Keurig Dr Pepper

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Sean King: All right, good morning. I'm Sean King, the U.S. Beverage analyst at UBS. We're pleased to welcome the leadership team from Keurig Dr Pepper to the UBS Consumer Conference. With us, we have Bob Gamgort, Chief Executive Officer and Executive Chairman of the Board. Bob also is a Director of Wayfair and the Grocery Manufacturers Association. Prior to running Keurig Green Mountain as CEO in 2016, he served seven years as CEO of Pinnacle Foods. I also have Ozan Dokmecioglu, Chief Financial Officer. Ozan served as Keurig Green Mountain's CFO since May, 2016. Ozan joined Keurig following a career of senior roles at Kraft, Kellogg, and Cargill. In addition, we're joined by Chief Corporate Affairs Officer, Maria Sceppaguercio; and VP of Investor Relations, Tyson Seely. So I guess, before jumping into some of the Q&A, we have some, I guess, obligatory questions that we're asking all the keynote CEOs.

First one is do you think consumer spending will stay the same, get worse, or get better as we lap the stimulus from tax reform last year?

Bob Gamgort: First of all, good morning. Thanks to the brave 7:30am crew for coming out here today. We told Sean we've already -- for next year, we want to book at 6:30 a.m. slot, so put that on your calendar. I think from our standpoint, every bit of evidence that we have in the North American market, and remember, we are a North American-focused company, is that the consumer's incredibly strong. We've had to take pricing in our carbonated soft drink business, for example, to offset inflation and you have models around elasticity but you don't really know what's going to happen until you put that in place, and the elasticities are coming essentially where we projected them to be.

And in our Keurig side of the business, which is a premium business that's become more affordable over time, we're seeing robust growth in household penetration, which says that people are willing to trade up to a premium experience for quality. So really, all the evidence that we have is that the consumer is really strong. You saw the results from some retailers over the past week that indicated stronger than expected performance, and that's really in line with everything that we're seeing.

So it's hard to forecast the future but as we sit here today, we're bullish on the U.S. consumer. I'll give you one other data point that others may not have talked about that we look at, which is the pressure, if there's pressure on us, it's in hiring people. And so we've got open positions and we have to pay more people. And I always look at that as a bullish indicator on the economy which is if people are employed and we have to pay more, yes, it causes some cost pressure that we need to offset with productivity, but I think it's bullish for the economy because that means people are making more money.

Sean King: Great. That actually leads into the second question, which is do you think that pressure on operating expenses will improve, stay the same or get worse compared to last year?

Bob Gamgort: There's definitely -- I'll let Ozan address that. There's definitely inflationary pressures that come with a more robust economy. You want to talk a little bit about what we've seen?

Ozan Dokmecioglu: Exactly. As we have -- first of all, good morning, everybody. Great to be here. And as we have seen, starting second half of 2017, especially our markets beverage and as well as CBG, which started to see some inflation, particularly in the transportation or the overall logistics.

In 2018, all companies have experienced the headwinds not only coming or continued from the logistics plus including the commodities. Obviously, we were part of that sector and inflation has happened in the tune of 3% to 5%, and 2019 is also an inflationary environment, that's what we are anticipating or expecting on the base of the again, logistics as well as some of the commodities that we all operate.

But at the same time, as Bob said, the great thing is we were expecting and anticipating and basically adjusting our performance on the basis of that, either a balance between the top line and the bottom line, which the productivity always plays important part. So yes, we have built in all these numbers, pluses, or minuses in our algorithm as well as our guidance that we put out there last week.

Sean King: Great. I guess, before getting into the high-level questions, I wanted to address the recent quarterly results. I think your fourth quarter results were in line with consensus. Your EPS guide for '19 was in line with your long-term algorithm. Why do you think this came as a bit of a disappointment to some investors?

