2018 related to a cash distribution from BODYARMOR and a gain from the acquisition of Core. Also benefiting the comparison was a lower effective tax rate in 2018 due to U.S. tax reform.

Turning to our segments. On an adjusted pro forma basis…

I'll start with Beverage Concentrates, which posted strong results for the year. Net sales, which represents our sales of concentrates to bottlers and serves the fountain customers, advanced approximately 4 percent, driven by growth in both net realize pricing and volume mix.

The increase in net sales was driven by very strong growth of Dr. Pepper and A&W as well as increased sales for Squirt, Schweppes, Big Red and Canada Dry. Operating income for Beverage concentrates advanced 5 percent for the year, reflecting the strong net sales performance and slightly lower marketing spend.

Turning to Packaged Beverages...

Packaged Beverages delivered 4 percent growth in net sales for the year, reflecting volume mix growth of 5.4 percent for continuing brands, partially offset by the anticipated unfavorable impact of 1.2 percent, resulting from changes in the Allied brands portfolio during the year. Pricing for the year was essentially even with the year-ago, driven by the pricing actions implemented in late Q3 that offset lower net price realization earlier in the year.

Driving the net sales momentum was double-digit revenue growth of Canada Dry, reflecting successful innovation.

Dr. Pepper also registered growth for the year driven by the particular strength of our college football marketing campaigns, Fansville, which featured an engaging storyline that played out over the course of the season.

Core and Bai also posted very strong growth, partially offset by Fiji, Vita Coco and Hawaiian Punch. Contract manufacturing also contributed to the revenue growth for the year.

Operating income in Packaged Beverages declined approximately 10 percent for the year, primarily due to inflation that was not covered until we took pricing late in the third quarter, as well as the impact of gains recorded from Allied brands being lower in 2018 than 2017.

Partially offsetting these factors were the benefits of net sales growth and productivity. Illustrating the importance of our late year pricing actions, operating income for Packaged Beverages accelerated in the fourth quarter growing more than 8 percent, which Ozan will cover shortly.

As we head into spring, we see the benefit for the launch of Diet Canada Dry Ginger Ale & Lemonade and the introduction of Canada Dry Ginger Ale and Orangeade, both of which will be supported by marketing investment. In addition, we have continued innovation plan for Dr. Pepper and Snapple among other brand.

Turning now to Latin America Beverages...

Latin America Beverages had a strong year with net sales advancing 4 percent and operating income of 28 percent.

The net sales performance reflected higher net pricing of 5.5 percent, and favorable volume mix of approximately 1 percent, partially offset by unfavorable foreign currency translation of 2 percent. Penafiel led the growth in net sales along with Clamto, Squirt and Motts.

Operating income for Latin America Beverages grew 28 percent to $82 million for the year, primarily reflecting the growth in net sales as well as the

favorable impact of comparison to a year-ago write-off of prepaid resin inventory and to a lesser extent, productivity.

Now turning to the Coffee Systems segment…

Coffee Systems had a solid year with volume/mix of 3.2 percent, driven by strong K-Cup pod volume growth, offset by lower net realized pricing of 3.7 percent, reflecting the previously discussed strategic pod pricing investment which continues to moderate.

K-Cup pod volume grew 7.4 percent for the year, driven by increased household penetration of the Keurig brewing system, which expanded by 7 percent and is now approaching 22 percent on a rolling 52-week basis ending December.

Somewhat counter intuitively, brewer volume declined 1.5 percent, despite the growth in household penetration. This is a result of increase in Brewer quality, which has led to consumers holding on to their Brewers longer and is also resulted in fewer returns. Brewer sales were also impacted by the discontinuation of select legacy brewer models, partially offset by the success of our recently introduced K Café and redesigned K-Mini. Since 2016, our entire brewer lineup has been refreshed or replaced with new models.

The launch of K-Cafe, which was supported by the second year of our Brew-The-Love campaign, featuring James Gordon, has been well received in the market. K-Cafe enables consumers to make lattes and cappuccinos at home using any K-Cup pod. The consumer reviews that the new brewer had been exceptionally strong.

In addition, our updated K-Mini Brewer platform, which features a modern sleek design and improved coffee quality and temperature, is another example of our robust type program designed to drive new household penetration in the Keurig system.

Operating income for Coffee Systems was up a strong 9 percent for the year, primarily reflecting volume growth and strong productivity, partially offset by strategic pod pricing investment, inflation and higher marketing.

As you know, partnerships are a key element of our Coffee Systems strategy, and in 2018, we had a Tim Hortons, the iconic coffee brand in Canada, which was previously unlicensed and Panera, the well-regarded bakery cafe brand in the U.S. We've also signed an agreement with McCafe Canada, previously an unlicensed brand, which we will begin distributing in 2020. We also added and expanded multiple private label partnerships in 2018.

And finally, the strong pace of Brewer innovation will continue in 2019. While too early to share the specifics today, on our next call we will have the opportunity to discuss our 2019 innovation plan, which will begin shipping in Q2. We will also be increasing our investment behind Keurig brand marketing this year.

Before I turn it over to Ozan to provide more detail on the latest quarter and 2018 full year, I'll speak to our 2019 targets. For the full year, we are targeting adjusted pro forma diluted EPS growth in the range of 15 percent to 17 percent, representing $1.20 to $1.22 per share.

