

Keurig Dr. Pepper Inc.

Moderator: Gamgort, Robert

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OPERATOR: This is Conference # 2280307

Operator Good morning, ladies and gentlemen, and thank you for standing by. Welcome to the Keurig Dr Pepper's Earnings Conference call for the Second 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 second quarter of 2021. If you need a copy, you can get one on our website at keurigdrpepper.com in the Investors section.

Consistent with previous quarters, today, we will be discussing our performance on an adjusted basis excluding items affecting comparability. The company believes that the adjusted basis provides investors with additional insight into our business and operating performance trends. With the exclusion of items affecting comparability is not in accordance with GAAP, we believe that the adjusted basis provides meaningful comparisons in an appropriate basis for discussion of our performance. Details of the excluded items are included in the reconciliation tables included in our press release and our 10-Q, which will be filed later today. Due to the inability to predict the amount and timing of certain impacts outside of the company's control, we do not reconcile our guidance.

Here with me to discuss our second quarter 2021 results are KDP Chairman and CEO, Bob Gamgort; our CFO, Ozan Dokmecioglu; and our Chief Corporate Affairs Officer, Maria Sceppaguercio.

And finally, our discussion this morning may include forward-looking statements which are subject to the safe harbor provisions

of the Private Securities Litigation Reform Act of 1995. These statements are subject to a number of risks and uncertainties that could cause actual results to differ materially, and the company undertakes no obligation to update these statements based upon subsequent events. A detailed discussion of these risks and uncertainties is contained in the company's filings with the SEC.

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

Robert Gamgort: Thanks, Tyson, and good morning, everyone. Since we spoke last quarter, consumer mobility across North America has continued to increase, with improving trends in travel, grocery and retail and recreation translating into changes in growth trends in beverage category segments and retail channels. Just as we experienced in 2020, the COVID recovery period in 2021 is creating significant volatility in demand, which has required us to remain nimble and flexible in managing our business.

One area in which mobility remains challenged is offices, which continues to be a headwind for us in coffee. While we've experienced some improvement year-to-date and expect more over the balance of the year, we project the recovery of office mobility to lag other areas of the economy.

Mix management was key to our success in 2020 as we were able to drive growth in on-trend segments and channels to offset those that were structurally challenged by COVID. While managing demand mix continues to be critical this year, we also face the added challenges of input cost and labor inflation, transportation constraints, labor shortages and supply chain disruptions, making 2021 arguably more difficult in many respects than 2020. We expect another 6 to 12 months of macro volatility before a more predictable operating environment emerges. Key to stabilization will be a return to both school and the office environment, the course of the COVID virus and its variants, the impact of reduced or eliminated government subsidies, the catch-up of global supply chains to meet unprecedented demand and an improvement in the labor market.

Despite all the challenges, we remain confident in our ability to deliver our EPS guidance for 2021 while increasing our revenue growth target to 6% to 7% for the full year. Our updated financial outlook offsets the challenges I mentioned a moment ago with new pricing actions announced across most of our categories, along with continued productivity and efficiency efforts and the improving performance in our higher-margin beverage concentrates and fountain food services businesses that both benefit from increased mobility. It's important to note that we still intend to reinvest any earnings upside into growth investments.

At the midpoint of our 2021 guidance range we will have achieved the 3-year financial algorithm that we communicated at the time of our merger, delivering annual adjusted diluted EPS within our target range of 15% to 17%, revenue growth well above our target range of 2% to 3% and our leverage ratio at or below 3x by the end of this year. We will share our outlook for the business and update our long-term algorithm for total shareholder return at our upcoming investor event in September. Details regarding the virtual event will be shared next week.

Turning to second quarter results we announced this morning. We posted another strong quarter, highlighted by double-digit growth in adjusted diluted EPS and high single-digit growth in constant currency net sales. These results were broad-based and balanced across the company with growth driven by both core business and innovation.

Because we're one of the few companies layering strong current year performance on top of strong year ago performance, it's also helpful to highlight our results on a 2-year basis. Comparing the first half of 2021 with the same time period in 2019 shows constant currency net sales growth of 13.5%, adjusted operating income growth of 19.5% and adjusted diluted EPS growth of just under 30%. We expanded our market share of total liquid refreshment beverages over the previous 2 years, driven in part by our 1.4 share point increase in carbonated soft drinks. Total K-Cup pod shipments increased nearly 15% over the same time, and brewer sales are up nearly 50%.

Looking specifically at the second quarter, more than 70% of our cold beverage retail sales base expanded market share, reflecting continued growth of CSDs driven by core brand strength and innovation, the most recent being our new Zero Sugar lineup, which is performing exceptionally well. Growth in key non-carb beverage brands such as Snapple, Core, Bai and Evian was good for the quarter but could have been even stronger had it not been for supply disruptions, which I will discuss in a few moments.

In coffee, our K-Cup pod shipments were essentially flat in the quarter, successfully lapping the very strong year ago period that was driven by peak at-home consumption. Comparing K-Cup pod shipment volume to 2019 removes some of the significant noise and timing for that business. For the quarter, K-Cup pods grew nearly 10% on a 2-year basis, demonstrating the underlying long-term growth trends in our coffee business. Brewer sales in the quarter increased by nearly 30% compared to a year ago, some of which was influenced by government stimulus and the timing of Amazon Prime Day.