Bob Gamgort: It definitely was not a disappointment for us. If you take a look at 2018 for us, a couple of thoughts. We put together two big companies and step one is, is there execution risk on integration? And I would say that we've been able to do this integration without dropping any balls, and that becomes job number one.

I think the second part is, we had growth across our entire business while we were doing this integration. If you take a look at the volume and the revenue growth that we delivered as well as the improvements in operating income and the fact that we grew share in the majority of our categories. And actually in the month of January, we grew share in every single segment in which we compete, we think that's a really good 2018 on top of the fact that we paid down $1 billion worth of debt and set ourselves up for the future.

I think there are really two things as we read all the reports afterwards is, a year ago -- March 20 a year-ago, we had an Investor Day. We announced the deal last January, we talked about 15% to 17% EPS growth. Despite an environment as you just referenced that has become more challenging and inflationary, we're really happy to be sitting here today talking about 2019 that's 15% to 17% EPS growth. The challenge was consensus got ahead of that. There was consensus somewhere in the 20% range.

Obviously, we don't control consensus, we just talk about what our targets are, and we've been very, very consistent what our targets are. And in an environment in which many of our peers have actually been lowering expectations, again, the fact that we're 15% to 17%, we feel good about. The other area that popped up on the call quite frankly has surprised us, and in the reports, is this focus on brewer revenue, which I think was really direct in the call and I said is we view as one of the most meaningless metrics in our business.

And Sean, I think you were the part of the visit we had to Burlington prior to sort of launching the new business, where we wanted to give kind of a one-on-one to all of the analysts on how our business performs. And one of the things I talked about was, what are the four metrics that we look at on the Coffee Systems side of the business to run as management to run the business?

We take a look at household penetration, pod volume growth, our share, our KDP manufactured share of the system and profit per pod. And we said, when we add that all up, that's what we look at every single week. We don't look at brewer revenue other than having plans for manufacturing and inventory. We don't look a lot at mix of pods within the system as long as we manufacture them.

So we felt we had established very clearly what the right metrics are, but I think we have to have a two-day session next time. That's my conclusion. I think people will learn over time that there's really no correlation between brewer revenue and household penetration.

Sean King: Got it. So I guess moving to more of the high-level. With two quarters now as a combined company, can you provide us with an update on sort of justification for the merger and I guess the value proposition that KDP represents to investors?

Bob Gamgort: Sure. Again, when we launched this and then we had our Investor Day, we talked about we're creating a pure-play beverage company focused on North America. We thought the separation historically between hot and cold beverages, separating coffee out from beverages as if it's not a beverage, was really a missed opportunity for people, and we seized on that. And putting the two businesses together allows us to do two things.

One is have a portfolio that reaches really all beverage needs out there. And I think people are starting to get it because I saw an interesting article yesterday that talked about the energy segment. And it said, now, Coke has a big position and Pepsi has a big position, but KDP really has a fairly small position in energy.

And then it went dot, dot, dot except their entire coffee business you could argue is an energy business. Exactly, people now get it. Coffee is a $4 billion, for us, is a $4 billion energy segment. That's the way the consumers looked at it. They drink coffee because they want a boost. But in the past, people created these artificial separations. And so portfolio is a big opportunity. But I think in beverages, equally important in some cases, I could argue, more important, the distribution side.

And so by putting these two companies together, we leveraged the direct store distribution capabilities that the legacy DPS business had. We put together the two warehouse delivery businesses. Remember DPS had, on a legacy basis, Mott's Juice, and Clamato and mixers, which all go through the warehouse. Well, that's the majority of the Keurig business. So we create scale and synergies there. And then the Keurig business was really good at away-from-home, meaning like office coverage as well as ecommerce. Probably it's harder to know but from a CPG standpoint, we're probably one of the largest, if not the largest ecommerce businesses.

So now, you have the ability to not only expand your portfolio but reach the consumer everywhere that they shop for beverages. That's what we were excited about and it's the exact same theme I would tell you today. We're just more excited about it than we were a year ago now that we get to live it.