This growth rate is the same as the long-term target we communicated at the merger announcement over a year-ago, despite an increasingly challenging operating environment marked by higher inflation and CSD industry volumes that are somewhat pressured by the elasticity impact of pricing.

To navigate these pressures, we are strengthening our productivity efforts and investing in innovation, marketing and retail execution to continue to drive market share gains.

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

Ozan Dokmecioglu: Thanks, Bob, and good morning everyone. Let me start with the results of the fourth quarter, which was another very good one for KDP. I will then transition to our outlook for 2019.

Continuing on an adjusted pro forma basis…

Net sales for the fourth quarter increased 0.5 percent to $2.81 billion compared to $2.80 billion in the prior year, which reflected underlying net sales growth of 2.3 percent, significantly offset by unfavorable impact of 1.8 percent from changes in our Allied brands portfolio, which we expected. The underlying 2.3 percent growth was driven by higher volume/mix of 2.7 percent, partially offset by unfavorable foreign currency translation of 0.4 percent. Net realize pricing in the quarter was flat.

Operating income in the quarter increased nearly 13 percent to $720 million compared to $638 million in the prior year. This performance primarily reflected strong productivity, lower general and administrative expenses, reduced marketing spending and the benefit of the net sales growth. Partially offsetting these drivers was inflation in input costs and logistics. On a margin basis, operating income advanced 280 basis points in the quarter to 25.6 percent.

Before turning to a quick review of the segments, it's worth noting the acceleration in performance in the second half of 2018 versus the first half prior to the merger close.

Specifically, operating income advanced 13.5 percent versus year ago in the second half compared to a slight decline in the first 6 months of 2018. This step up in performance largely reflected very strong productivity and the benefit of pricing actions in Packaged Beverages taken in the third quarter.

In terms of segment performance for the fourth quarter, on an adjusted pro forma basis…

Net sales for beverage concentrates increased 4.8 percent to $352 million, driven by higher net price realization of 2.6 percent and increased volume mix of 2.4 percent.

Partially offsetting these positive factors was unfavorable currency translation of 0.2 percent. This growth was fueled by sales of Dr. Pepper, along with increases in 7UP, Big Red, Schweppes and Sunkist.

The shipment volume growth for Beverage Concentrates was driven by Canada Dry, Dr. Pepper, Big Red and Sunkist.

In terms of bottler case sales, Beverage Concentrates registered growth of nearly 1 percent in the quarter.

Operating income for Beverage Concentrates increased more than 14 percent to $242 million, reflecting the benefits of the net sales growth and lower marketing, partially offset by inflation. As a percentage of net sales, operating margin advanced 570 basis points versus year ago to 68.8 percent.

Net sales for our Packaged Beverages segment were essentially even with year ago at $1.18 billion, including the unfavorable impact of 4.2 percent from the changes in our Allied brands portfolio, which we expected.

Excluding this impact, underlying net sales grew 4.3 percent, reflecting favorable volume mix of growth 2.7 percent and net price realization of 1.7 percent. Unfavorable foreign currency translation of 0.1 percent served as a slight offset to the growth.

Driving the strong underlying net sales growth were Canada Dry, Core, Dr. Pepper, Big Red and Mott's as well as contract manufacturing.

Operating income for Packaged Beverages increased 8 percent to $206 million, largely reflecting the underlying net sales growth, including pricing actions taken late in the third quarter as well as favorable product mix, productivity savings and lower marketing spending.

These factors were partially offset by inflation and the unfavorable comparison against the $21 million gain on Bai in the fourth quarter of 2017.

Net sales for Latin America Beverages increased 1.7 percent to $120 million compared to $118 million in the prior year. This performance was driven by higher net price realization of 5.8 percent, and favorable volume/mix of 0.1 percent, partially offset by unfavorable currency translation of 4.2 percent.

Operating income for Latin America Beverages at once 20 percent to $18 million, reflecting the benefits of the net sales growth and productivity savings, partially offset by inflation.

Finally, net sales of our Coffee Systems segment declined 0.5 percent to $1.16 billion in the quarter. This performance reflected higher volume mix of 2.9 percent, more than offset by lower net price realization of 3 percent and unfavorable foreign currency translation of 0.4 percent.

The 2.9 percent volume mix growth for Coffee Systems was driven by an 8.6 percent increase in K-Cup pod volume, partially offset by an 8.6 percent decline for Brewers during the quarter. The latter being primarily driven by shipment timing between the third quarter and the fourth quarter.

For perspective, brewer sales in the second half were modestly below year ago. As you know, Q4 is a big brewer selling period for retailers, and their purchase of inventory can ship between the third and fourth quarter, partially offsetting these factors was a recent innovation launches that have been very well received in the marketplace.

Operating income for Coffee Systems advanced approximately 9 percent to $328 million, primarily reflecting strong productivity, partially offset by higher marketing expense and inflation.

Turning to interest… Interest expense in the fourth quarter totaled $139 million reflecting a $21 million benefit from unwinding several interest rate swap contracts, our ongoing deleveraging and the benefit of commercial paper in our debt structure in 2018.

