Keurig Dr Pepper
Investor Call with BofA Securities and Morgan Stanley
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Dara Mohsenian: Hi, good morning, everyone. I'm Dara Mohsenian, Morgan Stanley's beverage, household products and food analyst. And on behalf of Bryan Spillane, Bank of America's food, beverage, tobacco and cannabis analyst, we'd like to welcome Keurig Dr Pepper's management team for joining us for a discussion as part of a series of in-depth video discussions we are having with C-Suite management teams and additional executives across the staples group. It's a joint effort between Morgan Stanley and Bank of America.

Before we begin, we have a quick disclaimer. This call is for Morgan Stanley and Bank of America's institutional client base. This call is not for members of the press. If you're a member of the press, please disconnect. Some of the statements Keurig Dr Pepper will make may be considered forward-looking and are based on assumptions as of today and Keurig Dr Pepper undertakes no obligation to update them. Please refer to KDP's Form 10-K for a discussion of risk factors that may affect results, and Morgan Stanley and Bank of America's websites for important research disclosures.

Bryan Spillane: Hey, thanks, Dara. I'm Bryan Spillane and we're happy this morning to introduce Keurig Dr Pepper CEO Bob Gamgort and CFO Ozan Dokmecioglu. The format of the call will be Q&A from Dara and myself, but if you have questions during any point during the call, please email either of us. It's Bryan.Spillane@bofa.com or Dara.Mohsenian@MorganStanley.com. This call is going to run for 60 minutes, and Dara, I'm going to turn it over to you to start us off with Q&A.

Dara Mohsenian: Great. Thanks, Bryan. And thanks for joining us, guys. We appreciate the time. So perhaps we could start with maybe some of the near-term COVID-related dynamics on your business starting with the coffee business. Can you help us understand or quantify the benefits you've realized since COVID began on the coffee side? Both in terms of increased household penetration for your brewers, as well as the benefit you've seen in attachment rates. And more importantly, I guess as we look going forward, as you think about how sustainable these gains are beyond 2020, I would assume it's reasonable to think household penetration has picked up in brewers in this environment. But is that more stealing future opportunity in your mind or is that something that's upside? And on the attachment rate side, how much risk is there that things just sort of fall off as the economy reopens from here?

Robert Gamgort: Sure. So first of all, good morning, Dara and Bryan. Thank you for hosting us. And good morning to everyone who is joining us today. I'm happy to talk you through the coffee business, which we're receiving a lot of questions on what is the COVID impact on coffee, and I can understand where they're coming from and I'd be happy to provide some context to it. I always am consistent in saying that any short-term conversation needs to be put in the context of the longer-term trends and strategy. Because this is a really solid and predictable business. And the more we break it down in the short-term, I think it's actually less valuable. But COVID is unique, so let me talk more about that.

You could go all the way back to when we talked about the combination of the two companies in our Investor Day in March of 2018. And that's 2.5 years old, but we still reference that deck and refer investors back to our website to look at that deck. Because everything that we talked about the coffee business at that time is still relevant today. So let me just refresh what are the key things and then I'll talk to you about COVID.

Key things are household penetration is the single biggest driver of our coffee system growth. It's the key metric to focus on for the long-term health of this business. We last updated that, because we only do it once a year, in Q4, on our Q4 call, so it's about 9 months old. But the number was 30 million American households. And if you look at that 30 million American household penetration number and you compare it to 2015, which is when KGM was taken private, that's an increase of over 40%. About 9% compound annual growth rate. And there are very few if any CPG companies that can talk about that level of real growth.

But we also talked back in 2018 about our belief that we could grow beyond 50% household penetration. And that's very much intact and we have a lot of confidence in that. So one of the other questions we get is, well how much runway do you have in front of you? Well, if you look at our growth rates and you look at that 50% number, you have at least 10 years of strong growth in front of us before we have a conversation about what next. So that's why we don't spend a lot of time talking about that. Because again, there are very companies that have line of sight to that kind of growth.

So with all of the long-term factors in place, COVID is unique. But what I will tell you right up front before I get into the details is, with all the pluses and minuses of COVID that I'll take you through, that long-term outlook and the way that we run our business is very much intact. Because we don't see this as a pandemic driven business. It was doing really well before, it's delivering really well during the crisis, and whatever the new normal is, we have enough flexibility to manage it to success.

There are 4 factors that we ought to talk about in the context of COVID and how it fits into the long-term strategy. You mentioned one of them and that's the attachment rate. Attachment rate, just to make sure everyone knows, is the number of cups per brewer that's installed. And we usually don't talk about attachment rate because it's been absolutely steady for years. That's the good news of when a new household comes in, the attachment rate stays intact. But it's been also -- it's not a number that we saw as a big growth driver. Well not surprisingly, the attachment jumped fairly significantly in the early days of the pandemic. What we are seeing since then is you see a direct correlation with consumer mobility. So as consumers have become more mobile, and I know you talk about that all the time, that attachment rate has come down from its peak of call it the March/April timeframe, but it still remains elevated. And honestly, where it goes from here is completely dependent upon the trajectory of the virus and how people think about their work situation going forward.

