Keurig Dr. Pepper Inc. First Quarter 2021 Earnings Call

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08:00 AM ET

Operator: Good morning, ladies and gentlemen, and thank you for standing by. Welcome to the Keurig Dr Pepper's Earnings Call for the First Quarter of 2021. This conference call is being recorded, and there will be a question-and-answer session at the end of the call. I would now like to introduce Keurig Dr Pepper's 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 first quarter of 2021. If you need a copy you can get on our website keurigdrpepper.com in the Investor section. Consistent with previous quarters, today, we will be discussing our performance on an adjusted basis, excluding items affecting comparability. The company believes that the adjusted basis provides investors with additional insight into our business and operating performance trends. While the exclusion of items affecting comparability is not in accordance with GAAP, we believe that the adjusted basis provides meaningful comparisons and an appropriate basis for discussion of our performance.

Details of the excluded items are included in the reconciliation tables, included in our press release and our 10Q, 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 first quarter 2021 results are KDP Chairman and CEO, Bob Gamgort; our CFO, Ozan Dokmecioglu; and our Chief Corporate Affairs Officer, Maria Sceppaguercio.

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.

Robert Gamgort: Thanks, Tyson and good morning, everyone. I hope you and your families are well. As we enter spring cautious optimism is in the air, vaccine rates are approaching 50% of the US adult population and growing across North America. Higher levels of consumer mobility are evident in retail, restaurants and entertainment, and there is an increasing belief that the worst of the pandemic is behind us.

If the last year has taught us anything, however, it is that our role is not to predict the future, but rather to be nimble, responsive and prepared for whatever we may face in the future. This same mindset enabled Keurig Dr Pepper to deliver meaningful outperformance in 2020 and a strong start to 2021.

While some companies have been devastated by the impacts of the crisis, others have experienced a windfall from it. We on the other hand have succeeded despite the pandemic by driving the parts of our business that are performing well to overcome the declines we've experienced in areas structurally challenged by COVID.

While that may sound easy in concept, it is very difficult to execute in the real world, and I would like to thank our 27,000 team members across KDP, who continue to step up to meet the challenge. In the first quarter of 2021, we delivered strong performance across the board, highlighted by double-digit growth in both net sales and Adjusted diluted EPS. We also reaffirmed our outlook for another strong year of double-digit Adjusted diluted EPS growth. Despite the specter of rising inflation, in part by increasing our net sales growth expectations from 3% to 4% to 4% to 6%. This sets us up for a solid 2021 and positions us to achieve our ambitious three-year merger targets ending this year.

Let me now provide key highlights of the first quarter. Our net sales grew by 11%, with all four business segments posting growth, driving this performance with continued strong in-market execution across the business. In cold beverages, we continue to perform well, with more than 80% of our cold beverage retail sales space expanding market share during the quarter. We believe a helpful way to assess both our results and those of the broader industry, given the unique volatility of 2020 is on a two-year stack basis. Over this time period, nearly 90% of our cold retail sales space grew market share and our consumption was up nearly 17%.

LRB performance continues to reflect KDPs broad-based strength in CSDs, premium unflavored water, Snapple teas and fruit drink and others. During the quarter we launched new zero-sugar varieties across our CSD portfolio, which has helped to solidify our number two CSD manufacturer status in key retail accounts.

We're also seeing KDP brands take over leadership position. The latest being Sunkist becoming the number one fruit flavored CSD brand, fueled by the zero-sugar introduction and flavor-line extension. In the past few months, we launched innovation behind Bai with Bai Boost, made with clean ingredients, including plant-based energy from tea extract, Bai Boost has been well received by retailers and consumers in early days.

Finally, on cold beverages, our new brand partnership and the growing sparkling water segment with Polar is performing well. National ACV has grown to 55% with more distribution to come, as shelf resets are completed across the country.

Our coffee business posted an exceptionally strong quarter, with net sales advancing 17% on a constant currency basis, due to a 14% increase in pod volume growth and a 61% increase in brewer volume. The latter primarily being driven by a roughly 40% increase in consumer sales, and some benefits of shipment timing between the quarters. Approximately half of the 14% increase in pod volume was due to strong consumption in the quarter, with the remainder driven by differences in pod shipment timing relative to the unusual year ago period.

The fact that pod volume growth in track channels registered at just above 3% for the quarter, demonstrates the trend that we've been discussing for some time, K-Cup pods are experiencing significantly higher levels of growth in untracked channels, particularly e-commerce. Digging deeper into untracked channels highlights further the growing importance of e-commerce. Strength in at-home pods has been tempered by continued weakness in the away-from-home channel, as the return to offices continued to be slow. We do expect improvement over the course of 2021, especially after Labor Day when we anticipate the rate of office reopenings to accelerate. On a two-year stack basis, dollar consumption of pods and track channels was up 11% with two-year shipments up more than 20%.