You may have also noticed that earlier this month, we announced the refinancing of our term loan in an oversubscribed indication that reduced the pricing on our outstanding term loan balance of $2 billion by approximately 30 basis points.

The support that we continue to receive from our banking partners speaks to the confidence our lenders place in KDP. Net income for the quarter

increased 28 percent to $423 million, driven by strong operating income growth and the lower interest expense we reported in the quarter.

Taking all of these factors together, our adjusted pro forma diluted EPS in the quarter increased 25 percent to $0.30 per diluted share compared to $0.24 per diluted share in the prior year.

In terms of leverage, we paid down approximately $940 million of bank debt since merger close, reducing our bank debt to adjusted EBITDA ratio which we referred to as our management leverage ratio by half a turn to 5.4x.

This aggressive pace of deleveraging is consistent with our expectations, and we are confident that we will achieve our leverage target in the timeframe previously committed. This rapid debt pay down in the 6 months following the merger close was supported by strong free cash flow delivery.

In 2019, we expect free cash flow to approximate $2.3 billion to $2.5 billion, which will be a significant enabler to our ongoing deleveraging. We remain firmly committed to achieving our targeted leverage ratio below 3 times in 2 to 3 years from merger closing.

And finally, in terms of our outlook for 2019…

As Bob already mentioned, for the full year, we expect Adjusted pro forma diluted EPS growth in the range of 15 percent to 17 percent, representing $1.2 to $1.22 per share, in line with our long-term merger algorithm.

Net sales are expected to grow approximately 2 percent, which is also in line with our long-term merger target of 2 percent to 3 percent, despite the short-term transitory impact we discussed with you last quarter from the changes in our Allied brands portfolio.

We continue to expect merger synergies of $200 million in 2019, consistent with our long-term merger targets.

There are a few items related to changes in the Allied brands portfolio in 2018 that we do not expect to repeat in 2019. These items totaled $58 million in

gains in 2018, specifically other operating income in 2019 is expected to be a few million dollars of expense, as it will exclude the $22 million gain on Big Red recorded in 2018.

Below operating income, other non-operating income and expense is expected to be an expense of $30 million in 2019, as it will exclude the combined $36 million of gains recorded on Core and BODYARMOR in 2018.

Interest expense is expected to be in the range of $570 million to $590 million. This reflects our expectation of significant cash flow generation and continued deleveraging during 2019 as well as the benefit from additional unwinding of interest rate swap contracts, which is a strategy we use to manage interest rate risk.

Our effective tax rate for 2019 is estimated in the range of 25 percent to 25.5 percent for the year.

We expect our diluted weighted average shares outstanding to approach ($1.42 billion) in 2019, including the (16.7 million) of shares issued in November 2018 for the acquisition of Core.

While we are not providing EPS guidance by quarter, we expect EPS growth versus 2018 will to be tempered in quarter 2 and 3 due to comping the significant gains on Allied brands in 2018 that we discussed today.

With this perspective, you should also keep in mind the following when doing your modeling:

We expect our second half synergies to be greater than our first half synergies, as our programs built throughout the year.

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

Finally, the shift in Easter into the second quarter this year from the first quarter in 2018 will likely pressure quarter 1 net sales and operating income in 2019 by approximately $20 million and $10 million, respectively.

With that, before taking your questions, I will turn it back to Maria who has some good news to share regarding IRI data.

Maria Sceppaguercio: I know that tracking KDP manufactured pod performance is challenging for you using the existing syndicated reporting. I'm pleased to share that, in addition to their regular reporting, IRI has developed a KDP Manufactured Sales Trends Report for single-serve coffee that encompasses all of the K-Cup pods manufactured by KDP, whether owned, licensed, partner or private label. This new report will be available directly from IRI beginning in March. I hope you find it useful.

With that, I'll turn it back to the operator for questions.

Operator: At this time, I would like to inform everyone, if you would like to ask a question, please press * then the number one on your telephone keypad.

If your question has been answered and you wish to remove yourself from the queue press the pound key. Once again, to ask a question, please press * one. Our first question comes from the line of Lauren Lieberman of Barclays.

Lauren Lieberman: I know you guys went through some of the data points on Brewer sales and the dynamics of the replacement cycle. But I think that might be -- there might be a bit of confusion this morning around results from the coffee segment.

So if you could just talk again a little bit about how you were thinking about the rule of Brewers, brewers sales, brewer profitability, how that may have changed in the long-term plan? And also, anything around pods that you see as being indicative of kind of consumer uptick, adoption rates, things like that.

Because I think what I'm getting from people this morning is just questions around that coffee segment and does this mean that my long-standing concerns about legacy KGM business are coming to fruition? So I'd just love your perspective on that.

Robert Gamgort: Yes, thanks, Lauren, happy to answer that. From our perspective, the metrics across the board on the Coffee Systems are all flashing green.

I think our understanding is that sometimes it's a complicated business that requires some thought from our perspective to tell you why we feel that way. And it's consistent with what we talked about in the March of a year-ago Investor Day as well as the follow-up analyst meeting that we had.

Let me start at a higher level about that metrics that really matter on this business from management perspective and then I want to drill specifically into household penetration, brewer sales, and a little bit on what we see on pods.

So our -- the way that we run this business is the 4 metrics that matter, our household penetration of the system, pod volume growth, KDP manufactured pod share, and coffee system profitability.

