Keurig Dr. Pepper Inc.

Moderator: Gamgort, Robert

February 24, 2022

08:00 AM ET

Operator: Good morning, ladies and gentlemen and thank you for standing by. Welcome to the Keurig Dr Pepper Earnings Call for the Fourth Quarter and Full Year 2021.

This conference call is being recorded and there will be a question-and-answer session at the end of the call. I would now like to introduce Keurig Dr Pepper's Senior Director of Investor Relations, Mr. Steve Alexander. Mr. Alexander, please go ahead.

Steve Alexander: Thank you. Hello, everyone. Thanks for joining us. Earlier this morning we issued our press release for the fourth quarter of 2021. If you need a copy, you can get one on our website in the Investors' section.

Consistent with previous quarters, today we will be discussing our performance on an adjusted basis, excluding items affecting comparability. The company believes that the adjusted basis provides investors with additional insight into our business and operating performance trends.

While the exclusion of items affecting comparability is not in accordance with GAAP, we believe that the adjusted basis provides meaningful comparisons and an appropriate basis for discussion of our performance. Details of the excluded items are provided in the reconciliation tables excluded 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 us today to discuss our fourth quarter 2021 results 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 the Private Securities Litigation Reform Act of 1995.

These statements are subject to a number of risks and uncertainties that could cause actual results to differ materially and the company undertakes no obligation to update these statements based on subsequent events. A detailed discussion of these risks and uncertainty is contained in the company's filings with the SEC.

And with that, I'll hand it over to Bob.

Robert Gamgort: Thanks, Steve and good morning everyone. As you recall, this past quarter represents the completion of our three-year merger plan and the beginning of the next chapter of our transformation and growth as we detailed for you during our Investor Day in October.

With the merger plan now in the record books, I am pleased to report that we met or exceeded all of our key commitments and we have demonstrated the power of our new company with a significantly faster growing business than at the time of the merger.

The volatile macro environment we have faced since the merger has tested the industry and our business. It has also provided the opportunity for KDP– demonstrate the strength and resilience of our business model and our ability to withstand unforeseen events and deliver on our long term commitments.

In terms of a few specifics, our top line strength over the past three years is a standout, growing approximately 5% on a compound annual basis over the period. Almost double the merger target of 2% to 3% growth.

More importantly, our sales growth accelerated significantly over the three years, with 2021 net sales advancing nearly 8.5%. Our strength since merger extends well beyond our financial commitments as we delivered high quality in-market performance, including broad based market share growth across our portfolio and meaningful expansion of new households using the Keurig system.

Importantly, we maintain top line growth each year since the onset of COVID. As we've been able to pivot the grow certain segments of our business faster to offset those that were, and in some cases, continue to be negatively impacted. Market share expansion in cold beverages was driven

by exceptional strength in CSD, which have grown 1.5 share point since 2019.

In coffee, the Keurig ecosystem continues to expand with 8 million new US household added to the system since 2018. Since 2019, we've driven growth in KDP consolidated net sales of nearly 14% and an adjusted EPS of 31%. These results were fueled by strong execution, successful innovation, and high impact marketing.

On a three-year basis, key financial metrics including adjusted EPS, management leverage ratio, and synergy capture were delivered well within our merger target range. With adjusted EPS up more than 15% on a compound annual basis over the post-merger period.

We delivered this performance while building a solid foundation for the future, including the advancement of our corporate responsibility agenda, achieving the goal set before the merger and expanding into new areas such as diversity and inclusion, positive hydration, and regenerative agriculture. All of this is underpinned by a talented team and a culture that rewards bold thinking, speed, and a mindset of ownership and accountability.

Investors who have been with us since the merger have been rewarded by a total shareholder return of 109%, which is more than 2x the consumer staples sector index and two times the return of the S&P 500 index. Important to the delivery of these strong results is how we manage KDP.

Our playbook includes a range of strategies and tactics that enable us to navigate through volatile conditions in the short term to stay true to our long-term vision. A good example is our strategic asset investment program, which we initially launched in 2019 and have used each year since, including in Q4 of 2021 to maintain or increase marketing investment in our brand portfolio. Ozan will discuss more in his remarks.

Let's talk about the current environment we're facing. At this point in the earnings season, you are fully up to speed on the range of issues negatively impacting the CPG industry. Supply chain disruption driven by labor shortages, lack of material availability, and broad transportation issues have reduced industry customer service levels and pressured gross margins.

In addition, unprecedented levels of inflation across nearly all components of cost of goods and cost to serve necessitated multiple pricing actions across the industry most of which lagged inflation in terms of timing in the market.

These challenges intensified in the fourth quarter with the onset of Omicron, causing significantly higher absenteeism across manufacturing and commercial frontline workforces. It has been reported that 6% of the US workforce was absent at the start of the New Year due to being infected with COVID or caring for someone who had been affected. As significant as that number is it actually understates the real impact on supply chains.

We, for example, experienced absenteeism at key plants in the double digits, which magnified an already challenged labor situation, causing the workforce to drop below critical threshold levels. We're certainly not alone. Our suppliers of inputs, transportation services, and plant equipment are also experiencing these challenges, which is comp– has a compounding effect on our operations.

Of course, we don't get paid to report the news, but rather to deliver our commitments regardless of the macro situation. That's exactly what we've done. By implementing an unprecedented set of actions to increase labor availability and prioritize our portfolio to ensure availability of the fastest turning highest profit items.