Sean King: Great. I guess, can you elaborate on some of the things that you were able to do with Keurig as a private company that set the combined company on a better path?

Bob Gamgort: Sure. One of -- go back to Keurig 2016. Many of you followed it and many of you told me about the scars that you had from following the volatility of that company. It's quite a different company today. When we got there, you remember, this is a company that had lost its IP protection, that was losing share to unlicensed manufacturers and the household penetration and the growth in the system was slowing fairly significantly. We had to come in with a fresh set of eyes with private financial backing, with a long-term horizon to say what is it going to take to restart this? Because the first piece of work we did was have household penetration maxed out. And it was interesting the words that were in the company. A lot of people used the word saturation when we got there because household penetration was slowing and they said, well, the system is saturated.

The first question we asked is what evidence do you have that the market is saturated? So we went out and did a piece of work and realized the household penetration should be 2x to 2.5x what it is today. There was no consumer reason why it had slowed down. It was a number of executional and strategic missteps that caused it to slow down. And so we then went off on a path of saying, we need to innovate to deliver brewers that have better benefits and were more reliable, better quality. We need to market the system much heavier than we did and the single biggest thing we had to do was lower the price of pods. That's a hard thing to do.

So imagine now, you go back to your new board who is a big investor in the company and you say, we want to substantially lower the price of pods, which will restart growth in the system, and we're going to offset it with a significant amount of productivity. And that's exactly what we did. That would have been really hard to do as a public company, if not impossible. I mean, look at the conversation we just had last week on brewer revenues. We don't have that with our board.

So to go in there to our board and say, volume will be up, pricing will be down, revenue will be negative but profit will be up because we can cover it. Imagine having that explanation in a public company environment. It will be almost impossible. So that gave us two years to be able to restart the business and then be able to do the merger that we did, and that's one of the benefits of being private for a period of time.

Sean King: You mentioned private packing, can you help us understand the nature of the relationship with JAB? I know some investors viewed this as a, I guess, an overhang for the stock but I guess there could be some potential benefits there?

Bob Gamgort: In my previous company, we were 100% owned by Blackstone, then we took the company public and then Blackstone sold their shares. And they were very clear that they were going to get out of the business over time, to do it in a responsible way. The day after we went public, every time -- and Maria and I worked together on this IPO at Pinnacle. Every time that we would go out and do an investor meeting, all we talked about is when is Blackstone going to sell its shares, and what does it mean when they sell their shares? Obviously, that means that they're -- it's time to get of the business.

And obviously, you know the story there and it worked out very well for public company investors as well. I think JAB, that was fundamentally different, which is they are very similar in terms of the quality of the strategic thinking and the support that they give management but really, the biggest difference is their time horizon. In some respect, there's a big piece of this money that's essentially evergreen, and they're in no rush at all to take their money out. Honestly, what we keep hearing, the biggest issue is, is there enough float in the stock and when is somebody going to put more shares into the marketplace? And if you look at what's happened, we're about 13% of the company is public but you've got a number of large shareholders that have taken a position and they don't appear to be selling anytime soon.

So it's actually reduced the actual trading in our stock significantly and I would tell you that the movement the day of earnings, the shares that traded represented less than 0.5% of the market capital of the company. So a small amount of share trading can move a lot of price in a short period of time. The way that we'll get more shares out over time, quite honestly, would be like we did with Core, which is we used stock as an acquisition vehicle. And you noticed that we've had no negative impact on the stock at all.

Sean King: Great. I guess, given recent investor questions surrounding the value of the ZBB model, why should investors view Keurig Dr Pepper as more than a synergy or cost cutting story?

Bob Gamgort: Yes. Ozan, you want to take that question?

Ozan Dokmecioglu: I mean first of all, efficiency is important, there's no question on that. As Bob said, especially on the private and a standalone KGM. We believe and we have all disclosed all these numbers and the results as well, found it very optimum in terms of the investments into the business as well as the efficiencies. Again, all public numbers in the past 2.5 years, we managed to improve the hot side of the portfolio margin-wise 1,000 basis points.