For total KDP, we delivered very strong bottom line results in the quarter, with Adjusted diluted EPS growth of nearly 14%, despite lapping the sale leaseback gains in the first quarter of the year. We also continue to generate high levels of free cash flow, enabling us to pay down debt and improve our management leverage ratio to 3.5 times at the end of the quarter. Since the merger, we have reduced our leverage ratio by 2.5 turns while also investing meaningfully across the business. Let me now hand it over to Ozan to walk you through the financial results for the quarter and provide further details on our outlook for 2021.

Ozan Dokmecioglu: Thanks, Bob and good morning, everyone. Continuing on an Adjusted basis, I will briefly review our performance for the first quarter, which was very strong, and our press release discusses in significant detail. I will then turn to our outlook for the full year 2021.

Constant currency net sales increased nearly 11%, fueled by higher volume mix of 10.3% and favorable net price realization of 0.5% with all four of our business segments posting growth. Adjusted operating income in the first quarter totaled 741 million dollars, an increase of 8.3% compared to 684 million dollars in the year ago period, driven by the very strong net sales growth, continued productivity and merger synergies and lower marketing spending in relation to the pre-COVID spending levels in the year ago period.

These drivers were partially offset by higher operating expenses associated with increased consumer demand, inflation in logistics and input costs and an unfavorable comparison to a 42-million-dollar gain in the prior year on the sale leaseback of four facilities. For perspective, this gain negatively impacted the year-over-year Adjusted operating income growth rate by more than seven full percentage points. Adjusted operating margin in the first quarter was 25.5%, a decline of 70 basis points versus year ago, which included the 160-basis points headwind from the gain on sale leaseback transactions.

Adjusted net income advanced 15.4% in the quarter to 471 million dollars compared to 408 million dollars in the year ago period, driven by growth in Adjusted operating income and the lower Adjusted effective tax rate. Adjusted diluted earnings per share grew 13.8% to 33 cents per diluted share, compared to 29 cents per diluted share the year ago period, which included the 2-cent gain from the year ago sale leaseback transactions.

Let me take a moment to discuss the inflationary pressures we have referenced this morning. Like most other CPG companies, we have increased our outlook for inflation over the past month. Price expectations continue to rise for aluminum, glass, corn inputs and polypropylene, which is the material used in K-Cup pods. Most recently, we have experienced a spike in transportation and logistics costs, which is especially acute when we have been required to purchase spot capacity to satisfy the strong demand for our products. Some of these input costs, for example, transportation and polypropylene cannot be hedged.

To manage inflation, we rely on a combination of productivity, cost control, pricing and incremental volume growth, pulling the right levers at the right time to protect the long-term health of our business, while offsetting rising input costs. For 2021, we are in a position of strength, as we are able to utilize our sales growth momentum to mitigate inflation. However, if inflation were to accelerate, we may need to utilize other options, just like we did in 2020. We will remain nimble and flexible to react to changing market conditions to ensure our continued success.

Finally, we get a number of questions on the benefit of hedging and forward buying with regards to mitigating inflation. First, while we use these practices wisely, their role is primarily to provide pricing certainty for a period of time and to insulate against short term volatility in input costs, they can postpone, but not offset inflation.

Coffee is a great example. We are seeing green coffee prices on the rise right now, but we are covered for a period of time, which lets us see how the market settles before we need to react. Like every other input cost, if green coffee inflation were to be persistent, then we would consider all of our available options to offset its impact on our profit and loss.

The good news today is our strong guidance for 2021 incorporates all of these considerations as we are confident that we have the tools and management discipline to deliver a strong growth in both revenue and earnings, despite the inflation outlook that has been widely discussed this earnings season.

Let me now turn to our segment performance in the first quarter. Coffee systems constant currency net sales increased 16.9%, driven by higher volume mix of 19.5%, partially offset by lower net price realization of 2.6%. The volume mix performance reflected pod shipment volume growth of 13.7%, driven by double-digit at-home shipments, partially offset by continued softness in the away-from-home coffee businesses. The 61% increase in brewer shipments in the quarter was fueled by strong consumer consumption and the benefit of shipment timing.

Adjusted operating income for coffee systems totaled 389 million dollars, an increase of 12.1%, compared to 347 million dollars in the prior year. The increase was driven by the strong net sales growth, as well as continued productivity and merger synergies. These growth drivers were partially offset by inflation in logistics and input costs and the unfavorable comparison to the sale leaseback gain in the year ago quarter that impacted the segment by 16 million dollars.

The year-over-year Adjusted operating income growth rate would have been 5 percentage points higher in the quarter, absent this year ago gain. Adjusted operating margin in the quarter was 34.1% compared to 35.7% in the year ago period, a decline of 160 basis points, including 170 basis points headwind from the asset sale leaseback gain in the first quarter of 2020.

