Keurig Dr. Pepper Inc.

Q1 2022 Earnings Call

April 28, 2022

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 2022. This conference call is being recorded. And there will be a question-and-answer session at the end of the call.

I would like to introduce Keurig Dr Pepper's; Vice President of Investor Relations, Mr. Steve Alexander. Mr. Alexander, please go ahead.

Steve Alexander: Thank you, and hello everyone. Thanks for joining us. Earlier this morning, we issued our press release for the first quarter of 2022. If you need a copy, you can get one on our website in the Investors section. Consistent with previous quarters, today we'll be discussing our performance on an adjusted basis, excluding items affecting comparability.

Beginning with this quarter we will also exclude the impact of foreign currency translation from our adjusted results. 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 provided 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 us today to discuss our first quarter 2022 results our 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 on subsequent events. A detailed discussion of these risks and uncertainties is contained in the company's filings with the SEC.

And with that, I'll hand it over to Bob.

Bob Gamgort: Thanks Steve, and good morning, everyone. Our Q1 results reflect different stories of challenges faced and progress achieved across our portfolio. One common thread, however, is the continued strong consumer demand for our brands as demonstrated by consumption growth and share expansion.

In Coffee Systems the story is one of accelerated supply recovery to enable us to fuel the continued strong growth of the Keurig System, following our addition of six million new households in the past two years. As discussed previously, the December-January Omicron wave caused widespread labor outages that resulted in supply shortfalls in coffee pods, at a time when consumer demand was at a record high. As the first quarter progressed, we accelerated our efforts to rebuild pod manufacturing capacity, increase finished goods inventories and improve service levels.

Our first coffee pricing actions intended to mitigate inflation, also begin hitting sales in the quarter with single serve cup -- coffee pod’s pricing up more than 5% at retail during the quarter, with additional pricing still to come. Across our cold portfolio, it's a story of continued volume growth at the same time we're implementing meaningful pricing action with the combination leading to double digit revenue growth in package beverages, beverage concentrate in Latin America Beverages. Given that, we’re still in the steep portion of the inflation curve, the timing of pricing is lagging inflation, which leads the pressure on margins.

Looking forward, we believe there will be an inflection point and which high current costs, begin to lap elevated year ago costs, leading to lower year-over-year inflation comparisons. At the same time, pricing actions will have caught up, which we expect we will lead to margin recovery. As we look forward, we believe our cold beverage portfolio will continue to perform well throughout the balance of the year and we are confident that our coffee production output and inventory levels will have fully recovered by the end of Q2. Therefore, we have increased our 2022 full year guidance for net sales from mid-single digits to high-single digits, while maintaining our EPS guidance at mid-single-digit growth.

Looking at Q1 earnings and EPS, Ozan will discuss the key drivers of results in the quarter. But the biggest headlines of the relationship between inflation and pricing and the investments we've made in the business, particularly in coffee. Taken together, we delivered modest net earnings growth and adjusted EPS in-line with year ago.

During the quarter inflation, which was significant across the board particularly for inputs such as coffee, resins, aluminium, and sweeteners, as well as transportation and labor approached 15%, which is higher than we expected entering the year. Within our segments, Packaged Beverages again reported another standout quarter with net sales advancing 13% on volume growth of 5% and pricing up 8%.

In-market performance also remained very strong with market share growth registered in almost 90% of our cold beverage portfolio, led by continued strength of CSDs, along with seltzers, coconut waters, teas, apple juice, and fruit drinks. Performance of Snapple and Core continued to improve from the material availability issues faced in 2021 with both brands posting improved market share results in the quarter and upcoming innovation and marketing plans for this summer expected to accelerate this progress, Bai continues to recover from supply issues last year, posting consumption growth for the past four consecutive quarters.

Margins for Packaged Beverages were impacted by escalating inflation, which outpaced the timing of pricing, as well as ongoing transportation and labor challenges. We expect new pricing actions already announced to the trade to be in market, late in the second quarter.

In Coffee Systems, we under-shipped consumption with negative KDP net sales for the quarter, comparing to 3.6% K-Cup pod consumption growth as measured by IRI. You'll recall from our fourth quarter discussion that record consumer demand for K-Cup pods was challenged by production shortfalls, as Omicron-related labor availability issues combined with the delayed start-up of our new Spartanburg manufacturing facility pressured our capacity.

We prioritized our service recovery during the quarter to partners and customers at the expense of our owned and licensed brands to rebuild our internal inventory levels. While that was the right decision from a Keurig ecosystem perspective, it came at a significant cost to KDP in terms of both revenue and profit. We made significant progress during the quarter in restoring our coffee supply chain with K-Cup pod production, finished goods inventory and customer service all improving by double-digits.

We now expect a full inventory recovery by the end of Q2, enabling Coffee Systems to return to normal service levels in the second half of this year. Supporting this recovery is new manufacturing equipment, we expect to come online as the year progresses, which will ensure supply to meet strong consumer demand in the second half of this year and in 2023. As we continue to work on coffee recovery and rebuild our finished goods inventory in the second quarter, we expect pod shipments to remain below consumption.

That trend is expected to reverse in the second half of the year with shipments outpacing consumption, as improved internal inventory positions will enable us to refill customer and partner inventories and return to driving our owned and licensed brands through marketing and promotion programs. This will result in a much improved top and bottom-line performance for Coffee Systems in the second half of this year.

