Keurig Dr. Pepper Inc.

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08:00 AM ET

Operator: Good morning, ladies and gentlemen, and thank you for standing by. Welcome to Keurig Dr Pepper's Earnings Call for the Third Quarter of 2020. This conference call is being recorded and there will be a question-and-answer session at the end of the call.

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

Tyson Seely: Thank you. And hello, everyone. Thanks for joining us. Earlier this morning, we issued our press release for the third quarter of 2020. If you need a copy, you can get one on our website at keurigdrpepper.com in the Investors section. Consistent with previous quarters, today we will be discussing our performance on an adjusted basis excluding items affecting comparability. The company believes that the adjusted basis provides investors with additional insight into our business and operating performance trends. While the exclusion of items affecting comparability is not in accordance with GAAP, we believe that the adjusted pro forma basis provides meaningful comparisons and an appropriate basis for discussion of our performance.

Details of the excluded items are included in the reconciliation tables included in our press release and our 10-Q, which will be filed later today. Due to the inability to predict the amount and timing of certain impacts outside of the company's control, we do not reconcile our guidance.

Here with me virtually today to discuss our third quarter 2020 results are KDP Chairman and CEO, Bob Gamgort; our CFO, Ozan Dokmecioglu; and our Chief Corporate Affairs Officer, Maria Sceppaguercio. And finally, our discussion this morning may include forward-looking statements, which are subject to the Safe Harbor provisions of the Private Securities Litigation Reform Act of 1995. These statements are subject to a number of risks and uncertainties that could cause actual results to differ materially, and the company undertakes no obligation to update these statements based upon subsequent events. A detailed discussion of these risks and uncertainties is contained in the company's filings with the SEC.

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

Bob Gamgort: Thanks, Tyson and good morning, everyone. I hope everyone participating on this call continues to be well. In the last few -- the last few months have been extremely volatile, given the COVID crisis. While consumer mobility has increased and the economy has opened up somewhat, the coming months are likely to remain unpredictable, as rates of infection in North America appear to be on the rise. As we'll discuss today, KDP continues to navigate well through the pandemic by anticipating and adjusting to trends in consumer behavior, driving brands, categories and channels with growth potential in order to offset other areas that are challenged.

As we said over the past seven months, the pandemic does not represent a short-term windfall for us. Instead, this is a day-to-day mix management effort across both channels and products, which is enabled by the flexibility of our business model, and the outstanding executional capabilities of our team. We monitor consumer mobility trends on a near daily basis to adjust our product mix, channel focus and production planning, and continue to view this metric as a reliable leading indicator for running our business.

Most of all, we continue to be thankful to our team members who have driven the results we reported today and the work our organization has done to give back to our communities when they are in need. Ozan will take you through the specifics of our third quarter results in a few minutes. However, I will tell you that in summary, they were outstanding, nearly 6% revenue growth, 16% adjusted operating income growth and 22% adjusted diluted EPS growth, with continued deleveraging.

We gained market share of total liquid refreshment beverages in over 90% of our retail base, driven by gains in the majority of category segments in which we compete, with a number of highlights worth mentioning, such as the 1.4 share point increase in CSDs, driven by growth in the great majority of our CSD brands, strength in the Snapple brand, which delivered a 1.5 share point increase in ready-to-drink tea, and nearly a 1 share point increase in juice drinks. And CORE being the fastest growing premium water brand over the quarter.

Our Beverage Concentrates segment saw substantial quarter-over-quarter improvement as restaurants experienced improved traffic. In single-serve coffee we delivered 10% growth in at-home consumption driven by increases in both household penetration and an elevated attachment rate, which was partially offset during the quarter by our away-from-home coffee business, which continues to be negatively impacted by persistently low return to work trends in large offices, which is our area of strength, and the timing of some partner shipments. In the fourth quarter, we expect total pod shipments to return to their more normalized mid to high single-digit growth rates despite our expectations that weakness in the away-from-home channel will continue.

Finally, the exceptional growth in brewer sales in advance of the fourth quarter speaks to the enthusiasm retailers have for Keurig in the holiday season, which is upcoming. So, with one quarter to go, our guidance for this year remains intact. Now at the high end of what we said we would accomplish in 2020, which means that we continue to meet or exceed the long-term merger targets we communicated over two years ago.

Before I turn it over to Ozan, I'd like to take a few minutes to put our quarterly results and several pieces of news that we communicated this week into a longer-term strategic context, all supporting the evolution of KDP to a modern beverage company. We focused much of our past earnings call content on how we are expanding the consumer reach of our brand portfolio, which is a critical driver of long-term profitable growth.

That conversation typically focuses on new brands and M&A. But it's very important to point out that the broad share growth we've experienced on existing brands, both before and during the pandemic, has been driven by increased household penetration in both our hot and cold portfolios, which we expect will stick going forward. This is the result of impactful innovation and renovation as well as strong marketing programming that's attracting new consumers into our brands.

Growth in existing brands provides the foundation upon which to add new ones. We continue to pursue opportunities to fill whitespace in our portfolio through national partnerships, such as our recent agreement with Polar and smaller bets, such as investments that we made last year in A-Shoc energy drink with Lance Collins, our recently announced Don't Quit! adult nutrition protein drink with Jake Steinfeld and a recent investment in Revive, a kombucha drink with Peet's Coffee.