A tangible example of the challenges we faced and the solutions we have implemented is in coffee systems. Record consumer demand for K-Cup pods bumped up against lower manufacturing output and a delayed new capacity availability, both directly related to COVID. This caused us to tap into our finished goods inventory in Q4 falling below safety stock levels, which impacted service to our partners and retailers.

We have successfully rebuilt production output since the height of Omicron absenteeism, but we are now servicing the continued high consumer demand while working to rebuild inventory, which is a process that will continue well into the next quarter.

Ozan will talk more about the impact of these supply challenges in his comments. While we're seeing light at the end of the supply chain tunnel, as the wave of Omicron runs its course, inflationary pressure continues to

be persistent. To address continued inflation, we implemented several pricing actions over the past six months and announced more pricing in early 2022. To date, our elasticities have held up nicely.

Most of the challenges discussed today were reflected in the 2022 outlook we provided at our October Investor Day. At that time, we expected the impact of supply chain disruption and escalating inflation to be significant headwinds for the year, resulting in our projection for net sales and EPS growth to be in the mid-single digit range for the full year.

Nearly five months since investor day, we continue to believe this guidance for the full year is realistic. Yet it's important to highlight the expected pacing of results throughout the year.

Specifically, we expect Q1 to represent our most challenging comparison to last year as we manage through the peak levels of supply chain disruption and significant ongoing inflationary pressures.

EPS performance is projected to improve starting in Q2, reaching high single digit growth in the second half of 2022, which would put us back on our long-term algorithm.

Let me take a few minutes to shift back to 2021 to highlight our full year results. Our top line performance continued to accelerate with full year net sales growth of more than 8% and all four business segments up strongly.

Our packaged beverage segment was a standout, posting double digit net sales growth for the year fueled by an impressive 17% increase in the fourth quarter.

Our beverage concentrates and Latin America beverage segments also delivered strong double digit net sales growth in 2021 while our coffee business, posted net sales growth of 6% due to an almost 6% increase in pod shipments and a double digit increase in Brewer shipments.

In 2021, we added nearly 3 million new US households to the Keurig's system on top of approximately 3 million new households added in 2020, which means total US Keurig households are now– approaching 36 million.

Adjusted EPS for the year advanced more than 14%, which translated to 31% EPS growth on a 2-year basis as previously mentioned. Strong in-market performance for our brands underpins the delivery of our financials.

Our LRB portfolio grew market share across nearly 75% of the portfolio in 2021 and almost 80% when looking at results on a 2-year basis. Most notable was continued strength in CSDs, which drew consumption by 26% and market share by 1.5 share point since 2019.

In fact, KDP took over the number two share position in CSDs in the grocery channel in 2021. The drivers of our CSD performance are widespread and sustainable. While nearly all of our CSD brands continued to perform well, Dr Pepper was again one of the fastest growing major CSD brands in the US last year, and it was the single fastest growing since 2019.

When Fortune recently unveiled its Halo 100 ranking for how well brands served their consumers, Dr Pepper was the only beverage brand in the top 100 and the only FMCG brand in the top 20.

Sunkist took over leadership of the fruit CSD segment in 2021, fueled by innovation. Since 2019, Sunkist has grown dollar consumption by 35%. With the success of our zero-sugar innovation in 2021, we gained over three share points and zero sugar CSDs, capturing a third of this zero sugar category. And later this year we will be launching Snapple zero sugar.

Looking at other key segments of our cold beverage portfolio, our CORE, Snapple and Bai brands whose growth was capped in 2021 by supply chain disruptions, demonstrated positive in market performance as product availability improved in Q3 and Q4.

Retail consumption was up double digits for both CORE and Bai in the quarter, while Snapple was up 5% in the quarter and ended with double digit growth in December. The Snapple refresh, which was designed to bring younger consumers into the franchise with new graphics and sustainable packaging, is proving to be successful.

Our premium water strength continues to be enhanced by strong partnerships. The success of Polar Seltzer demonstrates the power of the KDP distribution network as we continue to expand availability outside the

Northeast region, achieving a 4.3% share for our first year in the markets for, which KDP is responsible for the brand.

VitaCoco, a long-term KDP partner, in which we also made an equity investment in 2021, had an exceptional year. Growing dollar consumption 33% and market share by almost seven full percentage points to nearly 51% of the coconut water segment.

Switching to coffee, where retail dollar consumption of single serve pods manufactured by KDP in tracked channels, grew 2.7% for the year. With higher growth achieved in untracked channels due to continued strengthen ecommerce and club and a limited return to offices. Growth would have been even higher if not for the Q4 supply chain disruptions, which led to reduced promotions and increase out of stocks. KDP manufactured share remains strong, increasing to 83.2% for the year.

As mentioned previously, Keurig household penetration continued to be exceptional, adding 8 million new households to the Keurig system since 2018. Further demonstrating the power of the Keurig system, for the first time ever unit market share of Keurig compatible brewers surpassed traditional drip coffee makers in the fourth quarter.

In 2021, we debuted a new platform for Keurig with the launch of the K-Supreme Smart Connected Brewer, which is the first of many new connected brewers to come. The consumer reception has been very strong and we have a line of sight to having more than a million connected households in the next few years.