Our base assumption is that the attachment levels will settle, but they'll settle at a slightly elevated rate in this new normal given a combination of things about work from home and how people now view value and the fact that this is a much greater value than going out. The good news is, we talked about it before, we've got this connected panel of brewers. Smart brewers that give us point of consumption data. So attachment rate is something that we can literally manage, or not manage, measure hour to hour. So it's something that we have a good grip on.

Second metric is another one we never talk about, but worth referring to here, and that's the brewer upgrade cycle. So that's existing Keurig households upgrading their machine.

Well during COVID, we've seen an uptick in consumer upgrades, and it makes sense because one, people are staying at home and they value their brewer much more. The other element is, for years the company gave consumers no reason to upgrade. Now with our innovation pipeline and all the new brewers in terms of quality and benefits, we've given people a reason to upgrade. So you have to think about the Keurig business very much like it's an annuity. It's very similar to a subscription business. So every household that recommits is a really bullish indicator for the long-term. But again, it doesn't provide an immediate increase in pod sales. But we're really happy to see people upgrading their machines at a higher rate.

So then I get to the third metric which is the one that I keep saying is the most important which is household penetration. So no question, household penetration has accelerated during the crisis. But I want everyone to view this as an incremental boost to the long-term trends, not a transformational increase of short-term nature. And the reason why I put it in that category is pretty easy to understand if you analyze consumer behavior. Most consumers wait for their current brewer to break before they get a new one. So when the pandemic hit, clearly at-home coffee consumption went up, but the majority of that was satisfied by the brewer already in the home. But what we see is that as consumers replace their brewers, Keurig is getting a disproportionate share of those replacements. So if you look at NPD data which is available to everybody, if you look at the latest period, Keurig machines are growing at 17%, drip coffee makers are growing at 5%. So there's clearly an attraction to at-home coffee and we're getting a disproportionate share of that. But you have to remember, we have this incredibly strong and large household base that's already installed. So even that level of change is a modest increase to a household penetration in any given year. And that's why we keep saying it's interesting, but look at the long-term trajectory. That 9% compound growth over 4 years with continued strength is what you should be focused on and not overly focused on the short term.

The last piece I would talk about is one that again we rarely talk about that is our away from home business. And that's primarily office coffee. And you don't have a lot of external visibility to that and it has been just a really solid, profitable performer within the portfolio that's moved along with the Keurig systems growth levels. And therefore, we haven't talked a lot about it, but let's be clear, there's a big gain in at-home coffee consumption, there's big hit in office coffee. Office traffic has been one of the hardest-hit of all mobility measurements in the pandemic. And if you look at it, it's persistently negative. So even as mobility has started to increase and we're seeing restaurants recovering somewhat, you see mobility at retail increasing, people have not come back to offices. So we've got these strong at-home trends, but there's been a significant offset to that which is our away from home business. And if you think about how this all converges, in Q3 is when we're going to see the peak impact of the office on our coffee systems results. And then when you get beyond that, what are we seeing? We're seeing already in the latest IRI data, you're seeing changing seasons and the start of school, you're seeing an uptick in at-home coffee consumption again. And you're seeing some offices returning workers and talk about returning them at a faster rate. So as the balance of the strong at-home offset by a negative away from home hits us the most to the negative in Q3 and then it starts rebounding again.

And then remember, we think going forward as offices reopen, we actually have the ability to increase our share in that space because single serve coffee has become a much more attractive format in this new normal and we have the default single serve system. So that's really what I want to talk about in terms of COVID. All the things I just discussed, all factor into the guidance that we've given for the balance of the year. The timing gets a little uneven, as I'd point out in Q3, and Q2 was a different situation. But what I would suggest, whenever you look at any Keurig quarterly data, look at our conversations on these earnings calls over the past 8 quarters. We've been just as quick when we've had spectacular results to say look at the long term, as we've said when there's been results that have been below expectations, look at the long term. I would say the exact same thing here. And the takeaway is not that this is a COVID business or a pandemic benefiting business. This is a really unique, long-term growth play that has incredible line of sight to the future that has passed the COVID test. And that we believe that yes, there's some incremental benefit to it, but what's much more important is the long-term trajectory.

Dara Mohsenian: That's helpful, that's very comprehensive. Just 2 quick follow-ups on that. One, the brewer uptick you've seen, how much of that is new customers versus sort of upgrading existing customers? Is your sense that that's more incremental longer term or is it just sort of taking customers that might otherwise have come in over the next year or two? And then second, can you help put in perspective a bit more the size of the office and hospitality business in coffee relative to at-home, relative to market share, etc., however you want to frame that?

Robert Gamgort: Yeah. One of the metrics that we discount in our earnings calls are brewer sales. There's been a lot of attempts to correlate brewer sales with household penetration growth and we say over time there's a correlation, but it's not a direct 1:1, and definitely on a quarterly basis it's almost meaningless. Because embedded in those numbers is a combination of people replacing their existing brewers with new households coming in. So you've seen in the Q2 results and if you look at the NPD data that I just referenced, you're seeing a big increase in the number of brewers that we sold. It's a mix between new households coming in as well as existing households upgrading a machine. They're both good. Because as I said, this is a subscription business, you want people to reup and they're doing that. And then when people come in, it's very sticky. Or success rate in a new household coming into the system, our success rate of them staying for the long haul is very, very high. So the numbers that you are seeing in our brewer sales are a mixture of the two and we don't break them out specifically. But the most important takeaway is, every new household that we being in now is an annuity for the long term and they're not going to drop out post pandemic. This is a behavior that sticks for the long term.