With regard to the Keurig brand, we’ve consistently expanded household penetration year-in and out. And 2020 is turning out to be an especially strong year for system adoption. Rather than growing household penetration by 2 million households, which is consistent with our recent run rates, we now expect to add approximately 3 million new households in 2020. While attachment rates may move up and down and potentially back up again during another wave of the pandemic, converting new households into the Keurig system represents a long-term annuity stream that endures well into the future. While portfolio expansion has taken center stage since the merger, we've also been building our unique and valuable distribution platforms, although we haven't discussed them until recently.

On our last earnings call, we quantified how important e-commerce has become for us, representing more than 10% of total KDP sales and a larger portion of coffee sales. Yesterday, we announced news regarding our Direct Store Delivery system that is worth placing into a broader strategic context. Since our merger, we have invested in people, technology and assets to improve the effectiveness of our DSD network. We've also focused on consolidating key independent distributor systems into our company owned DSD operations, where territories overlap in order to drive scale and efficiency.

Yesterday we jointly announced with The Honickman Companies an agreement that provides KDP with long-term sales and distribution for key brands, including Canada Dry, Sunkist, 7UP and A&W across 18 counties in New York and New Jersey, reaching 17 million consumers. This follows a string of DSD territory moves and acquisitions across the country over the past two years, including California, New York, and the Midwest.

To be clear, our objective is not to control every market with our trucks, but rather to ensure that each market in which we sell our brands has a competitive route to market, regardless of who owns the territory. For example, in late 2019, we partnered with Honickman to facilitate their acquisition of a subscale independent distributor in Virginia. In Alabama, we agreed with our partner Buffalo Rock, to allow our brands to ride on the same truck with competitive brands in order to improve frequency and drop size across their system. Whether we operate our trucks in the market, or we partner with a local player of scale, every one of these moves ensures better reach, in-stocks, and merchandising for our brand portfolio, which builds our platform for long-term growth.

Our strong in-market performance this year demonstrates the value of these system improvements and we believe we have significant opportunity remaining. Important to a modern beverage company is a strong sustainability culture, and continuously pushing forward to meet new and more aspirational goals. Earlier this week, we announced that we have begun the transition of our Snapple and CORE bottles to 100% recycled PET or rPET as is commonly called. We will continue to expand rPET across our portfolio going forward.

Finally, consistent with our goal to build KDP for the long-term, we also announced changes earlier this week to our senior leadership team designed to further improve speed to market and place decision-making closer to our consumers and our customers. 2.5 years into our merger and with the benefit of learning what has worked so well during the pandemic, this is a decision made from strength. And we're fortunate to have the talent on our leadership team to assume broader operating roles with increased levels of responsibility.

Let me now hand it over to Ozan for more details on the quarter.

Ozan Dokmecioglu: Thanks, Bob, and good morning, everyone. Continuing on an adjusted basis, I will briefly review our performance for the third quarter, which our press release discusses in significant detail. The third quarter was another good one for us. As Bob discussed, we believe that we struck the right balance of continuing to invest in areas such as innovation, technology and sustainability that provides competitive advantage, while continuing to deliver our financial commitments. Constant currency net sales increased 5.8% with growth in three of our four segments, led by Packaged Beverages and Coffee Systems, combined with sequential improvement in Beverage Concentrates.

On a constant currency basis, adjusted operating income increased 16.3% in the quarter, driven by strong revenue growth, productivity, and merger synergies, as well as a reduction in discretionary overhead expenses, including marketing. These drivers were partially offset by higher operating costs associated with increased consumer demand for our products and inflation in logistics. In the third quarter, pre-tax operating expenses directly related to COVID-19 totalled $49 million, and consistent with previous quarters, were recognized as items affecting comparability. These expenses consisted of temporary and unusual compensation increases and incentives for frontline employees, as well as incremental safety and sanitation expenses across our business. Adjusted diluted EPS advanced 22% in the quarter, fueled by the growth in adjusted operating income, lower interest expense as a result of continued de-leveraging and a lower effective tax rate.

Turning to our segment performance for the quarter. In Coffee Systems, constant currency net sales growth of 3.2% was driven by strong volume mix growth of 6% partially offset by lower net pricing of 2.8%. The volume mix performance reflected a 34% increase in brewer shipments, incremental net sales from McCafé and higher shipments of K-Cup pods for at-home consumption. Significantly offsetting these growth drivers were the continued drop off in the office coffee and hospitality businesses. While the segment's operating margin declined slightly in the quarter due to primarily to mix, which includes the stronger brewer performance, constant currency adjusted operating income increased 1.6% to $373 million.

As mentioned on our second quarter call, we are excited about the upcoming launch of our first Connected Brewer. Demand for Keurig brewers remains extremely strong heading into the holiday season, in part driven by our new K-Supreme platform. We have decided to wait until 2021 to launch the new Connected Brewer to enable us to focus our marketing efforts in the balance of the year behind K-Supreme and our existing brewer line, given the unprecedented demand we are experiencing.