And then the business, about one-third on the base of the strategy price alignment. We took down the revenue deliberately but then the household penetration as well as the pod volume has started to grow. And we delivered almost flattish revenue in 2018, which we expect to go to positive in 2019. So there are, obviously, several examples in the marketplace that are going on. Then we look to our company, it is true, productivity has been a good source of investment vehicles that we have done and deployed in our company as well as the profit growth, absolute and margin-wise.

So we believe that we got the balance in a very optimum manner. When you look at our categories, all of them either on a volume-wise revenue or share-wise have grown, including coffee. That's why the share-wise, including the investments we are making behind our portfolio either the brands or the Keurig System in order to boost the household penetration.

And we also went public and announced we are building at the same time, a state-of-the-art coffee K-Cup pod manufacturing unit in South Carolina, which the investments are a significant amount and we are all managing, obviously, to make these investments in order to take our company and deliver again, a superior performance 15% to 17% EPS at the same time.

Now, if you have seen, all the trends are going down, we are improving profitability. On the basis of the productivity, probably that's not a good recipe but we have done exactly the opposite, and we will continue to do that.

Bob Gamgort: Sean, I see a lot of conversation where people talk about some people are too aggressive on cost. You need to have cost within investment and growth. Then you have other situations where people have talked about, hey, we're making all this investment in innovation, but they haven't done enough on the cost side to cover the productivity. The simple answer is you need a balanced approach on this. And I think the evidence of us being able to deliver a balanced approach is significant investments in pricing, significant investments in innovation and marketing has allowed us to increase our profit in total and our margin significantly, while we're making those investments.

But the metric that you should look at in addition to margin expansion is also growth and as I said, market share. And I always look at market share is the ultimate test, that's the consumer voting with his or her dollars. And you can drive a lot of margin, a lot of portability but if you're not growing and you're losing market share, you will hit the wall at some point in time. And as I said, we grew share in 2018 on the majority of our portfolio. In the early part of 2019, we've grown share on all of our portfolio segments. At the same time, we're expanding margin and we're investing money in innovation and marketing.

You can imagine, as we looked at 2019, if we didn't invest more in marketing or innovation, or some of the other areas that we're doing, we could've driven profit growth higher. But we're in this for the long haul and as they said before, our anchor investor is in this for the very long haul. And so there's no temptation to do that because we know what that story looks like in the end.

Sean King: Yes, so I guess, in that context of cost cutting, it's been some time since you announced the $600 million synergy target or three-year synergy target. Are you thinking about those areas of synergy any differently now?

Ozan Dokmecioglu: Not really because before, as we announced the deal on January 29, 2018 and reiterated during our investor conference, we have a great visibility in terms of understanding levers of the synergy. And since the legal merge has happened July 9 onward, all those expectations have been validated in a very well manner. That's why we have really great transparency as well as visibility in terms of the source of the synergies, and our position has not changed.

Sean King: Got it. Okay, so onto the Coffee business in particular. So coming out of the fourth quarter, it seemed to be a lot of questions on how to effectively model the Coffee business going forward. How should we think about doing this?

Bob Gamgort: Yes, so let me -- I've been thinking about this since the call the other day. Let me give you the formula for how Keurig makes money and this, again, is how we look at it as a management team. We just had a board meeting couple weeks ago, we reviewed this with our board, so I'll just share it with you to make it a lot easier. It's household penetration times the usage rate, we call it the attachment rate. And the combination of those two, when you multiply them against each other, you end up with pod volume growth for the category.

So how many households are in there, how much they use, that's pod volume category growth. I'll come back to how you can measure all of that stuff on your own, you don't have to take our word for it. Then you say, how many of those pods does Keurig manufacture? And we call that our KDP-manufactured share. And we know there's unlicensed players out there and one of our objective is to reduce that share because we think that we produce the best pods and our pods work the best within our system.

