

Keurig Dr. Pepper Inc. and Goldman Sachs Fireside Chat

March 26, 2021

09:30 AM ET

Bonnie Herzog: ...chat is scheduled for about 45 minutes. But before we begin, I'm required to make certain disclosures and public appearances about Goldman Sachs relationship with companies that we discuss, the disclosures relate to investment banking relationships, compensation received, or 1% or more ownership. We are prepared to read aloud disclosures for any issuer upon request, however, these disclosures are available in our most recent reports available on our firm portals. Disclosure and updates are also available on the firm's public website.

So, with that, I do want to kick things off this morning, Bob, with a question I get a lot from investors which is, are you guys a COVID beneficiary or will your business benefit from a reopening? And maybe within the context of that, you could touch on some of the recent trends you're seeing in each of your businesses, especially as we're now lapping the beginning of COVID last year, for instance, what are you seeing as consumer mobility has started to possibly improve as more people are getting vaccinated?

Bob Gamgort: Okay. Bonnie, thank you for hosting us and welcome to everyone. We're happy to be here. We do not see ourselves at all as a beneficiary of COVID. If you think about it, our performance was very strong entering into the crisis. We gave guidance on 2020 that was pre-pandemic, yet when the crisis hit, we held on to that guidance. But I will tell you, the way that we got there was completely different than we anticipated going into the year. And what it speaks to is the flexibility – we've used the term optionality that we have in our business model. We've got this wide-ranging portfolio that allows us to hit a number of consumer segments and needs and formats. And then, we've got a very unique distribution system that ranges from direct store delivery all the way through to e-commerce.

And so, it became really a giant mix management exercise as we went into the year. So, when you think about it, we were hurt significantly in our on-premise business on cold beverages, in small outlets and C-stores, as well as in office coffee. What we were able to do is pivot and drive large packs of cold beverages in larger outlets, we were able to use our e-commerce capabilities, and then we were able to drive at-home coffee to offset that. But all of us would have been very happy to have 2020 from a macro environment play out a lot like 2019. And as we're thinking about the recovery, we think about it the very same way which is we expect a lot of those segments and channels that got a benefit in 2020 to now be under pressure in 2021. And in addition to that, we think that we're going to get a benefit in areas like away-from-home coffee and small outlets and on-premise beverage as they recover.

So, really the answer to the question, did we get a benefit from COVID, no. We had to manage our way through it and we're looking forward to a recovery, but it does speak to the resilience and the flexibility of our business model to be able to withstand just about anything. Now, how we started off the year. Well, the time period that we're looking at is really through March or in through the middle of March, and all I can reference is syndicated data, obviously. But if you look at the syndicated data, you'd see that the single-serve coffee business is up about 7% of revenue, so still very strong growth. And our performance in the cold beverage side, still we're gaining share about 90% of our portfolio, which is how we ended or really that's what we delivered in 2020.

Now, to your other question, this gets very challenging for you and for investors in the upcoming – current and upcoming Nielsen and IRI reports which are following. Because we're going to start lapping, as an industry, some strong year ago numbers in most areas that are captured by IRI and Nielsen. And then, a number of those areas that we talk about that are going to recover that were hurt last year, you don't have as much visibility on. So, fountain foodservice, office coffee, and even e-commerce, you don't have the visibility. So, I think it's going to be a real challenge for investors, and ultimately they're going to have to rely on

the management team's ability to navigate this and the guidance that we've all provided.

My last statement on this is revenue – volume and revenue is really important, but don't miss the opportunity to look at mix and the impact on gross margin. All of us in the industry, because of that issue of channels and segments that I talked about earlier in 2020, were hit significantly in gross margin. You could see it in our P&L and you could see it in everyone else's P&L. We offset that by outperforming in growth and also by handling discretionary costs in a responsible way. But our outperformance allowed us to offset this mix issue. So, even if volume and revenue softened a bit, and we gave guidance on it, so I'm not hitting anything, we're really clear on our guidance for growth, but even if it did, we'd be happy to take that to get the pick-up in profitable mix that comes out of it. So, sorry for the long answer there. The question was kind of all encompassing, but happy to drill down on any of that as you wish.