Finally, with regard to coffee systems innovation, we were excited to announce earlier this week the launch of the K Supreme Plus

Smart Brewer, marking our first launch of a connected brewer for the broader consumer market. We look forward to talking more about the new Brew ID technology and the growth platforms it creates for us at our upcoming Investor Day event.

Shifting from demand to supply, nearly all CPG companies have discussed supply disruptions in 2021, and we're certainly not immune to these challenges. We continue to be effective in supplying K-Cup pods and CSDs, and we've been able to overcome ship shortages and ocean transportation limitations to supply the high levels of demand for our Keurig brewers.

However, our noncarb beverage portfolio has been negatively impacted by supply disruptions, especially Snapple and Core, which is evident in the latest Scanner numbers. I'll use Snapple as one example of the type of challenges that we and most other CPG companies are facing in the current environment. As we discussed on previous earnings calls, we started rolling out our refreshed Snapple bottle on the West Coast in November of 2020. That new package substitutes post-consumer recycled plastic or RPET for glass and nonrecycled plastic. And it also contemporizes the Snapple brand look and feel.

The consumer reception has been very strong, with Snapple growing share for the first 6 months of the year as we increased recruitment of younger consumers, exactly what we intended to do with the refresh. However, an unexpected shortfall in committed glass bottles from our supplier required us to transition our new RPET packaging faster, which pressured material availability from our supplier of RPET and stretch the startup curve of our new production lines. We're navigating through this challenge and other disruptions that have become the new normal in 2021 to maintain our guidance. However, we do expect some sales and share pressure on key non-carb beverage brands throughout the third quarter.

Our learnings on how to successfully manage our business through the volatility of COVID continue to serve us well as we build an increasingly resilient organization.

Before I turn it over to Ozan to discuss our segment performance in detail, I'd like to mention the great progress we continue to make in the area of ESG, which we know is important to an increasing number of investors. We recently issued our annual corporate guidance - our annual corporate responsibility report that highlights our performance against our previous ESG goals, increases our ambition through new ESG goals and expands our impact in new areas such as diversity and inclusion and health and wellness. If you haven't done so already, I encourage you to

read the CR report, which is available on the KDP corporate website.

Ozan, over to you.

Ozan
Dokmecioglu:

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

Constant currency net sales increased 8.1%, fueled by higher volume mix of 6.1% and favorable net price realization of 2%, with all 4 of our business segments posting growth driven by elevated consumption and strong in-market execution. For the first 6 months of 2021, constant currency net sales grew 9.4% versus a year ago and 13.4% versus the first 6 months of 2019.

Adjusted operating income in the second quarter totaled \$839 million, an increase of 8.3% compared to \$775 million in the year ago period driven by this strong net sales growth across our portfolio, productivity and merger synergies. These growth drivers were partially offset by significantly higher marketing investment in the quarter, inflation in logistics, manufacturing and input costs and higher operating expenses associated with increased consumer demand.

For the first 6 months of 2021, adjusted operating income increased 8.3% versus year ago and 19.4% as compared to the first 6 months of 2019. On a constant currency basis, adjusted operating income for the second quarter increased 6.8% versus year ago. Adjusted operating margin in the second quarter was 26.7% compared to 27.1% in the prior year, significantly impacted by the reinvestment in marketing in the quarter, inflation and unfavorable margin mix due to the higher brewer sales.

Adjusted net income advanced 14.7% in the quarter to \$538 million compared to \$469 million in a year ago period driven by growth in adjusted operating income and lower interest expense, largely driven by lower interest rates stemming from the strategic refinancing we completed in the first quarter of 2021. Debt repayments and the lower adjusted tax rate in the quarter.

Adjusted diluted EPS grew 15.2% to \$0.38 per diluted share compared to \$0.33 per diluted share in the year ago period. For the first 6 months of 2021, adjusted diluted EPS advanced approximately 14.5% versus a year ago and more than 29% versus the first 6 months of 2019.

Let me pause for a moment to discuss the inflationary pressures and supply chain challenges we have referenced this morning.

Price expectations continue to rise for aluminum, glass, corn products and polypropylene, which is a material use in our K-Cup pods. And like most other CPG companies, we have also experienced an increase in transportation and logistics costs as well as supply chain challenges related to supplier constraints, labor shortages and material and packaging availability. Despite these challenges, we have confidence in our ability to successfully navigate them. I will elaborate on this.

For 2021, we are in a position of strength as our sales growth momentum will help to offset inflation. As discussed previously, we rely on a combination of productivity, cost controls, pricing and various other revenue growth management strategies, pulling the right levers at the right time to protect the long-term health of our business.

In terms of price, we have already announced increases in both our cold beverage and owned and licensed coffee portfolios. Along with the other levers I just mentioned, this approach enables us to mitigate rising input costs and address supply chain challenges while reinvesting in the business and protecting bottom line profit.

As we did in 2020, we will remain nimble in response to changing market conditions to ensure our continued success focusing on flexibility, speed and delivery to manage our product and SKU performance at a granular level. Our updated guidance for 2021 incorporates all of these considerations, and we are confident that we have the tools and management disciplines to deliver strong growth in both revenue and earnings despite the dynamic inflation and logistic challenges.