Finally, although we don't give our Latin America beverage segment much airtime on these calls, I'd like to point out that our team delivered 14% revenue growth and 19% operating income growth behind particular strength in Peñafiel and Clamato.

In addition to being a strong contributor to total company results, LAB represents an attractive expansion opportunity for KDP.

Before I turn it over to Ozan to talk about our 2021 results and our 2022 outlook in more detail, I'd like to reflect on our long-term outlook as discussed at our Investor Day. The completion of our merger period

provides an opportunity to reflect on our accomplishments over the past three years as well as our potential over the next three years.

While we will always manage our business through the challenges of the day, we measure ourselves on long-term value creation and therefore keep our focus on delivering in the present and investing for the future.

As we look to the future, one of the most attractive aspects of the KDP investment story is our unique potential to drive outsized returns through a combination of an attractive organic growth algorithm, coupled with the opportunity for significant inorganic value creation.

You will recall from our Investor Day, our outlook was to generate approximately $4 billion of discretionary free cash flow between 2022 and 2024. Since Investor Day, we have received proceeds from our BodyArmor investment as well as funds from the settlement of our litigation against BodyArmor. Combined, this resulted in cash proceeds approaching $1 billion, increasing our discretionary free cash flow outlook over the three-year period to $5 billion.

This cash flow is being prioritized to the highest ROI use of our capital, which we continue to believe is strategic M&A where we have a differentiated and demonstrated management expertise and track record. Discretionary cash of $5 billion translates into more than $20 billion of M&A capacity, assuming the same reasonable expectations we discussed in October.

Coming out of Investor Day, we saw a few headlines suggesting that we were looking for a singular large acquisition. Let me assure you that we remain intentional and disciplined in our allocation of capital and that the significance of our more than $20 billion in M&A firepower represents total capacity for M&A, not a singular or targeted deal size.

In the absence of value generating M&A, we will use our new share buyback authorization to opportunistically repurchase shares. Our effective deployment of free cash flow over the previous three years is a good example of how we think about shareholder value creation through deployment of capital.

During that time period, debt repayment was our top priority and a strong generator of shareholder value; however, also during that time we acquired the CORE, Big Red, and Limitless brands; made an equity investment in VitaCoco and several startup businesses; brought 22 independent distributor territories into KDP to strengthen our company-owned DSD system; and invested in expanded production capacity and high-return plant and warehouse automation projects.

At the same time, we also passed on numerous M&A opportunities including BodyArmor. When we believed it was more prudent to be on the sidelines or a seller rather than a buyer. With our balance sheet and strong position and exceptional free cash flow in front of us, we're excited about our ability to continue to generate strong inorganic returns on top of our attractive organic TSR algorithm.

Let me hand it over to Ozan.

Ozan Dokmecioglu: Thanks Bob, and good morning, everyone. I will start with a review of our performance for the fourth quarter and full year 2021, which our press release discusses in significant detail and then turn to our 2022 guidance. All of this discussion will be on an adjusted basis.

Constant currency net sales in the fourth quarter increased 8.5% to $3.39 billion, fueled by higher volume mix of 4.4%, and favorable net price realization of 4.1%. This performance was driven by 17% growth in Packaged Beverages as well as very strong growth in Beverage Concentrates and Latin America beverages.

On a two-year basis, net sales for the fourth quarter increased 15.7% versus 2019. Adjusted gross profit increased 4.7% in the quarter to $1.83 billion. Adjusted gross margin declined 210 basis points versus year ago to 53.8% of net sales. This performance reflected the impact of the significant pricing actions we put in place as well as delivery from our robust productivity programs and merger synergies.

Offsetting these drivers was the impact of both widescale, accelerating inflation, and supply chain challenges. Many of which compounded with the onset of Omicron in the fourth quarter, which is also a seasonally high demand period for us.

Adjusted operating income in the quarter grew 6.1% to $910 million driven by the increase in adjusted gross profit and the benefits of productivity and merger synergies that favor of the impacted SG&A as well as $70 million gain in the quarter from our strategic asset investment program.

I will talk more about this program in a few moments. Partially offsetting these positive drivers were broad based inflation in outbound logistics and labor as well as higher marketing investment.

On a constant currency basis, adjusted operating income increased 5.9% versus year ago. And on a two-year basis, adjusted operating income increased 11.9% versus 2019. Adjusted operating margin declined 70 basis points to 26.8% of net sales in the quarter, primarily due to the lag between the timing of inflation and pricing.

Adjusted net income in the quarter advanced 15.5% to $640 million versus year ago, primarily driven by the growth in adjusted operating income, lower interest expense, and the lower adjusted tax rate. Adjusted diluted earnings per share in the quarter grew 15.4% to $0.45, compared to $0.39 in the year ago period.

Before turning to 2021 full year results, I would like to spend a moment discussing the inflationary pressures and supply chain disruption we have referenced this morning.

During the fourth quarter, inflation accelerated considerably. With increases across nearly all key inputs, leading to a double digit inflation rate across cost of goods sold and SG&A combined. This is significantly higher than we experienced in the third quarter. As we look to 2022, we expect this level of inflation to continue for much of the year, with some moderation expected in the fourth quarter.

As Bob explained earlier, similar to others in the industry, we have faced a number of supply chain challenges; however, in quarter four, it was our coffee systems business, in which short-term profitability was most pressured by the convergence of demand and supply events.