Bonnie Herzog: No. I think that was very helpful and kind of sets the record straight, just in terms of the puts and takes with your business. Maybe you could drill down a little bit further on some of the individual businesses, like as you described with sort of the reopening – like I'm thinking about the Packaged Bev side of the business and you just mentioned – you just touched on the mix component. And certainly, what we've seen during COVID and some of the lockdowns, consumers were purchasing the larger pack sizes. So, I imagine that's going to return to some of the more immediate consumption type of packaging. And so, is that what you're trying to suggest that we're going to continue to see this on top line in that business, and importantly, some improvements on margins, but then mindful of the cost environment?

Bob Gamgort: Yeah. So, we'll get to the cost environment separately, because I think that's an important topic for us to cover, but if I just focus on the growth side right now, in our BC business, that is where our fountain foodservice business is located. So, you're going to – we're going to see some recovery in there, as I talked about before, and that segment was pressured last year because of the trends that I talked about before. In our

Packaged Beverage business, which Derek will talk about at some point today and all the investments that we've made in there, we will see a shift away, in some cases, from larger packs and larger outlets, although, we still think there's a lot of growth there. It's not the big bit, but they're going to be significantly impacted. But there's going to be some softening in that where we do get a pick-up in the impulse channels and the impulse segments as well.

And then, in Coffee, we're lapping some very strong at-home numbers a year ago, but we've talked about our expectation on household penetration that still keep moving along at plus 2 million households. So, the underlying growth is really good there, but we do get a pickup in away-from-home coffee which was significantly hit in 2020 that nobody has visibility on. And e-commerce, across the entire business continues to move. I think the one thing – let me just give you some insight on how we're managing our business, because it might be helpful to investors. Obviously, we look at the comparison to year ago numbers. But because of all these puts and takes that we've talked about, we've now put together weekly expectations for each of our segments. And when I say our segments, even below the reporting segment you talked about, because we need a map to guide our performance on something other than just year ago.

And then, the other metric that we're looking at, that's very helpful, our two-year stack, because it takes a lot of the noise out there. So, I won't get into specifics, but I'll give you an example. Last night, we had our weekly executive team meeting. We were drilling into one segment that was showing negative versus year ago, positive versus our internal expectations. And then, when you look at the two-year stack, it was huge growth. We're saying this is going to be – if this is a challenge for us, it's going to be a real challenge for our analysts and our investors, and we'll help guide you through this as best we can.

Bonnie Herzog: Okay. Yes. Thank you for understanding. It has been challenging for a lot of us. Near-term, kind of thinking again about the businesses, is there anything in particular that we should be mindful of? And I guess what I'm thinking of is, you guys have some business in Texas and I'm

thinking back to the issues that state had, how impacted was your business? Is there anything there that we should think about, whether it's Q1 or heading into Q2 for your business?

Bob Gamgort: Yeah. The Texas issue was significant. We have a number of operations there, manufacturing and distribution. It's one of our strongest states in terms of brand development. But we managed our way through it and it's not something that we would call out specifically. And I'm actually very proud of our manufacturing team and Derek and his distribution arm, because we got back in stock very, very quickly. And so, when the consumer was ready to come back to the stores to reload, we were there for them. So, nothing material on that, and Ozan, is there anything else you would call out in terms of the timing versus year ago in the first quarter of note?

Ozan
Dokmecioglu: Not really, Bob. I think you covered it all.

Bob Gamgort: Okay, great.

Bonnie Herzog: What about – let's switch gears a little bit to the cost environment, because that just came up. And thinking about inflation, transportation costs going up, some of the input costs, can you guys touch on how well either hedged you are for some of your businesses or what are some of the key inputs that we should be mindful of as the year progresses?

Bob Gamgort: Yeah. Let me set it up and then, Ozan, I'm going to ask you to pick it up and go through more detail on there. The three areas where we're seeing some inflation, not surprisingly, is in commodities – I mean not all commodities, but in certain commodities; packaging; and then, of course, the biggest impact has been in transportation and warehousing, and the whole logistics costs have been on an upswing. There are different thoughts about the outlook for each, but I think it's helpful for us to talk about where we stand in terms of cost coverage and how we think about inflation and the guidance that we already provided. And then, again, we

could talk more, if you like, about how we think about longer term impact of some of these. So, Ozan, do you want to pick that up?