Let me now turn to our segment performance in the second quarter. Coffee Systems constant currency net sales increased 3.9% driven by higher volume mix of 3.5% and favorable net price realization of 0.4%. The volume mix performance reflected pod volume growth of 0.2% and brewer volume growth of 29%. The pod growth reflected successfully, lapping peak shipments in the year ago period related to consumer stock-up behavior in the early days of the pandemic and an improved performance in the away-from-home business. Even though the return to offices continues to be slow, and this business remains well below pre-pandemic levels, the 29% increase in brewer shipments in the quarter was fueled by continued strong consumer purchases stemming from successful brewer innovation and, to a lesser extent, favorable timing of Prime Day during the second quarter of 2021 versus the third quarter of 2020.

The favorable net price realization in the quarter was largely driven by brewers and the continued moderation of pod pricing declines, consistent with our strategic pod pricing initiative launched several

years ago. Looking to the back half of the year, we expect pod shipments growth to continue in the mid-single-digit range, while brewer shipments are expected to be about even with a year ago given the 30% brewer growth we achieved in the second half last year, which benefited from the government stimulus during COVID sheltering. At the time, we had some concern that the elevated brewer growth and incremental households we were adding in 2020 represented a pull forward from '21. Given the continued strength of brewers, which are now expected to be up approximately 10% for the year on top of the 21% last year, performance would suggest that the pull forward did not occur and that our momentum continues.

Adjusted operating income for Coffee Systems totaled \$371 million, an increase of 2.2% compared to \$363 million in the prior year. This increase was driven by continued productivity and merger synergies partially offset by inflation in manufacturing, input costs and logistics. On a constant currency basis, adjusted operating income increased 1.1% in the quarter. Adjusted operating margin in the quarter was 33.7% compared to 34.8% in the year-ago period largely driven by the negative margin mix associated with the very strong brewer sales.

Packaged Beverages constant currency net sales grew 7.3% in the second quarter driven by strong volume mix growth of 6.2% and higher net pricing of 1.1%. This performance reflected growth in both our company owned DSD operations and warehouse direct business. The majority of our LRB portfolio contributed to this growth, with CSDs, including Canada Dry, Dr Pepper and Sunkist, along with premium water leading the way.

Adjusted operating income for Packaged Beverages in the second quarter totaled \$286 million, an increase of 6.3%, compared to \$269 million in the year ago period. This was driven by the strong net sales growth as well as productivity and merger synergies. These growth drivers were partially offset by inflation in logistics, manufacturing and input costs, a significant increase in marketing investment and higher operating costs to meet continued strong consumer demand. On a constant currency basis, adjusted operating income increased 5.9% versus a year ago. Adjusted operating margin for Packaged Beverages was 19.1% in the quarter compared to adjusted operating margin of 19.3% in the year-ago period, largely reflecting our significant reinvestment in marketing.

Beverage Concentrates constant currency net sales increased 20.7% due to favorable net pricing of 10.4% and higher volume mix of 10.3%. The net pricing was driven by our annual price increase and a favorable comparison to prior year on our annual true-up of customer incentive accruals as well as strong revenue growth management. The volume mix performance was largely

driven by improving trends in the fountain foodservice business, reflecting higher levels of consumer mobility in the restaurant and hospitality channels compared to the year ago period as well as the benefit of significant marketing investment driving growth in the quarter.

Dr Pepper and Crush led the growth, partially offset by declines in Canada Dry. Adjusted operating income for Beverage Concentrates increased 15.3% to \$256 million compared to \$222 million in the year ago period, driven by net sales growth, which was partially offset by the significantly higher marketing investment. On a constant currency basis, adjusted operating income advanced 14.4%. Adjusted operating margin in the quarter was 68.3% compared to 71.8% in the year ago period, primarily reflecting the higher marketing investment.

And finally, Latin America Beverages constant currency net sales grew 20.8%, reflecting strong volume mix of 16.6% and favorable net pricing of 4.2%. Liquid refreshment beverage in market execution in Mexico continued to be strong and resulting in the overall liquid refreshment beverage share expansion and continued robust retail consumption, which drove significant net sales growth for key brands, namely Peñafiel and Clamato.

Adjusted operating income increased 61% to \$37 million compared to \$23 million in the year-ago period. On a constant currency basis, adjusted operating income increased 44%, reflecting the strong net sales growth and productivity. These growth drivers were partially offset by significantly higher marketing investments in the quarter and inflation in logistics, manufacturing and input costs. Adjusted operating margin in the quarter advanced 310 basis points to 22.3%.

Free cash flow in the quarter continued to be strong at \$492 million, which translated into a year-to-date free cash flow conversion ratio of nearly 95%. In addition to our ongoing deleveraging and investing in the business to drive top line momentum, we're also increasing our return to shareholders. Specifically, during the quarter, the KDP Board authorized the previously announced 25% increase in our quarterly dividend rate, which was paid earlier this month. Despite this healthy increase, our payout as a percentage of free cash flow remains below 50%, pointing to the exceptional strength of our cash flow generation and the future optionality it provides.