Pricing in coffee has also increased to mitigate the impact of inflation. Single-serve coffee category pricing increased 5.4% in the quarter, as pricing actions continued to flow through at retail. KDP-manufactured brands pricing advanced 6.7% in the quarter. Given the escalating inflationary pressures, we recently announced another round of pricing that will be in market late in the second quarter. While navigating through the well-discussed macro challenges over the past two years, we have also maintained our focus on driving long-term sustainable growth through innovation, renovation and partnerships across the full KDP portfolio. Although these topics have received less airtime in our recent conversations, I'd like to take a few minutes to do so now, starting in Coffee Systems.

You'll recall that in 2021, we debuted a new platform for Keurig with the launch of the K-Supreme Plus SMART connected brewer. This is the first of many new connected brewers to come including the K-Cafe smart later this year. Consumer response to our connected brewer continues to be positive and we believe that we will have more than one million connected households in the next few years.

In 2021, we also launched our popular Brew Over Ice feature on one of our smallest footprint brewers, our K-Slim + ICED coffeemaker, which debuted as a Target and keurig.com exclusive. More than half of K-Slim + ICED purchasers were households completely new to the Keurig system. We will be expanding retail availability of this model late this summer.

Next week, we are launching the new K-Cafe Essentials model, our first brewer less than $100 that offers coffee lattes and cappuccinos through a built-in milk frother. This brewer has scored an average 4.8 out of five stars in our consumer and influencer review programs and we look forward to its debut as a Walmart exclusive. In terms of coffee innovation, in January, we launched a Snickers-flavoured K-Cup pod under The Original Donut Shop brand as an expansion of our flavoured platform. This new product is already a top-selling variety, where distributed with a national rollout planned for later this year.

Lastly, we are pleased to announce the Community Coffee the largest family-owned retail coffee brand in the US, will be returning as a Keurig partner brand at the end of this year. The relaunch of our partnership after a five-year hiatus is a testament to the quality, innovation, service and consumer insights the Keurig ecosystem can provide to coffee brands. We look forward to working together with Community, the Community team to help accelerate their brand growth.

Shifting to cold beverages. We're excited to announce that we have agreed to make a minority equity investment in Tractor Beverage to expand innovation in the fountain and foodservice channels. Available nationally in Chipotle restaurants since 2020, Tractor offers the first and only certified organic non-GMO beverage solution, specifically tailored to foodservice operators. To enable Tractor to achieve widespread distribution across multiple food service channels, we have also agreed to enter into an exclusive sales agreement with Tractor that leverages the strength of our fountain foodservice sales team.

KDP cold beverage innovation and renovation continues to be robust and we have recently launched Snapple zero sugar; and Snapple Elements, a new line of teas and juice drinks inspired by the elements fire, rain and air.

Snapple Elements line is made from all-natural ingredients with no artificial flavors or sweeteners and less sugar than traditional Snapple beverages. Snapple zero sugar is a rebranding of Diet Snapple, similar to what we've done with several key CSD brands, resulting in increased velocity.

During the quarter, we launched two new CSDs, Simple 7UP, a new 7UP line with clean simple ingredients and reduced sugar; as well as Sunkist mango orange to expand our fast-growing Sunkist brand line-up. Finally, returning this summer as a limited-time offer is a fan favorite Dr Pepper Dark Berry, including zero sugar variety. The launch will feature promotional packaging tied to this summer's release of Jurassic World Dominion.

I'll now turn it over to Ozan to take you through more highlights of the quarter. **Ozan Dokmecioglu:**

Ozan Dokmecioglu: Thanks, Bob and good morning, everyone. I will start with a brief review of our first quarter business and financial highlights and then turn to our outlook for 2022. As usual, we will be discussing our performance on an adjusted basis. And as Steve mentioned, beginning this quarter, our adjusted results now exclude the impact of foreign currency translation.

As mentioned earlier, our top line was again quite strong for the quarter, as Packaged Beverages advanced a significant 13%, along with very strong growth for Beverage Concentrates and Latin America Beverages.

As expected, Coffee Systems net sales declined in the quarter, as the segment prioritized shipments to branded and private label partners and to rebuilding inventory, which improved sequentially in the quarter. All in, net sales advanced 6.1% to $3.1 billion, with net price realization up 6.3% and volume mix down slightly. Excluding Coffee Systems, net sales advanced 12.8% and volume mix was up 4.6%. On a two-year basis, net sales for the first quarter increased 17.5% versus 2020 with all four segments growing.

Adjusted gross profit was up 1% in the quarter, benefiting from the impacts of the significant pricing actions we put in place and productivity savings. Escalating inflationary pressures, combined with ongoing supply chain disruption and labor constraints were significant offsets, as the timing of pricing continues to lag inflation. As a result, adjusted gross margin declined 280 basis points versus year ago to 52.7%.

Adjusted operating income declined 1.2% in the quarter, reflecting the significant impact of inflation, including the ongoing impacts of macro supply chain and labor challenges, partially offset by our strategic asset investment and other benefits that enabled continued investment in the business. Adjusted operating margin declined 170 basis points to 23.8%.