Consistently strong consumer demand for K-Cup pods exceeded our manufacturing output, which was limited due to labor shortages and absenteeism driven by Omicron and a delay of our Spartanburg facility

ramp up. Also due to the impact of COVID on our European equipment supplier.

As a result, we missed pod revenue opportunities, incurred incremental logistics costs as we expedited the available supply to partners, and incurred substantial customer fines when our customer service levels missed targets.

It is important to highlight that embedded in our coffee systems pricing results as the customer fines related to service levels, which are included on the P&L as a deduction to pricing, which masks the positive net price realization the coffee systems achieved in the quarter.

As Bob also mentioned, we have taken action to maximize production within our existing network to improve customer service levels and to meet the continued strong consumer demand.

Working closely with our partners, we have been able to simplify variety and implement minimum order sizes. We have also used the supply challenges as an opportunity to rationalize certain SKUs in our owned and licensed brand portfolio and we have shed some lower profit partner business.

Collectively, these actions are already enabling us to improve production output and rebuilt inventory. Our KDP manufacturer shares and to a lesser degree, owned and licensed that you will see in syndicated data, we will be negatively impacted by these actions; however, they will have little to no impact on our profitability.

Finally, we continue to work with our equipment supplier on ramping up Spartanburg, but we have de-risked our plan by increasing capacity at existing facilities and assuming no additional pod capacity coming from Spartanburg until 2023. The actions we had taken to increase production in all other sites will enable us to supply the needed demand until that time.

Let me turn now to our full-year results for 2021. Constant currency net sales grew 8.4% to $12.68 billion. Driven by higher volume mix of 5.7% and favorable net price realization of 2.7%. More importantly, net sales growth was strong and balanced across each of our business segments.

On a two-year basis, KDP net sales advanced 13.9% versus 2019. Adjusted gross profit growth of 7.9% to $7.04 billion equated to a gross margin of 55.5% for the full year a 70 basis points decline versus last year.

This performance reflects a series of pricing actions implemented late in the year combined with productivity and merger synergies. Offsetting these positives was a significant growth based inflation and supply chain disruption previously discussed, which accelerated in the fourth quarter.

Adjusted operating income grew 7.2% to $3.42 billion and adjusted operating margin declined 50 basis points. Given the industry challenges in 2021, finishing the year with operating margin down only 50 basis points speaks to the underlying strength of our business and the benefits that come with a strong top line growth.

In addition to the gross margin performance, also benefiting operating income were strong productivity and merger synergies as well as the year-over-year benefit of our strategic asset investment program. This program, which we started in 2019, creates value from certain assets to enable the investment in strategic assets to drive accelerated growth.

Earlier I mentioned the impact of this program in the fourth quarter result; however, most relevant is the much smaller full year impact of only $28 million, which is significantly below the increase in marketing investment we made in 2021. We plan to continue to use this program in 2022 and beyond.

Adjusted net income for the year advanced 14.7% versus year ago to $2.28 billion, primarily reflecting the growth in adjusted operating income as well as lower interest expense and the lower adjusted tax rate.

For the year, adjusted diluted EPS grew 14.3% to $1.60, compared to $1.40 in the year ago period. On a two-year basis, adjusted diluted earnings per share was up 31.2% versus 2019. Free cash flow for the full year continued to be strong at almost $2.6 billion, representing a free cash flow converging ratio of approximately 113%. This strong free cashflow, combined with the cash proceeds of $576 million from the sale of our equity interest in BodyArmor, enabled us to reduce our outstanding bank debt by over $1.7 billion and the structural payables by $11 million.

We also ended the year with $567 million of unrestricted cash on hand. Due to our growth in earnings and reduction in bank debt, we improved our management leverage ratio to 2.9 times at the end of 2021, which delivers on our merger commitment to achieve a management leverage ratio at or below 3x.

As Bob discussed earlier, in addition to the $576 million received from the sale of our BodyArmor equity interest, we also resolved our litigation against BodyArmor in January, which resulted in additional proceeds of $350 million driving the combined amount of these items to almost $1 billion in cash proceeds.

With these additional proceeds, we now expect to have approximately $5 billion of discretionary cash over the next three years to drive inorganic value creation.

Let me now move to our guidance for 2022. Earlier today, we affirmed our 2022 full year guidance for both net sales and adjusted diluted earnings per share growth in the mid-single digit range. Supporting this guidance, we expect the following.

Adjusted interest expense is expected to approximate $430 million. Adjusted effective tax rate is expected in the range of 22% to 22.5%. Diluted weighted shares outstanding are estimated to be approximately 1.43 billion.

Finally, while we do not provide quarterly guidance, given the current environment, I want to share perspective on how we expect 2022 to unfold over the course of the year.

From a timing standpoint, we expected peak of the supply chain challenges to occur in quarter one. With our results improving through the remaining three quarters. Inflation is expected to pressure margins for much of the year with some moderation late in 2022.

Specifically, supply chain disruption worsened in the second half of last year and is expected to moderate as we lap it in the second half of 2022. Inflation spiked in the second half of last year, particularly in the fourth quarter and as such, is expected to moderate as we lap it in the latter part of

2022. Total KDP revenue growth is expected to improve sequentially throughout 2022.

From a segment standpoint, it's worth noting that coffee systems is expected to start the year slowly as you rebuild inventory to meet strong consumer demand and improve service levels, while comping net sales growth of 17.4% in quarter one 2021.