During the quarter, we reduced our outstanding bank debt by \$427 million and structural payables by \$4 million. We also ended the second quarter with \$167 million of unrestricted cash on hand. Due to growth in earnings and our reduction in bank debt, we improved our management leverage ratio to 3.4x at the end of the

second quarter of 2021. Since the merger close in July 2018, we have reduced our management leverage ratio by 2.6x.

Let me now move to our outlook for 2021. For the full year 2021, we now expect net sales growth to be in the range of 6% to 7%. This compares with our original guidance for the year of 3% to 4% and our most recent guidance of 4% to 6%. We continue to expect adjusted diluted EPS growth of 13% to 15% for the year and plan to reinvest any over-delivery back into the business to support continued momentum.

Supporting this guidance, we continue to expect merger synergies of approximately \$200 million for a 3-year total of approximately \$600 million, in line with our merger targets. Adjusted interest expense in the range of \$505 million to \$515 million; an adjusted effective tax rate in the range of 23.5% to 24%; diluted weighted shares outstanding of approximately 1.43 billion. And finally, our management leverage ratio is expected to be at or below 3x by the end of this year.

With that, let me hand it back to Bob for some closing remarks.

Robert Gamgort: Thanks, Ozan. Before handing it over to questions, I want to highlight that earlier this month, we celebrated the 3-year anniversary of the Keurig Dr Pepper merger. Transaction that was based on our vision to create a North America-focused beverage company that approach the consumer and customer beverage experience in a more contemporary way. In the 3 years since we've accomplished a great deal and we are on track to achieve all of the financial commitments we made back in January 2018. We will continue to demonstrate what we believe it takes to be a modern beverage company, and we look forward to sharing more details with you in September.

I will now turn it back to the operator for your questions.

Operator: As a reminder to ask the question you will need to press star, one on your telephone. To withdraw your question, press the pound key. Please standby while we compile the Q&A roster. Your first question comes from Bonnie Herzog with Goldman Sachs.

Bonnie Herzog: I guess I was hoping for a little more color on your Packaged Bev volume in the quarter, which was definitely strong especially considering you were lapping a tough comp from the pantry loading last year. Could you guys give us a sense of how maybe the growth progressed through the quarter and your expectations for this business in the second half? And I'm also curious how

much of the strength was driven by the rollout of your new zero line and how incremental that has been on your portfolio. And maybe any early reads on the rollout from retailers in terms of securing incremental space.

Robert Gamgort: Sure. Bonnie, the growth in Packaged Beverages for this quarter was pretty well balanced across all items. CSD had particular strength, and I'll talk about Zero Sugar in a minute. The one area that we did flag is that in our noncarb portfolio, we started seeing some weakness as we got into the month of June in particular. And it is 100% driven by some supply issues with real issue on Snapple and Core. Both those brands were growing very, very well up until the supply disruptions. If you look at the IRi data, you see where we actually start to drop off during a little bit in May, but really in the month of June on those two. So that was the flow of the volume over the quarter as well as what the composition was.

And as we talked about in the prepared remarks, we've increased our guidance on the year. Obviously, it's driven a lot by our Packaged Beverage business. And so all of the supply issues that we talked about are taken into consideration in that guidance. So we're navigating our way through it. Real bright spot within the quarter continues to be CSDs. We refreshed or we converted our diet flavor brands over to zero sugar. If you look at an even comparison of those two, in other words, take out Dr Pepper Zero Sugar, which is an incremental item, if you just look at like-for-like on the conversion, our sales were up 16% as a result of the conversion from diet to zero sugar.

And then the Dr Pepper Zero Sugar variety has been incredibly strong. Year-to-date consumption, if you look at an IRi is about \$100 million. Our early read is about 70% of that is incremental. And we've been able to get that in distribution in 85% ACV. So great execution across the board in that conversion and the addition of Dr Pepper Zero Sugar yet one more thing that's driving our CSD portfolio. And that gave us strength combined with everything else I just talked about in the Packaged Beverage segment.

Bonnie Herzog: Okay. So, as I think about the second half, you expect some of this momentum to continue. Would that be fair, Bob?

Robert Gamgort: Yes, that's fair. And you can take a look at, I think, a very high level of info that we gave today, which is updating guidance for the balance of the year. So, it allows you to see a first half, second half calculation. And then we were very specific about within that,

what we're expecting in terms of coffee brewer sales as well as pod sales. So, you start - we're narrowing it down for you to give you what a Packaged Beverage business should look like.

Operator: And your next question comes from Kevin Grundy with Jefferies.

Kevin Grundy: Congratulations on the quarter. Bob, just picking up on your prior remarks but maybe bringing it up to a total portfolio level. So the 6% to 7% upwardly revised guidance is fantastic. This has been stair-stepped up from 4% to 6% previously and then 3% to 4% initially. So just maybe sort of again picking up on the last line of question, but bringing it more broadly to both the coffee and total LRB side of the portfolio, how has the view evolved over the past 6 months for you guys thinking about the portfolio? And the growth outlook, what specifically has come in better? What gives you confidence for the balance of the year?

And then longer term, and maybe you want to get into this more at the upcoming Analyst Day, what do you want to communicate to the Street in terms of what you think the sustainable growth rate is for this business longer term?