On a two-year, basis adjusted operating income increased 6.7% versus 2020. Despite the inflationary pressures, we maintained our investment in brand marketing. In fact, while we reduced the spending in Coffee Systems due to supply limitations, we increased marketing spending in our cold beverage brands by 7%. During the quarter, we also made significant investments to accelerate coffee recovery and get us back to normalized inventory positions and service levels to realize our full growth potential in the second half of 2022. Those investments were focused on additional labor, warehousing and transportation capacity.

As Bob mentioned, we prioritized partner and customer brands over our owned and licensed brands for the long-term benefit of the ecosystem, but with a short-term profit and revenue hit to us in the quarter. These incremental investments were paid for in part by a $38 million benefit in the quarter from our strategic asset investment program, along with a $28 million benefit in non-cash stock compensation expense and a $28 million benefit in legal fees.

Adjusted net income in the quarter increased approximately the 1%, primarily reflecting lower interest expense, partially offset by a higher adjusted tax rate. Adjusted diluted earnings per share was $0.33 in the quarter, essentially even with year ago. Free cash flow for the quarter at $632 million continued to be strong, driving a free cash flow conversion ratio of over 133%.

During the quarter, further strengthening our cash position, we received a $350 million settlement from the successful resolution of our litigation against BodyArmor, which was used to reduce financial obligations. At the end of the quarter, unrestricted cash on hand totaled $592 million. As announced earlier this month, we completed a $3 billion strategic refinancing given the current interest rate environment. Since the time of the merger nearly four years ago, we have generated significant cash flow and rapidly delevered. This strategic refinancing further strengthens our balance sheet and liquidity profile with extended maturities and more favorable rates that will lower our interest expense.

Turning now to our segment performance in the quarter. Packaged Beverages again delivered double-digit net sales growth with the first quarter up more than 13%, driven by favorable net price realization and higher volume mix, the latter reflecting continued market share expansion and strong in-market execution across the portfolio. On a two-year basis, net sales increased an impressive 21% versus 2020. Adjusted operating income increased 16.9%, reflecting the strong net sales growth and productivity combined with the strategic asset investment program benefit of $38 million.

These benefits were significantly offset by the unfavorable impacts of escalating inflation and macro supply chain disruption and labor constraints that drove higher-than-anticipated costs to serve the continued strong consumer demand we experienced. Beverages Concentrates also posted double-digit net sales growth approximating 10% in the quarter led by favorable net price realization and higher volume mix. The volume mix performance was driven by higher fountain foodservice volume due to improving, but still recovering consumer mobility in restaurant and hospitality channels. On a two-year basis, net sales advanced almost 17% in this segment.

Adjusted operating income increased 3.3% in the quarter, driven by the strong net sales growth, meaningfully offset by the impacts of escalating inflation and a significant increase in marketing investment. Latin America Beverages also posted double-digit growth in net sales approximating 18%, essentially, balanced between higher net price realization and increased volume mix. On a two-year basis, Latin America net sales increased an impressive 26% versus 2020. Adjusted operating income increased 13% reflecting the strong growth in net sales, partially offset by broad-based inflation and a significant increase in marketing investment.

And finally, Coffee Systems net sales in the quarter declined 4.3%. This reflects the impact of rebuilding our internal inventory positions combined with prioritizing shipments to branded and private label partners for which we receive lower revenue recognition per pod than we do with our owned and licensed brands. In addition, Coffee Systems faced a significant comparison to the first quarter last year where net sales increased 17%.

On a two-year basis, Coffee Systems net sales increased 12% versus 2020. We achieved higher Coffee Systems net price realization of 3.2% in the quarter, which was driven by pricing actions taken primarily on our owned and licensed pods in late 2021, and the first quarter of 2022 combined with sequentially lower retailer fines incurred in the first quarter.

Lower volume mix in the quarter of 7.5% reflected comparison to the strong 19.5% growth in the year ago period and the impact of our coffee recovery program. Consequently, pod and brewer shipment volume declined 5.2% versus a year ago comping the strong growth of 14% and 61%, respectively in the year ago period.

Adjusted operating income decreased 24% in the quarter. While this performance reflected the higher net price realization we achieved, it continued to lag inflation and the cost of our recovery plan. This plan which will continue through the second quarter accelerated customer service recovery to partners and retail customers quickly. However, it added significant costs during the quarter.

I would like to spend a moment discussing our expectations as the year unfolds in the context of the first quarter. We expected the first quarter to be our most challenging period this year due to the timing dynamic between inflation and pricing and in comparison, to quarter one last year before inflation spiked, coupled with our need to invest heavily in coffee supply. With the first quarter now behind us we continue to believe it will prove to be the toughest this year. During the quarter, we delivered strong brand growth, implemented new pricing actions, and delivered significant improvements in coffee production, customer service levels, and inventory.

As we look ahead, we expect continued strong revenue growth, driven by innovation, renovation, partnerships and are pleased that we will be in the position to invest in marketing to restore full demand to our coffee business in the second half as inventories are rebuilt. As discussed, this morning, accelerating coffee recovery and investing in our cold beverage marketing came at a cost in quarter one. However, we have the flexibility to leverage our strategic asset investment program and other one-time benefits to cover these investments. This puts us in position for accelerated revenue growth in second half, including unconstrained growth in coffee.

Looking ahead inflation still looms as the greatest challenge and has proven difficult to forecast even for the experts. We continue to lock in coverage on all items where possible have implemented additional pricing and are ready to add more pricing if required. We have and will continue to protect our marketing investment as we believe brand strength and stability to lessen pricing elasticity is a key competitive advantage for KDP.