Included in our guidance is the 53rd week in coffee systems, which will occur in the fourth quarter of the year. The net of all of these points is that we expect our adjusted earnings per share performance to strength during the year, reaching the high single digit range in the second half, which is in line with our long-term algorithm.

With that, let me hand it back to the Operator for questions.

Operator: 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. Your first question comes from Bonnie Herzog with Goldman Sachs.

Bonnie Herzog: All right. Thank you. Good morning. I had a couple questions on your guidance. First you guys ended '21 with stronger than expected top line and it really does seem like underlying consumer demand for both your Package Beverage and Coffee business is strong.

Yet you did again maintain your outlook for this year, so I guess I'm just trying to understand how conservative this might be and how are you guys thinking about the affordability for your brewers given the pressures on the consumer, especially the low income consumer this year, just trying to understand what's factored into your guidance on brewers in terms of volume growth and potential downtrading risk and then just one final quick clarification on your EBIT growth this year.

Do you guys expect it to be up mid-single digits as well? Again, I'm just trying to understand that in the context of maybe something below the line driving your mid-single digit EPS growth outlook for the year. Thanks.

Robert Gamgort: Good morning and thank you for those questions. Ozan, do you want to talk about the guidance– there were two of them related to guidance and then I'll come back on the brewer question.

Ozan Dokmecioglu: Yes, certainly Bob. Good morning, Bonnie. So let me start with the last question with regards to the EBIT growth expectations for next year. As we have guided everyone back on October 1st during our Investor Day, our expectation from the top line stand point of view was mid-single digit as well as earnings per share as mid-single digit as well.

As you know we don't guide specifically on either operating income or earnings before interest and taxes; however, as you said, we always push and find opportunities to improve below the operating income or the EBIT line. Specifically, in our interest expense line as well as the taxes, and as you know overtime due to our debt payment capacity along with the improved working capital, I believe we managed to do a pretty good job of lowering our interest expense and that will continue into 2022 as well.

At the same time, we always look for further tax effective rate efficiencies and that will be another good year that we expect as we also guided a little bit lower tax rate expectation in 2022. Therefore, I think this sums up with regards to our guidance and expectations on the profit.

Robert Gamgort: Yes, let me talk about the first one, which is about the top line pacing with regard to 2022. You're right, the revenue growth has been incredibly strong. If you decompose that growth, we're getting about half of that from volume and mix, which compared to a lot of sectors, this is very robust and the remainder of that is coming from pricing, so I think that's where it gets challenging to forecast what's going to happen in the balance of the year.

We have a great feel for what volume and mix looks like. We're thoughtful about elasticities. We're all entering into uncharted territory here in terms of the price increases collectively that are happening across the industry. And we build it more off of that than we build it off of anticipated pricing going forward, and that's why we thought it prudent to build a business model that delivers mid-single digit EPS off of mid-single digit top line growth.

The area will have to be thoughtful about it and as you look at companies going forward is if top line numbers are exceeded because of additional pricing due to additional inflation, that doesn't mean that any of its ever going to show up in earnings or EPS, but that's all hypothetical and to come, I think the fact that we build our business model primarily off of volume growth and known pricing is how we got to that guidance. A lot could change between now and this time a year from now, based on inflation and pricing trends.

With regard to brewer affordability, it's an excellent question because our number one driver of the Keurig system is continued household penetration growth. We've added 8 million households in the past three years back to back years of 3 million households, which is nicely above what we think is our long-term trend.

I will remind everyone that there were concerns we delivered that 3 million that we had pulled forward from the following year where we actually had another record year off of demand. We understand very well the critical price points. The threshold price points for consumers at different levels, entry level, upgrade level. And we also know where there is more sensitivity around pricing, and so we've been very strategic in the pricing that we've implemented in our brewers.

We've been able to design Brewers to value so that we hit an approximately $50 price point, and certainly below that on promotion. We know that $100 is the next price point, and then we also know that we have a significant number of brewers that have very low price elasticity because we offer so much value to them.

So even though you'll see pricing move across brewers in aggregate, we will also protect those– critical price points and understand that we can lean in on more uncertain brewers and certain channels where there's less elasticity than others and we will never be distracted from our overall mandate of driving household penetration.

Bonnie Herzog: Okay. That's really helpful and just if I may just clarify because I know Bob or Ozan you mentioned in terms of the brewer volume that will be quite pressured in Q1 as you work to, I think, you mentioned rebuild inventory levels, so I'm just kind of putting that context of the full year, especially on top of like you mentioned two really good strong years in terms of brewer

volume. I mean, again, just trying to think about what's factored into your guidance. Do you expect total year brewer volume to be up, or is it more conservative on the brewer's side in terms of being flattish for instance?

Robert Gamgort: Yes, I'm glad to be able to clarify that. First of all, the pressure that we're talking about in the rebuilding of inventory is all on the pod side. What's quite remarkable is, given all of the global supply chain challenges for a product line that is made overseas and shipped on the ocean, and the fact that all of our brewers contain chips in them, our team has been pretty amazing in being able to find alternative materials, chips et cetera to be able to continue supply brewers.