In Packaged Beverages, constant currency net sales grew 10.7% due to strong volume mix growth of 11.4%, partially offset by slightly lower net pricing of 0.7%. This performance reflected strong growth in both our company-owned DSD and warehouse direct businesses. In the quarter, we grew both our carbonated and non-carbonated brand portfolios due to increased at-home consumption and continued market share growth, resulting from strong in-market execution. This growth was partially offset by a decline in the convenience and gas channels. But the decline moderated as compared to the second quarter of this year as consumer mobility improved. Constant currency adjusted operating income increased 51.2% in the quarter to $304 million, primarily reflecting the sales growth and discretionary spending reductions.

As Bob mentioned earlier, we are thrilled with the agreement announced yesterday with Honickman, which will drive significant value creation for KDP over time. Long-term sales and distribution access for our key brands that we are gaining through this transaction is being done through a unique asset-light structure. Specifically, Honickman is selling these rights to a third-party funded by Prudential Capital and KDP entered into a simultaneous transaction with the third-party to gain long-term access to the rights.

There were various ways that we could have structured this deal, including a straight-up acquisition. Instead, we chose to use a third-party and pay a small annual fee given that we already have a sales and distribution presence in the area and didn't need any other assets from the transaction. The arrangement provides us with control of our brands for which we can maximize the economics and it also provides the scale to our existing brands currently being distributed in the area through our company-owned DSD network and dedicated independent operators.

In Beverage Concentrates, we experienced a meaningful sequential quarterly improvement. Specifically, constant currency net sales versus year ago declined a modest 2.2% versus the double-digit decline during the height of the shelter-in-place directives in quarter two. This modest decline in quarter three was due to lower volume mix of 4.8% partially offset by higher net price realization of 2.6%. This sequential improvement reflected a moderating decline in the fountain foodservice business as consumer mobility increased and restaurant traffic picked up. Constant currency adjusted operating income increased 8.6% in the quarter to $265 million, primarily reflecting lower discretionary spending.

And finally, in Latin America Beverages, constant currency net sales grew 0.7% reflecting strong pricing of 5.2% partially offset by lower volume mix of 4.5% due to limited consumer mobility in Mexico. Operating income was flat to the year ago period. On a constant currency basis, operating income increased 12% to $25 million in the quarter, due to the strong net sales growth, as well as continued productivity and lower marketing expense. The drivers were partially offset by the unfavorable impact of foreign currency transaction expense.

While the current environment has proven the power of our brands, it has also made evident the importance of simplification. To meet heightened demand and drive efficiency, we have continued to focus our production and delivery on the highest priority brands and products with great success. Through this process, we have performed a detailed review of the offerings in our system to ensure we deliver on our customers' needs, while also ensuring we are efficient. This will continue to be a focus of ours going forward.

In terms of our ongoing productivity and merger synergies, we continue to focus and execute on these opportunities. We remain committed to delivering our value capture commitments through both productivity and merger synergies, and fully expect to deliver our planned merger synergies of $600 million by the end of 2021.

Now moving to cash flow and liquidity. Free cash flow in the quarter was again strong at $525 million, and our year-to-date free cash flow conversion rate was approximately 105%. In the quarter, we reduced bank debt by $225 million and structured payables by $21 million. And we ended the quarter with over $190 million of unrestricted cash on hand. In terms of leverage, our bank debt to adjusted EBITDA ratio, which we refer to as our management leverage ratio, improved to 3.8 times compared to 4.8 times at the end of the third quarter of 2019. This improvement was driven by continued reductions in outstanding debt balances, and continued growth in adjusted EBITDA. Since the merger close, we have reduced our leverage ratio by over 2 full terms.

Turning now to CapEx. We continue to support the business with necessary CapEx investment to drive future growth and efficiency. As we discussed last quarter, our new Spartanburg pod production facility has been delayed approximately 6 months resulting from equipment supplier delays, and our new cold beverages production facility in Allentown is also delayed about three months for similar reasons. We have always expected both of these facilities to primarily be contributors to our business in 2021. And our expectations regarding these minor delays have not changed, which brings us to our guidance.

We continue to have confidence in our ability to manage through what is likely to be a bumpy road in the balance of the year, much as we have done to-date.

Our outlook for the full year adjusted diluted EPS growth remains unchanged at 13% to 15%. With delivery likely at the high end of this range, this outlook reflects our expectation for: constant currency net sales growth at the high end of the range of 3% to 4%; continued strong management of discretionary costs across the business, while maintaining investments in innovation, technology and sustainability; expected higher marketing investment in the fourth quarter of the year, relative to the third quarter, given the expectation for an environment in which consumer receptivity to marketing and marketing return on investment continues to improve.

It is important to note that we plan to reinvest any over delivery we may generate in the fourth quarter into incremental brand investment to further drive top-line growth, while still delivering our adjusted EPS guidance for 2020. We also have confidence in our deleveraging targets. And now we expect our management leverage ratio to be in the middle of our 3.5 times to 3.8 times range at the end of the year.

With that, let me now turn the call back to the operator for your questions.