Every single one of those metrics is going in the right direction in a very significant way. Household penetration, up 7 percent in the past year to about 22 percent of households - There are now 28 million households in the United States that are using a Keurig brewer on a regular basis. We still believe there's another 67 million households left for us to target.

But 7 percent growth in household penetration up to 28 million households is significant. Pod volume growth is up significantly. If you take a look at the pod -- K-Cup pod category in IRI, plus 10 percent for the year, incredibly robust. KDP manufactured share, up a point to 82 percent, as we talked about.

And we gave you the list of partners that we've added over the past year, some of them very significant, several of them were unlicensed parties and we haven't lost anyone in the past year. So that's speaks to the forward-looking confidence we have in that.

And then finally, coffee profitability. I'll get to brewers sales because then people are concerned about brewers sales which shows zero correlation in the short-term between household penetration and brewer sales, and we're going to give you the example that right now.

But also things like mix and pricing. We also have to look at the Coffee Systems even with the investment of pricing, grew margin in the fourth quarter by 240 basis points, and for the year, 290 basis points, which tells you that we also had incredible line of sight to productivity that we used to protect that pricing investments that we made.

So, those are the metrics that matter. Some of those are easier for you to get than others, but we're disclosing household penetration on an annual basis as we did today, and as Maria said, there's now a report available through IRI that will allow you to measure KDP manufactured pod shares. So those are all pointing in the right directions, so that you can see the business the way that we do.

Let me just talk about brewer sales for a minute.

At a very high level, we talked in the past, theoretically, that you could have situation where brewer sales were up significantly but have little impact on household penetration because they were all replacements.

Similarly, we talked about theoretical scenario where brewers could be down significantly yet household penetration was up because the replacement cycle was different and they were all going to new households. We're more towards that in 2018 in the last quarter, which our brewer sales were down but household penetration was way up.

The reason underlying that is actually really good news. A higher percentage of the brewer sold went to new households versus replacement households. Why is that? Because the quality of the Brewers is up significantly. You can see that by going online on Amazon or Wal-Mart or anywhere else and look at the star ratings of the Brewers and how much higher they were than those in the past. We also see it because we see significantly lower returns and significantly lower warranty claims.

Those are really good for the P&L and addition to speaking towards a better mix of new users versus replacement users. And the other part is we know as

one of the metrics that we track internally is that consumers are happier with their Brewers.

They don't break. And as a result, they're holding onto their Brewers for longer. So we're in this virtuous situation that the opposite, I think, of being concerned. We're actually very bullish because of the quality of our brewers, we're driving household penetration.

And ironically, it means that we're going to have some lower Brewer sales in situations that we did in fourth quarter because nobody's -- fewer people are buying and to replace a broken brewer - that means happier consumers in the end.

So net-net, we see these as all flashing green from that standpoint. Then the last thing I'll say on this point, and apologies for the very long answer, but I think it's a really important question. In the past, when the company lost a significant amount of money on brewers, everybody wanted to model brewer sales because the more you sold the bigger, the negative impact on profitability.

Similarly, if we made a lot of money on brewers, you want to know that because there'd be a direct correlation between sales going up and down in profitability.

We're about breakeven, as we've talked about. So be honest with you, brewer revenue going up or down has zero impact on the profitability on our P&L. And the only thing to you guys would care about it for is a proxy for household penetration.

And as I just went through in great detail, it's actually of poor proxy for household penetration. So short answer is, brewer revenue is really a meaningless metric in terms of our P&L as well as in indicating health of the system.

Operator: Your next question comes from the line of Judy Hong of Goldman Sachs.

Judy Hong: So I guess the other sort of question or concern that I'm hearing for investors in 2019 guidance and I know it's in line with our long-term target in terms of the EPS guidance.

But if I sort of take the implied EBIT growth in 2019, it looks like it's around 10 percent versus the 11 percent to 12 percent EBITDA growth that you have given previously. So first just wanted to confirm that this is in fact sort of what you're guiding to for '19 just from an EBIT growth perspective?

And if so, is this reflective of some of the challenges that you called out particularly on, I guess, the CSD side? And does that imply that you're going to be putting more investment to deal with some of the operating environment getting tougher?

Ozan Dokmecioglu: This is Ozan. Our guidance, as we have communicated just now, is on the EPS, which is in line with our long-term merger target that we put out there, 15 percent to 17 percent and on net sales 2 percent to 3 percent.

And as you pointed out, we do -- we did also provide significant amount of details with regards to the makeup of the P&L and hoping we make your jobs easier to model it out.

And you're right, we put the 11 percent to 12 percent operating income guidance back then as well. But as we said, it's a long-term algorithm. And it wouldn't be right to make a specific comments on a year basis. What matters is how we are managing the overall results delivery over the long term, as the name implies.

Sometimes there are big pluses or minuses here and there, but what matters is that we're 100 percent committed to daily to two things which is bottom line of the company as well as the cash deleveraging to reduce our bank debt and overall to get to a lower multiple.

On your second part question, as Bob explained, we always looked to the business from a holistic basis, cold and hot, if we make the investments whenever it is necessary.

And then we look to the brewer side of the equation, we've been investing in our campaigns in order to improve the household penetration numbers and came in at a 7 percent growth, which was a very robust number.

