Keurig Dr Pepper Inc.

Second Quarter 2022 Earnings

July 28, 2022 at 8:00 a.m. Eastern

CORPORATE PARTICIPANTS

Steve Alexander – *Vice President of Investor Relations*

Bob Gamgort – *Chairman and Chief Executive Officer*

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Maria Sceppaguercio– *Chief Corporate Affairs Officer*

PRESENTATION

Operator
Good morning, ladies and gentlemen, and thank you for standing by. Welcome to Keurig Dr Pepper's Earnings Call for the Second Quarter of 2022. All participants will be in listen-only mode. Should you need assistance, please signal a conference specialist by pressing star then zero on your telephone keypad. 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. Steve Alexander. Mr. Alexander, please go ahead.

Steve Alexander
Thank you and hello, everyone. Thanks for joining us. Let me start this morning by introducing our new Senior Director of IR Chethan Mallela, who joined us in May. Many of you may know Chethan from his six years working on the sell side with Andrew Lazar of Barclays, followed by IR roles over the past few years at American Eagle Outfitters and Peloton. He's a great addition to our team, and we believe you will enjoy working with him.

Earlier this morning, we issued our press release for the second quarter of 2022. If you need a copy, you can get one on our website in the Investor's section.

Consistent with previous quarters, today we will be discussing our performance on an adjusted basis, excluding items affecting comparability. Beginning last quarter, you may recall that we began excluding 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 results are KDP Chairman and CEO Bob Gamgort, and Ozan Dokmecioglu, our current CFO and President of International, who is transitioning to the CEO role effective tomorrow, at which time Bob will become Executive Chairman. Also with us is our Chief Corporate Affairs Officer, Maria Sceppaguercio.

And finally, our discussion this morning may include forward-looking statements, which are subject to the safe harbor provisions of the Private Securities Litigation Reform Act of 1995. These statements are subject to a number of risks and uncertainties that could cause actual results to differ materially, and the company undertakes no obligation to update these statements based upon subsequent events. A detailed discussion of these risks and uncertainties is contained in the company's filings with the SEC.

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

Bob Gamgort
Thanks, Steve, and good morning, everyone. The second quarter was one of significant progress for our

company in a macro environment that continues to be challenging on many fronts. Broad-based inflation continues to impact industry margins, as pricing continues to increase but has not yet caught up to inflation. The good news is our brand strength has held up well in the face of new pricing, with modest elasticity impacts across our portfolio during the quarter.

With concerns having shifted to the potential for a recession, it's worth spending a moment on how our categories have performed during previous recessionary periods. During the last significant economic downturn in 2008 and 2009, our lead segments, particularly carbonated soft drinks and coffee, were among the CPG categories that held up best. These categories are true staples, with regular consumption behaviors and few direct substitutes, and they have the benefit from the trade-down effect from out-of-home consumption to in-home consumption that frequently occurs during recession. As we've done successfully in the past, we will continue to manage KDP against a range of potential macro outcomes and believe that the all-weather business model we've created positions us well as we continue to operate in a challenging environment with significant uncertainty.

Since the formation of KDP, we have delivered great returns for our shareholders, with a four-year total shareholder return of in excess of 100%, well above broad market indices and nearly all food and beverage peers. More notable is that these returns were delivered during our transition from a closely-held company to a widely-held one, with the public market absorbing approximately 675 million new shares into the float, equivalent to $25 billion in market cap. With our inclusion last month in the S&P 500, along with our existing position in the NASDAQ 100, we continue to broaden our appeal.

Let me take a few minutes to remind you how the KDP business model creates value and then let Ozan apply that framework to our Q2 results. KDP is underpinned by an attractive and competitive organic total shareholder return algorithm, driven by a flexible and scalable strategy.

In Coffee Systems, our strategy is focused on attracting about two million new households every year into the Keurig system, while also driving revenue and profit growth among our 36 million existing Keurig households through new platforms, such as connected brewers and new beverage formats and occasions. Given the size of the remaining addressable new households for the Keurig system, which we estimate at more than 50 million, we have line of sight to household growth well beyond the next 10 years.

In Cold beverages, our strategy is focused on driving growth in core brands through marketing and brand renovation, filling white space in our portfolio through internal innovation and external partnership, and enhancing the effectiveness of our omni-channel selling and distribution system, including our company-owned direct store distribution system. The investments we have made in selling and distribution have built a stronger go-to-market capability that has a multiplier effect on our brand investments, as evidenced by our consistent share growth.