And then the last part is profit per pod, all right, that's the way we look at it. So household penetration, we said we would give it you once a year because it's got some quarterly fluctuations that aren't really meaningful. But you don't really need that, you could take a look at pod category volume growth and it's the combination of the 2 variables that I talked about upfront. So you get that. We also have worked with IRI to be able to give you access to KDP-manufactured share. We want you to have the right numbers. It's a very complicated calculation to get there because of the number of SKUs we produce or don't produce. So we're giving that information to IRI and they're making that available to you.

So I mean, you can now get that on a regular basis. And then the part that's always the most challenging is what's our profitability? And what you're going to have look at is on a quarterly basis, you're going to get profitability for Coffee Systems, and that's going to tell you how we're doing. And the reason that my advice to many of you is to not drive yourself crazy and try to calculate what's their pricing, what's their mix, is because you'll never get the most important part is, what's the productivity that we have to offset any issues in pricing and mix. And the proof is in the margin at the end.

So you could talk a lot about pricing, you could talk a lot about mix but what people are skipping over is yes, but you've increased your profit margin by 240 basis points in the fourth quarter while you're able to do all that. So that's really literally, the formula we use. So all the way back to household penetration, as I said before, we'll give it to you and you can look at pod volume growth. Brewers are not a proxy for category growth.

And the reason is very simply, if you take a look at the last six months of 2018, brewer revenue was flat in the back half of 2017. Yet, we grew household penetration by 7%., that's the piece people find very confusing. The formula for that is, we take a look at our brewer forecast, how many new households will be coming in? They're new, they have to buy a brewer then every other brewer we sell is a replacement.

And the good news is if you've got 7% household penetration and your brewer sales are flat, that just means there were fewer replacements, which means, quite honestly, people were satisfied unlike sometimes in the past with the brewer that they have. And the 3 things that we see that give evidence of that -- or actually, four things is, we see the brewer hold -- people are holding onto their brewers longer, that's why we see fewer replacement sales, that's the second metric. We also see returns are down significantly and warranty claims are down significantly.

So those are all the -- that's the convergence of data that suggests the only difference in the back of the year why brewer revenue was flat despite having growth in household penetration is because there were fewer replacements for the reasons I just talked about. The funny part in some of my conversations post that was the irony is, had we had 7% household penetration growth and a lot of people kind of came in and bought new brewers because theirs broke and they were unhappy, that would've been categorized as a good quarter by some people and we would've thought it was a bad quarter.

So that's the -- sorry for the long answer, but we're trying to be as transparent as possible about how you think about that business and how we, as management, model that business.

Maria A. Sceppaguercio-Gever: The other thing that's really important, you might just want to just mention is we use to lose a lot of money on brewers.

Bob Gamgort: That's a very good point.

Maria A. Sceppaguercio-Gever: And there was a time when a focus on brewer sales and brewer volume really mattered because they were losing money. Over the course of the past few years, what we've seen is we've spent an awful lot of time and resources on improving the quality of our brewers. And as - and it takes time to really see that the returns or the replacements are taking time because people hold onto them now instead of, say, a year, it looks like two years or three years.

So people are keeping them longer, they're happy with them, we're not getting returns, as Bob said. Those things -- those metrics that we look at are helpful to the P&L. They're actually profit drivers. So it's a big difference in the way the old model worked versus the way new model works. Because if we sell more brewers, it does help the topline but it does nothing for the bottom line because they're essentially breakeven.

Bob Gamgort: That's important point. I'm glad you brought that up. In the past, if you sold more brewers, it would be a hit to the profitability of the company because they lost money previously on every single brewer. So now that we've got it roughly at breakeven, does it help profitably sell more of them? It doesn't hurt profit if we sell less of them, which is a nice place to be in. And one of the ways that we got to that breakeven approximately on brewers was these return rates and warranty claims. That was a lot of the cost that was in the -- people say what do you pay per brewer.