Your point about the away from home, your question about away from home coffee, we've not broken that out either. But what we have said, I can talk a little bit about that, is about half of our coffee business is in untracked channels. That includes away from home which has taken a big hit, specialty retail with department stores, etc., you can imagine those have taken a hit. The Canadian business is in there and Canada's behavior looks a lot like the US, so everything I just said before applies to Canada. But also in there is eComm. I think it's important just to take a moment to say eComm has been a very big driver of growth and has been able to offset some of that hit that we talked about in specialty retail and to a degree away from home.

We said on our Q2 call that eComm represented 10% of KDP sales. You can imagine that's a much more meaningful number in coffee systems. And I think that that is another really strong future indicator that as our business becomes more developed in eCommerce, that's stronger towards the long-term trends, where consumers are going, where they're shopping for the future.

Bryan Spillane: Hey, Bob, just one follow-up to Dara's question, more longer term. As Keurig was building household penetration early on, wedding registries, so getting on the wedding registry was one way, an effective way of sort of getting in the household early and household formation. And another was people, consumers were actually replacing using the Keurig machine as a replacement for drinking coffee away from home. So put a mug in the machine before you got in the car and left in the morning. So are those two behaviors still relevant today? Are those still driving sort of adoption into the system today?

Robert Gamgort: Very much so. Gifting is an important driver and what we've talked about in the past is a requested gift is better than an unrequested gift. So when somebody puts it on a wedding registry, that's the definition of a requested gift. But it has always been a driver. And your second driver, which is using this in replacement for away from home coffee, becomes even more relevant if we were to enter into a recession. Because now you've got a much bigger installed base. The quality of the machines and the coffee that it produces is significantly greater. And remember, we've got K-Café and K-Latte that produce cappuccinos and lattes, so it's a much better installed base than it once was. And that conversion for cost reasons is available, not to mention our pod price is way down from where it was before.

Just one more point on gifting, we had a very strong Mother's Day. We talked about that on our 2Q call. And when we get feedback from retailers as we gear up now for the Christmas and the end of year holiday season, we're seeing some really interest and strength from retailers as well. In an environment like this, there's a shift to more pragmatic gifts and with all the innovation that we have coming out there, we're giving people a reason to really push Keurig for gifting. So we're very optimistic about that being a continued driver of household penetration.

Bryan Spillane: Thank you. Maybe, Ozan, just to shift a little bit, on the last earnings call it was pretty clear that you had a bias in the second half of the year to reinvest any upside that there might be back behind the business. So just wanted to better understand that, especially after 2Q was a little bit better. And maybe the theoretical benefits of COVID on the topline and even after the away from home weakness, it sounds like topline benefits that emerge could be offset by reinvestment. So I guess is that the case? Or is it more that there probably is not much topline benefit by year end, putting all your puts and takes together?

Ozan Dokmecioglu: Thanks, Brian, and good morning, everyone. First of all, let me start with the fact that as Bob was saying, the COVID-19 environment was not a windfall for us at all. In fact, it was a product of effective mix management and a ruthless prioritization. And let me expand what do I mean with those points. For example, when you take a channel look, we have experienced, and it's still the case, significant swings within our channels from the sales channel perspective. It is true that at-home consumption of our beverages has increased while the office and hospitality coffee consumption has declined significantly. As has fountain food service, convenience and gas on the cold beverage side of our equation. When we take for example a look over the products and the packaging formats of our business, we have also seen significant swings in what consumers are buying in terms of the rapid shift. By shifting towards larger multipack sizes, away from more profitable either impulse or convenience driven items. Well, we have had to drive our growth areas harder to offset the pressure from declining segments. And then our share gains across our core portfolio is a great example to this. We have also had to manage the cost side of our portfolio to offset the negative mix impacts and continue to deliver on our financial commitments by doing several things. You should not forget that we are more than two years into our integration process that actually enabled us to have a great visibility as well as the management of all the cost drivers across the network, across our company. A couple of them to share as an example, the significantly lower travel and entertainment expenses. Also, some reduced marketing spending given that the return on investments were not there in some of the investments that we were planning to do before. And at times, it was not even appropriate to continue or carry on the investments that we thought. Therefore, it was not justified for environment perhaps and as part of the whole sector that had some reductions. Plus, again, as I said, we have great visibility in all other controllable cost drivers. We are managing this business for the long term, no question on that. Therefore, we never like to reduce marketing spend. But this is an extraordinary year in which everyone has needed to do so. Having said that, we continue to deliver our merger algorithm on the financial results, the commitments that we put out there. And this made sure that all those financial returns have been well above our peer set. Therefore, we believe it makes sense to reinvest any financial upside beyond those already aggressive returns back into brand growth and innovation to ensure continued momentum in 2020 and beyond.

Bryan Spillane: That's very clear. So just to be clear, it's really investing -- a lot of it sounds like it will go behind innovation, right? Just teeing up the innovation pipeline for next year, is that a big priority back half of the year?

Ozan Dokmecioglu: Innovation investments have always been priority and that has never changed. And we are increasing our innovation investments in all parts of our business whenever we see the opportunity. And that applies as you say, both this year as well as next year as well as by considering the longer term of our topline as well as bottom line growth.