Ozan
Dokmecioglu:

Yeah. Sure. Thanks, Bob, and good morning, everyone. So, we expect 2021 to face higher inflationary environment and pressure versus 2020. I think this is known across the sectors that we operate. And the good news is we have built that into our guidance that we provided during our earnings – during our very recent earnings call. And at the same time, we are really confident that we can manage the exposure. As Bob and you said, primary areas of inflation in 2021 would be in logistics and corn-related products and a little bit packaging at the same time, which when we sum them up, all these line items will negatively impact or will put more pressure on the cost profile, primarily behind the Packaged Beverage segment that we have.

At the same time, we also have other areas or commodities that we use as input cost that will serve as partial offset. For example, green coffee beans, because of our hedging policies that we have applied at time that we managed to create, for example, year-over-year favorability. And we also have a great line of sight to the productivity programs as well as merger synergies that we announced several times which will help to offset all these inflationary pressure. And when the opportunity presents itself, we continuously will improve our hedging positions in order to further create year-over-year favorability. Therefore, we believe that we strike a good balance in terms of dealing with inflationary pressures coming from two angles as well as what we have as offset.

And there's also another reality that I believe beverage industry has shown the resilience and the able to recover the inflation through a combination of pricing as well as several productivity programs, and I wouldn't expect this trend to change our algorithm down on the track as well. Therefore, net-net, we believe that we are quite balanced in terms of managing any inflationary exposure we have in light of the results as well as the targets that we put out there.

Bob Gamgort: And Bonnie, we think that the form of inflation is going to evolve over the year and we'll begin to think about longer term. There's been a massive amount of stimulus, so consumers have the ability to spend more. We know that because of lockdowns and just reduced mobility, they've been spending a lot of that on goods versus services. I think that if the reopening happens at the pace that the more optimistic people think is going to happen, which is this summer, there's going to be a big shift from goods to services. That would reduce pressure on commodities and transportation and warehousing, but it may pick up inflation in labor.

So, I think we've got a level of persistent inflation to go, although, the shape of it may change. But anybody who's in consumer products is less concerned about labor inflation, because the reality is it gets people more to spend on our goods. So, I think, it will be a reasonable environment going forward, but Ozan's points are right, which is a combination of hedging and coverage, strong productivity, and then rational pricing allows us to have a number of different options to offset that.

Bonnie Herzog: Definitely. It sounds like a lot of levers that you guys can and are willing to pull. Thinking about the reopening and thinking about your Coffee business, brewer sales were very strong and your household penetration went up quite a bit. I think it's now 33 million households own a Keurig machine, which is great. So, as we think about the reopening and the consumers getting more mobile again, possibly returning to the workplace, how do you guys think about attach rates, pod attachments? Is there any concern that even if a consumer has your machine in their home, they won't be buying as many pods if they are returning to work or how are you thinking through that and managing that part of the business?

Bob Gamgort: Yeah. First of all, the 33 million household number which is up in the past five years from 21 million households is actually a higher standard than owns a Keurig machine, it's regularly uses a Keurig machine. Because there's another group that we target which is owns a machine, but hasn't used it in the most recent period. So, the 33 million is a higher bar than you might expect. In terms of attachment rates, for years, we said

attachment rate is flat. In fact, it's so predictable and so even that we recommended investors to take a look at pod volume growth as the best proxy for household penetration growth. Because if you think about it formulaically, the attachment rate doesn't move, then the only way to move pod volume over time is through household penetration. And that relationship is probably the best correlation you could find of anything that predicts household penetration until 2020, because what we saw was a spike in attachment rates.

Now, our ability to assess attachment rates is much better than you might expect, because we've got this panel of 10,000 connected brewers. And so, we get minute by minute, it's really real-time consumption data from those machines. And so, we were able to see the spike in attachment rate and we're also able to see what happens to it since then. So, our expectation as we go into 2021 from a planning standpoint is that attachment rate returns to normalized rates, the normalized long-term rates. And that household penetration continues at about the 2 million household per year pace that we've seen before. And a lot has been made about the fact that we got 3 million households in 2020, which we're happy to take, because we know that's an annuity. But I point out, in the context of going from 21 million households to 33 million over five years, 1 million incremental households is nice, but it's not a game-changer and it's really the long-term sustainable growth this business is most attractive.