Also impacting the comparison was unfavorable margin mix, due to the exceptionally strong brewer growth in the current quarter, and the breakeven margin structure of brewers, offsetting these impacts were continued strong productivity and merger synergies.

Packaged Beverages constant currency net sales grew 7.2% in the first quarter, driven by strong volume mix growth of 6.8% and higher net pricing of 0.4%. This performance reflected growth in both our company owned DSD operations and warehouse direct businesses. Driving this growth were Dr Pepper, A&W, Canada Dry, Sunkist, 7UP and Squirt in CSDs, along with Snapple and Clamato, partially offset by a decline in Bai.

Adjusted operating income for packaged beverages in the first quarter totaled 197 million dollars, a decrease of 3% compared to 203 million dollars in the year ago period that included the sale leaseback gain of 26 million dollars for the segment. The year-over-year Adjusted operating income growth rate would have been 14 percentage points higher in the quarter, absent this year ago gain.

Inflation in logistics and input costs, and higher operating costs to meet strong consumer demand were also headwinds in the quarter, as were continued channel and format mix challenges, as we are comparing to a largely non-COVID period last year. Partially offsetting these drivers were the strong net sales, continued productivity and merger synergies and lower discretionary expenses.

Adjusted operating margin for the segment was 15.1% in the quarter compared Adjusted operating margin of 16.7% in the year ago period, a decline of 160 basis points, including the 220-basis point headwind from the year-ago sale-leaseback gain.

Beverage concentrates constant currency net sales increased 6.5% due to favorable net pricing of 7.2%, partially offset by lower volume mix of 0.7%. This performance continued to be affected by the unfavorable impact of COVID-19 on the fountain foodservice business, albeit, improved since the beginning of 2021.

Adjusted operating income for beverage concentrates increased 21.3% to 239 million dollars compared to 197 million dollars in the year ago period, driven by net sales growth and lower marketing spending.

Adjusted operating margin in the quarter advanced 850 basis points to 72.9%, primarily reflecting the favorable net price realization.

Finally, Latin America beverages constant currency net sales grew 7.7%, reflecting strong net pricing of 10.3%, partially offset by lower volume mix of 2.6%, as consumer mobility in Mexico continued to be impacted by COVID-19. However, this has improved from the beginning of 2021.

Liquid refreshment beverage in-market execution in Mexico continued to be strong, driving market share growth for key brands, namely Peñafiel, Squirt and Clamato.

Adjusted operating income decreased 15% to 23 million dollars, compared to 27 million dollars in the year ago period. On a constant currency basis, Adjusted operating income decreased 14.8%, reflecting the impact of foreign currency transaction expense and inflation in logistics, partially offset by the strong growth in constant currency net sales, continued productivity and lower discretionary spending. Adjusted operating margin in the quarter decreased 470 basis points to 18.4%, primarily reflecting the unfavorable impact of foreign currency transaction expense.

Switching back to total KDP. Free cash flow in the quarter was again exceptionally strong at 458 million dollars, which translated into a free cash flow conversion ratio of nearly 100%. As previously announced, we completed a 2.2 billion dollars strategic refinancing in March of this year. Since the time of the merger, nearly three years ago, we have generated significant cash flow and have rapidly de-levered. This strategic refinancing further enhances our liquidity profile and strengthens our balance sheet.

To that end, our strong free cash flow performance in the quarter enabled us to reduce outstanding bank debt by 25 million dollars and structured payables by 5 million dollars, and we paid 95 million dollars for the early retirement of debt in conjunction with previously mentioned March strategic refinancing. We also ended the first quarter with 335 million dollars of unrestricted cash on hand.

Due to growth in earnings, our reduction in bank debt and increased cash on hand, we improved our management leverage ratio to 3.5 times at the end of the first quarter of 2021. Since the merger closed in July 2018, we have reduced our management leverage ratio by 2.5 times.

Let me move to our updated outlook for 2021. For the full year 2021, we now expect constant currency net sales in the range of 4 to 6% compared to our initial guidance of 3 to 4% at the beginning of this year, which reflects the strong demand for our brands across all segments. We also reaffirmed our EPS guidance range of 13 to 15% growth for the year, in part driven by the benefit of higher net sales outlook in offsetting higher inflation. As indicated in our release this morning, we plan to invest any earnings upside above our guidance range back in the business to drive future growth.

For perspective, on a two-year stack basis, assuming the midpoint of our guidance range, Adjusted diluted earnings per share growth will approach to 30%.

Supporting our guidance, we continue to expect merger synergies of approximately 200 million dollars for the three-year total of approximately 600 million dollars in line with our merger targets.