As discussed on the last call, we also see the strategic asset investment program as an ongoing effective tool to drive marketing investment in an environment marked by significant cost pressures. Our confidence in our top line led us to increase our guidance for full year net sales growth to the high single-digit range while reaffirming our full year guidance for adjusted diluted earnings per share growth in the mid-single-digit range. Supporting this guidance, we continue to expect the following unchanged assumptions.

Adjusted interest expense is expected to approximate $430 million including the benefit of our recent strategic refinancing, which was planned early this year. Adjusted effective tax rate is expected in the range of 22% to 22.5%. Diluted weighted shares outstanding are estimated to be approximately 1.43 billion.

Finally, while we don't provide quarterly guidance, given the current environment, I want to share that we expect the second quarter to show modest sequential adjusted earnings per share improvement versus the first quarter with more meaningful improvement in the second half. Specifically, we continue to expect adjusted earnings per share to strengthen during the year reaching the high single-digit range in the second half which would put us on our long-term algorithm for the period translating to mid-single-digit growth for the full year.

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

Bob Gamgort: Before moving to Q&A I want to recognize Steve Alexander for his recent promotion to Vice President of Investor Relations. Many of you on this call have had the opportunity to work with Steve during his 15 years with KDP and Dr Pepper Snapple and have benefited from his strong understanding of the beverage industry.

And finally, earlier this month, we announced that I will be transitioning my CEO role to Ozan at the end of July, and I will remain Executive Chairman for the following two years. This transition was designed to ensure continuity of leadership and strategic direction for KDP as well as to enable dedicated focus on the new and very significant inorganic value-creation opportunity we have in front of us.

I have tremendous confidence in Ozan based on working side by side with him over the past six years and I'm excited about the opportunity to continue to partner with him, the KDP executive team, and the KDP Board of Directors over the next few years.

With that, I'll turn it back to the operator for Q&A.

Operator: Ladies and gentlemen, as a reminder, if you would like to ask a question, please press *1 on your telephone keypad. Again, if you would like to ask a question, please press the *1 on your telephone keypad. We will pause for just a moment to compile the Q&A roster.

Your first question comes from the line of Bryan Spillane with Bank of America. Your line is open.

Bryan Spillane: Hi, thanks operator. Good morning, everyone and congratulations to Bob to you to Ozan and Steve on all your new roles.

Bob Gamgort: Thanks Bryan.

Ozan Dokmecioglu: Thank you.

Bryan Spillane: So, the I guess my question -- I have a couple of questions just around Coffee Systems. One is just -- you talked about new capacity coming online. So just want to make sure we're clear about when that will be. And at what point in the year do you think that service levels will be optimized, right? Are we still six months out a year out? Just at what point do we think service levels will be normal?

Ozan Dokmecioglu: Yeah. Again, good morning, Bryan. Thanks for the question. Let me start with your first question with regards to the coffee capacity and the production availability. As we announced during -- starting actually middle of last year, we were expecting some slowdown ramping up our state-of-the-art manufacturing facility in the K-Cups in Spartanburg slowing down. But during our last call, we also announced that Spartanburg will be turned on primarily in 2023. So that was our stance. In the meantime, we've also gone through a significant consumption demand coming from our consumers. And as we always do starting last year onward, we actually acquired new production lines utilizing the existing technology that we have. And we are commissioning them as part of our ramp-up plans.

Therefore, two-third of that capacity already went in and one-third is also going to coming online in the upcoming quarters. Therefore, we feel good where we are with regards to managing our overall coffee production capacity. And also, just to add you also asked the question when we will be feeling good in terms of restoring the capacity that we will be requiring and needing. And as we spoke to during our prepared remarks, we have seen sequential monthly improvements of restoring our production capacity. That includes inventory. That includes our service levels to our partners, to our retailers as well as our owned and licensed. And we expect actually to fully restore our capacity including all those spaces sometime in quarter two. Therefore, we feel very good where we are, and it took a few quarters to go back to the levels that we were requiring for.

Bryan Spillane: Thanks, Ozan. And just one follow-up just staying with coffee and pricing. We've fielded a lot of questions about consumers potentially trading down and demand elasticity. But maybe Bob could you talk a little bit about how you see pods as a relative value to coffee away from home? And is that really maybe the more sort of tangible comp especially since, coffee away from home the prices and the inflation there has been pretty meaningful. So just trying to understand if we should when we're looking at elasticities and cross-elasticities is it really away from home more so than people maybe trading up and down within the coffee aisle?

Bob Gamgort: Yes. Well, I'll start Bryan with in-home, which we think is very relevant and we can talk a little bit about away from home. But we put in this strategic pricing investment over a number of years, and we've had a lot of investor questions about this as well. So, if you go back to 2016, before we implemented it, the cost per cup which is the relevant measure of K-Cup pods versus bag coffee for example was a $0.30 per cup premium. We lowered that to $0.20 per cup during that investment and we saw tremendous consumer response.

Now we're moving up in price, but the game as you point out is really a relative game. And if you look at now the difference today between K-Cup pods and bags it's still $0.20. So, we're maintaining that $0.20 differential while we're taking our pricing up which we think is the most relevant comparison.