Robert Gamgort: Sure. The last part we will cover in some depth at the Investor Day, which is coming up, so I'll wait for that event to talk about beyond 2021. With regard to 2021, we're seeing strength across the board. So, in the decomposition of the year-to-date numbers that you've seen, you've seen strength in every single segment, and you've seen some mix benefits. So, for example, fountain foodservice and beverage concentrates, which are among our most profitable items, were negatively impacted in the year ago period. We're getting a good rebound on that. We're seeing continued strength in at-home coffee. Certainly not at the peak of consumption in home that we did a year ago, but we've been talking about that expectation since Q2 of last year. And then brewer sales continued to be exceptional. We're projecting for the rest of the year that those will be flat. But as Ozan said earlier, it certainly takes aside the concerns that many had that the incremental households we gained in 2020 and the extra brewer sales were a pull forward. That's certainly not the case.

So quite simply, we're seeing strength across the entire business. That's given us the confidence to take our revenue expectations up. And then anything in a first half, second half or quarterly comparison is really driven by the volatility of a year ago. And that's why I think it's really important to look at 2-year numbers to take the noise out. And it's easy for all of us to get enamored with

1 quarter performance. We've always taken a long-term view. And you're seeing a lot of rebound from other companies, but the reality of it is if you compare our numbers to 2019, our revenue was up almost 14%. Operating income is 20%, as I said before. Earnings per share is up about 30%. I think that's the real way to evaluate performance.

Operator: And your next question comes from Bryan Spillane with Bank of America.

Bryan Spillane: So Bob, maybe just to step back a little bit further, and I guess I wanted to get your perspective on two things. One is just given all of the supply chain, I guess, challenges or constraints, and this is - we're hearing this across a lot of companies, just how you're thinking about the balance of reinvestment or like stimulating demand, while it's just becoming more challenging to produce things.

And then maybe if you can also comment on just this whole environment with inflation and labor force being tight and just - have you seen this before? How does it change the way you think about just kind of how you're running the business day-to-day over the next year or so? I'm just trying to get a sense of just do things have to change because this just environment is so dynamic.

Robert Gamgort: Yes. I think we've seen a lot - a number of things in the past 2 years that we've never seen before in our career. Certainly, the shutdown of COVID and all of the related issues around keeping employees safe and running our operations under real constrained conditions was unique. I think this rebound, as I said in my remarks, in some respects, is actually more challenging than that because we're getting a lot of mixed signals. There's reopening in certain areas, and then there's problems in others. We've all dealt with inflation. We've seen it in commodities and input costs.

We've never seen this level of labor inflation, which is not necessarily a bad thing because there are consumers as well, so it gives them more purchasing power. But the labor shortages are something that none of us have seen in our career. And I have no idea how much of it is tied to government stimulus and concern about going back to work, how much is tied to the fact that kids need to be in school in the fall to free up the labor force who are watching the children. We're going to know a lot more when

September, October rolls around, but I'd say this is very much unprecedented in all of our careers.

The way that we're managing through it goes back to how we started in March of 2020 when we had to make some dramatic changes due to COVID. We stay very flexible. We're looking at the short term as well as the long term, but emphasis on not committing to anything for too long because we know it's going to change.

Your comments about supply chain disruptions, I'm calling it the new normal now. Hopefully, it's not normal. It's the reality we're dealing with. And we just flex when we have capacity in one area. We lean in more on demand generation when we have constraints and others. Certainly, we're not going to promote or spend incremental dollars promoting an area that we have supply constraints on. So the game is really going to be won or lost by speed and flexibility. That's something that we were able to do last year. And we're certainly doing it to even a greater degree this year. And I think that will continue until this all settle down.

Bryan Spillane: Okay. And then just - and maybe not even specific to KDP, but just would your expectation be that like it just doesn't stop at the end of the calendar year? Meaning this - some of these sort of factors could continue for a while? Or should the baseline expectation be that within the next 6 months or so, this should start to settle out?

Robert Gamgort: It's really hard to forecast. And I said in 2020, if I want to get out of the forecasting game and get into the reaction game, and I think that served us well. I listened to the Fed, and they don't know if inflation is short term or long term. And you even hear the President talking about supply issues, and they don't have a good handle on what's going on here. So, I'm not going to be a better forecaster than they. I do - if you really push us, I think we'll see this start to settle out in 2022. But again, it's going to be driven by the course of the virus and the variants. It's going to be driven by things like government stimulus. Those seem to be the two biggest factors in everything that we've just talked about.

Operator: And your next question comes from Lauren Lieberman with Barclays.

Lauren Lieberman: I wanted to talk a little bit about marketing spending because in 2020, where we all know that you pulled back on marketing spend quite a bit particularly in the CSD business and yet posted these tremendous market share gains, not just the sales growth. And so as you bring marketing back into the fold, I guess, one kind of short-term question, would you say, at this point you're kind of back to 2019 levels of spend on your - the CSD - the cold businesses, I should say, excuse me, number one?

And number two, as you think holistically knowing the plan is to reinvest any revenue upside into the business, but have you discovered better ROI on your spend that you think is sustainable rather than just was a function of the environment last year? And if so, what are maybe some of the key changes or areas where you're getting greater efficiencies?