Brewers supply has not been an issue, at all. What we're working towards those we look at a forecast for the long term, not just for 2022, but as we think about the long term for Keurig, we think about 2 million new households per year is what we describe as our long-term trend.

And there's always a significantly higher number of brewers sold, but a lot of those are due to replacements or upgrades while they show up in our revenue line, they don't really have a material impact on our profitability. That's why we don't focus on brewer sales, nor do we forecast them for you. What's most important are the brewers that are in place to be able to drive new household penetration, and we're fine on that.

With regard to pods, we've had incredible demand on pods now. Well, the demand has been increasing every year. We saw it also remained very strong through COVID, although the composition of that growth shifted from– away from to at home, and a little bit of that's going back. The issue is that we've been building demand for pods based on that increased installed household base for the Keurig brewers, and as the fourth quarter hit with and then later with Omicron into January, we could not supply the current demand.

That caused us to draw down our finished goods inventory down to below safety stock levels and now we're rebuilding that production, our production is up significantly versus where it was in early January, for example, but now we're serving two masters. We have to continue to serve strong current demand and at the same time, we have to take some of that production and use it to restock inventory to improve our efficiency.

And that's the process is going to take another quarter or so, but we've seen the bottom of that, and that was really driven by the absenteeism issue that hit in early January, late Q4 and we're improving that now, so it's all pod related with regard to inventory. Nothing with brewers at this point.

Bonnie Herzog: Okay. Perfect. Very helpful. Thank you.

Robert Gamgort: Okay, Bonnie. Thank you.

Operator: Your next question is from Chris Carey with Wells Fargo Securities.

Chris Carey: Hi. Good morning.

Robert Gamgort: Hi, Chris.

Chris Carey: Just following up on coffee. Typically when pods outperformed, that's a margin tailwind. Obviously, there were other drivers this quarter. And I wonder if you can maybe just review what you see as maybe structural or a bit more lasting to the margin rate this quarter and areas that you would expect to improve from here on a sequential margin rate– said another way this high 20s level of margin base from which to go forward or should things sequentially improve with your supply chain.

And then just connected to that on pricing, so in coffee clearly getting the– your own business pricing, can you just maybe frame the impact of the strategic pricing versus these charges that you incurred and your updated thoughts on pricing of the business going forward. Thanks for those.

Robert Gamgort: Yes, sure. Those are great questions. Let me start with do I think anything is structural and long lasting? The simple answer is no. What we're experiencing right now is the supply challenge, not a demand challenge, and the supply challenge that we're dealing with is solvable. It's already being solved and it's short-lived. The demand remains incredibly strong based on the fact that we're continuing to drive great household penetration.

If you think about the convergence of events that happen in Q4 and carried over into Q1, it's happened to a number of people in the broader CP industry. It really hit us because our demand was so incredibly strong at the

same time that it caused a lot of pressure. We just had serious issues and being able to maintain the production due to absenteeism quite honestly.

As I said in my prepared remarks, 6% was the national absenteeism rate in the beginning of January. We had plants that were in regions that were harder hit where the number was a multiple of that. You get to a point where your production, you drop below a threshold level for your production, and that's exactly what happened to us. And then there's a series of knock-on effects that happen.

All of them are short-lived, but if I give you a sense of it is, we missed sales as a result of that we expedite orders to try to prevent out of stocks and service our partners. We prioritize our partners over us in some cases. We are now paying a lot of overtime for people who are showing up.

So all of these things start to build up to cause serious short-term pressure on the business. All of which is being unwound as we speak, and none of which is structural in nature, but it has a significant impact as we say because we have to rebuild inventory.

What compounded this is a bit further as we were expecting in late '21 a ramp up in new production from our new plant in Spartanburg and quite frankly our equipment supplier missed their deadlines. Again if you think about it as European driven manufacturing and they were ahead of us on COVID in general and Omicron and so they started feeling the pressure at the time that we started seeing the demand really ramp up. So that wasn't available to us at the same time.

Again, that's all solved, we talked about in our script that we've now built our production outside of Spartanburg to be able to handle that demand. We are now giving our supplier full reign of that plant to be able to optimize production without trying to also serve current demand and we also have a contingency plan should they continue to miss any milestones. We have a backup plan, so we won't let it go any further than 2022.

And when Spartanburg is up to full capacity, not only does that represent a growth opportunity, that represents productivity that's yet to be realized. So not only is that not a structural issue going forward, that's a structural opportunity in front of us.

The last point is pricing, because in an environment we know the pricing is critically important. I'll go all the way back to statements we made more than four years ago, and we put the two companies together and we said that with regard to coffee systems, we said the strategic pricing investment, which was intentional to get the price point out pods down to the appropriate threshold levels would moderate overtime once we hit those thresholds.

So if you think about what's happened since then, in 2018 our net pricing in Coffee Systems was down about 4%, 2019 down 3%, 2020 down about 2%, and 2021 down less than 1%. In Q4, we had positive pricing that was masked by customer service fines. That's one of the knock-on effects of the production issues I talked about.

And as we said in our prepared remarks, in 2022, we're putting in more pricing, so you will see positive pricing in coffee systems going forward based on the pricing that we've already put in place, so we've moved beyond now the strategic price investment into positive pricing and all of that is yet still in front of us.