With regard to away from home, it's hard to come back with an exact number to be able to measure that against but we know that we're talking about an average price per pod or price per cup of $0.50 for K-Cup versus $0.30 for bag coffee. You're talking about a multiple of that somewhere between five and 10x depending on what you buy out at retail and that gap continues to get wider and wider. And so, we see as people get concerned about pricing clearly, there's a trade-off from away from home to in-home which benefits the entire category, but our price gaps versus other forms of roast and ground coffee have stayed the same at that lower level that we guided to in 2018-2019.

Bryan Spillane: Great. Thank you.

Bob Gamgort: Okay.

Operator: And your next question comes from the line of Bonnie Herzog with Goldman Sachs. Your line is open.

Bonnie Herzog: Hi. Thank you and congratulations from me as well for everyone. I have a few questions this morning on your guidance. I guess, first on the top line your updated guide implies top line growth in the high single-digit range for the remaining quarters this year plus some. So, I guess what gives you guys the confidence that your top line can accelerate? Especially since -- I'm thinking about your Q1 results, which were driven entirely by price realization, so I guess I'm asking about this in the context of the increasing pressures on consumers and kind of a little bit of what you just touched on as it relates to elasticities.

And then on the bottom line, I guess, I'm trying to understand how you're factoring in some of the one-time items such as benefits from the gain on litigation settlement that you called out and continued sales leasebacks. I guess it seems like these did help to drive your slight EPS beat in the quarter. So how should we think about these items for the rest of the year? And how many points of growth do you expect from one-time items in your EPS guide? Thank you.

Bob Gamgort: Okay. I'll start with the top line and then I'll ask Ozan to pick up the second part of your question there. With regard to the top line, you have to pull apart the quarterly results by coffee and all other. And all other businesses outside of coffee, so that's LAB, BC, and Packaged Beverages, were up, all to up double digits. And they were up in terms of pricing, but also volume. In fact, volume was up fairly substantially across those. So, our confidence is not that it's just all pricing driven, as we're seeing really strong growth in both. And our expectation is that that continues.

We talked about more pricing being implemented. Of course, we've built our model around elasticities and the kind of elasticities we've seen and we expect going forward. So that's where we get the confidence on the cold side. The coffee side of the business, which was a significant drag on growth in the quarter, we know, will recover substantially in the second half of the year, for a couple of reasons. One is, we made substantial investment in the first quarter to accelerate our coffee recovery. And part of those one-time benefits you talked about, were used to fund those investments and Ozan will talk about that in a minute.

But that puts us -- that acceleration puts us in great shape, because as Ozan just said, we believe our customer service levels will be back to normal by the end of the second quarter, which means that we can have unconstrained sales in the second half of the year. We've been pulling back on shipments. We've also been pulling back on promotion and advertising in the first quarter. So, we can go back to unconstrained demand for coffee in the second half of the year.

And then the other point on coffee is, we're under-shipping consumption for the first half of the year. That flips around in the second half of the year. And we have the opportunity with the increased internal inventories to restock customers, partners and then again be able to turn on the promotion and marketing. So, the combination of all of those leads us to the confidence that the second half of the year will be in that high single-digit range that we guided. Ozan, do you want to talk about the investment we made off of some of those discrete benefits?

Ozan Dokmecioglu: Absolutely, absolutely. And thanks for your best wishes as well, Bonnie. So let me start with the strategic asset investment program which we also define as one-time benefits that we have incurred. First of all, as you would remember, we have been implementing these initiatives since 2019. So, there is no new news or no new initiative or implementation with regards to that.

So over time, we have leveraged, as I was saying, the strategic asset investment program to cover investment and the significant inflationary and macro challenges. So, this is important to understand the sources and the use cases.

Then we also have occasional benefits that we can utilize in exceptional times, like, this that allow us to continue to protect investment in the growth of our business, which is super important to us, so we can continue to innovate and support our brands, which is one of the reasons why our elasticities have held up to this point very nicely.

Going forward, as opportunities arise, we expect to use the strategic asset investment program as an effective tool or the single factor to drive marketing and other investments when required. Exact timing of these transactions is not predictable, because we take an overall holistic perspective and on an annual basis. So that's the important part.

And I'd like to take the opportunity to expand for a little -- for five seconds on the other two one-times that you have mentioned, which one of them was the stock comp benefit. Now that we have almost four years of history as a public company, we have transited to estimating our restricted stock for futures raised, as opposed to actual events, which is in line with industry practice. So, both practices are 100% in line with the US GAAP, as well as how our peer group is treating this type of expenses.

And on the legal fees, over the past few years, we recognize as ongoing expense costs related to our litigation against BodyArmor. And with the settlement agreement in our favor, we simply recognize the return of our legal fees to ongoing results and that will be it. Thank you.

Bonnie Herzog: All right. Thank you.

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

Lauren Lieberman: Great. Thanks. Thanks so much. So, I was curious to talk a little bit about the go-forward in terms of the announced management changes. I mean, Bob, as you move into an Executive Chairman role, I'd love to hear a little bit about how you'll be spending your time. I know it was in the release you talked about M&A, but just where your focus areas will be.

We've talked about the big kind of check book that you, as a company, will have at your discretion. So curious about how you'll be focusing those efforts a little bit more. And then Ozan, I mean, you and Bob have been partners since the start. But curious also as you're thinking about the path forward, things that you think you can add where you can add value in a different way than you already have been in your current position. Thanks.