Adjusted interest expense in the range of 505 million dollars to 515 million dollars and Adjusted effective tax rate in the range of 23.5% to 24%. As you have seen in our results this morning, our effective tax rate was below this guidance range at 22.1% in quarter one, due to one-time discrete favorable items including employee stock vesting, which we anticipated, this is largely a first quarter event.

Our dividend rate will increase 25% beginning with our regular quarterly dividend to be announced in the second quarter subject to official board declaration, as previously disclosed. Diluted weighted shares outstanding approximately of 1.43 billion.

Finally, we continue to expect our management leverage ratio to be at or below three times by the end of this year. While we do not provide quarterly guidance, given the comparison to an unusually volatile quarter two 2020, let me provide some additional perspective on the second quarter.

Given the inflationary pressures we discussed and the significant year-over-year increase in marketing spending, we expect to deliver double-digit Adjusted diluted EPS growth for the quarter, although it will be below the full year guidance range of 13 to 15%. Transportation will continue to be a headwind in the second quarter. With respect to marketing, we continue to restore investment behind our brands this year, especially to support our strong slate of innovation, which is comping a year ago period in which everyone in the industry reduced marketing expenses, due to the uncertain consumer demand environment under COVID. We hope this provides some helpful clarity on the phasing of our business results this year. With that, let me hand it back to Bob.

Robert Gamgort: Thanks, Ozan. Before moving to Q&A, I would like to provide a brief update on corporate governance. As you are aware, we transitioned from a controlled company to a widely held one in 2020. Since that time, we've enhanced our board structure, increasing its independence and diversity, and establishing the role of lead independent director.

I want to highlight our announcement yesterday that we welcome Lubomira Rochet, as a new Director to our Board. Since November, we've added four new directors, each of whom brings unique experiences and fresh perspective to the Board. Finally, many of you have asked questions about our post-2021 outlook. We plan to hold an Investor Day shortly after we report our Q2 earnings, during which we look forward to sharing insights on our long-term strategy and financial expectation. Details for the conference will be provided in the near future. I will now hand it back to the operator.

Operator: Ladies and gentlemen, as a reminder if you would like to ask a question, please press star then the number one on your telephone keypad. We'll pause for just a moment to compile the Q&A roster. Your first question comes from the line of Bonnie Herzog with Goldman Sachs. Your lines open.

Bonnie Herzog: All right, thank you. Good morning.

Robert Gamgort: Hi, Bonnie.

Bonnie Herzog: Hi. I wanted to ask you guys about the brewer sales in the quarter, I was hoping just to get a little bit more color on the much better than expected sales that you guys reported and how impactful some of the innovation that you've put in the marketplace has been? Then in looking forward, how should we think about your brewer sales to the balance of the year, especially in the context of some of the tougher comps that you're going to be facing?

Then separately, thinking about attach rates on a go forward basis especially given some of the brewer volume growth that you've seen. I guess to me, it seems like if your attach rates hold, this really could be a meaningful driver behind pod volumes in the coming quarters and years. And if you could just touch on that or is that the right way to think about it? Thanks.

Robert Gamgort: Yeah, okay. Sounds great. Let me start with attach first. During the pandemic, we saw an increase in attachment rate, especially in the early days and that was very different than the long-term trend we had experienced where we said the attachment rates were very stable. Our expectation that we communicated at that time is that, as consumer mobility normalized, we would see attachment rates normalize back to their long-term levels and that's exactly what we're seeing right now. So, I think attachment rate, on one hand have come down from their peak in Q2 a year ago, no surprise there, but the reverse side of it is, our attachment rates holding up versus their long-term trend, even as we add new households, absolutely.

I think it's as simple as when we're able to convert a home from brewing coffee by the pot to brewing it by the cup, it settles in at a consumption rate and unless there's some substantial change in their behavior, stays very solid over time, which is ultimately good news.

As we talked about a number of times, so it's worth, but it is worth repeating. Household penetration growth is what drives our pod growth over the long-term and brewer sales over a longer period of time has some correlation, but especially in the short term, there's not causality. So, you can't automatically look at strong brewer sales and say, that's going to mean that we've got even higher rate of household penetration and let me give you a little more depth on that, because it's such a critical point.

In 2020, as you know, we added 3 million new households to the Keurig system and that was about a million households above our normal run rate of 2 million and there were a lot of questions about is this a pull-forward from the future? When we look at 2021? We said absolutely not and that's exactly what's playing out right now.

To get those 3 million households, we sold 11 million brewers. So that tells you that we had a record year, not only in terms of new households, but a record year in seeing existing households, which are now 33 million strong in the US, replace or upgrade their brewers. While replacements and upgrades don't lead to household penetration growth, they're really important because they represent a strong recommitment to the Keurig system.