In addition to our core algorithm, KDP's extraordinary free cash flow enables the potential for incremental shareholder returns through strategic capital allocation. I will elaborate on this later in the call.

Ozan, over to you.

Ozan Dokmecioglu
Good morning, everyone. Bob provided an overview of our successful growth strategy, and I want to spend a moment to highlight our quarter two results in the context of our overall strategy.

On a total company basis, net sales advanced 13.5%, with net price up more than 10% and volume mix up more than 3%, with all four segments posting strong growth. KDP adjusted gross profit increased

10%, while adjusted gross margin declined 180 basis points, reflecting the timing gap that remains between pricing and inflation.

During the quarter, we experienced cost of goods sold inflation across all inputs, including ingredients, packaging and manufacturing labor. In addition, we also experienced a much higher rate of inflation in transportation and warehousing at a time of robust consumer demand, and SG&A inflation was also significantly higher. Taken together, our total inflation for the quarter exceeded 17%, which was more than two percentage points higher than the 15% we experienced in quarter one. As a result, adjusted operating income declined slightly as significantly higher costs to serve offset the 10% increase in adjusted gross profit in the quarter.

All in, adjusted net income increased approximately 3%, reflecting a lower adjusted tax rate and lower interest expense. Adjusted diluted earnings per share also increased 3% to $0.39, and we closed out the first half of this year very much as expected.

Free cash flow for the quarter at $600 million continued to be strong, driving a free cash flow conversion ratio of 108%.

Let's shift to a discussion of segment performance starting with Coffee Systems. I'm happy to report that our Coffee Supply Recovery Plan has been completed ahead of schedule with pod manufacturing output restored to levels that will provide full service to our partners and retailers. While that success came at a cost, as we discussed last quarter, it sets us up for a strong second half of the year.

For the quarter, Coffee Systems net sales were up 9%, driven by both higher pricing and increased volume mix, reflecting strong sequential improvement in sales. For the quarter, pod sales grew 10%, led by both higher pricing and higher volume mix, while brewer sales grew almost 6%, led by higher pricing that was partially offset by lower volume, due to the 29% volume growth comparison in quarter two last year. Marketing investment in the quarter was up slightly.

Single serve coffee category pricing was up nearly 9% during the quarter based on IRI, as coffee brands and retailers mitigate the impact of inflation, particularly in green coffee, with new price actions. We have noted a few industry reports directly linking category volume deceleration in IRI with pricing actions and attempting to draw conclusions on elasticities. In addition to our typical caveat that syndicated data reflects only about 50% of total pod sales, let me also caution you that there is significant noise in the category numbers in quarter two, due to the impact of the supply chain issues, including out of stocks and significantly reduced category promotional and marketing support. There are also some timing impacts from consumer mobility with regard to out-of-home coffee consumption during the quarter.

As we move into the second half, we continue to expect strong dollar consumption growth in the category, with some ongoing volume pressure related to increased consumer mobility compared to the prior year. This is consistent with our prior expectations that at-home attachment rates would eventually return to pre-COVID levels, and we are continuing to see this occur. At the same time, we are seeing improvement in office coffee, which we expect to gradually improve over time.

In this dynamic environment, we continue to track the relationship between single serve coffee pricing and other forms of coffee, including out-of-home coffee. Despite the increase in single serve pricing, the gaps between formats have remained consistent, as all forms of coffee have increased in price.

Let me shift to some highlights of Coffee Systems growth drivers. In quarter three, we will nationally launch our new K-Café SMART brewer which, in one machine, is a representation of the cumulative enhancements we have made to Keurig brewers over the past five years. The K-Café SMART is enabled by our connected BrewID technology that recognizes the pod and adjusts the brew for a perfect cup. It also features multi-stream technology, which enables a wider range of temperature and strength, including our best-ever brew over ice coffee delivery yet. This new brewer also incorporates a new multi-speed frother to enable consumers to create cappuccinos, lattes and other specialty coffees, guided by an interactive recipe experience located in their Keurig app. Taken together, the K-Café SMART enables consumers to create a coffee shop experience in-home at a fraction of the cost and with greater appeal to younger households. With our continued SMART technology development, we remain on track to reach a million connected households in the next few years, which continues to unlock new platforms such smart auto delivery for pods.