Bob Gamgort: Sure. Bonnie, for me, first, there's really three areas of focus as we go forward. One is continuing to lead the Board, as we've evolved the Board overtime from being closely held to widely held and that also will continue to evolve somewhat over time. And so that's an important part of my role. Second part of it is working with Ozan on the executive team to make sure that the transition is seamless, and that we continue the great momentum that we have on the organic delivery of our business, and I have a ton of confidence in that. And then the third part is, to give some time and space for me to work on the inorganic opportunities in particular M&A. Wouldn't be a surprise to anyone that the last 2.5 years or so have been very intensely operationally focused, very much managing it seems like everybody in the industry from one crisis to the next.

And while that's critically important and is the right priority it doesn't leave a lot of time to think about and work on the strategic aspects of the business that require a significant amount of time, investment, patience even relationship building to be able to do that properly. And so, I'm certainly looking forward to being able to have more space against that, while always being available to Ozan and the team to jump in and help as needed over the next couple of years.

Ozan Dokmecioglu: Yeah. Also, thanks to you as well Lauren. So, I'm sure you all know that we have a robust strategic plan as we have all taken you through back during our Investor Day October 1st last year. And obviously I have been one of the important architects of that plan along with Bob, along with the executive leadership team as well as our Board and I'm 100% behind that strategic stance. And when you do a double click you would see that, we have great growth opportunities in Coffee Systems, doubling our business overtime by recruiting new households as well as tapping to our innovation both in the brewers as well as the coffee beverages side. And we still have some white spaces that we can fill in.

When we look to the cold beverages again, we have great growth trajectory in front of us so be it via distribution making it -- making our distribution more effective more impactful as well as efficient. As Bob was saying, we have quite a bit of still white spaces in select brand groups that will get us to new consumption occasions. That includes perhaps some geographical dimensions. And Bob was also saying M&A.

Therefore, as you see, it's a full package in terms of the growth trajectory that we have in front of us which makes us obviously very excited and motivated. And our job is to continue to execute very successfully against this strategic planning stance and deliver the business goals that we put on us.

Lauren Lieberman: Okay. Thanks so much.

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

Kevin Grundy: Great. Thanks. Good morning, everyone and I wanted to extend my congratulations as well. First, I think just housekeeping maybe on Ozan's replacement at the CFO position. Maybe just are you looking internally for that? Are you looking externally for that? I suspect it is both. Maybe just comment on sort of what attributes you're looking for that candidate and maybe timing.

But the broader question I have is really around investment levels. I think this is to kind of pick up a little bit on what Bonnie was getting at before excuse me just how you are balancing that with EPS growth. Because Bob, you've been really clear about your commitment to how seriously you take the EPS growth targets and the delivery has been very, very good since the merger in what's been a really volatile environment. But with the onetime items now providing some help the question is really around balance. And number one like, what's in the outlook for brand support now?

And what's your willingness to sort of commit to those brand levels, or is there some element that you're possibly willing to pull back if needed to hit the EPS growth target? So just the question is really around balance what's in the guidance and your willingness to pull back if needed to deliver against the EPS growth target. So, thanks for all that. I know there's a lot there.

Bob Gamgort: All right. Ozan, why don't you start off? And I'll pick up the second part.

Ozan Dokmecioglu: Yeah, absolutely, and again, thank you very much as well Kevin. So, on the CFO search as we announced publicly the decision was to go outside and recruit a world-class CFO. And for the fact that -- in order to deal with the complexity of our company, but also and more importantly to bring a CFO that will be able to navigate through the future growth plus the existing complexity of our company. And that's what we are looking for. And the search has already started. And we believe that we will manage the timelines that we have communicated previously in terms of being able to recruit.

Bob Gamgort: Yeah. On your second question, I think the simple answer is we take all of our commitments seriously. And we put commitments out there in a balanced manner. So, think about what we delivered over the first three years as a public company. We delivered a 15% EPS CAGR, while we accelerated growth, so we beat our growth targets. At the same time, we were more competitive in the marketplace as evidenced by all the share gains that we had across the board as well as accelerated household penetration on the Keurig system and we put in place a foundation that's now scalable as we move into the future.

So, all of those were delivered. As you could imagine, when we put that commitment out there in 2018, the world looked very different than it has over the past three years, yet we've been able to balance across all of those without optimizing one metric at the expense of the other. We were able to deliver balanced performance and that's exactly the way we look at it, going forward. So, one thing, I would point out is that early back in October 1, we saw a lot of challenges in the macro environment in 2022. And therefore, we said that, we would be on mid-single-digit EPS growth in 2022.

We're pleased that, we did that given what has materialized since then. And now we're in this mode of balancing investment and growth. And you can see we've taken our growth expectations up. It's not just pricing driven, it's volume and pricing. And we make investments in brands. As we mentioned, on our Q1 call our cold business investment in marketing was up during the quarter. Even though it was incredibly challenging quarter we spent more. And the one-timers you're talking about I would suggest we not focus on any one quarter.

You have to look at those type of, I put those mostly in the category of normal business especially when you look at it over time. And we're just incredibly transparent about those. And any time they hit in one quarter we tend to over focus on those. And then we don't talk about them as a group when they're not or it's an unfavorable comparison versus a year ago. We never get any questions about those. So just look at it over the period of a year. The fact that, we have some of these items to double down on investments in our brands, as well as in accelerating our coffee recovery, allows us to have the confidence in the balanced delivery that we committed to.