They're skipping over one of the most important parts is how many of them do you have to take back and how many warranties do you have to satisfy? That's one of the ways that we were able to get to breakeven.

Sean King: Got it. I mean, you've touched on this somewhat, but how should we think about I guess, the strategic pricing investment in pods? And I guess, a little bit of that is I guess, sort of a history might kind of help people out and sort of the path forward. Is there going to be a point where you're raising pricing in pods?

Bob Gamgort: I don't know about raising pricing. I mean if you go back and look at the work that we did in 2016, the single biggest barrier to new people coming into the system was the price of pods. If you benchmarked the price of pods to other markets like Europe or household penetration in certain markets, it's 60%, 65%. It was clear that our pod pricing was way above that marketplace.

And so when we thought about it is, it was a new technology and like all new technologies, you come in at a premium price, you skim, there are early adopters. But over time, as you get smarter, you should be able to lower your cost of goods, reflect that to consumers who bring more -- and bring more consumers into the system.

And you see that over and over again in any new platform. The difference with the old business model is they stopped at some point and did invest in the productivity side, they didn't want to lower the price. And we've embraced the fact that that's how you get more consumers into the system. And so the way you should look at it is, it was clearly very intentional. We did it very aggressively in the early stages when we were a private company to catch up. It has moderated considerably. It's going to continue on for a period of time but the other two points to make on this is, one, we have a lot of visibility on our pricing because our pricing is mostly contractual, and we have a lot of visibility on the productivity that we're using to offset that pricing.

And so it doesn't stress us out, but I know it seems to stress everybody else out because they keep looking at -- they say looking at mix and looking at pricing but then they're skipping over the fact that we're able to hold and grow our margin. That tells you that we've got a lot of productivity that we're investing in to deliver. And we see this as this win-win scenario where if the price goes down, more people come in and we're able to grow the system.

Sean King: Okay. And then I guess, what risk does private label pose in that business? And then I guess in the same game, what risk does Amazon pose as a competitive threat?

Bob Gamgort: Private label and Amazon are not a threat, they're partners of ours. The only thing that we don't like are unlicensed pods. So those are -- and those are in some cases, brands and in some cases, private label. That's another confusion is that most people equate private label with unlicensed. We produce a majority of private label. So we want to produce every pod that's in the system because it is a system and we know that the quality of the experience with consumers is a combination of how does the coffee work with the machine and nobody does that better than we do.

We've got a lot of evidence that we've been able to show our retailers that if somebody comes into the Keurig system and uses an official pod and it could be a private label pod but manufactured by us, their adoption rate and the level at which they stick with it going forward is significantly higher than if they come in with an unlicensed pod. Because the problem is, the consumer puts an unlicensed pod, which they don't know, into our machine. It fails and they blame us. And so they say the system's bad or the coffee that comes out of the machine is bad. So we've been on an education process to show from a retailer standpoint, if you play the long game, you would invest in doing business with us.

And by the way, in addition to producing the best quality pods, which we can prove, as well as ones that work in our system, we've lowered our price dramatically. So there's not much of a gap anymore to do business with us. Whereas in the past, you had to make a huge leap to work with us. And so that's only threat to our business is unlicensed and the reason is because it gives consumers a bad experience.

Sean King: Got it. I guess, on to the legacy DPS business. What is the long-term growth proposition for Concentrates and Packaged Beverages? And how is KDP uniquely positioned in that market?

Bob Gamgort: So it's couple of things. One is, it's -- we talk about portfolio play and there's a lot of conversation about CSDs on a long-term decline. We are, by design or by great fortune, we have a portfolio that has bucked the trends on that. And I'm being a little flip in that, also some really good marketing and innovation behind it. So take a look at the two flagship brands in the system: Dr Pepper, as well as Canada Dry, both of them have grown over the past couple of years. The Canada Dry business, for example, was up double digits in volume and value last year and continues to be incredibly strong and that is bucking the trend of CSDs.