The enhancements to Keurig system quality and innovation continue to be recognized by key industry players, and we're pleased to announce the addition of two new super-premium coffee brands into the system, with Intelligentsia and Black and Bold joining our roster of Keurig partners. In addition to enabling the Keurig system to reach premium consumers with price points of around $1 per pod, the participation of these brands provides a strong endorsement for the quality of the coffee delivered by our new brewers.

Last quarter we shared that Community Coffee will also be joining the system as a partner brand. Production of K-Cup pods for Community began this month and our licensed pods will be available on Keurig.com and at retail nationwide later this year.

In addition to adding new brands, we have had great success in driving growth in existing brands. McCafé, which you will recall joined the Keurig system as a licensed brand a few years ago, was the fastest growing brand in single serve coffee this past quarter.

Shifting to Cold beverages, we again grew or held market share across the vast majority of our portfolio. In carbonated soft drinks, we grew dollar consumption by 11% in the quarter and are holding or slightly expanding the substantial share gains we achieved over the past two-plus years. This past July 4th holiday represented the 23rd consecutive holiday period in which KDP grew carbonated soft drink's market share. We are doing this by leveraging the strength and differentiation of our portfolio, successful innovation such as Dr Pepper and Cream Soda, which was recently ranked by IRI as the #1 Food and Beverage Pacesetter for 2021, as well as exceptional in-market execution and effective marketing.

CORE Hydration and Snapple are two examples of strength in our non-carbonated portfolio, both of which had been held back by supply chain disruption last year. CORE is the fastest growing brand in the premium unflavored water category this year, with dollar consumption growth of 31% in quarter two. Snapple is benefiting from investment in the Snapple brand refresh launched last year, which continues to attract younger consumers and build momentum for the brand, driving dollar market share growth year-to-date.

We have also had great success in driving growth for our partner brands, with Polar Seltzers becoming the fastest growing unsweetened sparkling water brand in the category, advancing market share two full share points to 10.3% in the quarter and continuing to grow. In addition, Vita Coco grew over 16% in the quarter, advancing household penetration by 9% and dollar share by more than four points to 54%.

Within Cold beverages, Packaged Beverages net sales were up 13%, driven by both higher pricing and increased volume mix, with elasticity impacts remaining modest. Increased marketing investment and strong in-market execution supported continued market share growth in the quarter. For Beverage Concentrates, net sales were up 23%, reflecting higher pricing, including the benefit of favorable timing related to trade accruals, and higher volume mix.

Finally, for Latin America Beverages, net sales were up an impressive 27%, balanced between higher net pricing and increased volume mix, supported by a significant increase in marketing investment. Elasticities for the segment remained modest. Latin America Beverages has been a consistently strong performer, led by a portfolio of strong brands such as Peñafiel, Clamato, Squirt and Motts. On a two-year basis, net sales in the quarter increased more than 50%.

During the quarter, we announced an agreement to acquire the global rights to the non-alcohol, ready-to-drink cocktail brand Atypique, which is a highly unique offering in the emerging and fast-growing non-alcohol cocktail segment in Canada. This new platform complements our strong and successful ready-to-drink alcohol portfolio in Canada and provides KDP with incremental growth opportunities in an exciting new category.

We completed our minority investment in Tractor Beverage and signed an exclusive sales agreement to expand innovation in foodservice channels, leveraging the strength of our Fountain Foodservice sales team. As we announced last quarter, Tractor offers the first and only certified organic, non-GMO beverage solution specifically tailored to foodservice operators.

While these are great examples of small but strategic investments, let me turn it over to Bob to provide some commentary on the broader capital allocation and M&A opportunity for KDP, which will be one of his key focus areas as Executive Chairman.

Bob Gamgort
We have built a business that has been pressure tested by macro volatility and crisis and has emerged stronger and nimbler than ever. In the past four years, we have distinguished ourselves as strong operators, with the great majority of our team members solely focused on running the business with excellence. The value of that approach is reflected in our industry leading TSR since merger and our attractive forward-looking organic algorithm.

We also know we have an opportunity to enhance organic shareholder returns through the strategic deployment of our discretionary free cash flow. We have a proven capability to build new brands and create exceptional value for KDP and our partners by adding new brands into our growth machine. Look no further than the examples discussed during today's call, such as CORE, Polar, Vita Coco, and McCafé. Therefore, it's logical for us to consider M&A as our leading opportunity in capital allocation.