Bonnie Herzog: That's a really good point and I know – I think you have plans to share more of the innovation, especially behind your brewers with us, maybe in the middle of the year when you have your Investor Day. I don't know if there's anything you might want to share with us now...

Bob Gamgort: Yeah.

Bonnie Herzog: ...hints on what we can expect maybe game changing.

Bob Gamgort: Yeah. So, I'll build on that. We've had a number of game-changing platforms over the past five years that helped get the growth that we

talked about before in terms of the new price points and new features and benefits as well as improved aesthetics. One thing I would point out is we had new – 3 million new net households last year, yet we sold 11 million machines, and I could tell you that the quality of the machines we've been selling in the previous four to five years has never been better. So, it's not replacement because of failure. It was really upgrade due to people spending more time at home saying, I'm going to upgrade my machine. And also, we're giving them reasons to upgrade, because of all the new innovation that I talked about before. And although that doesn't add anything in the immediate term to it, it's a recommitment when somebody buys a brand-new Keurig machine and we know that the renewal, if you look at it that way, is important.

One of the innovations that we talked about at a high level that we'll be launching in 2021 is the first widespread connected brewer. So, we've had a panel – as I said before, had a panel of 10,000 households with the connected brewer that give us point of consumption data. That's been important for us and our partners to manage the business and to understand where there's growth opportunities. But it was also a trial for us to get data – get information from those households based on the actual pods they were consuming, which requires our ability to recognize pods. That will now be launched in a more wide-scale format starting in 2021 and expand to beyond that. And the benefits for the consumer are the machine recognizes the pod and then adjusts the brewing parameters per the instructions of the coffee roaster. So, Starbucks or Peet's roasters encode information into the brewers that tell the brewer how to brew their pod for the maximum flavor. And then, the consumer has the ability to then customize it and then save that for themselves. So, they have their own preferences saved in the machine.

And then, in addition to it, and I won't go through all the benefits, another one is we've been seeing an increase in subscription business. The Keurig pod is ideally designed for e-commerce, and for a lot of reasons that are pretty obvious, we have a good subscription business, but imagine a subscription business that can be empowered by actual consumption data. It's much smarter way to be able to replenish the consumer. And so, that's another benefit of many that will shop. So, much more to come on that,

but we're excited about this as one of the next new platforms to come for Keurig.

Bonnie Herzog: No. That's really helpful. And I think, again, another key question that we're all trying to think through is the growth opportunities for your business now and especially after the merger synergies you guys roll off of those this year. And so, listening to you, it sounds like you feel pretty confident that you've got the right platform with all your business to drive maybe sustainable or possibly accelerating growth, given some of these innovations and synergies that you've already achieved.

Bob Gamgort: Yeah. And we haven't – and then, we're talking specifically about the Keurig side, we should talk about the cold side as well. But the one point on the synergy that I would point out, we've said all along that we're on track to deliver the \$600 million in synergies. And then, people do the quick math and they say what if we backed that out of your results, you're going to – and the point is look at all of the investments that we've made in the past 2.5, 3 years since the merger in innovation, new manufacturing capacity, very few people in food and beverage are putting new plants in. We're putting three very large plants in. So, we're increasing our capacity and our productivity, as well as investments in areas like data and IT. We're setting this thing up for the long haul and I think the biggest proof is that we've been able to deliver the synergies at very high margins and EPS growth. A lot of other mergers have done that. The difference is we had accelerated the top line, post-merger. So, it's a really important balancing act to deliver the EPS, the synergies, and the growth while you're investing in the future. So, that's why we're very optimistic on the platform that we've built.

Bonnie Herzog: You bring up a very good point, Bob, because I certainly do hear that if – investors sometimes, the bear argument would be something you touched on, if you back up the merger synergies, are earnings accelerating as much as we would hope. But it's hard for us to have the visibility of some of the investments that you just mentioned. But would you say that what you've seen, what you've done and invested in, that your foundation, your business now is really kind of poised to come out of this

three-year merger synergies in a much stronger place where you feel confident that things can accelerate?