And the Dr Pepper brand is incredibly resilient and continues to grow share as well as grow revenue nicely at this point in time. And I would say that in addition to being a really unique product that's hard to replace in consumer's minds, there's been some outstanding marketing by the team. I can't take credit for that marketing because when we came onboard, it was in place. I mean, really outstanding marketing. Not just my judgment. When we take a look at the ROI, the impact of that is incredibly strong and I'm skipping over a bunch of other brands that are in the system in the interest of time, but we see that across the board.

So we feel really good about the prospects of that, but we also realize that we have to get into faster growing segments. And we can do that through innovation, our internal development. We can do it through partnerships, although the partnerships going forward will be a different structure. And we can do it through M&A, but look at what we just -- I'll just give two examples then I'll stop. If you take a look over the past six months or whatever, we entered into a very long-term partnership agreement with Evian, with Danone, for Evian brand, and you'll see significant acceleration and growth on the Evian business because now when you take the quality of that brand with our distribution system.

And we acquired Core, which is growing at 50-plus percent rates right now in the premium water segment. We do need to be more in those -- and so you think about ready-to-drink coffee and energy shots and a bunch of other areas that we're participating in. The good news is, you want to be able to innovate in those fastest-growing segments while your core is still doing well. The biggest mistake, most people make is they aggressively move into the new segments when the core starts to fall apart, and then your business model is challenged. And so to have growth on the CSD side of the business and be able to enter into new segments is really a unique position to be in.

Sean King: Great. I guess couple of weeks ago, we heard from both Coke and Pepsi that they were investing in small package capabilities to drive profitability and mix. KDP has strategic alignment with both companies in CSDs. How do you think about that -- those capacity and capability investments, in terms of a competitive threat or sort of a shared opportunity?

Bob Gamgort: No, it benefits us. Remember, we're a unique business model, which is we have our own PB Packaged Beverages system, which we delivered DST to 75% of the country. We have independent network that we have close partnership with that covers the rest of the 25% of the population. And we do business with Coke and Pepsi. So we think that the small packages that you're talking about are a very serious growth driver in the industry.

The more that that capability exists throughout all networks, the more we have access to it as well, and we think it's good for the industry. So it's not a threat, it's an opportunity for all of us to really push into those. And it's the right way to deliver, particularly on indulgence. And I used to work in the confectionery business at Mars. Delivering indulgence, which people want, in a smaller portion size is a win-win. And so we're all for that and love that development.

Sean King: Okay. Back to the quarter. I don't believe we talked about CapEx in the fourth quarter, and what are your expectations for spend in 2019? And how should we think about that number over the next couple of years?

Ozan Dokmecioglu: Yes, sure. I'll take it. So we have came out with a plan between 2019 through 2021, the plan to spend $1.6 billion of CapEx. So that's what we are going to see in the CapEx line in our cash flow. Obviously, cash disbursements will be a little bit different by year, given that we need to make the investments up front and then pay on the agreed terms with our suppliers.

Then we also have another $400 million of operating expenses in order to support the initiatives to deliver the productivities as well as deal synergies and other investments across the board. So you're talking about, give-and-take, $2 billion of total spend between '19 and 2021. So second part of your question, Sean, on 2019. So we are planning to spend around $200 million of our base capital spend, which is basically to keep the maintenance going behind primarily our manufacturing units, our logistic systems and so forth.

We are going to also spend, give-and-take, $150 million of the $750 million cost to achieve, which relates to the synergies as well as CapEx. And like 10 minutes ago, I mentioned the state of the art K-Cup pod manufacturing facility that we have been building in South Carolina. That will take another $300 million to $400 million of spend. And lastly, $100 million of operating spend expenses in order to further fuel the initiatives we have. But the simple math, the cash impact, because of the disbursements, will be different than the investment planning. The give-and-take would be around $400 million cash flow that will impact us in 2019.