Robert Gamgort: Yes. We have certainly been more efficient in our marketing, and that's a continuation of a trend that's been in place for a while now. The nature of marketing has moved from being more broad targeting to more precise targeting. We have a significant number of tools and metrics available to us today that weren't available even a couple of years ago. And so, the efficiency of our spend continues to increase, and that got pushed to an extreme during COVID, in which we were able to continue to generate demand, as you point out, with significantly lower levels of spend.

I think part of that was efficiency and a big part of that was a unique situation a year ago. And if everybody pulls back at the same time, really, it's execution, in-store availability, the right promotions that were driving a lot of demand. And we did that very well. But our intention is to continue to ramp our spending back up.

You see a big jump in our numbers this quarter versus a year ago. I think everybody experienced that. We, along with pretty much everyone in the industry, is not fully back to 2019 levels of spending, but we're ramping our way up. And I think we're doing it for two reasons. One is there are a lot of cost pressures on all of us right now and a lot of volatility. So it's prudent to be able to keep some in reserve as you're increasing your spend to say let's ramp it up versus go all at once because we need some offsets to volatility going forward in addition to productivity, efficiency and the pricing that we've put in place. And that's what I just said is true for everybody in the industry right now.

I think the second part is, it gives us an opportunity to really test efficiency. If you ramp it up, you can see where your next dollar is being spent, and it's a good return on investment. And that gives

you the confidence to add the incremental dollars beyond that back. So, our track is to continue to increase over time. We'll talk more about what the long-term projection of that is when we get together in September, but that's how it's playing out right now in 2021.

Lauren Lieberman: Okay. That's great. And as you also just think about continuing to reinvest in the business this year with any further upside you may see, what would you say are key areas, right? Because there's an element of we're getting greater efficiency in marketing. We don't need to go too quickly both because of the supply commentary that you talked about with Bryan and then industry kind of standard. What are other areas? I mean is it as you've kind of continued to change your route to market? What are the kinds of activities that you might be investing in there where some of this profit or sales-driven upside might go?

Robert Gamgort: Sure. When we get together in September, we're going to talk about the investments that we've made in the areas of R&D and product development. That's both on the hot side as well as the cold side of the business, and we'll give you some real examples of that. You point out route to market, which is critically important in beverages and something that we think is very unique. So the investments that we've made in our DSD system, which has been a big driver of growth, we've talked about it in bits and pieces over the earnings call. But when we get together, we'll be able to do a more holistic view of what we've done over the past 3 years and where that's going. And that's a big source of investment for us.

E-commerce is another area. It's hard for you all to see the sales that we're generating in e-commerce because it doesn't show up on IRi right now. But when you see the disconnect sometimes between our shipment numbers and the IRi numbers, with the shipment numbers being stronger, and that happens over time, you know that we're getting some significant growth out of e-commerce. And that's a big investment area.

And then just purely from a brand perspective, we would - as we add more money, we would add to the number of - add to our portfolio the number of brands we advertise. So right now, we focus our advertising on our largest brands. But we've got some midsized brands in there that are deserving of advertising as well, and that would be the next area that we would fund once we get to what we think is threshold on the large brands. So there's a lot

of opportunities for investment. We're very selective and test our way through it. But again, these are some of the themes that we look forward to sharing with you in September.

Operator: And your next question comes from Andrea Teixeira with JPMorgan.

Andrea Teixeira: I wanted to discuss a little bit more on, Bob, if you can, on the pod attachment rate. So, I think you guys said last April that it is too elevated. Your comments so far on the call have been very positive against the historical levels, but a bit off peak, right? So - and I wanted to kind of also get a little bit of - because I believe, Ozan, spoke to pricing during the quarter or planned pricing. So with the benefit of a few months since your last comment, can you update us what you're seeing as the office reopen and the at-home could moderate? Obviously, as you're seeing probably less than 1:1 trade-off with away from home more than offsetting the at-home kind of moderation at this point.

And on the beans, on the coffee beans and the green coffee, I think it's not that much of an impact for you, but can you kind of explain to us how protected or hedged you are and what are you embedding in your guidance?

Robert Gamgort: Okay. Yes. Let me just go with pod growth first and just remind everybody the formula for our pod volume. It's a combination of household penetration. In growth in household penetration, the number of new households that we're adding to our existing base times the attachment rate, which is the current usage per machine.

At this quarter a year ago, we saw a peak level of attachment rate as people were really in lockdown mode. And as we talked about it at that time, we saw that as temporary and that over time, that would revert back to the long-term average. Over the very long term, attachment rate is very steady, and that's why we've suggested prior to COVID that you could use pod volume growth as a good proxy for household penetration growth.

Very simply, our household penetration was very strong last year. We were up about 9%. We added 3 million households. We've - told you before that we expected 2 million additional households this year and that attachment rate would go back to the long-term average. It's exactly what's happened. The attachment rate that we're seeing right now is very much in line with what we've seen over the long term, and household penetration continues to grow. And that's what you're seeing in the pod volume growth.

So, so far, everything has gone as expected. When we look at mobility, we're seeing a significant increase in people going out of the home into restaurants and hospitality. Certainly, people going and getting coffee out-of-home in coffee shops has gone up significantly. In fact, we saw a bit of a spike at one point in the early part of reopening. I think people felt liberated to go back out and wanted to enjoy a coffee on the go.