Robert Gamgort: And Bryan, just to add to that, we've had very strong innovation on the cold side as well as the hot side in 2020 that has served us really well. We'd like to invest incrementally behind those as we have the opportunity. Because we see opportunity now to continue to build household penetration on the cold side as well as the hot side of our franchise.

Bryan Spillane: Right, okay. Maybe -- I know it's early to talk a little bit about 2021, but at a high level I guess, Ozan, if you could talk a little bit about maybe how you're seeing the external environment shaping up, maybe some of the considerations like on comparisons, maybe some of the company specific levers that you have to deliver on your 2021 targets. I know there's going to be some concern about whether it's a tough comparison year or not in 2020. Again, we talked a lot about puts and takes. But just maybe at a high level just kind of how you're thinking about the environment for next year as you see it today and how that sort of squares with delivering on your targets for next year?

Ozan Dokmecioglu: Sure. And please let me start by saying that critical component, we are only one of the few companies that have provided visibility into the 2020 financial results delivered for the full year and not just for the next quarter. And that visibility included double digit EPS growth as well as a significant debt reduction. We continue to express our confidence in our 3-year merger algorithm which takes us through the end of 2021. And 2021 we likely expect to continue to be another volatile and challenging year. But, if this crisis has proven anything, it is that we can drive our business to succeed in nearly any working environment. That speaks to the long-term confidence we have in this business and how we have been running and have the control of both the top and the bottom line drivers.

We will share our 2021 outlook at the appropriate time, no question on that. But let me provide a few thoughts. We are on track to achieve our leverage ratio of 3x or below by next year, which will provide significant optionality to create value for our shareholders. For example, cash generation is and will continue to be exceptionally strong. As you will remember, when we announced our 2019 full year results, our cash flow conversion ratio was in excess of 140%. And in quarter two this year, 2020, the same ratio was approximately 112% and we expect it to continue to be strong going forward. We are currently investing in several large projects as well that will provide productivity and support of our growth in future. Just to name a few, the state-of-the-art K-cup pod production facility that we are building as we speak in Spartanburg, South Carolina. For beverage concentrates, our newest Allentown facility, and for the beverage concentrates of the new facility we are building in Ireland. So we will still have considerable white space in our portfolio that we can address through many means. Likes of M&A, partnerships, innovation, and so forth. I believe we have proven our ability to execute in each of these areas with strong plans that we have brought into the KDP portfolio and that we will continue as such.

Robert Gamgort: Hey, Bryan, just one thing, you talked about a tough compare. We get some of those questions, is this going to be a tough compare next year? This goes back to a couple of points we made a couple of times, so apologies for reiterating, but I think it's really important. This situation, 2020, is by no means a windfall for us. We've had a large number of negatives impact our business as well as the positives. As Ozan said, this is really a mix management exercise that I think we've executed really well. So as the economy and the environment changes in 2021, there are an equal number of rebounds that we get. It's not a situation where we had a windfall, now we have to comp against that. We got a lot of negatives. I talked about away from coffee, we get a rebound on as well. So it's a very different situation than a lot of other CPG companies that have been able to get a one-time benefit in 2020. We're quite different than that.

Bryan Spillane: Yeah, very clear.

Dara Mohsenian: Then, Ozan, maybe we can talk about coffee pricing for a bit. You know, retail pricing has improved recently aided by mix. Obviously, that accrues to your partners, not necessarily KDP as much. But I was just hoping we could review the pricing environment in coffee longer term post-COVID. And also, with smart brewers now out there, recyclability coming in the US, it seems like you're sort of upgrading your system relative to other alternatives that are out there. So does that factor into pricing over time? How should we think about that relationship with your partners over time and how much of an impact that might have?

Ozan Dokmecioglu: Sure. So let's take a step back just to refresh our memories. As Bob referenced, during our March 2018 Investor Day, we said the following, and I think it will shed quite a bit of light to the question as well, Dara. At that time, we said pricing was starting to moderate and volume was improving. But not enough to offset the pricing from a negative perspective. We also said and projected that as pricing continued to moderate, volume would accelerate, driving revenue growth of 2% to 3% and the margin would continue to expand. Well, we are more than 2 years, 2.5 years into that, and what have we seen? Let's take a look at it. Exactly what we said. For example, in 2018, pricing was down almost 4%. Net sales were flat and margin expanded approximately 300 basis points. So then when we take a look to what has happened for example in 2020, first half, pricing was down less than 3%, net sales were up 3%, and margin continued to expand another 120 basis points.

So COVID-19 environment doesn't change that long-term outlook. But the pricing trends you mentioned do confirm our consumer elasticity insights. Overall, pricing has reached a level where consumers believe provides a good value and the category has evolved into good, better and best pricing structure. With the stronger growth at the best level in 2020 that we are all seeing when you look for example to IRIs in this category, pricing for the coffee systems in our profit and loss statement primarily reflects the contracts and the partnerships that we have in place. Those investments, while predictable to us, are not always evenly paced. It's an important point to know. That creates some fluctuations. Most importantly, all the investment in pricing and very importantly the productivity we were driving to enable the investment, is transparent to us. So we run all these things around a very tight strategy and execution as we have communicated several times. Please note that coffee system margins continue to expand, 140 basis, for example in quarter two this year, as we continue to make these investments.