And whenever it is needed, as we have been doing, we will make the – all the trade-offs and the necessary investments in our cold side of the portfolio as well, which included a couple of brands of acquisition that we did in the second half of 2018.

Robert Gamgort: Just to add, I think, our role as managers and also, as we said a number of times, we have a significant amount of our personal investment in the company as well. So we're all in line of creating wealth is to make sure that we do it over the long term.

So I think what you really want us to do as leaders is navigate really difficult environments, make sure that we're delivering to the commitments that we have, which we are.

We're right in line with the targets that we gave a year ago despite the environment that everyone else has talked about. But also doing it at a high quality way. So we're getting to these numbers that we talked about, whilst investing more in the marketing and innovation side of our business. And what's the evidence of that?

The evidence of that is that we grew share of across the great majority of our portfolio in 2018. And actually to take away the IRI in the first quarter of 2019, we grew share in every single segment of our business.

So to be able to grow our business, invest in innovation and marketing, deliver the EPS targets while absorbing inflation that is significantly higher than it was at the time of the merger a year ago. I think, it's pretty good management, good navigation of the complexity and that's what you want out of us.

Judy Hong: Yes, I guess just follow-up on that just wanted to be clear just in terms of the (forward) commentary because Bob you alluded to sort of the price elasticity pressure in CSD.

Obviously, you know Pepsi is investing pretty significantly in their beverage business this year. So is that -- obviously is kind of driving maybe some of the caution as we think about 2019 from an operating standpoint. Why you're sort of managing to get into that long-term target?

Robert Gamgort: Yes, let me give some stats on that, right. So as one of the offsets, but not the only offset to this significant inflation that the industry has faced, we've all taken pricing. And I think it's -- the good news it's a very rational industry.

When you take a look at the final quarter of 2018, for example, the category pricing was up 5.6 percent. Volume was down 4 percent. So that's the elasticity impact of the price that you see in the category. For KDP, in the fourth quarter, our pricing was up 5.9 percent.

These are all in IRI, by the way. But what's interesting is our volume was down 2.2 percent, so the elasticity impact of our pricing actions is lower, or more muted than you see for the industry in total.

And that speaks to the quality of the brand marketing and the innovation pipeline, which means consumers are effectively willing to pay more for some of our brands, as a result of the -- of all the innovation market behind it.

So that's why we say, we have to be really balance this management to make sure that we're offsetting inflation with pricing and productivity.

But we're also on the other side of the equation investing in our brand to continue to drive growth. And we're talking forward-looking but -- all you have to do is look at the last quarter for evidence of it working.

Operator: Your next question comes from the line of Sean King of UBS.

Sean King: Can you expand on any benefits from Green coffee coming down? Is that yet to come? Or is that sort of being absorbed in the pricing investments in K-Cup's now?

Ozan Dokmecioglu: Sure. Obviously, we do have certain coverage positions. Actually not only in coffee, but across our commodities that impacts both the categories.

And on the basis of that, that we have a great visibility in terms of our cost structure in line with the price structure at the same time.

That is through that coffee beans are being in the declining mode 18 to 24 months and we take all the opportunities on the basis of the positions that we do have. And all the pluses or minuses they have been configured and included in our 2019 guidance.

Robert Gamgort: And the other thing just to build on that Sean is compared to -- what I would say traditional coffee company, the percentage that coffee represents in the total cost to good sold in a Keurig system is significantly lower than you would see for somebody's producing traditional roasting ground because a lot of value added to comes in the single serve format in the delivery of that.

So it has a benefit or negative, if we go to the other direction. We're well covered, so it never is a short-term impact for us. We like to be able to plan going forward, so we have great visibility for the year.

But any movement -- as you think about coffee in the future, any movement up or down is less of a direct impact on our P&L than it is for all, sort of, lower value added coffee scenarios than K-Cup's.

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

Kevin Grundy: Bob, I apologize if I missed this, but from a quantitative perspective, all the color on the Keurig side is very, very helpful, but specifically, part of the long-term guidance beginning 2019 was that the Keurig side of business was going to get back to 2 percent to 3 percent revenue growth.

Are you still confident in that? Maybe you could touch a little bit on that. And then, touch up on, Bob, the composition of pricing and volume.

I think the hope was that the price investment was going to kind of tail off after this year and stabilize. Are you comfortable with where pricing is? Should we still expect negative pricing as well? So maybe you could talk a little bit about the composition as well.

Robert Gamgort: Your -- it's a great question, thank you. You're seeing it -- over the past couple of years what you're seeing is we made it -- we made that decision to invest in pricing in a significant way.

We did for two reasons to get all of our partner's unlicensed players into the system and to extend the agreements with our partners, which has been successful. And also it was the single biggest barrier to consumer adoption of the system.

So we were able get two consumer and partner benefits by doing that, but obviously, we needed to have protection on that by visibility and to productivity, which from my earlier comment, the margin expansion suggests that we have that well under control.

Where we sit now -- let me talk from pricing for a moment. If you look at the last three quarters of 2018, the average KDP manufactured pod retailed for $0.53.