The one area that has been lagging and continues to lag is office. So even with the strong numbers that we have in our coffee business, we're still getting a fairly significant headwind out of the away-from-home business, which for us is concentrated in offices.

And very similar to the question Bryan asked, it's hard for us to predict what's going to happen there. We see an improvement versus a year ago. You couldn't get much lower than the numbers we saw a year ago and away from home, but nowhere near back to normal, nowhere near back to 2019. So that provides long-term or longer-term upside for us. And as we said before, that's a higher-margin business, so it will be accretive to both top line as well as mix. But we think that will be a slow recovery, and that assumption is embedded in the numbers we gave you.

With regard to pricing, like everyone who has a coffee business who has reported so far, we've talked about the significant increase in coffee pricing. We are hedged like everyone else. But hedging, it just delays the pricing, it doesn't make it go away. And so our best practices have always been is that when we see an increase in pricing that we believe will be sustained that you take pricing now, because it takes time for it to flow through the system, and you know that you're eventually going to be paying that price when you add new coverage into your portfolio.

With regard to us, you're right, coffee is a lower percentage of our cost structure compared to if we were just a traditional roast and ground player. But when you have a significant increase like we're experiencing right now, it certainly does impact us to the level that we want to take pricing.

And then the last point I'll add because I think you're asking about the different forms of pricing, we have big piece of our business are brands that we own or license. We're responsible for everything on those, so we've taken pricing on that because we pay for the coffee that's in that. And then the remainder of our business is either partner or private label. In most of those situations, the partner is responsible for the price of coffee. We're responsible for everything else. So, it's really up to them to decide what they want to do from a pricing standpoint with regard to

coffee. That's not something we get involved in. So, I think I've covered everything you asked about with regard to coffee.

Andrea Teixeira: That's super helpful. But is there like - if I can just ask on that, what are you seeing in terms of like any trade downs to your private label or the ones that you represent, as you said, the brand that you have passed through, how is that reacting?

Robert Gamgort: It hasn't really. If you take a look at the IRi numbers, you haven't seen much pricing actually reach the shelf right now. So, it's more to come. That will be something we could talk about on the next quarter call about what that impact is. But typically, we don't see much in the way of trade down. But if we do, I will just remind everybody that we have - we manufacture pods that are generating 83% of category sales. So, wherever the consumer goes in terms of brand choice and wherever they go from an outlet in terms of where they buy it, we got it covered. And so, we're fairly neutral in those perspectives, and we just give the consumer choice and let them decide what they want to buy.

Operator: And your next question comes from Steve Powers with Deutsche Bank.

Steve Powers: Bob, just to round out that conversation on coffee, so what I took from just the cadence of what you described is that you're implementing pricing down that pricing builds over the back half. And then presumably the delayed inflation to the extent it manifests would be a 22 phenomenon. You'll have the pricing in place when you get there. Is that better way to think about it?

Robert Gamgort: Yes, that's a good way to think about it, yes. And the pricing and the costs never match up exactly, and that's why we always create some margin for us to smooth that out, but that's a reasonable assumption.

Steve Powers: Great. And I guess - and maybe just a little dovetail into some of the themes you talk about in September, but I just - maybe just an update on the build-outs that you've had going on at Spartanburg and Allentown and in Ireland and just where those are, any

unexpected development, positive or not so positive? And then just any way to think about the impact of that on - the benefits of that on the business as we go forward beyond '21.

Robert Gamgort: Absolutely. Yes, I think it's a good time to talk about that. Ozan, would you like to jump in and update Steve and everyone on those projects?

Ozan Dokmecioglu: Absolutely. Absolutely. Steve, with regards to Allentown, we began our production of cold average cases earlier this year. And as we speak, we are proceeding to ramp up to reach full utilization levels, and it will continue through this year as well as 2021. Also, as a side note, the combined cold beverage and coffee warehouse that we put together in Allentown is also fully operational.

With regards to Spartanburg, we began to produce some of our K-Cups as being the first line back in June, which is very recent. And we'll continue to ramp up over the course of approximately 18 to 24 months and the reason being is due to the sheer size of the huge volume and the planned capacity that we have been implementing. And the lines will be coming up and running in a sequential, let's say, order.

With regards to the investment in the project in our Ireland facility, the concentrate beverage plant that we have been building, is almost complete. And we are expecting to put into service and ramp up from there on sometime in quarter 4 this year. Therefore, after the COVID related some delays, as we have communicated in 3 major of our investments, we are back on track. We have been getting the lines up and running in line with our new timelines right now. And we are very happy with the progress that we have been seeing.

Operator: And your next question comes from Sean King with UBS.

Sean King: In the prepared remarks, you mentioned the macro volatility lasting for the next 6 to 12 months before sort of seeing normalized consumer behavior. Is it safe to say that this could impact, I guess, the pending outlook for '22? Or am I trying to jump ahead a little bit too far here?

Robert Gamgort: Yes, it's a little jumping ahead a little bit. I mean clearly, we think about this and going into '22, but I wouldn't have any read-through in terms of trying to predict what that means for us in 2022. I think we've done a really good job of recognizing the challenges and

being able to mitigate them pretty substantially if you take a look at what's happened last year and what's going on this year. And look, I can't forecast that. I can tell you that we all hope that things start to return to more normal in 2022.