Operator: At this time, if anybody has a question, please press star one on your telephone keypad. Again, that would be star one on your telephone keypad. Your first question comes from Bonnie Herzog from Goldman Sachs. Your line is open.

Bonnie Herzog: My question this morning is, I guess I wanted to drill down a little bit more on your brewer shipment volumes, which were obviously much better than anyone would have expected in the quarter. So I was trying to understand, how much of that will be reversed next quarter, and essentially, how much of your brewer volumes in Q3 really reflected a pull forward in demand from Q4? Bob, maybe you could touch on this. But for instance, are you already seeing a step down in brewer orders during October versus the year ago period? And then in terms of innovation, you did call out that you're now shifting some of this to next year. But I just really wanted to verify that there are no plans for any more brewer innovation in 2020. Thank you.

Bob Gamgort: Good morning, Bonnie. First is on brewer shipments. As we've talked about over the past couple of years, brewer shipments especially quarter-to-quarter aren’t a great measurement of what's going on with household penetration. What I would suggest is that every third quarter has shipments built into it that are for the holiday season. And what you're seeing is a little bit of a pull forward this year meaning some of those holiday shipments that would have gone in October, November are going into the third quarter because of the pandemic retailers are trying to get ahead of everything. The most important thing to take away from that is the confidence that retailers have in Keurig for holiday gifting, in part driven by the innovation and the strong marketing support that we have in place and the feedback that we're getting on all of the brewers that we've introduced in the past year or so but especially the K-Supreme and the K-Supreme Plus which is really the featured item for this holiday has been leaning forward and really in a position to push Keurig for the holidays.

The single most important metric we gave you on this call, though, is our outlook on household penetration. Because as we've said before, shipments can be up and down in a quarter, they're somewhat useful to look over a longer period of time. But the most important metric we talked about today was the fact that we believe that instead of our typical run rate of 2 million households being added into the Keurig system in the year, we expect that now to be 3 million. And as we said before, attachment rates move up and down, shipments move from quarter-to-quarter. It's kind of interesting during the quarter, but it really doesn't mean much over the long haul. But an additional 1 million households, is something that stays in the system for a very long time.

The question about the balance of the quarter, and what we're seeing here, I think we're in a position where we've now given visibility on household penetration. We gave you an indication of how we see pod volume growth delivering in the fourth quarter, which shows that, that is now smoothing out. And we've also been really clear that our guidance is at the high end or our latest estimates are at the high end of our guidance for the year and that we're going to reinvest everything else back into marketing and innovation.

And so, there's no new innovation being launched in the fourth quarter, because we have a huge line-up on our cold side as well as our hot side that we're now implementing in the fourth quarter. But the investments that we can make to get a head start on 2021 are just -- I would think are the right thing to do to ensure that we get off to a good start next year as well. And remember, we've committed to a three-year target of total shareholder return that goes all the way back to 2018 and ends in 2021. And so, as we're confident in finishing our 2020 strong, we are shifting our sights to 2021 to make sure that's a good year as well. So, thanks for those questions.

Operator: And you next question will come from Kevin Grundy from Jefferies. Your line is open.

Kevin Grundy: Hi, hey congrats on the quarter. Ozan, I was hoping we could drill down a little bit on margins, remarkably good for Beverage Concentrates and Packaged Beverages, both multi-year highs. Of course, I understand that synergies contributed there. Can you talk about marketing levels in the quarter, how that stood year-over-year, and the other key drivers that drove the strong margin performance? And then longer term you kind of touched on this a little bit, but the company has done a fantastic job in terms of synergy realization, which you'll complete by the end of next year. Maybe talk a little bit about productivity longer term. And if that's something you will kind of formalize and put out a new program at the appropriate time for The Street? So, thanks for that.

Ozan Dokmecioglu: Sure, good morning, Kevin. And first of all, let me touch to two margin lines that we have. One is the gross margin. As we have just spoken on the call, there was a small 120 bps of decline in our gross margin, while at the same time our OI margin has expanded 260 bps. So, on the gross margin, while the third quarter was strong as we spoke, it's 5.8% constant currency net sales growth and 22% EPS growth. It was by no means a windfall for us. It required extraordinary effort to deliver these results in the midst of the crisis. So the gross margin, small decline is a challenge due to a long and complex list of puts and takes. But clearly, unfavorable mix was one of them, or the bigger puts, which included the brewers, given that brewers don’t make much money, yet the volume was extraordinarily high.

So, we also had a little bit higher operating costs with the increased consumer -- in order to meet the increased consumer demand and some inflation that we have experienced in our logistics expenses. Yet, we also delivered a substantial reduction in our overhead base that includes overall sales, marketing and general administrative overheads via a series of the base productivity programs and merger synergies that came in a very substantial manner that helped us to reduce our overall cost structure.

In that SG&A number, we also include and categorize our advertisement and promotion investments. So, whenever the return on investment in advertisement and promotion didn't make sense, we also reduced that spend due to the COVID-19 environment. So, you see it's a combination of the factors and the things and mostly on the positive side that helped us to drive and further expand our OI margin by 260 basis points, which is quite substantial. So, on the productivities, as we just spoke as well, we affirmed our merger synergy target of $600 million to be delivered by end of 2021, and we are exactly on that trajectory.