So it's been -- relatively stable over that last time -- over the last 3 quarters. It breaks out into tears they're exactly what you'd expect Premium at $0.68, mainstream at $0.49. That's actually really important metrics, so mainstream is just under $0.50 and private label that we manufacture is $0.33.

And all of those were within those thresholds that we talked to you guys about from a consumer standpoint below $0.50. Almost every American says no longer expensive. At $0.30, most say it's a bargain.

So we're right into that structure that we thought about. And you're also seeing this pattern of volume doing very well, accelerating and pricing change moderating. So you're going to -- we're going to continue seeing some negative pricing.

But as that moderates and as volumes increases to get to the very first part of your question, yes, we're comfortable with the way that we talked about the revenue growth of Keurig going forward. And it's all falling into line really exactly on plan.

Operator: (Operator Instructions). Your next question comes from the line of Bill Chappell of SunTrust.

(Grant): It's actually (Grant) on for Bill. Just a quick question on the Dr. Pepper side. As you guys have done a little bit more visibility into that business now, maybe looked at some more cost-cutting initiatives kind of beyond just the synergy realization, have you found more opportunity here going forward to brings more structure to the system?

And kind of following on that Ozan, is there a bigger opportunity on working capital from that business and maybe they've seen in the past?

Robert Gamgort: Sure, let me do the first right now. I'll ask Ozan to do the working capital part of that question.

From our standpoint is, we've got the base Keurig productivity programs and the ones that we're investing in significantly, like the new plant (in Spartenburg) and the whole reinvention of our pods supply.

We have the synergies that we talked about at lengths and good news is we're very much on track for that. And then we always look at what our opportunities to drive productivity above and beyond that. And we see lots of opportunities in that space.

And again, with evidence of that, evidence of the fact that we've been able to find more productivity is the fact that we've been able to stay right on track with the guidance that we gave a year ago, despite a significant uptick in inflation while at the same time upping the investment in our brand.

That tells you that we've been able to find more efficiency within the system that we've been able to deliver a really nice balance forecast for 2019 that delivers the commitments while still investing in the long-term health of the business. So Ozan you want to talk about the working capital side?

Ozan Dokmecioglu: Sure, and as we share with you everybody, we had long-term guidance between 2019 and 2021 in terms of the working capital delivery from an incremental perspective and the improvements.

And once we had a greater visibility into the legacy DPS business, we are very happy to share that all the findings were either on the forecast that we anticipated or even better. That's why increases our confidence in terms of delivering our deleveraging commitments that we put out there more (12 months) ago.

We are quite pleased with the performance of the working capital coming along, and you'll see in 2019 and beyond when we report quarter in and quarter out, improvement as well on our balance sheet.

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

Amit Sharma: Two questions. Bob, and Ozan, can you just provide us a little bit update on the new capacity for K-Cups? How far along are we? And once it is up and running, what does it do to you cost structure?

And the second one Bob, and that something that we're hearing today as well. I mean, at least if you look at 2019 EPS growth, bulk of that is coming from cost, synergies from the merger and interest savings and in the context of what happened to the packaged food space last week.

The questions are like once those factors start to moderate, do we have enough visibility that the base business will be able to continue to grow at this level of EPS growth once you (latch onto) these benefits?

Robert Gamgort: Let me start with the last part first. And the last part is, I think, in this environment the fact that we're able to deliver 15 percent to 17 percent EPS growth while investing in our business and the fact that we're growing across every single segment, growing share, gives us a ton of confidence in the sustainability and the health of this business.

In terms of visibility -- given visibility at the time of the merger announcement for 3-plus years, and we're only what 9 months into -- a little less than 9 months since we've closed on the business, 6 months from a financial reporting perspective.

So we're in the really early days of that. We've got the visibility that we've communicated, and again the fact that we're here today saying despite all these changes in the environment, we're right on track since we have the flexibility to navigate through the right answer.

We'll worry about what happens after 3 years from now when we get closer to it because we have no idea what the environment is but the fact that we have that kind of visibility, I think, puts us in good position versus most of the world.

With regard to the pod supply chain, all of the savings, all the pricing and everything else is all built into the long-term targets that we've given you. So start pulling those all a part actually isn't fully constructive. That's how we're able to do, what we're able to do, as I said before.

A lot of the concerns about brewers sales and pricing – my counter to that is volume up and accelerating household penetration growing very healthy, consumers returning Brewers at a lower and holding on them too long because they like them, and margins for Coffee Systems up almost 300 bps for the year. We get there by the combination of all of the things we talked about. So it's all contemplates, all built into it. Where are we on builds?

One of the big projects within our pod supply chain reinventions, (Spartenburg), buildings our construction, lines have been tested at the manufacturers. They're ready to be installed once the building is done. Things are moving along nicely on that and it's all part of the long-term plan that we put out there before.

Operator: You're next person comes from the line of Laurent Grandet of Guggenheim Securities.

(Clay Cremose): This is (Clay Cremose) on for Laurent. Bob, if we can just go back to coffee real fast. So I think in the standard data, we continue to see that you're losing share to private label and you touched on the pricing which is really helpful, but could you talk about the interaction of your branded portfolio with private label?

And then how you, sort of, reconcile that performance with the fact that you're the third party manufacturer for the majority of the private label offerings?