We employ a disciplined and rigorous process in our deal evaluation, which balances risk versus reward and understands the true underlying value of any new business to us. We also consider a range of structures to enable us to expand our brand portfolio, with M&A being one, but not the only, path to filling whitespace. It's no secret that historically, when our disciplined approach has faced lofty valuation expectations from sellers, the outcome has been fewer acquisitions and more strategic partnerships for KDP. We're good with that, as we know that no deal or an alternative partnership structure is far better than an over-priced acquisition.

The environment for high growth companies has shifted in recent months, and we're encouraged with the conversations that we're having with several potential partners. We believe that our proven success in creating value for our partners, combined with a more challenging investor environment for these entrepreneurs, has begun to narrow the bid ask spread. Time will tell if that improves actionability. All potential M&A investments compete against the asset this team knows best, which is the value of our own equity. As noted in our press release, we repurchased approximately 2.5 million shares during the quarter at an average price of $34.51 per share. We see opportunistic share buybacks and investment in our internal growth projects as attractive uses of our capital.

Finally, we believe the size of our discretionary cash flow, which is expected to be $5 billion over the next three years, distinguishes us as a unique investment opportunity.

Ozan will now provide some commentary on our outlook for the balance of the year before we move to Q&A.

Ozan Dokmecioglu
As indicated in our press release, we are increasing our guidance for full-year constant currency net sales growth to the low double-digit range, while reaffirming adjusted diluted earnings per share growth in the mid-single-digit range. We continue to expect adjusted earnings per share growth in the second half to reach the high-single-digit range, driven by strong performance in the fourth quarter, leading to mid-single-digit growth for the year.

Supporting this guidance, we continue to expect the following, unchanged assumptions. Adjusted interest expense is expected to approximate $430 million. Adjusted effective tax rate is expected in the 22% to 22.5% range. And diluted weighted shares outstanding are estimated to be approximately 1.43 billion, assuming no additional share buybacks.

Finally, given the current environment, I want to share some detailed perspective on our expectations for the second half. At this point in the year, we are largely covered on input costs and have good line of sight to price realization. Quarter four is expected to be the strongest of the year in terms of earnings per share delivery, while quarter three is expected to look much like quarter two. The primary driver of the phasing of our second-half results is the timing relationship between pricing and inflation. You will recall that inflation in quarter one was 15%, which advanced to more than 17% in quarter two. We expect inflation to be even higher in quarter three, largely driven by our green coffee positions. Because we are getting the benefit of more pricing in our quarter three P&L, we expect to offset this incremental inflation to deliver EPS growth for the quarter.

In quarter four, we expect the rate of inflation versus the prior year to be roughly half the rate of quarter three. As a reminder, we will be lapping the significant spike in inflation we experienced in quarter four last year and we will realize the full benefits of pricing already taken, which will enable us to offset inflation and deliver margin improvement in the fourth quarter.

Finally, I want to acknowledge that tomorrow I will assume the CEO role of KDP. I am honored to take on the leadership of this great company, including our 27,000 dedicated employees, and I greatly appreciate the endorsement and support of Bob, our Board of Directors and our Executive Leadership Team.

Looking ahead, I couldn’t be more excited about the growth potential I see for KDP in this new chapter. We have the opportunity to leverage all the progress we made since the merger to further strengthen our brands, enhance our go-to-market capabilities and build our world-class team. Doing this will enable us to flawlessly execute our strategic plan, while standing ready to proactively capitalize on new opportunities that come our way and face whatever macro challenges arise, just as we did in our last chapter. The KDP team has distinguished itself as flexible, nimble and fast, and it is these key attributes that will again differentiate us moving forward.

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

QUESTIONS AND ANSWERS

Operator
We will now begin the question and answer session. To ask a question, you may press star then one on

your telephone keypad. If you are using a speakerphone, please pick up your handset before pressing the keys. If at any time your question has been addressed and you would like to withdraw your question, please press the star then two. At this time, we will pause momentarily to assemble our roster.

The first question comes from Bryan Spillane with Bank of America. Please go ahead.

Bryan Spillane
Thanks, operator. Good morning, everyone.