Bob Gamgort: What we built is a – we’ve invested in the areas I talked about in our distribution system and we built the system that now is very scalable. So, we look at opportunities to plug new businesses into this infrastructure. We’ve got a better manufacturing base and we’ve got a better distribution base than ever before, and that allows us to add significant value. The one thing that we haven’t talked about, if you’re okay with this, I would like Ozan to talk about another element of this which is cash flow, because this business has incredible cash flow to the point where I think ahead of the schedule for most investors, we increased our dividend by 25% – we increased it by 25% with still payout ratio that’s below 50% and we’re doing that while we’re delevering down to 3x by the end of the year, and I think that surprised people, and that’s another element of the long-term strategy of this company, which is the cash flow gives us more optionality.

So, Ozan, you want to talk a little bit about that, because I think that’s a part of the value creation that needs to be appreciated?

Ozan Dokmecioglu: Absolutely Bob, and also I’d like to touch upon Bonnie, you said in relation to the synergies or the expectations and so forth. So, first, let me start with that one. So, our focus is, for sure, to ensure to deliver \$600 million synergies that we put out there actually more than three years ago when we announced the deal. And the great news there is that, from day one, we’ve said that we had great visibility in order to source and deliver that \$600 million synergies and that’s what we have been doing, and that trend is continuing. And this year, 2021, will be the last year of delivering the \$200 million, \$200 million, \$200 million, in total \$600 million of synergies.

At the same time, as Bob touched upon it as well, besides the merger synergies, we also have several base productivity programs. And this base productivity programs were covering a lot of elements of either our cost of goods sold or our overheads and other efficiency programs in the areas.

So, we dropped the merger synergies to the bottom line in order to improve our earnings. We also, which is very important, invested a good chunk of our base productivity efficiency numbers back into our business, as Bob was saying. And in several areas, likes of improving our supply chain network, improving our route to market, in terms of efficiency and the effectiveness. And more importantly, we continued to invest behind our innovation led by brewers, including technology as well as e-commerce.

And then, when you look to the usage of the cash that I will expand a little bit more, it's important to talk, that we used a good chunk of our cash to invest in the state of the K-Cup pod manufacturing facility in Spartanburg, South Carolina, Allentown for cold beverage, Packaged Beverages, as well as the new concentrate plant in Ireland. So, when you look to our free cash flow generating abilities, definitely one of the best-in-class. And actually not since merger, since 2016, we have been delivering net income to free cash flow ratio of well in excess of 100% which is one of the industry-leading ones. And we continued to deleveraging our balance sheet exactly in line with the plans that we put out there. In fact, we are even a little ahead. While as we continued to invest behind our business, either the brands or infrastructure, in order to help us to service our business from the growth standpoint of view.

At the same time, as Bob said, we improved and accelerated the top line growth. And as a result of this, we have a winning algorithm in terms of the cash management as well as the profit and loss management at the same time. Therefore, the cash generation, once we will be at the end of this year that we will deliver, if not better, against our merger thesis and targets, it will also provide further optionality for us. And as we did before, we are not ruling out anything and only further shareholder value-enhancing initiatives will be on the table as was the case before. That's why we feel very good in terms of not only the great performance of our business, but also the great performance of the cash flow generating initiative we have successfully implemented and we are seeing the benefits and we will continue as such.

Bonnie Herzog: Okay. That's very helpful. And as you think about this optionality that you touched on with your free cash flow, could you kind of walk through the priorities for us of your cash? And I guess, as you mentioned, you've been paying down debt, you obviously just increased the dividend very nicely. M&A, I assume is now going to become one of the top priorities. So, could you remind us of how you think about that and what would be a good fit for your portfolio? Maybe touch on white space opportunities that you might see within your existing portfolio.

Bob Gamgort: Yeah. I think when we – we are going to do an Investor Day this year in which we are going to clearly spell that out. We said all along that our priority was to make sure we got our debt down to 3x leverage and we've done that. And we said, at that point in time, we have optionality to be able to invest in M&A, to think about other ways to return value to shareholders, and we did that with the dividend increase, as I said, ahead of schedule.

M&A is a very interesting space for us. And if you just take one segment as an example, it speaks to the optionality or the flexibility we have to be able to add items to our portfolio. So, let's take water as a segment, premium water is a segment that we really were very intentional expanding our position and we're now the number two premium water company. We acquired Core, but we used shares for that. We made some small acquisitions on brands like Limitless and we paid cash for that. We did a long-term distribution partnership, because we couldn't own the Evian brand with Danone. And then, we signed a long-term franchise agreement for Polar, which we're now scaling up right now.