And then related to that, just how are you looking at the composition of your current branded coffee portfolio, especially given sort of the recent press that in our major brand could be on the block?

And even more broadly than that, how are you thinking about potential opportunistic M&A across the portfolio, given the constraint balance sheet that doesn't have to just be coffee, I mean, it could be sparkling water, for example? So I know there's a lot there but anything you could offer would be helpful.

Robert Gamgort: I'll start, you may have to remind me on a couple of weak points here. I'm not sure if I got them all down. I think -- let me just clarify some things on share because there's a lot of confusion on that. First of all, we produce the majority of private label pods that out there.

As I said before, 82 percent of the dollar in pod is going to the Keurig system are manufactured by us and that's up a point versus a year ago.

We said that's one of the 4 metrics that we really track very carefully here. Within that 82 percent, there's a mixture of brands that we own, partner brands that you would recognize as well as some private label brands. The differential in margin between each of those has been narrowed greatly.

So we're much more -- we're fairly indifferent to mix within that. All we care about is, do we manufacture the pod? And is household penetration growing, which means the pod buying is going to grow. So why are we so bullish today?

The number of households that take on the Keurig system last year, they use it regularly is up to 28 million, which is a 7 percent growth in household penetration of the 22 percent. Pod volume's in IRI are plus-10 percent and our KDP manufactured share pod is up to 82 percent, up a point.

So those are all things that really matter in the system and that's why the profitability of our Coffee Systems is so robust in 2018. The mix within there's much less of a concern. And again, I think there's this confusion where people are quite private label with unlicensed.

We do the majority of private label in the margin that we achieved on that is very respectable. The last thing I would say is our owned unlicensed portfolio so those brands that we're actually not manufacturer but also the brand owner, Green Mountain, Donut Shop as an example. If you go back, they once had 100 share of the system.

So as brands have been added to the system and has grown, by definition, our share of owned and license pods has declined. And we're at a point now where in the latest 4 weeks, at the end of the year 2018, we have 24 share, down about 1.5 versus a year ago.

That's all projected in the numbers that we've talked about and we look at going forward and we see that is all part of the natural, sort of, evolution of the system as it continues to grow the single biggest benefit for consumers as brand choice.

We want every coffee brand to be in the system, and we want to be the manufacturers of those pods. That's the way we think about it strategically. And again, that's why we're so bullish on the Coffee System and it's delivery.

(Clay Cremose): On the M&A side?

Robert Gamgort: M&A side we don't talk about M&A on any side. I would tell you on the cold beverage side, there's still a significant amount of white space in our portfolio. We've filled in that whitespace through a combination of brands we acquired like Core, new partnerships that we've entered into like Evian and Pete's and other things that we're contemplating in the future, including organic development of brands on our own or segments on our own.

But the fact that we have available whitespace in the cold side of the portfolio is net -- a real positive for the future of this business because it tells you we have many avenues for growth that haven't been pursued yet.

Ozan Dokmecioglu: And you also mentioned that our balance sheet is tight due to into our leverage or the multiple and this can be limiting factor. In fact, it's the opposite, as we have shown and proven the Core acquisition.

We always more than welcome to use our share in order to buy right targets for us, if they do exist as well. So there's no constraint in terms of the balance sheet and we still 100 percent committed to our deleveraging commitment at the same time.

Operator: Your next question comes from the line of Peter Grom of JP Morgan.

Peter Grom: So I just wanted to kind of follow up on your last comment, kind of, get your thoughts on how brand portfolio. So maybe could you provide a little bit more color on how Evian is performing versus your expectations?

And then any commentary you'll be willing to offer on the pipeline for your (Allied) brands? And then aside from organic beverages, are there particular categories you're looking to become more involved in?

Robert Gamgort: Yes, let me just do a quick refresher just for everybody on sort of the Allied brands portfolio as we sit here today, has been transformed versus where we're setting a year ago.

And I think a year ago there's a lot of concern what was to happen and I say again, fast-forward to a year later, is there while we've got a really good stable partner brands and their providers is a source of growth for us going forward.

The new brands we added were Evian, Pete's, and Forto. The brands we acquired were Core and Big Red. The brands that left were Fiji and BODYARMOR. And the brands that continued on with us Vita Coco, High Brew, and Neuro.

So we like that line up and we've got a lot of opportunity in front of us to really now drive Evian, Pete's and Forto, which are new brands. It's just getting started in this quarter. There were minimal sales of those businesses in the fourth quarter of last year.

That's now ramping up in the first quarter and will accelerate throughout the year, as we kick up distribution. And that's exactly we track as a management team, are we given the distribution a bill that we committed to, to our partners? Are we getting the pricing and the merchandising performance?

All of that is nicely on track. Again, having said all that, you've got to remember that when you take out two brands like Fiji and BODYARMOR and you add these new ones, which are in the emerging stages, we took quite a hit in the fourth quarter and in the beginning part of this year on revenue because those brands were gone and the new ones weren't in yet.

And that's now more of a tailwind for us going forward because as we build it, we're able to get the revenue and profit growth over this businesses that we had observed. But I repeat myself, as I said a couple of things, despite that hit, we did miss a beat in terms of profit delivery or commitment to our algorithm. I think, we put ourselves in a really nice position to grow.