Bob Gamgort
Good morning, Bryan.

Bryan Spillane
Two questions for me. One, Ozan, as we're looking into the back half of the year, and just thinking about pricing and inflation, are there plans for further price increases in Hot or Cold beverages in the back half of the year? Or have you pretty much pushed through or put in all the price you need to cover inflation? Then I have a follow-up.

Ozan Dokmecioglu
Yes. Good morning, and thanks, Bryan, for the question. I mean, first of all, it is also important to know that—because as you know, pricing obviously goes hand-in-hand with inflation and what's going on in the macroeconomic environment. So we are largely covered on the input cost side and also we have a good line of sight into the price realization for the remainder of the year. So it's very clear for us.

So at the same time as we have announced several times that starting from 2021 as well as earlier this year, as well as early quarter two, we have taken several pricing actions across our portfolio both in the Coffee Systems as well as the Cold beverages. So those pricing activities went through. And as you know, we don't necessarily talk with regards to future action plans in terms of the detailed pricing action plans but as we have done previously, depending on how the macroeconomic situation is going to trend along with the inflation, we are ready to take further action plans, as well as activate several other levers that we have been managing our business.

As you know, we don't necessarily just focus or fixate on one lever. We have multiple levers in our business starting with the volume, combined with the mix management, then obviously, productivity delivery in relation to the pricing, and our business investment. So we have several levers available for us in order to pull and continue to weather the storm, as we have been doing the last four years. Therefore, if the macroeconomic situation changes, along with the expectations that we have, we will take the necessary measures in order to put further pricing.

Bryan Spillane
Thanks, Ozan. And then, Bob, just a question for you just to pick up on the comments you made about the M&A environment. And, I guess my question is when you're thinking about or looking at high-growth companies, a year ago or two years ago there was a lot of focus on revenue multiples and TAMs and profit and cash flow were sort of taking a backseat, I think, in terms of a lot of the valuation discussions that were being had. So has that changed also? As you're looking at high-growth companies, is there maybe more of a consideration now in terms of profitability and cash flow than maybe where those sellers' expectations were or how they were trying to value the businesses before?

Bob Gamgort
Yes. I mean, Bryan, from our perspective, we've always focused on profit and cash and what we looked at in any potential partnership, whether it's an acquisition or a seed investment, is what's the long-term

growth of that business, and then in our business model, what kind of profit and cash could we generate off of that, once we put it in place and have the synergies and access to the resources of this company. For us, the valuation has always been based on long-term profit and cash.

Having said that, we were in theory competing against people who were just looking at revenue multiples. And as recent as a year ago, we had conversations with potential sellers who were talking about valuations they were getting from SPACs, or the fact that they could go out into the IPO market. Those are very different valuation models than what we're looking at.

So as we said, we remain disciplined; we always have. We'd rather have an alternative partnership structure, as we've done with Polar and Vita Coco and McCafé. We're up for acquisitions, and we've done some of those which have performed well in our business. But we're not going to overpay and we've never been caught up in valuing anything on a multiple of sales.

Bryan Spillane
Alright. Thanks, Bob. Thanks, Ozan.

Ozan Dokmecioglu
Thank you.

Operator
The next question comes from Bonnie Herzog with Goldman Sachs. Please go ahead.

Bonnie Herzog
Thank you. Good morning, everyone. I have a question on your coffee business. I guess I'd be curious to hear some more color on the consumer and whether you're seeing any signs of down-trading within the home, actually, that could affect your pod attach rates going forward. During the quarter, I think your pod attach rate decelerated a bit. So wondering how big of a risk do you see for lower coffee pod consumption in an economic slowdown with thinking about the possibility that consumers start brewing ground coffee in their homes, even if they do own one of your brewers? Or, Bob, thinking about your comments, do you expect something like that to be more than offset by incremental consumers switching back to consuming coffee in their homes.

Bob Gamgort
Yes, so the first part is household penetration is the biggest driver of growth in our Coffee Systems more than attachment rate. So as we've talked about we had three million households per year for the past two years. We saw that as above our long-term trend of two million households. And so our expectation continues to be that two million is the right growth rate for us on household penetration.