Again, most important thing is, there are few if any CPG businesses that have line of sight to growing their volume in the mid-single digit range year after year by converting people from one behavior to another, which is brewing by the pod to brewing by the cup. Not only is that intact, it's been delivered and we still have 55 million potential households remaining to be converted even after we converted 8 million in the past three years.

Chris Carey: Thanks, Bob.

Robert Gamgort: Okay, Chris. Thank you.

Operator: Your next question is from Kevin Grundy with Jefferies.

Kevin Grundy: Hey. Good morning, everyone.

Robert Gamgort: Hey, Kevin.

Kevin Grundy: First a housekeeping question for Ozan. Just on the tax rate, which has been trending lower here, just comment, I guess, your expectation longer term

and if there's any different– (1) Is that sustainable? (2) Is there going to be any difference between the book tax rate and your cash tax rate?

And then Ozan, maybe just spend a moment on commodity cost inflation, which is clearly gotten worse since you initially provided the mid-single digit EPS growth guidance. Just spend a moment please on key exposures what you're expecting and then as we think about gross margin, how much you expect to offset with pricing and productivity? Thanks.

Ozan Dokmecioglu: Absolutely. Good morning again. So with regards to the tax rate, we have initiated and successfully implemented several strategies around lowering our effective tax rate. And when you look to our financial since the onset of they putting the two companies together the last three years, I believe we have been quite successful of managing a lot of tax rate.

And as I have just explained in our prepared remarks, we expect our tax rate for 2022 to be around 22%, maybe 22.5%. So that's our ingoing assumptions on the basis of the implementations that we are expecting to deliver the results for us.

So that's number one. And on a normalized basis pro-update ‘22 levels we will more or less sustain, maybe a little bit lower, but not much. So that's our expectation with regards to overall effective tax rates for '22 and beyond.

So let's talk a little bit about the inflation and the commodities and our exposures, right? So as we all know, inflation accelerated throughout 2021 with the 4th quarter in '21 increasing double digits with significantly higher than what we anticipated and we also expect to continue through much of 2022 with some moderation in the fourth quarter, so as Bob also alluded a little bit ago, we expect quarter one to be the most challenging comparison to last year. When I say quarter one, I mean 2022.

As we manage through peak levels of supply chain disruption and significant ongoing inflation, but when you look right now to our overall commodity exposures, we typically covered 6 to 9 months. Therefore, we feel that we are well covered for 2022, but we continue to layer in some further coverage outdated significantly higher rates than last year at this time, and some costs like transportation, some packaging materials like so polypropylene, which is the material for K-Cup, for example, that we can't

hedge them because there is no any– structured market that we can hedge. Therefore, we believe that we struck a good balance right now with regards to our coverages. The impact of the overall commodity inflation along with other input costs in '22 versus '21.

We also, for example, in coffee, had longer positions in 2020 as well as 2021, but our low cost positions are now fully utilized, which making green coffee, for example, one of the largest percent changes year-over-year in our basket of input costs for KDP, but all these assumptions that we have built in our guidance and in our numbers that we have just reported. Therefore, we believe that we have a good balance right now of dealing and managing the overall inflation, which is arising as a result of all input costs transportation along with labor in relation to the guidance that we put along with the margin structure quarter in, quarter out.

Kevin Grundy: Okay. Thanks for the color. I'm sure there's a number of other questions. I'll pass it on.

Ozan Dokmecioglu: Thanks.

Robert Gamgort: Thank you.

Operator: Your next question is from Brett Cooper with Consumer Edge.

Brett Cooper: Good morning. A question on how you look at the portfolio in its entirety and making business and pricing decisions. I guess the specific question is that with the cold beverage business performing well, how much flexibility does that give you and potentially taken less pricing coffee in order to manage pod pricing to the levels that you targeted with your prior strategic actions? And then just a follow on from that would love any thoughts on the impact of pod pricing moving back above those target levels given the pricing action? Thanks.

Robert Gamgort: Yes, Brett. Thank you. The benefit of the portfolio that we have is a bit of diversification in terms of different consumer trends, different competitive dynamics, et cetera. And so if you go all the way back to the commitments we put out there in 2018 and the fact that we've been able to deliver them

despite all of these challenges that with COVID now inflation, supply chain disruption, et cetera.

That's the benefit of having the portfolio that we have that we're able to leverage one part of the portfolio to be able to offset challenges in the others and then you've seen it reversed in certain situations where coffee was overdelivering to help one side business and now the cold business in some cases in Q4 was able to do that. That's great from an investor perspective.

With regard to how we take pricing, though we don't think about it that way. We look at pricing at the consumer level segment by segment. We understand price elasticity's competitive dynamics and in an inflationary environment like the one that we're in right now, we're going to push pricing as hard as we possibly can based on our best assessment of the impact on that individual business.

And that doesn't put us in a position where we say because we can take pricing in one area will take less pricing in the other. We take the maximum amount of pricing that we can in each individual business until we get to the point where we think it adversely impacts demand to a level in which it's not a great business decision, but the diversification of the portfolio, though, allows us to step back we deliver consolidated results and have the confidence that we are able to deliver against the guidance that we put forward despite all of the uncertainty and volatility that we face. Can we take the next question please?

Operator: Your next question comes from Lauren Lieberman with Barclays.