So where are we future on Allied brands? We've taken a very disciplined approach to this something that we talked about before.

There's a lot of interest in brand owners to work with us and our system. As we've all talked about and we now realize first hand, distribution -- DSP distribution into small outlets in cold cases in particular is a scarce resource.

And we're one of the partners that's a really good opportunity for them, given that we have so much whitespace but we've been really disciplined about the terms of how we will work with somebody.

And it either has to be a situation where if we can't own the brand in the future like Evian then we need a really rock solid long-term equity-like agreement, and by the way, the other side wants that as well.

But if it’s a brand that we can own, we want to have an equity stake in that up front and we want to have a path to ownership, which means, for the most part, we've pre-negotiated the terms that exit in the future.

What we won't do is just quickly jump into a distribution agreement, make the brand successful and then have a negotiation with them about what the value of that brand is. That's not something that we're repeating.

So short summary of that one is we're really bullish about the brands that we have in our portfolio and there's all up side and a lot of work to do to get that distribution. Lots of interest, but also it's matched with a lot of discipline on our part to make sure that we're entering into this in a right way.

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

(Freddy Mitchell): This is (Freddy Mitchell) on for Robert. I had a quick question on marketing spend. So the third quarter you guys have called out the timing of the marketing spend was a benefit to operating profit performance.

And indicated that we part ways investment I guess for holiday season. And then so again we're kind of calling out marketing is a benefit to the fourth quarter? And so I was wondering are you spending the right level? What are the puts and takes on that?

Robert Gamgort: Let me clarify that because you'll get a chance to go through the K review but the only comment we made on marketing spend was on the Beverage Concentrates business, not in the other sections of the business. And we're investing heavily in both the Keurig system as well as the cold system.

And then the other thing you have to -- and this is a little more nuance but it's really is important to understand when you put two companies together one of the synergies that you create is more purchasing power on media and we've got a significant increase in scale and capabilities on our media side now. And what that means is that you're able to get the same region quality at a lower cost.

So in that situation, you can actually spend the same dollars and have a fairly significant increase in the effective reach of those dollars because you bought that media at a better price because of their consolidation.

So there's a lot of that all working together but what you need to take away from this is were not using marketing as a source of profitability at all as tempting as that would have been given the world of inflation right now, and a factor we're doing the opposite investing more behind our total business.

Operator: Your next question comes from the line of Damian Witkowski of Gabelli Research.

Damian Witkowski: Bob, your comments on the Keurig machines and household penetration make a lot of sense. But I'm just curious, do you actually have enough information to precisely know whether new Keurig machine is a replacement machine versus a new household?

Robert Gamgort: We do. It's a great question. I mean. We use multiple sources internally to get at household penetration and then we're able to get sort of qualitative data below that in terms of how are they feeling about brewer, how long have they had it, et cetera. We also know when somebody drops out of the system, why dropped out of the system. We also see it – throughout this ongoing data source that's proprietary to us, that we have, that's been consistent for years, so we're able to test that backwards against the history to make sure that it's accurate, and it's very good.

In addition to that, we also have metrics on return rates, which we get from our customers and also warranty claims, and that – those are really hard numbers. And we've seen a significant improvement in those numbers. I'll give you an example, if somebody puts in a warranty claim in, and they return, that actually boosts brewer sales.

So, if you send people back out there to rebuy a brewer that they turned in for warranty, perversely that increases the revenue of Brewers. I would argue that's a terrible situation. So the fact that we're getting fewer warranty claims and few returns is of profit positive to us.

It also means happier, more satisfied consumers but it also has a negative impact on revenue. And quite frankly, we don't care about that because there's not profit or loss impact resulting in that. So sorry for the long answer, but we really have a ton of data.

The other thing that we haven't talked about, but I just want to remind everybody is, we have a household panel that's statistically significant, that's about 12,000 to 15,000 connected Brewers out there. And we provide that data to our partners. So if you're in the Keurig system, you get exclusive access to this.

And it literally captures point of consumption data meaning when somebody brews a cup, in this panel, we know what they brewed, what brand, what size, which strength, and we see that live to our partners and you get a lot of data in terms of the quality of household penetration around that. So we feel really good about those numbers.

We like to give -- we want to give them to you on an annual basis. You could get a proxy for this by looking at household penetration of pods through IRI. The caution on that is it's volatile for no good reason. But over time, it's a good proxy, but that's what we're going to give you household penetration.

Damian Witkowski: Thanks. That's very helpful. And did you comment at all about your pricing expectations for CSDs in 2019?

Robert Gamgort: I can't forecast it. Like I said, it's rational industry and it's going to depend on inflation but the numbers that you see it on a weekly basis through the syndicated data, as I said before, in the 13-weeks ending December, the category was up between 5 percent and 6 percent, which is pretty robust pricing in CPG environment. So it's all going to depend on what inflation looks like going forward.

Operator: That was our final question for today. I will now return the call back to Maria Sceppagurcio for any additional or closing comments.

Maria Sceppaguercio: Thank you, thank you all for listening in today. As always, we are around. If you have any follow-up questions and you want to talk to us, just give us a call. Take care, have a good day, everyone.

Robert Gamgort: Thank you.

Operator: Thank you for participating in Keurig Dr. Pepper's conference call. You may now disconnect.

END