And so, that has allowed us, and of course, Bai was there when we merged the two companies. And so, the combination of all of those has allowed us to be the number two player in premium water, but we got there in very different manner – in a very different manner for each. And that's the way we think about other white space in our portfolio is where do we want to play and how do we want to play becomes really important. I think the area that we haven't talked a lot about and given that we have Derek on here would be good to talk to is the investments we made on the distribution side through acquisitions.

Bonnie Herzog: Definitely.

Bob Gamgort: If you're okay, let's – I think that would be great for Derek to explain, because that's underappreciated in my opinion. You know this industry really well.

Bonnie Herzog: Right.

Bob Gamgort: Getting your distribution right is critically important.

Bonnie Herzog: I was waiting for an opportune time to ask Derek that perfect question, because I do think this is – I think honestly and speaking with investors that they don't really appreciate some of the changes you've been making on the distribution side and really how meaningful that could be, whether it's cost savings or potentially top line acceleration. So, yes, please, Derek, educate us.

Derek Hopkins: I'll do my best. Thanks, Bonnie. Listen, we're very proud of the distribution system that we're building, which happens to be a combination of a company-owned DSD system and also our independent partners that we have throughout the country. We're talking about investments earlier. In 2020, we invested with the extension of our DSD network through multiple transactions. There was one that was a big one that we recently announced, which was Honickman. What's special about that agreement is it allows us to sell and distribute key KDP brands in the New York-New Jersey metro markets, so 18 counties, but importantly on the 17 million people.

So, if you actually take a look in aggregate now, our DSD system covers roughly 80% of the US population. And Bonnie, you know the business well, but for others that may not be as close to it, the DSD business is really a market-by-market game. So, we may have different brands by market. So, when we look at our business, we're really looking at it market-by-market and the goal for us is very simply just to have the most competitive distribution system in every single market that we compete

in. So, what that did is it led us to a little over a dozen transactions over the last 12 to 18 months, and we've been able to do a couple of things. One is we've been able to improve our execution. We've been able to improve certainly our efficiency. But what we've been able to do with our customers is really improve our service and our reach, and that's a lot of the feedback that we'll get directly from our customers.

So, as it relates to DSD, it's a scale game as you know. So, we're going to continue to try to strengthen our scale and there's a few different levers that we have to do that. One of it is through innovation, through our own brands, the other one is, Bob mentioned earlier, is Polar which is a brand that we brought on which we're very bullish about it. It fits into our system incredibly well. And the other one is where we actually look and we try to find win-win transactions in the marketplace and we've done a number of those in different variations.

So, if you look at Southern California, we did something with Haralambos, which was a Snapple distributor that was an easy fit into our existing footprint. So, it didn't take a lot of capital, but we were able to pull that in. We've done other ones like – that were big ones like Honickman, but then also it's not a one-size-fits-all model. So, if you take a look at something like Buffalo Rock, which is one of our partners, we actually elected to give them our brands in that marketplace, because it made sense for them to take it to the marketplace, because it was more efficient from that standpoint. So, DSD is a focus of ours to continue to scale it and it really is a market-by-market plan that we have.

Bob Gamgort: And I think, just to add to it, there's a virtuous circle here, because our system gets better when we add the right brands to drive incremental volume and scale. But though having a better distribution system attracts better partner.

Bonnie Herzog: Yeah.

Bob Gamgort: And so, that's why these work in tandem and Derek has done an amazing job of building this out with a lot of upside still left to go.

Bonnie Herzog: That was a quick clarification. So, you've already made a lot of progress. Where are you at in this process? Are you halfway there or are you the bulk of the way there? I'm trying to get a sense of how much more there is to do.

Bob Gamgort: Derek, do you want to cover that?

Derek Hopkins: Yeah. Sure. I think it's two things, right. I think it evolves over time, right. So, I think we look at it market by market where opportunities present themselves. So, I'd say we're on a journey. I don't think this journey necessarily ends at any point in time. So, I think there's kind of the path around we're talking about where we potentially bring other distribution in, we're going to continue to look at those and be opportunistic, if there's a win-win. And then, I think there's the other things that we're actually doing at our existing footprint of our DSD organization which is, as Bob mentioned, make it better for brands to come in. So, there's a number of things that we're doing there, one is, if you take a look at that, we've gotten much more efficient in our operations over the last 12 to 18 months. So, we create a consistency of actually how we operate our warehouse and our distribution system, kind of one way to do things. That goes all the way from routing to delivery. And I think where that really came to our benefit was during COVID is we were able to act incredibly quickly in a standardized way across the network that played to our benefit.