Kevin Grundy: Very good. Thank you, both. Good luck.

Bob Gamgort: Okay. All right. Thank you.

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

Chris Carey: Hi. Good morning.

Bob Gamgort: Good morning, Chris.

Ozan Dokmecioglu: Good morning.

Chris Carey: I just wanted to follow-up quickly on the M&A commentary Bob with your new role and then I'll ask a question on coffee. Just around M&A and priorities clearly the Tractor investment is on the smaller side, but potentially interesting over a long time period. Historically, you talked about reticence for large-scale M&A. So, would we expect these types of deals to be more on your radar, or are you open to larger deals, if the category or geography fits?

So, kind of following up on the prior line of thinking there and then just on the coffee side of the business, I think you said that, your owned portfolio pricing was in the 6% range which is ahead of what you did in the quarter with coffee. Were there any service charges that impacted you in the quarter?

And can you just expand on the partner brand pricing and when you would expect total Coffee Systems pricing to better approximate what you're doing from an owned perspective? Really, what I'm trying to get at there is just if you're pricing and whether the rest of the category is following and you're not expanding price gaps too much. Thank you so much.

Bob Gamgort: Sure. First thing is, our reticence I think is the word you used on large deals was not on large deals. Our reticence is on overpaying for large deals. And so, it's not about the size. It's about the multiple. And I think that, we're in an environment now where we're seeing all kinds of valuations shift. And people -- our investors are more in favor of paying for cash flow and earnings than just multiple of sales with no earnings potential in them. So that may represent some interesting opportunities. But what I would point out is that the way we think about inorganic is across the range of partnerships like we just announced with Community, which is a huge win for Community, and a huge win for us to be working together again.

And we don't need to own that business by any means to have the benefits of that. And likewise, by partnering with us they win as well. We can make seed investments as we announced today on Tractor Beverage, which is small today, but we will certainly accelerate it. And it's in a unique channel in fountain foodservice, which is one that we are incredibly strong, but yet haven't done a deal like this in that channel before. And then we're also looking at mid- and larger-scale M&A as well. And so, we have -- I would say, we have a consistent dialogue with a large number of potential partners.

I can't get into the details of that, but the fact that we are in this position when we talk about businesses like Community and Tractor is good evidence that of how we think about being proactive and creative in our partnerships. With regard to coffee pricing, again, the category is up 5% or a little over 5% and we were up a little bit more than that.

Again, I wouldn't overreact to any one move in the quarter. Sometimes that's mix. Actually, if you break it apart further the area that has moved late is private label within pods. So premium brands have actually moved substantially.

The mainstream brands where we're a heavy participant in with our owned and licensed have all moved about the same level. There was a late move in private label. But they can't avoid the price of coffee and now you're seeing pricing coming up on that. So, we're not seeing any distortion in the gaps between private label mainstream and premium and pods sticking for any time period.

Chris Carey: Thanks, Bob.

Bob Gamgort: Okay.

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

Andrea Teixeira: Hi. Good morning, everyone and I will echo all the congrats and best wishes to Bob, Ozan and Steve. So, I wanted to just break down a bit on the new guidance. And for -- isn't that conservative still given that volumes will likely recover from here on the under-shipment comments in hot beverages in perhaps call it low-single at this point?

And then, your price/mix should accelerate from the 6% that you posted so far. Isn't there potentially like an upside for that, or we should be thinking in the high single and with the visibility that you have now in terms of costs you're not ready to -- it's too early in the year to call a little bit better EPS given that -- given the puts and takes ahead of you? Appreciate that.

Ozan Dokmecioglu: Yeah. First of all, good morning, and thank you very much Andrea. With regards to your top -- and you also touched to the bottom line as well. So let me try to break it up. You are right we feel very bullish with regards to our top line as Bob explained the reasons. And on the basis of that, we have increased our guidance from mid to high-single-digit top line growth expectations, and there are so many proof points with regards to that. And coffee will be one of the important determinants of, especially second half kicking in after we reinstate and put all the supply chain disruptions that we have had.

So -- and we are also planning to take a second round of pricing in most of our portfolio by early summer, which would be more or less in line with the peer group and the market players that we have all announced to the trade. Of course, there will be some different timing with regards to the implementation, but we feel very good with regards to our price expectations and what do all those mean and translate to our top line growth.

Having said that, there's a reason why everyone is taking pricing which is the inflation factor that came in and continuing to come in higher than everyone's expectation. For example, when we step back and look and just to remind our previous communications 2021 approximately inflation came in as we announced around 7%.

And we also said during our Q4 2021 call, which was like a couple of months ago, that we expect 2022 inflation to trend around low teens. But in reality, in Q1 we have faced approximately 15% inflationary pressure, which was higher than what we were expecting. And I'm sure you have heard what all other industry players have been saying, which is essentially in line with what I'm articulating right now.

Therefore, true we are taking pricing. True at the same time our volumes continue to increase, coupled with our very strong in-market execution and you can see the proof point in our market share, which is around 80% of our LRB that we have either maintained or continued to gain market share. Therefore, really strong performance and delivery all around. But inflation is not stopping, and we are still seeing a lag in relation of the pricing and the inflation.