So, let's talk about 2021. When we put our initial thoughts about 2021, we said that we believe that we'll return to our long-term trend of adding 2 million new households per year, and we weren't concerned about any pull-forward. We had a really strong quarter in brewer sales in Q1, and by the way, 40% of that 60% growth was driven by consumption. So, there's some shipment timing in there, but it's really consumer sales driving the majority of that. As happy as we are with that, it is far too early in the year for us to conclude that that translates to household penetration growth above 2 million.

Why is that? Because we've got a ton of innovation in the market right now and you're also seeing two rounds of government stimulus in the past few months that have people feeling very liquid. So, a number of people are using it to still invest in their homes and they're upgrading their brewers, and we've given them innovation to do so.

So, as we sit here today, we're still talking about 2 million new households, which is a tremendous growth. And as we always do, we'll update our household penetration growth at the end of the year and the start that we see on brewers should give us confidence, if nothing else to give us confidence that the 2 million number is very doable.

Operator: Your next question comes from the line of Bryan Spillane with Bank of America. Your line is open.

Bryan Spillane: Hey. Good morning, everyone.

Robert Gamgort: Morning.

Bryan Spillane: Just two quick ones for me. First one just Ozan on the inflation outlook for the year and relative to the comments on hedging. Just wanted to clarify, is your inflation outlook, you know, is it hedged. So, meaning is there a potential for more, I don't know, volatility, I guess in the COGS inflation over the balance of the year, or is the outlook pretty well locked in?

Ozan Dokmecioglu: Sure. Good morning, Bryan. Like you have heard, likes of many of our peer group of companies, we have increased our outlook for inflation over the past month. And when you looked at the major reasons of the inflation, you would see that primarily around the packaging likes of aluminum, glass, as well as polypropylene, the material that we use in the K-Cup pods, that includes corn inputs that translates for us as the high fructose syrup.

Then in the past one month, we were expecting already an inflationary environment in the transportation and the overall logistics, but we have seen an uptick in those and we also service our increased volume using at times off the spot rate, which makes it a little bit higher inflationary environment.

Right now, we believe that we have included a healthy amount of inflation expectations, in our year to go period. Some of the input costs, especially transportation, which translates for us as freight as well as polypropylene are not really hedgeable in terms of they are not regulated market, so we can’t perform some of the hedging activities that we have been.

Nevertheless, Bryan, we feel very good with our expectations and how much inflation we have increased in our outlook and built for the rest of the year. For the commodities and the other input costs, there are other hedgeable items, as we always use widely hedging techniques to protect and bring price stability and then forecast transparency for the year to go, they are all intact.

But please make no mistake, that hedging or forward purchasing provides high certainty for a period of time and in a persistent inflation is just postponing, is not really mitigating the inflation as such. But in short, we feel very good with our expectations for the rest of the year and we believe we de-risked our P&L as much as we could.

Operator: Your next question comes from the line of Lauren Lieberman with Barclays. Your line is open.

Lauren Lieberman: Great, thanks. Good morning. I want to talk a little bit about marketing plans for this year, as you mentioned in the prepared remarks industry - cold drinks industry, everyone reduced spending significantly in 2020 and you guys had tremendous results regardless. So, I just wanted to talk about how your marketing plans for 2021 possibly have changed with inflation being so much worse than initially anticipated. I'm sure marketing is up year-over-year, but just how much, anything that you can offer, how that may have shifted.

And then also the mix of that spend, again given the very strong returns on the relatively low level of spend in 2020. How is that informing your thought process on what actually needs to be spent to support this business? Thanks.

Robert Gamgort: Sure. Good morning, Lauren. Thanks for the question. Marketing plans, well, let me talk about marketing spending first. As you point out, everybody in industry dropped their spending in 2020. It was a combination of covering mix issues, but also in the early days of the pandemic, the marketing wasn't very efficient. As we got through the year, as you also point out, not only did we restore some of the spend, but we also learned to be incredibly efficient with that spend, nothing like being under pressure to innovate on how we're able to reach consumers in a more efficient way.

And a lot of that learning carries over into 2021, where we build in that expected efficiency, plus we have plans to invest more in marketing. To be really - direct to your question, we have not changed our commitment to the increase in marketing that we have planned in 2021, despite the fact that we're seeing higher inflation, so we haven't touched marketing to offset inflation at all, in 2021.

Our expectation is increased marketing spend, restore as much of that as we possibly can, although we won't get all the way back to where we were in 2019, for sure, that will take a couple of years to get there. We are also looking for opportunities to invest more in our marketing spend.

So, as we talked about a number of times, that we think 13 to 15% growth in an environment like we're in right now, especially when you look at a two-year stack of 30% EPS at the midpoint is fantastic return and anything above that, we would then use opportunistically to invest back in the business to continue to drive long-term growth. Getting the balance right between delivering best-in-class EPS, plus best-in-class growth and market share expansion is what we're doing here. And we will reinvest any opportunity that we get.