We also have our base productivity programs that we have been running and executing very successfully, so the productivity programs and our laser focus and strong delivery has not changed, and we are seeing quite benefits of improving our margins as well as profitability in the third quarter as well. And as we spoke previously, our base productivity programs and the merger synergies will continue into 2021.

We have several programs still focusing on our manufacturing footprint, our logistics footprint and including further improvement in our overall cost reductions. And we have several facilities that we have been building, for example, the Spartanburg, the state-of-the-art K-Cup pod facility in South Carolina that will be operational mostly in 2021, and it will give us continued productivity as well as the volume in coffee. And we are building the Packaged Beverage plants in Allentown that will contribute to our productivity programs, including at the end of the year, the facility, the Beverage Concentrate facility that we have been building in Ireland. Therefore, we are very pleased with all of our either base productivity or the merger synergy programs that have been working very nicely.

Bob Gamgort: Hey Kevin, just to add to that, I mean, you could tell from Ozan's answer here that we are very focused on making sure that we run a highly efficient business, and we have a lot of programming going on for that. In terms of your question about beyond 2021, our focus has been, first of all, navigating through this crisis, which continues. I don't ever want to talk about it as if it's over because it's far from that; delivering 2020, setting ourselves up for 2021. At the right time in 2021, we will have a conversation with you guys about what does the post-2021 world look like for KDP and part of that will clearly be strong productivity and efficiency program, which will take you through at that time.

Kevin Grundy: That’s great. Thanks for the color guys. Good luck.

Bob Gamgort: All right, thanks.

Operator: And your next question will come from Nik Modi from RBC Capital Markets. Your line is open.

Nik Modi: Thanks. Good morning everyone. Just two quick questions, if I could. Just on the -- Ozan, maybe on the COVID-related costs. I'm just starting to think -- and of course, I'm not asking for 2021 guidance or anything, but just wanted to understand how much -- what you've spent this year -- what you expect to spend this year, do you think will be permanent? That's kind of the first question. And the second question, I guess for you, Bob, it's becoming increasing clear at least in this environment, and I suspect even as we move forward that the purchase decision is going to increasingly migrate away from the traditional kind of brick-and-mortar and into the home, right, whether it be E-Commerce or people bringing more stuff at home because they're staying at home longer. I mean that was certainly a trend we've even seen before COVID start. So, you at KDP have created a very advantaged business model with your go-to-market portfolio. And so, I'm just trying to get a sense of how you're thinking of building on that competitive advantage as you -- as we move forward and what I would characterize as a more stay-at-home environment?

Bob Gamgort: Sure. Ozan, you want to kick this off?

Ozan Dokmecioglu: Yes. Yes, I will. Good morning, Nik, and thanks for the question. First of all, let me give a little bit further context with regards to the COVID-19 expenses that we have been adding back. In fact, we have been consistent in Q1, quarter 2 as well as quarter 3. So, the costs we excluded from adjusted results are unique and temporary impacts resulting from the crisis. So, they are not normal ongoing cost of business. This is consistent with our long-term -- longstanding treatment of the extraordinary and one-time costs here. And these costs are clearly and not only defined as the significant expenses to provide temporary financial incentives to our frontline employees, which represented more than 80% of the costs that we have been adding back. And the balance for the extraordinary measures we undertook to protect employee health and safety, including enhanced benefits for them and their families.

So, as you have noted, our run rate in Q3 was lower than Q2, and we do expect our quarter 4 run rate to be substantially lower than quarter 3 as well. Therefore, by nature of this, Nik, we never said these are sustained costs or increased cost base in our profit and loss statement, it's the contrary. And I think our quarterly trend is proving. And again, in Q4, we expect to see a substantially lower number.

Bob Gamgort: Nik, with regard to your point about at-home and how we're thinking about our portfolio and our go-to-market strategy on here, I mean, we’ve referenced mobility data, and it's something that we look at very carefully, and we can get it down to a very granular level. But at the highest level, we think about people spending time at home, people spending time at work and then other. And other is a whole host of recreation activities, et cetera, and we can get more details on that. We have really built a portfolio that has the optionality to drive that at-home business. It's not like we are 100% at-home business, far from it.

You see the negative impacts on our fountain foodservice business, you see the negative impacts on our away-from-home business. So we keep saying it's not like this was a windfall for us, but we do have the options to pivot towards that changing consumer behavior. And if it shifts, to pivot back. And I would point out, before I get on to coffee, which is an obvious answer. Even on our cold portfolio, we have made significant shifts in where we focus our selling efforts and what we're selling.

And what you're seeing more is large outlets, planned purchase and stock ups are continuing to grow. Impulse, while improving sequentially is still down versus where it was before. And we focus a lot of our effort on the cold side of our portfolio on multi-pack, take-home packs, larger pack sizes, for example. And some of the growth that you're seeing even outside of our CSD business is because we've been able to shift over the past couple of months from businesses that were more heavily focused on single bottles into multi-packs, and it's helping drive growth in our business.