Attachment rate has been remarkably consistent over the long term. The only difference was during COVID we saw an increase in attachment rate that has been working down gradually from that peak to pre-COVID levels. And there's a little bit of noise even in this quarter of a bigger reopening where people are going out-of-home and that's actually been, as strong as our business has been, that's actually been a negative factor that's been weighing against that strong growth that we've had. In our opinion that's just about done; we're almost back to fully open.

Interestingly, the one area that hasn't reopened fully are offices and so still in front of us is the opportunity to recapture even more growth in our office coffee business.

With regard to trade-offs, we have studied this a number of different ways. And I referenced in our prepared remarks that we went back and looked at the last recession across all CPG categories, coffee, and CSDs, are among the most resilient, if not the most resilient, in all of CPG for the reasons that I talked about. We don't see any trade-off in between forms of coffee within the home. You see over the quarter a slight increase in private label pods, and some reduction in premium pods. If you recall during COVID, the reverse is true so it's almost a reversion back to the long-term trends. And even if that does happen, remember, we make the great majority of private label pods. So this is a business that's well-protected against all forms within single serve. And honestly, we do not see trade-offs between other forms of coffee. And if there is a real recessionary impact, we know that people go from out-of-home consumption to in-home consumption, which would be a net positive for us.

Bonnie Herzog
All right, makes sense. Thank you so much.

Bob Gamgort
Okay, thanks, Bonnie.

Operator
The next question comes from Kevin Grundy with Jefferies. Please go ahead.

Kevin Grundy
Great, thanks. Good morning, everyone.

Bob Gamgort
Good morning, Kevin.

Kevin Grundy
I wanted to touch on SG&A. Good morning, Bob. SG&A came in a bit higher. I think there was some mention of higher marketing spending in PB, I think to a lesser extent in coffee, sort of a near-term dynamic to that. Maybe talk about what you're coping with in that line item SG&A and then within that investment levels.

And then Ozan, and for both you, Bob, as well, what's the right level for advertising and marketing? You guys reduced, as did many others within the industry during COVID. And at one point, it was 6% as a percent of sales. We're still kind of tacking in the low 4% area. Maybe just comment on what the right level is longer term and when you expect to get back to that. Thank you.

Ozan Dokmecioglu
Yes, thanks, Kevin. So I will start with the first part of your question. When you look to our SG&A line, in fact, there are quite a bit of pluses or minuses and it's a line that a lot of cost elements actually get together and we consolidate. So let me try to expand a little bit, provide or shedding a little bit further light.

First of all, we have the transportation and warehousing expenses that are included in that line, which obviously has been one of the most volatile and inflationary spending line item for us. And T&W, transportation and warehouse, represents almost the biggest increase factor in the SG&A line that you are looking at. And the second big bucket that we have in that SG&A line is, as you said, advertisement and promotion, and we had some good levels of increase in our investments behind our brands so that also included in that line. And also the whole labor across our company, with the exception of manufacturing or production related, which is core elements of cost of goods sold, that leaves us with all the frontline employees we have, including our DSD, including our merchandising, including our white collar. And as you know, labor especially on the frontline has been one of the most pressurized line items starting last year. So that increase is also included. And the remainder of all the overheads, whatever left that are included in that line having an inflationary factor. And as you see, there are so many pluses or minuses in that line. But I think these are the four factors that do explain the majority of the increase in that line.

Bob?

Bob Gamgort
Let me talk about the marketing piece. COVID forced a wide number of changes in the way we do business and I'm obviously not going to recap all of those. Some of those experiences were good learnings that we want to continue in the future. Some of them we're saying, okay, we want to go back to the way things were. So I think it's really reset the level of marketing spend that's required.

We were all forced to work with lower marketing spend. It caused us to be much more sensitive about return on investment and dial up our understanding in terms of a precision marketing perspective. And I think the best evidence that we were able to do that successfully is the strength of our brand portfolio. And that's really where the proof is in the end.

So for us, it became much more of a focus on which brands we want to support the portfolio at critical levels? What tactics do we want to use? And then how do we use all of the data that's now available to be able to target more precisely and course correct? And it's worked pretty well.

As we say all that, if you think about the strat plan that we took you through on Investor Day, our long-term plan is to continue to increase to marketing over time. The reason is because we have more ideas for growth than we're supporting right now and that's a great position to be in. And so I think, as we continue to weather all of the pluses and minuses of inflation and recession, and the volatility over the past three years is nothing like any of us experienced over our careers, we will increase our marketing spend over time. But as we sit here today, the strength of our brands really speaks to our ability to navigate this environment.