Increasingly, we're spending more and more on digital, that's not a surprise, everyone's doing that. We have much more science behind our marketing and our team continues to build their expertise in doing so and that leads to more efficiency. So absolute spending investment is no longer as relevant, as it once was because we're dialing up the productivity and efficiency of that spend every year and so we're able to squeeze more out of every dollar in terms of the consumer impacting, as you point out. Even though our marketing was down in 2020, we gained share on 90% of our core portfolio, and we added 3 million new households secure. So clearly, we knew what we were doing on that spending.

Then my last point is, what are we going to spend the money on this year. We've got an incredible lineup of innovation, on the LRB side, well, first on CSD, zero sugar is our big news. You're already seeing advertising right now on Dr Pepper zero sugar. We're running NASCAR for the first time this weekend, in many, many years with Dr Pepper behind zero sugar and Bubba Wallace.

We're introducing Bai Boost, which we'll support with advertising and then on the Keurig side, we've got a number of innovations, Green Mountain Brew Over Ice. We're continuing the One Step Lattes and cappuccinos on Donut Shop, both of whom have done really well. And then, of course, substantial spending beyond the Keurig business to drive household penetration.

So not only do we restore the spending, do we know how to spend it, but we're really focused that spending on innovation, which we know drives really efficient marketing. So, thanks for that question.

Operator: Your next question comes from the line of Andrea Teixeira with JPMorgan. Your line is open.

Andrea Teixeira: Thank you. Good morning. So, I wanted to go back to the comments about Q2 coming in below the guide for EPS, despite obviously being the easiest comp for you. I understand the transportation cost pressures and reinvestment, but can you talk about the top line outlook? And if it's coming above the - what do you have for the year now that you raised? Thank you.

Robert Gamgort: Yeah. Ozan, I'm going to let you talk about the EPS side, the earning side of it and the pluses or minuses. Andrea, thanks for the question. We did something that we usually don't, which gave guidance on a quarter because of the volatility. So, we're certainly doing in the earning side, but we do not plan to give guidance for quarter-by-quarter on the revenue side. But Ozan, do you want to talk about the earnings visibility that we have and why we decided to give some extra color on Q2?

Ozan Dokmecioglu: Absolutely. Good morning. So, when we look to our overall expectation and the construct of the quarter two, we still see a very healthy quarter, as you have said a good top line increase expectation. And when we look to the inflationary pressures that are coming along, we expect a healthy amount of inflation to realize in our quarter two P&L.

And we should not also forget that when you comp versus the last year in quarter two, we have seen some declines, especially in the transportation and the logistics area, for example, which was purely driven by the demand and supply, which was coming from the marketplace as part of the pandemic environment.

So, we are going to lap lows periods that on a like for like basis is up ticking the overall freight costs, as well as logistics expectation for us. But the good news is we have a good handle on those things, and we have built in our forecast and the plans and not only for quarter two, but beyond, including the second half of the year.

At the same time, last year, in quarter two, as part of the overall industry giving there wasn't much return in a pandemic environment, we reduced more, so from our marketing spending, especially behind the advertisement and promotion. And as Bob was articulating a couple of minutes ago, we started to reinstate some of the advertisement and promotion investments behind our brands and also support a slate of the innovation that we have and putting in the marketplace.

Therefore, this is also technically creating a negative comparison, increase in the advertisement and promotion versus last year, but it's all good spend that goes behind our branch and investment and of our business. As we always do, we are very careful in terms of delivering on our productivities, merger synergies as well as other cost controls that we have been doing very successfully since the actual merger date, but we took it to the different levels starting with the pandemic environment.

Therefore, when we put all the puts and takes, we do still expect a very healthy growth in terms of either the top line, mid part, as well as the bottom line of our P&L.

Operator: Your next question comes from the line of Chris Carey with Wells Fargo Securities. Your line is open.

Chris Carey: Hi, good morning. So, I know we're still not in a completely normal operating environment with COVID, but I guess with the strength that you're seeing in coffee, what looks like a pretty rational environment in the North American beverage environment, especially on the pricing front and you're still gaining share.

I wonder if you have some incremental thoughts as we get into this year, just about the steady state organic sales growth of this portfolio because it continues to show an ability to grow better than a low single digit top line algorithm, which to category exposure might suggest that the packaged beverage unit specifically has been coming in significantly better. And I just wonder if there's more opportunity here, than what again, that low single digit category growth rate might imply? So, thanks for any thoughts around that.

Robert Gamgort: Sure. Good morning. Thanks for your question. This environment is anything but steady state, as we sit here right now. And as we said upfront, it appears to be returning to more of a business as new normal, whatever that's going to be when it settles basis, but way too early in this year, for us to even think about steady state.