Sean King: Got it.

Ozan Dokmecioglu: And obviously, we have built all these numbers in our algorithms and our 2019 as well as the three-year CAGR output that we put more than a year ago. And we are staying behind that.

Sean King: Great. Yes, I thought it was great to see that you kept your long-term guide for '19 in range for '19, you kept it in range with the long-term guide. That's like back half waiting of the synergies. For this year, are you just as confident in achievability of those synergies?

Bob Gamgort: Yes, and it's a combination of synergies and timing of inflation. But go ahead on that.

Ozan Dokmecioglu: Yes, it's a -- couple of things going on there. First of all, there will be some impacts due to our Allied brands portfolio changes that we have performed in 2018. And obviously, there will be some quarters that we are going to, not to have them, or not going to lap them in 2019 that will create some pressure to our growth rates in 2019 on a quarterly basis versus '18.

Bob Gamgort: So I mean put simply, we've got, Peet's, FORTO, Evian. They're just ramping up now. So by the time you get to third or fourth quarter, they're very robust. But in the first couple of quarters, we're lapping a year ago with Allied brands that were up and running. So there's a gap there that is part of that impact in the first quarter that has nothing to do with the synergy side.

Ozan Dokmecioglu: Yes exactly, it's a timing difference. In our deal synergies, obviously, we are ramping up each initiative as normal -- as we would expect. Every quarter, the synergy deliveries or the initiative deliveries come to more fruition. And obviously that accumulates as long as we go into the quarters from quarter one to quarter four. And then we look to the inflation, actually curve, that we are going to experience between the logistics and the commodities, the first couple of quarters, it would absorb a higher rate compared to the 2018 quarter, the absorption versus '19. So when we combine all these factors that we have built in our guidance, that EPS you will get at the bottom line 15% to 17% growth.

Sean King: Okay, great. With that, I'll turn it over to questions from the audience. I have a list here, which I'll start off with. These have been sent in. So the first one is what's the rationale for having the Burlington office and the Texas office?

Bob Gamgort: The Burlington office is really the center of our coffee technology. We've got a great group of engineers that have a long history of being able to develop these brewers. This is actually a really good market to recruit people with a technology program as well.

We've also talked about that the next generation of brewers are going to be smart brewers. And we already have a household panel of more than 10,000 connected brewers that give us point-of-sale consumption, which is the first point of sale consumption in CPG that we make available not only to ourselves but our partners and our retailers who participate with us as well.

So the next generation is not just how do I design an appliance that performs well, delivers new benefits, and now, as you can see from our new brewers, look good on your kitchen counter, because we focus on industrial design now, but also how do you make them smart so they recognize pods, they're connected or whatever. This is a good market to do that, and we want to build on the talent and the expertise that we have. The Texas area's the legacy DPS business. We have a significant number of people there.

And so we don't see an issue in having two different headquarters. It's not unusual for most companies. Most companies have multiple locations, though. The fact that we have two is not really a big deal.

Sean King: Okay. I guess this one wasn't from a prior presentation, but it actually is for you guys. Are you looking into infused drinks containing CBD?

Bob Gamgort: I mean, we're monitoring it like everyone else. The first question we have to understand is, is it effective? Does it actually do anything? Second part of it is, is it safe? And the third question is, is it legal, so.

Maria A. Sceppaguercio-Gever: And I bet you guys would be more than happy to test it for us.

Ozan Dokmecioglu: Yes, definitely.

Bob Gamgort: I mean, those are big questions. And guess what, we've got a ton of white space in our category -- in our portfolio right now that we can go chase on things that are safe and legal. So we'll start there and figure that one out later.

Sean King: Any other questions from the crowd? All right. Well great.

Bob Gamgort: Thanks for joining us bright and early. Thank you everyone.

Sean King: Let's give a round of applause for Keurig Dr Pepper.

Bob Gamgort: Thank you.