I mean, obviously, when I shift over to the coffee side, the Keurig system was designed for at-home consumption. And we said year in and year out that don't worry about attachment rate, all we're focused on is household penetration. While we're seeing improvement in attachment rate as people spend more time at home, but more importantly, we're seeing an acceleration in household penetration. As I said a couple of times, it's really a lasting benefit.

And as people think about their homes differently, both living at home as well as working from home, they're upgrading across the board, and we're seeing a combination of new people coming into our system at a higher rate. And we're also seeing upgrades in brewers of existing consumers, and that may not drive growth in the short-term, but it's a reconfirmation or a recommitment that they're in the system for the long-term.

The away-from-home business, which is offices, has been a negative, and I want to offer 2 points of perspective. If you look at traffic in large offices, it's down 60%. So, we've never quantified the size of our away-from-home business. But even if it was very small, a negative 60% trend on even a modest business has a major impact on us. Here's the good news. That really can only impact us now through, call it, February, and then it becomes actually a tailwind instead of a headwind. So, the risk of that, which I know some people are focused on, is pretty well capped, and we've already given you some visibility in the fourth quarter anyway. And that really sets us up for strong at-home.

And then the last point I would make on your overall conclusion, which is 100% right about where consumers are going is, our investment in e-com and our capabilities in e-com are paying off really well. When we launched this new company in 2018, and we talked about e-com and the legacy Keurig business and how we can apply it across the portfolio, I think most people were skeptical at best about what would e-com and beverage look like. Nobody is skeptical about it anymore, and it's an area that we're really focused. And if you saw the management changes that we made this week, embedded in that at a level below that, is also an increased focus and commitment to e-com because we think that's really the future.

Nik Modi: Very helpful guys, thank you.

Bob Gamgort: All right Nik. Thanks.

Ozan Dokmecioglu: Thanks.

Operator: Your next question will come from Peter Grom from JPMorgan. Your line is open.

Peter Grom: I think there's kind of been a view in the investment community that this step up in households was going to quickly drive an acceleration in organic revenue growth. And when I look at the year-to-date performance in coffee, it's pretty similar to last year, and there seems to be kind of a disconnect between that and the penetration you mentioned. And I know you just mentioned that a lot of this is being -- is a result of away-from-home business and then you will cycle that in February. So, is that kind of the right timeframe where we should think about you know this higher penetration driving stronger organic -- organic revenue growth in coffee? And then how does the step up in households frame your view of what the business can grow longer term?

Bob Gamgort: Yes. I think the longer-term view is always the best way to view this business. We talked about the year in and year out household penetration increases the system has seen, and there's been a lot of debate and a lot of analysis quarter-by-quarter. And sometimes when you look at the IRi data month-by-month, and it doesn't serve anybody really well. But when you step back and look at it, you see this nice, steady increase.

And one of the comments that we made on an investor conference that we attended fairly recently was, we do expect household penetration to accelerate, and that's why we quantified that for you today to give you some perspective. But you have to always remember that we're operating off of an installed base of already 30 million households in the U.S. and 3 million households in Canada. So even an additional 1 million households, which is significant growth and profit generator for the long-term, you're putting them on top of an installed base of 30 million. And so, it's such a solid business right now that it's not one that can be moved up or down quickly by any type of action, but it just speaks to the longer-term potential.

When we launched the business or the combined company in 2018, we put some information on our Investor Day that is 100% relevant today as it was then, and that is, we believe that household penetration for the Keurig system would go north of 50% over time. At the rate that we're growing, that's 10 years out before we even have a conversation of what happens beyond 50%. So, you're looking at 10 years of solid growth. And all that this proves is that, as people think about spending time at home, they just step up their interest in the Keurig system, increased household penetration. And the dividends or the growth that you get of that plays out over the next couple of years, it's not an instant boost that you see.

And then my last point is, you can look at the IRi data and see that we have been growing at-home consumption by north of 10% over the past 6 months or so. And on the latest period, it was plus 10%. And that tells you what's going on in-home. So if you look at that number and then you compare it to what you're seeing on some of the shipment numbers as we've been totally transparent, that is 100% driven by an away-from-home business, which is primarily large offices, where we're seeing, traffic attendance might be the better word in large offices, down 60%.

So, again, that's been a significant drain on us, but there's a limit to that because as soon as we start hitting the month of March and we go into April, that becomes all opportunity and not risk, and it's really that simple to explain the disconnect between what you're seeing at-home versus what you're seeing in total.

Peter Grom: Thank you for that. It’s helpful.

Operator: Your next question will come from Peter Galbo. Your line is open.

Peter Galbo: Hay, good morning Bob and Ozan. Thanks for taking the questions. Just two quick kind of clarifying questions on Beverage Concentrate. You know it looks like, just given the shipment volume versus bottler case volume you guys reported, it's been running -- the shipment volume has been running 250 basis points to 350 basis points below kind of the bottler case volume and then understanding that there's obviously a foodservice component there. But just over time, how should we think about the cadence of that kind of correcting maybe into fiscal '21? And then just the second part, for Beverage Concentrate, has your guidance taken into account some of the renewed lockdowns in some major U.S. cities that have come out in the past couple of days? Thanks very much.