We're also using technology much more. We have an unbelievable amount of data as we have store level invoicing. So, we put in predictive ordering into all of our facilities, and what that allows us to do is, it allows us to manage our labor, it allows us to make sure that salespeople are focused on selling versus replenishment, it allows us to schedule much more on merchandising labor out of the back room versus sorting through things in the back room. And then, I think the third thing that we've done is we've really focused on the last-mile, because the last-mile is actually where you win in DSD and it's much more around the executional element. So, if you think of things around prioritization, really uniform

activation that we have across the marketplace and be able to measure that. So, we've kind of got two-folds, one is around the piece that we're talking about as are there new territories, and the other piece is making sure that what we have now is better.

Bob Gamgort: And Bonnie, just to add to that, to Derek's points there on how much more opportunity is there, when we talk about this 80-20 relationship where we can reach every store in the country, 80% of the population through our company-owned network, 20% through independents, I think most investors immediately go, okay, were you going to take that 20% to 15% or 18%. What's missing in that is that even within the 80% where we've coverage, we don't have coverage for all of our brands, based on legacy agreements.

Bonnie Herzog: All right.

Bob Gamgort: So, there's actually opportunity for us in some of these transactions that Derek talked about. It didn't expand our reach, but what it did it improved our scale where we already had a truck going to a store, but not with our complete set of brands. And so, that's the nature of the beverage industry, lots of longstanding contracts that are market by market, and we are working our way through them to drive efficiency market by market wherever we see a possibility.

Bonnie Herzog: Okay. Again, very helpful. And then, maybe sticking with Packaged Bevs, innovation pipeline, it sounds like you've got a fair amount that you're going to be rolling into the marketplace. Bob, you touched on it on the Q4 call just in terms of the zero lines. Love to hear insights from you in terms of how incremental you think that can be. And then, in the context of that, thinking about how much you're getting by way of shelf or cooler space gains with your portfolio and is that expected to increase this year?

Bob Gamgort: Okay. I'll take the first part of that which is the innovation ideas and then, Derek, why don't you pick up on the shelf space and how we think about getting innovation to market. 2020, we had two – we had a number of

strong innovations, but two really stood out. Dr Pepper & Cream was really the top performer in the CSD category for innovation. And then, we had Canada Dry Bold, and Canada Dry has been a longstanding year-after-year growth brand that gets accelerated by an addition of something like Bold. But we didn't get the full benefit of that in 2020 because of the complexities of COVID, even though, Derek and his team did an amazing job. So, we get a bit of carryover of that into 2021 where we get the full years' worth of distribution on those two.

In addition to that, we're converting our diet lines over to zero sugar. One exception is why add zero sugar to Diet Dr Pepper, because Diet Dr Pepper brand is so strong, we don't want to alienate anyone on that. We're completely refreshing the Snapple business and that has already started rolling out in the West Coast and we'll continue rolling out throughout the year. And then, we're adding a number of smaller innovations like Bai Boost, which is Bai with caffeine, and then flavor refreshes or new flavors or limited editions are really critical to the business. Getting the pipeline is one thing, getting it on shelf and making sure it's incremental is a completely different thing as we've learned especially in 2020, in an environment where retailers are trying to reduce complexity. So, Derek, why don't you update everybody on where that environment stands versus 2020 and then how we're specifically thinking about it at KDP?

Derek Hopkins: Yeah. You bet. Listen, I think the good news is 2021 is a much more normal year than certainly 2020 when certainly a lot of the shelf sets were really either delayed or just canceled completely. And the good news is and Bob mentioned it, we've got a pretty good head start with Dr Pepper & Cream Soda and also Canada Dry Bold. It started last year, but unfortunately hit during that time of really the crisis. So, we entered the year with those two items plus a great level of innovation and a pipeline to put into the marketplace. So, if you take a look at it, I think our retail and distribution execution has significantly improved over the last 18 months. So, we are in a very good position to push that market innovation and renovation into the marketplace, and really across all the channels, whether it's grocery, mass or also convenience, because we have so much innovation coming out, some of those play by the different channel types. So, there's certainly a focus by channel around that.