As you know, no one can take an anticipated inflation and pricing accordingly which on a pure math basis this means margins will continue to be under pressure as well as there will be a lag. But we also believe that towards quarter three and probably more in quarter four of this year, there will be we expect on the basis of our assumptions again an inflection point in terms of the pricing catching up to cost. And that's where the margin expansion actually will kick in from a pure math and algorithm perspective.

Therefore, we believe that we have a good robust algorithm that we put out there. Inflation is real. Inflation is -- has been higher than what we were expecting. And it's nothing to do with our coverage whether we can cover or not, because there are some input cost elements that we cannot cover, no one can cover, for example, rPET, for example polypropylene that we use with regards to the material of the K-Cup pods and some parts of the transportation and labor.

So, you see, it's not like one or two. Therefore, this is continuous levers that we pull in order to run our business as well as deliver against our algorithm. And of course, if we do see some opportunity to do better as you all know we are not going to hold back. But we think we have a good algorithm right now a balanced one that keeps us to continue to invest behind our brands and business.

Andrea Teixeira: Thank you, Ozan. That's fair.

Operator: And your last question comes from the line of Brett Cooper with Consumer Edge. Your line is open.

Brett Cooper: Thank you. Good morning and congratulations to all. I had two questions if you don't mind. You've spoken about building the infrastructure to be a bigger company. I was hoping you can expand on the most important pillars that you've built or have in place that allows for that leverage. And then the second one is, you have a scaled e-commerce business in coffee, both direct to consumer and third party. So just from the outside we can't always see what's going on. I was hoping you can provide us an update on the progress you've made in preparing for the move in your cold beverage business to e-commerce and/or evolving the customer relationship to a more digital one. Thanks.

Bob Gamgort: Sure. A couple of things, Brett. First of all, on the scalability piece that you talk about, I think there are three big areas in which we've set up a business at scale. I think one is just management structure. So, we've got a management team that has the bandwidth to take on more than they have today. And our focus on North America, I think gives us a bit of an advantage here. Having managed global businesses in my past to be able to focus in one region where you have common consumers, common customers, yet a significant amount of white space for expansion is an advantage for management to be able to continue to take on more without being distracted.

I think the second area where we've made significant investment in is in our distribution capabilities. And we talk about a wide range of them. But if you think about today, we announced an expansion in our fountain foodservice business. We talked about on a number of calls, Dr Pepper is the most available CSD in fountain foodservice. So we've got a really strong team but they've had a relatively small set of brands and businesses to sell.

Now, we're equipping them with a new brand in partnership with Tractor, where they're able to get into new territory with GMO-free organic and some really unique products to be able to expand. So, it expands their toolkit. There's a good example of a great foundation that we can now scale. DSD is a very important area for us. We've made significant investment over the past three years, increased tools and capabilities. But also, we've expanded our DSD breadth and depth by acquiring close to 25 independent distributors to be able to boost our system. And obviously anything that you can scale within DSD improves both your effectiveness as well as your efficiency.

And then as you touched on e-comm is a really interesting area. When we put the two companies together and we showed how we were bringing the best of both to share across the business, one of the conversations was about e-comm. But in 2018 e-comm and beverage didn't seem like a big idea.

Certainly, it was a very significant idea during COVID. And it's one that on the cold side of the business has to build over – will build over time but it has to be through click and collect and regional delivery. Shipping liquids by UPS and FedEx is not a great business model over the long term. But we see that area rapidly evolving and we're in a really good position.

Part of enabling us to do exactly that required us to go back and redefine and renegotiate a number of our distribution agreements that were not contemplated in an environment of e-comm and we've been very successful in doing that over the past now four years to set ourselves up so that we have a win-win with our distribution partners, our independent partners and yet we're able to drive e-comm to the benefit of the consumer as well as us and our partners.

With regard to our coffee business, you're 100% right, we have a scaled business in e-comm. We've been very agnostic in terms of where our brands are sold on e-comm. So, we're very supportive of Amazon, of walmart.com on any type of retailer.com. We share our information with them. We try to make them better. So, it's not that we're in competition with them at all. In fact, we know the consumers want to go online but they want to buy it from their preferred retailer. And so, we enable that by doing what I just said.

With regard to keurig.com we have focused it on auto reorder or reorder, and that's its primary reason for being. And also, it's a good place to find SKUs that are small that are favourites of a small group of consumers who can't find them at normal retailers. We'll sell everything on there. Obviously, that's been a challenge during the supply recovery phase.

We will get back to that again. And so that's a big part of it. And as you think about the one comment, I made in my remarks about connected brewers and the fact that we believe that we'll have 1 million connected brewers in the next few years, that really adds additional power to an auto reorder business because you go from replenishing based on shipments to replenishment based on consumption and that is a whole different level of convenience for the consumer. And so that's why we're really bullish on that business over the long term as well.

Brett Cooper: Great. Thanks.

Bob Gamgort: Okay. Thank you.

Operator: Thank you. And I'll hand the call back to Steve Alexander for any closing remarks.

Steve Alexander: Great. Thank you, operator. Thanks everyone for joining us today. Maria and I are around all day. If you have any questions, please feel free to reach out, we will get back to you. Thank you so much.

Operator: Thank you. And that concludes today's conference. You may now disconnect.