Sean King: Right. Great. One more, if I could just sneak in. Just on the substantial brewer growth that you've been seeing, is there any way you can kind of break that down between brewer replacement, new brewers versus trading up? And I know a lot of that has to do with your household penetration comments, but any color you can provide around there would be great.

Robert Gamgort: Yes, it's really hard to do that in the moment. We're always able to do that in hindsight, and we do quite a bit of analysis of understanding how much of these are brewer upgrades versus straight-up replacements versus completely new households or even a secondary placement in an existing household. So that's something that we dig it in we're able to see in hindsight.

For perspective, a year ago, we added 3 million net new households, and we sold 11 million brewers. So that gives you an idea of how much household penetration growth we were able to drive, which was substantial, almost 10%. But at the same time, we continue to offer better brewers with new features that are encouraging people to upgrade. And although an upgrade is not something that we profit from in the moment because we don't make money on the brewers, as you know, it really is a serious recommitment for those households to stay with the Keurig system for the long haul because the model is dependent upon not just bringing in new households but also keeping our current households, which we do at a very high rate.

And so right now, it's hard to know the breakout, we are offering really attractive brewers that offer new benefits. We just launched this week the K-Supreme Plus Smart Brewer. If you go online and look at some of the reviews both on our website from consumers as well as from the media, it's getting terrific reviews. And I just think this will be yet another reason for people to upgrade. So, something we'll share with you when we have it, but it's a very, very bullish indicator in terms of the health of the business from both the current households as well as new households.

Operator: And your last question comes from Chris Carey with Wells Fargo Securities.

Christopher Carey: Just following up on the line of questioning around pricing. I guess I'm conscious that you're seeing like polypropylene inflation in one of the categories where you have a stated strategy to actually lower pricing. Obviously, you have these new plants coming online. You're announcing pricing in the back half. But I guess, can you just comment maybe on like holistically how do you think about offsetting inflation? And certainly, one could argue an area like packaged beverages probably has a bit more maybe like structural pricing power in North America right now than does pods. And so maybe just comment on that. I guess it's - you're seeing positive pricing in coffee systems this quarter for the first time. I realize that's mix driven. But I just wonder if we're on the verge of seeing that stabilize and potentially rebound with inflation, if you're comfortable with that concept. So, anything just around conceptually how you're thinking about offsetting inflation with pricing on a sort of a total portfolio basis would be helpful.

Robert Gamgort: Yes. So, I think our entire portfolio has good pricing power, which is one of the reasons why I think beverages is a great category. We are aggressive in productivity and efficiency as our first line of defense. We implement all kinds of purchasing strategies, hedging, as I said before, being one that delays the inevitability of inflation. It gives you some short-term pricing certainty but doesn't eliminate it. And then of course, pricing, when it can't be covered by the others, is the ultimate answer. And you're seeing pricing now not just in the beverage industry but across the board. I have absolutely no concern with pricing in coffee.

As we talked about it, 3 years ago when we talked about it publicly, but it's been in progress now for 5 years. We wanted to lower the price of coffee pods in the U.S. because we knew they were too high. And when we compare them to steady-state rates around the world, they were way out of comparison to those 5 years ago.

The price has been reduced significantly. And the data that we put in our Investor Day deck in 2018 is very relevant in terms of what the right price point is for consumers. And it shows that, to a degree, the industry has actually overshot that and its pricing it below the levels that consumers thought would be a good value. They're doing it for a variety of reasons, and I've talked about it before. There are retailers who know that K-Cups are a real attraction to consumers, and so they'll price them very low just to bring people in. Putting a little bit of pricing in to recover inflation is not a concern at all given where we stand across the industry in

pricing. And I think price stabilization is something that we've talked about happening for a long term. It's already happening as we speak. And I still think it's an incredible value to consumers.

Christopher Carey: And I appreciate right the end of the call, I'll keep this quick. But just on the roll-out of zero, is there a way to think about how long this launch could go before getting it fully penetrated? You're running 2 to 3 share. But obviously, other Zero offerings from competitors have had kind of like years of runway. Just how you're thinking about the time horizon from which this can continue to benefit the portfolio.

Robert Gamgort: Yes. My - we've been successful in driving growth in our CSD portfolio now for years. We've done that through a combination of very solid marketing and good market execution on our core brands and by bringing news and refreshment to them. And it's hard to put a timetable around what is any one line extension or refresh to do for the brand. So, we have a constant stream of them. Think about what Dr Pepper and Cream has done for the Dr Pepper brand, and that's still growing right now. I think zero sugar both on Dr Pepper and across our flavors is a similar platform.

And we have additional innovation and renovation ideas to come that we'll be layering on top of that in the future. And that's really the game is that you don't launch something and assume that that's the answer forever, that is part of the news that you're delivering. And that's how we think about this as well. So, thanks for that question.

Operator: All right. There are no further questions at this time. I'll hand the call back to the company.

Tyson Seely: Thank you. This is Tyson, everyone. Thank you for the time. I know we're slightly over, and you all have very busy days today. Please reach out to myself or Steve or the IR team for any follow-ups. We look forward to talking to you. Have a good day.

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