What we're actually seeing is good success from our retail partners of what our sets will look like. And so, we've gotten good success so far, and it's kind of interesting, it really is a little bit of a virtuous circle to be honest when you look at it and I think it's a combination of a few things. One is I think it's a combination of actually good innovation. I think we've built some credibility with our retail partners around innovation. So, if you take a look at the innovation we brought to the marketplace, they have been some of the best innovation. It's like Dr Pepper & Cream Soda was one of the best innovations in CSD in the last year on its own. So, we've got some credibility. The other thing that we have is which is great if you have momentum behind our brands. So, when you're gaining share in 90% of the categories that you're getting sharing and that we gained almost a point of CSD share last year, it gives us momentum and a reason to be in front of the customers to talk about more shelf space and more items.

And then, there's really a structural benefit that's gone on last year. Flavors have done well. Flavors have done well as people are at home and consumers want things that are a treat. The other two things is, I would call, our service during the crisis was extremely strong. And retailers typically reward you for having good service and getting the basics right and we've been rewarded for some of that, and of course, we've got robust planning for our – with our retail partners. So, we're bullish about what the shelves would look like this year we go into – with some momentum, would certainly help.

Bonnie Herzog: That sounds great. And then, as I think about all of that, whether it's Packaged Bevs or Coffee and you're bringing more innovation to the market and you've got this momentum, how should we think about you're A&M spend behind some of this? I mean, obviously, it was reduced during COVID year last year. My sense is it would be an increase this year. But I'm curious, do you believe you need to get back to say 2019 levels or could you operate at a lower A&M spend level in this new – maybe this new hybrid world that we're entering?

Bob Gamgort: Yeah. So, Bonnie, I mentioned before that in 2020, we had the significant gross margin impact due to mix, even though we were able to grow our top line, one of the areas that we had to go to is marketing. The whole industry did that. In fact, when we did benchmarking, we cut less than the industry. The fact that we were able to grow above our plan and actually gain market share suggest that the priorities in terms of brands and vehicles that we chose were more efficient and we made the right bet, our goal is to increase our marketing spend over time. So, do we have to get all the way back there? Hard to do in any one year, but it will move back up over time. But we have learned a lot about marketing efficiency and sometimes necessity forces you into being more creative. And again, the choices that we made and the results that we got, suggest that we can get a lot more bang out of the marketing dollar than we did before. And so, I think it's a combination of adding back and being more efficient that gives us the max impact.

Bonnie Herzog: Okay. While I'm mindful of the time, I think we're fast approaching the 45-minute mark and I know we've touched on a lot and talked about a lot this morning which was great, is there anything else that you might want to share with us or maybe something that you still think is misunderstood by the market about your company?

Bob Gamgort: No. I think – and thank you again for hosting us, because having the opportunity to get into some of these specifics really does help educate our investors on the business model which I will agree is a bit complex, but over time, I think that people are appreciating the fundamentals of it. When we have our Investor Day coming up, we'll be able to talk much more about what does the world look like beyond 2021 and that's the last year of our merger algorithm. And so, look, I'm happy – I'm actually very happy that most investors are saying, okay, we want to talk beyond that, because remember, when we launched this thing, nobody believed that we could deliver the three-year objective. So, we'll take that as a victory.

We will also give our investors more exposure to our management team. So, everybody hears a lot from Ozan and from me. Today, you get a

chance to hear from Derek and that's important, because Derek led the integration of the two companies, then he ran our commercial operation across the business, and now he runs our Cold Beverage business. And when people say, how did you gain share on 90% of your portfolio, I always – first thing I always say is our people, our team. So, Derek is a great example of that. So, you'll get more exposure to that. So, we look forward to talking about what does the world looks like beyond 2021 in that meeting. But until then, we are 100% focused on navigating through the changing world that we still face every day in 2020 – 2021.

Bonnie Herzog: I understand. Well, great job. Thank you so much for your time this morning. I really appreciate it. Thank you.

Bob Gamgort: Okay. Bonnie, thank you.

Ozan
Dokmecioglu: Thank you.

Bonnie Herzog: Bye, everyone. Thank you.

Derek Hopkins: Thank you.