We have our entire organization remaining on their toes. We're looking for changes in the environment, none of us went into this year expecting the level of inflation that we're seeing right now, for example, and we don't know if it's temporary or if it's sustained. So, I don't know what steady state looks like and when we get towards the end of the year, we'll probably have a better view on that.

I think, your question is, what's the longer-term growth outlook for this portfolio and whatever that environment is? I won't steal any thunder from our Investor Day, which we'll be doing right after our Q2 earnings, because that will be the topic. What does the KDP outlook look like both from a strategy and a financial algorithm post-2021. At that point in time, we'll have more data on what the marketplace looks like and that'll be a very robust part of that conversation.

Operator: Your next question comes from the line of Steve Powers with Deutsche Bank. Your line is open.

Steve Powers: Hey, thanks. And good morning, everybody. Two questions, if I could, I guess, maybe Ozan for you just to round out the 2Q versus balance of the year question. I appreciate the color you gave to Andrea's question. But if you could just hit maybe for us a little bit more specificity on what you expect to get better in the back half versus 2Q, whether it's the cost environment, or the cost savings momentum, pricing benefits, or otherwise. Just looking for a bit more clarity on where the back half acceleration has to be sourced from relative to what you said about 2Q?

Then Bob, what I really wanted to ask about was just the relative strength of packaged beverages on the top line, not just this quarter, but what we've seen over the past several, there's been tailwind in that business, but you've, I think, pretty consistently exceeded expectations. And I'm curious, if there are things you can hammer home for us in terms of what you attribute the outperformance to.

Part of that, I think, is that your market shares are stronger in future consumption channels where consumers have been biased to shop this past year. To the extent that's true, I guess maybe you could talk about that, but I'm also curious if you feel you see opportunities to leverage the strength you've had in those channels into future gains and immediate consumption channels when traffic builds as we go forward? Thank you.

Robert Gamgort: Ozan, do you want to start with the first one?

Ozan Dokmecioglu: Yes. Yes, Bob. Good morning, Steve. Thanks for the question. So, in order to bring a little bit more color, let me try to break up a little bit more. And then we go from there.

So, as I said, we do believe that we have a good planning stance, not only for Q2, but for the remainder of the year, but let's make sure that we all agree on one thing is still we are not 100% out of the woods in terms of the pandemic environment. We still don't know exactly how all these things going to play out and how the macroeconomic situation going to react, and most importantly, how the mobility is going to be impacted.

As we said in numerous numbers of times, we did not get any windfall from the pandemic environment. This was a ruthless prioritization in terms of managing the mix, along with the innovation and the categories that we operate. Therefore, we also said that we have seen some pressure in our, for example, in the coffee side, the away from home business, that primarily serves the offices, as well as the hospitality sector.

On the cold beverage side, the most negatively impacted part of our business was the fountain foodservice, as we discussed, again in numerous numbers of occasions. The good news with those, starting quarter two onwards, we are going to lap those negative numbers that we have seen in 2020. And with the increasing of the mobility, we do expect those two parts of our business to start to perform better than 2020. And albeit, we already started to see month in month out since January onwards.

So, we don't know, and we don't have a real crystal ball in terms of how the mobility is going to be impacted and what would be the puts and takes on our business. Having said that, we also have a good understanding and some expectations in terms of how our top line we would like in relation to the price stability that we believe now we have in our overall cost of goods sold portfolio, that goes back to the inflationary comments, and I have just made, which a good chunk of our portfolio that is hedgeable and we are taking all the necessary measures to shore up the rest of the year.

And for the other input costs, like soft polypropylene and freight that there are not regulated markets that we can hedge, that we believe we put the incremental inflationary environment that would be applicable for our business for the rest of the year.

And as we also discussed, we have several levers actually in case the inflation goes further to put into the service, likes of productivities, cost controls, pricing whenever it is appropriate as well as our increased volume profile to support the bottom line. Therefore, we are very fortunate in terms of having several resources in order to fight back even with further inflation that may happen given that we don't know exactly what we don't know at this point in time.

Therefore, when we step back and look at it, we will also continue to ramp up our remainder productivity programs as well as merger synergies more in the second half of this year. So, when we add up all these puts and takes, we believe that we have quite a bit of healthy profit and loss profile to deliver our EPS commitment of 13 to 15%, with the associated top line.

Therefore, the good news is that we have built in all these, again, puts and takes into the remainder of 2021 and came up with the full year profile that we have been talking. Bob?

Robert Gamgort: Yeah. I'm going to add one thing to that, Steve, before I get to your second question. To bring together your question and Andrea's question, sometimes we get into the details, which are important, we lose the big picture. So, let me just step back before I move on and say the big picture on it.