Bob Gamgort: Yes. Peter, your comment is right about the disconnect sometimes and the timing of it, and it's really hard to forecast when they get aligned. But your statement that over time they align is 100% correct. And so that's some of the nuances we get quarter-to-quarter on Beverage Concentrates, but we don't spend a lot of energy on that because we know, over time, they align, and it's just difficult to try to predict that. The biggest takeaway from the Beverage Concentrates segment is the fact that we've seen sequential improvement in restaurants. And I would point out that when you look at the KDP businesses in fountain and foodservice, that's our business that we talked about that services restaurants and hospitality, it is heavily concentrated towards quick-serve restaurants.

As we've talked about a number of times, Dr Pepper brand is the most available brand in quick-serve restaurants, and they have done a really good job of navigating towards drive-through and take out. And so even if there is a resurgence and as we look at what may happen in the next couple of months, we're really confident that, that segment, in particular, will not only hang in there, but may actually do better -- although that's not in our forecast, but it may actually do better as traditional sit down restaurants could become more challenged and people shift even more towards takeaway and drive-through. And so that's the way that we're thinking about it going forward, but we were encouraged to see the -- at least a sequential rebound in that business, and we're watching and partnering with those restaurant partners to try to help them grow their business, and they're doing an excellent job of navigating to the new world.

Operator: Your next question will come from Lauren Lieberman. Your line is open.

Lauren Lieberman: Great, thanks. Good morning. I want to talk a little bit about Packaged Beverages and the share gains that you've seen. I know in the script you talked about conviction in some of these household penetration gains, in particular, for these brands sticking. But I was also curious about the degree to which some of the performance has benefited from some of your competitors narrowing SKU counts. While in crisis mode, particularly in flavors, flavors aren't really core to the other players. So, I was just wondering to what degree you think that and kind of can shortages may be benefiting you guys? And then what you're doing beyond the innovation to try to hold on to those gains when the situation does ultimately normalize?

Bob Gamgort: Sure. Yes. Thanks for your question, Lauren. Good morning. I think there are a number of factors that are driving our performance, and we've dug into that and we’ve pulled it apart to make sure that we understand that we can continue to drive those things that are working. It is primarily driven by a combination of marketing strength, innovation, which on -- across our portfolio, not just on our CSD brands with Dr Pepper and Cream and Canada Dry Bold, but we've introduced new Bai items and a whole host of item across the board in Snapple, for example, they're playing out really well and as I talked about on an earlier -- one of the earlier questions, we've also shifted our brands into the right pack sizes and formats and into the right channels. And that's not underperformance by anyone else, that's just us moving quickly towards the consumer, and I have every confidence that if the consumer were to shift again, we'd get ahead of it and we'd move back over there.

So, the household penetration gains that we're seeing, the great majority of it are driven by marketing innovation and good execution on our part, and it's not really driven by the thoughts about can shortages or executional missteps by anyone else. And so therefore, it's driving household penetration, which we believe will stick. The other subtle point that I would point out is, a number of our brands, the Dr Pepper brand, in particular, but other brands as well, a good portion of those are actually distributed -- manufactured and distributed by other independent companies and some of our peers. I know that gets confusing when we talk about it, but those who really dig into the business understand that. And just as we're gaining from good execution on our end, we actually get hurt by performance on the other end when there are can shortages or difficulty getting the product out there.

And so as strong as our results are, there are actually positives from our system being offset in some cases by negatives in other systems. And so it's not all windfalls, I keep saying, this is -- the results you're seeing are the net of positives and negatives, and we've been able to move through it really quickly, but it's not all positive that then become a headwind as you think about next year.

Lauren Lieberman: Right. So, Bob, I feel like I do understand the distribution network.

Bob Gamgort: No, I know you do. I'm talking about the broader audience.

Lauren Lieberman: Okay. And so I just actually had thought that, contractually, there might be some element of Dr Pepper needing to be brand, needing to be prioritized when it's -- when the distribution and manufacturing is through large companies, not independent, so that was sort of what you're referring to. But separately, I'm also curious, the -- it was great in the script when you guys shared detail on a lot of the optimization work that you've -- that's been underway for some time, right? This doesn't just start with The Honickman or the Buffalo Rock announcements. To what degree is that already starting to show up and that we're seeing it in terms of operating leverage? I know there's so many moving parts right now because of COVID. But yes, I was just wondering how immediate those benefits can be in terms of the better scale on your distribution assets?

Bob Gamgort: Yes. Let me go back -- before I answer, I want to go back to your point, though, about the contractual pieces or whatever. If you look at social media and you look at some of the new stories that were popping up about shortages of some of our brands, that's all you need to know is what's actually happening out in the marketplace. And that's not coming from -- if you take a look at where that's coming from, it speaks to the broader challenge in the industry that has been well documented. So, my point again is this is not a -- we're not -- there's no complaints. We never brought it up as an excuse. But if you really think about now flipping it to next year, I don't want anyone to take away from this is, we got all positives next year that will become negative this year, that will become negative next year. It's a mix.