Dara Mohsenian: Okay. As we think about the long-term on the pricing front, obviously one of your goals in the last few years was with the significant cost savings you've had, you could sort of reinvest that in pricing and drive household adoption. You mentioned that we're now getting to a more sustained pricing level in consumers' minds. As you think about long-term, is there less of a need to take pricing down over time? How should we think about that looking out from a multiyear standpoint?

Robert Gamgort: I'll take this one, Dara. I mean I think if you look forward on this, as we said, we've got long-term visibility to the pricing that shows up in our P&L because they are long term agreements with our partners. What they choose to do with pricing we give them is really up to them. Those partners are branded partners as well as store brands. And the environment right now is allowing for retail price stability and increases, but that's really up to them to do that. And just because, as we pointed out before, if someone wants to invest in pricing because they want to gain share or they want to drive foot traffic in their stores, that's really up to them to do that. So it's impossible for us to predict. The most important thing that our investors need to take away though is, we have line of sight to the pricing that we're going to realize in our P&L, and we have that matched up with the productivity programs that you talked about. They don't always come in the same period, but we have the line of sight to that one and that's what gives us the confidence to do so.

I think your other point though about in the future, can pricing go the other direction? I think that's an innovation idea. I'm sure we'll talk about brewer innovation, but there's broader innovation conversation that we could have that would give you an indication that we can.

Dara Mohsenian: Right. Why don't we switch to brewer innovation then? Obviously, you've come out with the smart brewer recently. You can control it from your phone, customize it to customers' needs in terms of temperature, brew preferences, etc. I guess first, how significant an upgrade is this in your mind, both from a retail customer and maybe from a partner perspective? What are the financial implications as you think about that longer term and sort of the advantages that can emerge from having a smart brewer?

Robert Gamgort: As I was saying earlier, our innovation pipeline across brewers is strong and it continues to get stronger every year. If you look at some of the platforms we introduced in the past couple of years, that's the way we think about it, is how do we go after platforms that we know unlocks the consumer household penetration? Specialty coffee with the K-Café, K-Latte, those brewers continue to do very well. K-Duo lineup, which allows consumers to do large batch and single serve, also continues to go well. What we're introducing for the holidays is the K-Supreme and the K-Supreme Plus which now have this multi-stream technology which is 5 needles which gives you more extraction. It also controls temperature and strength better. We're doing limited edition brewers with designer Jonathan Adler. So there is a portfolio of brewers now that is completely different than it was several years ago and they attack specific consumer needs. And that's what's giving this continued and sustained growth, strong growth in household penetration.

One of those platforms that we've been talking about all the way back to the Investor Day in 2018 were smart brewers. We were in smart brewers, but we were doing it in a limited format with this connected brewer panel. That gave us and continues to give us incredible data that we use to manage the business. We also make that data available to our partners. But it was also our opportunity to test connected brewers which could recognize the pods and eventually make adjustments to the brew algorithm to optimize that. That's now ready for consumer sale. So like all technology, you start small, you expand your knowledge, you see how consumers use the technology. The cost curve improves and then you cascade that into more models.

So let's be clear, this is our entry point and it's a beautiful machine that will be high priced and is our flagship right now in terms of not only the intelligence of the brewer, but the quality of the brewer. But let's be clear, our intention is to take everything I just said and cascade it down to our brewer lineup. And we want all our brewers in the future to be smart. Because what they're able to do is, they recognize the pod, and that pod recognition allows them to brew each pod differently based on the recipe that the roaster of the coffee provides to us. As you said, it allows people to brew remotely, which believe it or not, is the number one request that we get from consumers. It provides a better range around temperature and strength which are the two variables that consumers want to control to customize their coffee. And then it opens up the door for something very interesting which is intelligent auto reordering of K-cups. We have a pretty good auto reorder business right now through Keurig.com, but it's based on ordering patterns. Imagine if we were able to do that with actual consumption patterns at the SKU level. So our intention is, this is the start of it, but we're excited about the future. By no means is this the end. We expect this just to be the very beginning.

Dara Mohsenian: Okay. And as you think about market share, obviously, you have a very large percentage of the market out here between your own brands and your partner brands. Your own brands have seen a pickup in market share recently during COVID. Is that something you think can be sustainable post-COVID? What's driving that? But also, as you just think about the overall bucket with your partners included, are there big chunks of the market left that you can sort of go after, particularly with some of the private label manufacturers out there? Are there reasons to believe you can make progress in terms of gaining some new customers? Or will there always be these manufacturers out there that are willing to sort of compete pretty aggressively on price? How do you think about that?

Robert Gamgort: I'll pick up the last point first and then I'll go to the bigger question, which is, we clearly have been willing to compete aggressively on price as well. But we've had productivity and the innovation to be able to expand margin while doing so. Which I'd put that in the clear category of a win for everybody, including consumers. But from the bigger picture perspective, what we say is the critical metric is KDP manufactured. We're north of 80%. That's a really good number. Could that number be bigger? Yeah, in theory, but you can imagine at 80%, we've got almost every single coffee brand in the system. And then of the store brands, we have the great majority of them. And those that aren't in the system tend to be much more price focused than quality focused. And there's a point at which you say, I don't want to compete for business where there's no consideration for the quality that we provide. And what we've been able to demonstrate is that we're not the cheapest, but by far the best quality. And 80%+ of coffee decisions have voted in our favor and that's a good place to be.