Lauren Lieberman: Thanks. Good morning. This is probably a good lead in from the last conversation, but I feel like there was, Bob, in your comments of the last few minutes. It was really sort of passion discussion of the visibility that you think you have– just same volume growth as you can keep in transition in coffee and driving consumer behavior, but I was curious how you think about the structural potential of the cold businesses?

I'm guessing this is where the bulk of the M&A is expected to reside. You've already made all these moves of course on route to market, so can you talk a little bit about sort of the structural potential and how you think about volume perhaps versus price mix in those businesses as well? Curious

kind of hear your same kind of multi-year view on that side of the business. Thanks.

Robert Gamgort: Yes, good question. Our cold business has performed exceptionally well since the merger. It's been driven by the formula that we discussed a number of times, which is building share and volume growth on core brands through renovation and marketing. Countless examples of that and we won't repeat them because we mentioned most of them in our prepared remarks.

Innovating into white space and also doing acquisitions to fill in territories that we aren't covered with our current portfolio and then investing in and improving our route to market to ensure that the delivery, the merchandising, the servicing on the cold side of the business improves every single year. And it's the combination of those three that's delivering the very strong result.

What I just described has a significant amount of runway in front of it. You mentioned we've done a lot of work on the route to market side, bringing independent territory into our system. We've also invested heavily to improve the delivery and effectiveness of our system where we already covered. There's still plenty of runway left on both of those.

White space, still have significant amount of open territory in our portfolio to be able to fill in to leverage that distribution system as well as the marketing strength that we have and we still have tremendous line of sight to innovation and renovation in our existing brand portfolio.

As we talked about three years ago a lot of conversations will allow Dr Pepper's been successful, you can't possibly grow that any further. What else are you going to do? And then I would point out that Dr Pepper was the fastest growing major CSD in the past two years driven by marketing innovation. And we feel like we still have plenty more to go on that. So it's a combination of existing brands, white space, and distribution system effectiveness that gives us line of sight to significant growth still in front of us.

Lauren Lieberman: Thanks so much.

Robert Gamgort: Okay. Thanks, Lauren.

Operator: Your next question comes from Andrea Teixeira with JP Morgan.

Andrea Teixeira: Thank you. Good morning. I wanted to double click on your comments about M&A, should we interpret that the board is mostly looking for bolt on M&A compared to bigger transactions? And if so, what are the white spaces at this point with energy and coffee shops be out of question in this scenario?

And related to that– on your use of capital, you mentioned buybacks and normally you don't embed that in guidance. So just wanted to clarify that on 2022. And lastly on pricing, I think what is included in your mid-single digits and correct me if I'm wrong, you're assuming what is in the market already and with the labor and other costs worsening since your Analyst Day, would you contemplate additional pricing at this point? Thank you.

Robert Gamgort: On the M&A side, what we talked about is our capacity for M&A. So we say is north of $20 billion based on the $5 billion of discretionary free cash flow and some of the assumptions that we put forward in the Investor Day. The clarification we were making today is, there were a number of headlines that came out of that where people said we were looking for a $20 billion acquisition and what we're saying is that we've got significant capacity to continue to do acquisitions of a variety of sizes and our four areas are filling in the white spaces we just talked about, continuing to build our distribution capabilities, which we also talked about adding new capabilities, which as we get further along, we could explain some of that and then obviously we always have the opportunity for some geographic expansion.

We operate in North America today, heavily in the US with nice positions in Canada and Mexico. We talked about today, Latin American beverages, for example, just continuing to deliver fantastic results that are accretive to total KDP. That's an area where we could see some opportunity for additional investment. So we have a wide range of targets, all of which are strategic. They range in sizes, but we wanted to clarify that we're looking at it 20 billion plus as capacity, not as a target.

I'll have Ozan talk about buybacks in a second. With regard to pricing, the pricing that we have in the plan is not just what we've already put in place, but also pricing that we've already announced. It's happening in the early part of '22.

With regard to the rest of the year. We always say we need to be flexible based on inflation, productivity, pricing, and marketing investment, and that we don't talk about any one lever in the future at the expense of others. We look at all four in combination, and that's how we will continue to manage through 2022.

Ozan, this will be our last question. Do you want to end the– this on the buyback conversation?

Ozan Dokmecioglu: Absolutely, Bob. And hello, Andrea. So a couple of quick points on our buybacks. I just want to remind ourselves that our board has authorized us a four-year program up to $4 billion of buyback, which started January of this year through end of December 2025.

And we also expressed before that our program, again an opportunistic one is not formulaic by any means. It would just depend on the market conditions and will be at the discretion of the management to decide on the buyback or not. And I believe, Andrea, as you said, in line with our Investor Day announcement and we are also repeating now, we did not build any plus or minus that may come as a result of our buyback decision into our guidance for 2022.

It is also fair to say, as Bob explained just now, that our priority to use our capital as well as cash would be in M&A. For some reason, in absence of that, that we may decide to do some buyback, again on an opportunistic basis.

So that would be my couple of quick remarks on the buyback. Thank you.

Andrea Teixeira: Thank you, both.

Robert Gamgort: Thanks.

Operator: I'll now turn it back over to management for closing remarks.

Steve Alexander: Thanks everyone for joining this morning. The IR team, Maria, and myself will be around all day. If you have questions, please reach out to us and we would love to talk to you. Thank you very much and have a good day.

Operator: Thank you. This concludes today's conference. You may now disconnect.