There are some things that will be more challenging to lap in 2021, but I have a long list of things that are negative this year that flip to the positive as well. And so, it's really important to understand this is a balance between the two. And it's -- we're not just -- this isn't a weather report, we actually control the outcome in many cases. And so a lot of the positives are driven by the fact that we got ahead of things quickly, and we were able to pivot our business to do so. And it's a flexible business model, we can pivot again next year.

To your point about the distribution pieces, as we talked about in the script, this partnership with Honickman that we talked about today is by far the single biggest move that we've made in this optimization. But we also talked about, there has been a string of smaller but very important moves that we've been putting in place over the past 2 years. And so you're starting to see some of that effect in the strong performance in the marketplace in 2020, but big moves like the one that we just talked about today as well as other partnerships with our independent distributors like the Polar deal, those are mainly 2021 and beyond. And I would suggest that the investments that we're making in our distribution infrastructure is part of the conversation we'll have about what does KDP look like beyond 2021. And you can see, clearly, we believe distribution is a critical asset with a lot of upside.

Lauren Lieberman: Okay, that’s super helpful. Thank you so much.

Bob Gamgort: All right. Thanks.

Operator: And your next question comes from Bill Chappell. Your line is open.

Bill Chappell: Thanks, good morning. Hey Bob, just help us understand the -- I guess -- or just respond to the thought of on the brewer side, the thought that anybody who ever thought about getting a brewer now owns one because they've been working from home or staying home and if they've even considered it, they've bought it. And so, while it's great that you've had a jump from, of a normal 2 million to 3 million households, that's a big pull forward and it's going to be much less in future years and more -- less and less people. So, help us understand how you grow household penetration after such a big jump this year and why that wouldn't be the case?

Bob Gamgort: Sure. Bill, good morning and good to hear from you this morning. I'm smiling, you can't see that in-person because we remember when we took KGM private. We actually had some dinners and some meetings at that time with previous KGM investors and analysts and just to talk about the business and what we were thinking about doing over time because we knew at some point, we would be public again. And household penetration at that point was round numbers, 15%. And that was the exact same question, we got a 15% household penetration, and people were using the words like saturation. And we talked at that time about we have every indication the household penetration over time will be north of 50%.

There is no sign of slowing down or saturation. And we talked about what were the barriers to entry. So if we really believe the number is that big, why isn't it happening now and doesn't everybody know about Keurig already, and our answer to that point was we still have a lot of work to do in terms of marketing, innovation, price points, features, improving sustainability. It's a long list of things that we have benefit of working on every single day. And then sometimes, it just takes time. And the number one reason why somebody moves to a Keurig machine is when they replace their coffee maker that breaks, and that just takes time.

And so, I understand the concept. We get this all the time, but we got that question, millions and millions of households ago, and I expect we'll continue to get that question going forward. But again, every indication is that we'll be north of 50% if we keep going on our game. That's 10 years out of strong growth, and I think that this latest quarter is just yet one more quarter on top of many that preceded it, that showed that that's the right way to think about our business.

Bill Chappell: Okay, so you don't worry about, I guess, a meaningful in-line household penetration increase next year?

Bob Gamgort: I think it's the same trend going on year after year. I mean if we -- we'll look at it in absolute numbers and how may that compare to 2020, I don't know yet because I don't know what the world is going to look like in 2021, but the best way to look at this business is over time. And every time you lengthen the time period from a quarter to 6 months to a year beyond that, the business makes total sense, and it does exactly what we just described. There are some quarter-to-quarter fluctuations and month-to-month. But as we look at 2021, solid innovation, lots of interest in the business, great marketing plans still in front of us, we're not worried about lapping 2020. We just think this is all part of the long-term growth in the system.

Bill Chappell: Got it. And then on the pod side, 1 quick question. What's the current promotional environment, both from you and kind of the competitors? And kind of what are you expecting? And I would think with such strong demand, people could kind of dial back some of the price cuts or discounting and couponing, but I didn't know if you're seeing that or expect to see that?

Bob Gamgort: Yes, you see it in the IRi numbers where you see the average price going up, and that's been a combination of some reduction in promotion as well as a shift interestingly, a shift towards more premium brands and we talked about before I think as people move from coffee out of the home and in home they take their favorite coffee shop brands with them, which tend to be priced higher. Hard to say what it's going to be in the fourth quarter.

It really depends on what the consumer dynamics are, and behaviors are. But I would expect, over time, promotional levels will return more towards normal. That's not something that we have -- we don't have lack of promotion baked into any of our plans. But in the short-term, if there's strong demand and there's some supply or stock issues at retail, if there's another stay-at-home type behavior, I think they’ll pull back on promotions across the board. That's potential to happen.

Bill Chappell: Great, thanks for the color.

Bob Gamgort: Okay, all right Bill.

Operator: This brings us to the end of our Q&A session today. I'll turn the call back over to management for closing remarks.

Tyson Seely: Thank you, and thank you, everyone. This is Tyson. Thanks for dialing in today. I know it's a very busy day for many of you. The IR team is around. So, please feel free to reach out to myself or Steve for any follow-ups. Thanks, everyone. Bye.

Operator: Thank you, everyone. This will conclude today’s conference call. You may now disconnect.