That leaves us free to really manage growth of the system on behalf of us and our partners. And that's what our partners want us to do. They want us to continue to drive household penetration because that's where the real win is for them, not in the next fraction of the cent of cost on the pie.

You asked a question about our owned and licensed portfolio. Let me go back, because again, the theme is consistent, the long-term view is most helpful. At one time, Keurig had 100% share with its owned and licensed brands of a very small system. There was a strategic decision made years ago that we all benefit from which is to open the system. All of the other single serve systems that were competing were brand focused. They all failed. And the one open platform succeeded. So as that's the great success story of Keurig, the downside, if you want to call it a downside, is that owned and licensed share, by definition, declined every single year.

What we said back in 2018 when we did our Investor Day is, there's a point at which pretty much every major coffee brand that can be in the system is. And the owned and licensed share declines would moderate and that we weren't that concerned about it because we care most about household penetration and the ecosystem. Everything that we said in 2018 is happening right now. It's not happening anything that's related to COVID. It's driven by the stability of the number of brands entering the ecosystem and the fact that we put a significant amount of marketing and innovation behind our flagship brands and they're responding to it.

And then two other points on this one. One is I will remind everyone that McCafé moved from being a partner brand into a licensed brand. That will start showing up in the IRI in the Nielsen numbers if it hasn't already in your reports. But that is a good boost to our total owned and licensed brand portfolio. When we go to retail and we sell promotions and merchandising, it gives us even more strength. And then also, people talk about private label in the context of it being competitive to us. We care about the ecosystem. And we are the majority manufacturer of private label and we are perfectly happy with the role they play in the system of providing an entry level price point.

Dara Mohsenian: Great. Thanks.

Bryan Spillane: Hey, Bob, maybe if we can shift to the cold side of the business and maybe talk a little bit about market share. You've had good performance with Dr Pepper, but also with this year, really across a lot of the brands in your cold portfolio this year in terms of market share. So maybe you can talk a little bit about maybe not just what's driving it specifically this year, but going back to the merger and some of the changes you've made in your approach to the cold business and carbonated soft drinks specifically. Kind of what, how you've changed the approach and really what do you think -- do you believe you can continue to gain share going forward?

Robert Gamgort: Yeah. I mean as you point out, we were gaining share prior to this. We've seen good share performance during the crisis and I'll give you a couple of reasons why that is, because I think that's important to understand. And then again, let me talk about the future because your question, how do I look at this opportunity going forward? So a couple of facts that are important. We gained shared not just in CSDs but across the entire LRB portfolio. In fact, nearly every single category and brand in our portfolio has gained share. That's the equivalent of 90% of our liquid refreshment/beverage retail base gaining share. CSDs have been an even stronger performer in there. In the latest 13 weeks, we've gained almost 1.5 share points. And I think the most important thing towards your future question is, what's driving this is more coming from new households into our brands rather than existing households consuming more. And that's very bullish on your question about can you continue to do this going forward.

Why have we done well? It's pretty straightforward to explain, it's always hard to execute. Innovation has been strong and our ability to innovate and renovate our CSD brands has been well documented. And this year Canada Dry Bold, the Dr Pepper & Cream are good examples. Dr Pepper & Cream is the best performing CSD. It's about to hit $150 million of retail sales in 2020, its first year out. So that's a formula that's worked really well.

We also invest heavily behind our key LRB brands. And the quality of our marketing and our high returns is documented and you can see how well it's working right now. And even though college football looks different this year, we're still out with Dr Pepper Fansville campaign. I watched it over the weekend a number of times. And those, that is a formula that works really well for our key brands.

And then I think the biggest shift that we've made, because that formula I just described has been in place for a while, the biggest shift that we've made over the past year or so is the investment in our company-owned DSD system. And our strengthening our partnerships with our independent distributors where we don't have company-owned DSD coverage. It's a very different relationship with that group than we had in the past. And the execution across those two, but particularly in our company-owned DSD, has been incredibly strong. This is an example of day in and day out winning the shelf, winning the merchandising, servicing the customers better than anyone else. It is helping us gain share. It's a combination of management and process and talent. It's also examples of investments that we've made in our company-owned DSD system. And we're crystal clear on, we get the question all the time, how do you think about DSD going forward? We're crystal clear. We see it as a strategic advantage. It can always be more efficient and more effective, which is where the investments go, but if the pandemic has proven anything, it has proved that being able to control your own distribution system is a huge advantage. Especially one that's centrally controlled and is able to deliver the innovation and deliver the merchandising that I talked about previously. That will continue into the future.

Bryan Spillane: That actually is a good tie-in to one of the questions we got from the audience which kind of comes down to the complexity in the business. You've got 7 routes to market and seemingly a business model that's got a lot of complexity to it. So now that you've been in this for a while, any thoughts towards is that complexity a competitive advantage? Is there room to tweak it to maybe drive higher margins? Just how you're thinking about the kind of business model as it sits today.