The second quarter, we said is going to be below our 13 to 15% annual guidance, but still double digit. So, we're talking very strong performance in second quarter. The biggest driver of that fact, in Q2, if you want to look at why is Q2 below the balance of the year is this reinvestment in marketing in 2021 compared to a quarter a year ago, where marketing across our business and the entire industry had a dramatic pullback. I view that as a position of strength, not as a cost, but obviously it shows up on the earning side for one quarter. So, all of that detail is really important, but let's not lose the big picture of what I just said, and I think this is actually a very, very strong position.

With regard to our results of our packaged beverage business, it's two things, its brand strength and its outstanding execution at retail. With regard to the brand strength, we have talked about our share gain on Dr Pepper, Canada Dry for years, which continues to stay and I won't drill down deeper into those because we talked about those all the time, but we're getting broader share strength across our portfolio.

So, I mentioned one today this deserves a little bit of a call out which is Sunkist, which has now moved to the number one fruit flavored CSD share position. We never talked about Sunkist, but we've had innovation, renovation and marketing behind that brand, and you see that it responds, and I could keep going throughout our CSD portfolio to talk about that.

Beyond CSDs, we've had fantastic results on brands like CORE, Snapple, we're in the middle of a Snapple reinvention right now, which is a completely new look to it, new bottle, 100% post-consumer recycled, et cetera, et cetera. So, I won't go through this laundry list, but there is real brand strength and it's not accidental. It's driven by innovation, renovation and really strong marketing and that will continue.

With regards to execution, it's more than just we're getting the blocking and tackling right. We have added really strong leadership to that side of the business. We've upgraded the data and technology that helps aid our decision making. We have real strength in things like - on areas like revenue growth management, which allows us to be very precise in our promotion program.

Then finally, we've made 14 investments, some are substantial, like the Honickman partnerships. Some are very small, but we made 14 transactions in our route to market to take some independent businesses and move them over to our businesses in which our thesis is that when we can consolidate the supply and distribution, we're able to execute better in market, and that's showing up and that's not going to slow down.

So, it's really the combination of those. Your point about C store versus others is really not a major factor here. If you want to look at our relative C store performance, I can make it really simple for you. The single biggest reason why we are not as large as some of our competitors is because we don't have a meaningful position in energy or sports, but particularly energy. And energy is a big category in C stores, but it's nothing beyond that.

Operator: Your next question comes from the line of Kevin Grundy with Jefferies. Your line is open.

Kevin Grundy: Great. Thanks. Good morning, everyone. Thanks for taking the question. Bob, a question for you on Polar and the company's sparkling water strategy more broadly. So, you spent a little bit of time, you mentioned distribution opportunity for the brand. It also seemed like it contributed to the strong package beverage result in the quarter building on Steve's question a moment ago.

So, a few questions, please. What is the ACV opportunity? I think you mentioned it's 55%. What is the ambition? Where do you think that can go? And where are those shelf space gains going to come from as you expand? Have you been pleased with the existing velocity as you've expanded here at existing retailers?

And then Bob maybe just more broadly on the company's sparkling water strategy, just more broadly, given the attractiveness of it, and it continues to be one of high growth categories in the beverage space a lot there? Thank you.

Robert Gamgort: Yeah. Okay. Yeah, thanks for question. Really if you look at our previous position as sparkling water was relatively limited, we had some regional positions in Canada Dry and Schweppes, and we actually think those brands are much more fit for the ginger ale and CSD business, they are in sparkling water, but it made some sense when we didn't have anything.

Polar is the brand that we're backing. We're happy with the velocity. We're really pleased with the ACV that we're at right now, which is 55%. And where does it go from here? It's going to deliver at the ACV level of all of our top brands. That's almost universal distribution. So, there's no reason why this is one of our big investment areas is not going to achieve that strength.

With regard to how do we plan on playing within sparkling? We have some niche brands. The businesses that we can add around the edges here, Limitless was one which is caffeinated, that we're expanding beyond just caffeinated, that we will position against that, but I think very clearly Polar is the brand that we're backing.

It's an important brand in a high growth segment, one that's been a gap in our portfolio, and like our position in premium water in total, where we've now become the number two player, we're being very intentional about making sure that we have a good position in sparkling water going forward.

Operator: All right, thank you. That concludes the Q&A session of today's call. I'll hand the call back to Tyson.

Tyson Seely: Thank you, Jerome. And thank you everyone for your participation today. The IR team is around as usual. I know it's a busy day for everyone. We didn't get to everyone in the queue, but the IR team is here for your questions throughout the day. Please reach out to us. Have a good day.

Operator: Thank you, presenters and thank you ladies and gentlemen. That concludes today's conference. Thank you all for joining. You may now disconnect.