Robert Gamgort: Yeah, a couple of observations. One is, it's more complex from the outside than it is from the inside. We know it really well, we live it every day, and so we know where the priorities are. We know what to focus on, to shift, we know what to maintain, and we know which areas to almost ignore. In the end, I am firmly convinced it's a competitive advantage because we have this unique ability to distribute our products. Where it makes sense, warehouse direct for the most efficient delivery, cost efficient delivery. Where you want effectiveness, and that is DSD. And we just talked about our DSD being unique to others. And then we have other aspects of our delivery system like offices which we talked about earlier and eCommerce. And the point is, wherever the consumer shops, we have the ability to get product to that consumer in the most effective and cost-efficient way possible. Yeah, it's really complex from the outside, and sometimes it's hard to explain, but I think that's part of the magic for us in our ability to master that and run that. And yeah, we know where there's opportunities to improve it, and that's part of what you're seeing right now.

Bryan Spillane: Then maybe if we talk a little bit about the Polar relationship and how that came to be. And maybe if you could talk a little bit about how that relationship will work and maybe how it might differ from some of your other allied brand relationships?

Robert Gamgort: Yeah. We have more white space in our portfolio than our peers. We view that as an opportunity for growth in the future. The question is, how do you get there? And there are a number of different mechanisms that we can use to get there and one of them is partnership. And so we are flexible and thoughtful about how we go after the white space in our categories. So let's take sparkling water. Really great segment. We had a very small presence in it. Sparkling water has grown 15% plus in the last year, it's accelerated to over 20% in more recent periods. We think it is still on the upswing of adoption among consumers, and so we need to participate in that. So we could develop or accelerate our own brands. We could acquire somebody at a seed level. We could acquire a large player. Or we could do a partnership.

You cannot prescribe in advance which is the right outcome. You have to pursue all of those. And my answer for that is the same for every other segment which we have white space. Polar one is unique because it's a great brand, it's the third largest brand. It's only in 1/3 of the country which makes it the largest velocity seltzer. But they needed a path to fill out 2/3 of the country. We've had a 30-year relationship with Polar because in the northeast, particularly New England, they manufacture and distribute some of our key brands. So this is a known entity. Both of us are known entities to each other and that gave them the comfort to enter into a long-term franchise agreement where we will manufacture and distribute the product, not just be a distributor for the parts of the country that they don't cover. That's the ultimate win/win structure. If we had the chance to own the brand, we would, but we don't. So you have to then say, what is your other alternative? We think this is a very unique structure enabled by our flexibility, our route to market capability that is attractive to them, and the fact that we have this long-term partnership and we know each other well.

Bryan Spillane: And I guess we can't talk about seltzers without asking about hard seltzers. So if you can kind of give us your thoughts and observations about the category and how it may or may not fit for KDP?

Robert Gamgort: Yeah, look, we look at everything. Right now, we have focused in the non-alcoholic segment. I don't want to talk about what our plans might be in the future, but the approach that I described earlier is the way we think about all categories. Which ones are attractive, where do we have coverage or not, and how do we access the areas of white space and do we have any right to be in that category? Do we have a brand? Do we have a distribution or manufacturing facility? Is there some value add that we can provide in there? And that's how we think about it.

I'm not going to say any more about hard seltzer. I will say about water though, water was one of those strategic categories back in 2018 where during the merger that we said we want to have a bigger share of premium water. Not commodity water, premium water. Look at where we are today now with Polar. You add Polar to the Core acquisition, to the partnership we announced back in 2018 with Evian, plus Bai and now even smaller acquisitions like Limitless, we're the number two premium water company since 2018 because we put a real focus on it. So when we decide that we want to be in a category and we have a strategy, we can get there. The category you're talking about is one of many that we evaluate, just not ready to talk about what our plans are.

Bryan Spillane: Thank you.

Dara Mohsenian: So Ozan, maybe moving to the margin front, you spent a lot of time on topline questions. Just help give us some comfort on you still reaching your synergy target of $600 million. Obviously, supply chain has become stressed in a COVID environment, so why are you still comfortable with that goal despite theoretically maybe some delays in many pieces of it given COVID? And just overall, your general level of visibility as you think about synergies looking out for the end of next year.

Ozan Dokmecioglu: Absolutely. First of all, let me reiterate our position on the 3-year algorithm that we laid out at the time of the merger which is very much intact, no question on that. Also, as it relates to synergies, we remain very confident in delivering the $600 million over 3 years. As you know, the first year is starting with 2019 and ending 2021. And look what is happening in this during COVID-19 environment, working environment. I believe we have demonstrated our ability, which is really important to be agile and flexible. That enabled us to accelerate some of the projects that are easier to do or execute in this environment. To replace others that are more complicated or required some delays. Which allowed us to deliver still as we stated on our financial commitments. And this is a very important point.

As I also said, Dara, a couple of minutes ago, given that we are more than 2.5 years into our, more than 2 years into our merger, we also developed a great visibility into all of the cost drivers that we have across our entire business. Which is very, very important. And you have seen how quickly we put into service for example some of the value creation ideas and still successful in delivering against our targets, there's no doubt, for 2020 as well. Therefore, the bottom line is that we are on track to deliver $600 million synergies over 3-year period and we have no concern which includes again overall delivery of our EPS as well as the de-leveraging targets, besides the synergies.

Dara Mohsenian: Thanks.

Bryan Spillane: Maybe -- we touched on it a little bit earlier, but maybe for both Bob and Ozan, if we could talk a little bit more about capital allocation and looking beyond, once we're below the 3x leverage. And I guess a couple of questions there, I think one of the perceptions that investors had when the merger first occurred was this was going to be a business model that you put these two companies together, you de-lever the balance sheet, and then it becomes an acquisition vehicle. So I guess first question is, is that a good characterization of how we should be, how investors should be thinking about the business model going forward? And then the second I guess tied to that, opening, building the concentrate manufacturing plant in Ireland is pretty few away from St. Louis I think which is where your bigger one is. Does that at all imply expansion internationally in terms of maybe where you may be thinking in terms of M&A?

Robert Gamgort: Let me start off, Bryan, give you a couple of thoughts on this, and then I'll turn it over to Ozan to give you some thoughts about how we view optionality in 2021 and beyond that. I think the point that becomes an acquisition, take synergies out, and then you've got to reload, is based on some models that are out there in the food industry primarily where I think the outcome hasn't been great. And we reject that every time we hear that. And I could go on a really long answer of why we are a completely different business model than that, but the short answer to that is, our previous conversation. The difference is, we're delivering our $600 million in synergies. We're delivering EPS growth at double digit levels and probably the most rapid de-leveraging you would have seen in the CPG space. But yet we're growing share on 90% of our retail base. And we're investing heavily in marketing and innovation. That's the piece I keep pointing to investors is, doing all of the costs on the de-leveraging side is absolutely critical. Doing that at the same time that you're accelerating your growth, capturing market share and investing heavily not only in innovation but in long-term platforms is a massive differentiator. And I don't think there's another model that looks like that. Having said that, which I'll give it to Ozan to talk about, your point about when the leverage ratio is down below 3x, is M&A part of the value creation story going forward? It absolutely can be, but it doesn't have to be. We don't have a strategy that is dependent upon M&A. We have a strategy that will deliver significant, superior total shareholder return with the optionality of M&A, which you know, nobody controls.

Ozan, you want to add couple of thoughts on how we think about post-2021?

Ozan Dokmecioglu: Absolutely, Bob, absolutely. Not to repeat what you said. First of all, Bryan, to address our near-term focus, 100% remains on de-leveraging as we stated many, many times. Which will be in line with the targets that we set at the time of the merger. Then once we lower our leverage at 3x and below, next year, which becomes the second part of your question, post-2021, when we achieve those leverage target ratios, we will have far more flexibility and optionality for value creation. But please make sure that as Bob was saying as well a couple of minutes ago, we never made our let's say leverage ratio being a little bit high to get into any M&A deals. We adjusted in 2018 using our shares or a stock deal for core hydration for example. So what does this mean? That means that whenever there is a good white space feeling on competitive ground or company that we like to work, that is part of M&A transaction, definitely we would, as was the case. So but it is also important to note that we are a highly cash generative business. And we will assess our options for the use of cash base on the operating environment to drive value creation for shareholders as what we have been doing. As Bob said, this includes or may include M&A, dividends, investing further in our business behind innovation, our distribution network as well. So a host of other areas to allocate capital in the interest of continuously driving shareholder value.

And just a quick touch to your last part of your question with regards to Ireland investment being far away from St. Louis. That is true. But there are quite a bit of merits from the business side that it makes sense for us to build a concentrate facility in Ireland. For example, the main reason why we are doing, a couple of reasons we are doing it, and one of the main ones is to create a second facility for the very important for our business from a manufacturing capability perspective. And when we looked at expertise as well as this source of major raw material majority, in fact coming from Europe. So Ireland being at the forefront of Europe and really close proximity to the US and the shipment quantities of concentrate needed was not making it less economic or detrimental to what we have today. And obviously, resources, talent, as well as being close to the raw material source were very, very important criteria for us. And of course, there are, as we announced publicly, of course there will be some further financial benefits as well. But that is not the only reason. But it's a whole package.

Bryan Spillane: Thank you. And then maybe, Bob, last one, just more on an ESG angle, but tied to pods, just 100% recyclability. Can you just update us on where you stand there in terms of getting there for the end of the year? And then or I guess into next year? And do you see that as sort of having been maybe a limiting factor in terms of household adoption of the Keurig systems?

Robert Gamgort: Yes. So all of Canada was converted in 2018 and by the end of this year, all of the US pods will be recyclable as well. I mean we're in, the last time I checked, we're north of 95% already there. And that allows us to activate more communication around that. We did a barrier analysis that we put in that March of 2018 investor deck, so you can go back and look at it, of what are the barriers to entry. Sustainably, recyclability was one of those barriers, so we knew we have to get after that. Plus, it's just the right thing to do and it's part of our broader sustainability platform across the entire business. So we're well on track with that and I would put that in the same category as improving quality, improving innovation, of all the reasons why consumers will be free to come into the Keurig system over the long term. But it's a very important one and the good news is, we're just about done with it.

Bryan Spillane: Okay. Well, we're just about at the top of the hour. So on behalf of Dara, Bob, Ozan, we really want to thank you for spending time with us. It was as always really helpful for us in terms of furthering our education and helpful for investors. Hope you are all -- have a good rest of the day and look forward to catching up at earnings.

Robert Gamgort: Excellent. Thanks for hosting us today.

Dara Mohsenian: Thanks, guys. Appreciate it.