Kevin Grundy
Very good. Thank you both.

Operator
The next question comes from Lauren Lieberman with Barclays. Please go ahead.

Lauren Lieberman
Great, thanks. Good morning, everyone.

Bob Gamgort
Good morning.

Lauren Lieberman
I want to talk a bit about brewer sales, and you called out the brewer volumes were down 4% versus the I think it was 29% comparison so to some extent, very much as expected. But of course, retailers have been signaling challenges with small household appliances, discretionary items of the sort. So, I just wanted to get your perspective on brewer sales for the balance of the year, knowing again, you've got some pretty big comparisons, what you're seeing if anything from retailers in terms of pushback on inventory. Bob, I know you referenced, again, the traditional run rate of two million households per year. But does that still feel feasible? I know it's an on average rate over time. Is that really a feasible addition in this economic environment, for this year in particular?

Bob Gamgort
Yes, let me start with the last part because that is the most important part, which is household penetration. And it feels like every year we get asked questions about why this is the year we can't do two million households. And so I would say there's no indication whether it's COVID, COVID recovery, recession, inflationary environment that our ability to add two million households per year is very steady and strong. And we have a ton of confidence in that. And that leads us to more than 10 years of household penetration growth at the size of the available market. So that area, I think we're in good shape on.

The second point I would make, and we say this even when we have incredibly strong brewer sales quarters, the correlation between brewer sales and household penetration is loose; there's some correlation over time. It's not what you might think. And clearly on a quarter-to-quarter basis, there is zero correlation. Let me just point out just last year, we added three million new households to the system. We sold more than 11 million brewers. That tells you that the majority of brewers sold are replacements or upgrades and we certainly have been giving people a reason to upgrade with the addition of new features and benefits and new design.

So with that, in context, when we say three million households a year ago, two million this year, 11 million brewers a year ago, year-to-date, our brewer sales are down approximately 5%. And we're up on a two-year basis or at the same time period in the 30% to 40% range. We're taking pricing on brewers that we see inflation there. Like everything else, would I expect some elasticity effect? Definitely. But I see it not impacting household penetration. I see it as impacting some of the upgrade cycles, which we're perfectly fine with. As you know, we don't really make money on brewers. It's really in service of household penetration and coffee consumption. So all of our core assumptions are very much intact.

Lauren Lieberman
Fantastic. Thank you. And then just the one question, though, on retail inventory levels, pushback from retailers and think it's just topical, would love to get your perspective.

Bob Gamgort
It is definitely an issue. And as you know, the shift in consumer behavior caught many of them by surprise. And so they're overstocked with goods that have long lead times that are not selling but we're in a category that sells incredibly well. As I said, we're talking about 5% volume change off of 11 million units. This is still a very good growth and profit opportunity. And again, most of the retailers that sell brewers also sell pods, and they know that every time they convert a household over from drip coffee maker to single serve, the great majority of those future pod purchases go to the retailer who sold the brewers and is a significant trade up and profitability for them.

So this is not the area they're looking to cut back on inventory right now. This is still one of the best growth and profit drivers in their entire store. So this is not where they're focusing.

Lauren Lieberman
Okay, fantastic. Thanks so much.

Bob Gamgort
Sure.

Operator
The next question comes from Chris Carey with Wells Fargo Securities. Please go ahead.

Chris Carey
Hi, good morning.

Bob Gamgort
Good morning.

Chris Carey
My question is specifically on coffee pricing. So just looking at pricing in the coffee segment in the quarter, it does look like partner and private label pricing remains pretty minimal to KDP, even though we can see these partner and private label operators raising pricing much more substantially in tracked channels. Can you maybe just give any commentary on when you think the overall pricing within the coffee segment will be more consistent with the pricing that we're seeing in the overall category, which is quite a bit higher? Then I just have a follow-up.

Ozan Dokmecioglu
Sure. Thanks for the question, Chris. Probably it would be better if I focus on our own, our owned and licensed products in terms of the pricing and how much we are seeing through the realization. As I was articulating a couple of minutes ago, we have taken few pricing actions across our portfolios and in coffee, which is owned and licensed brands that we control, obviously, the pricing and the full economics of it, including our brewers, as Bob just said. So we have taken a few pricing actions last year, which was in 2021, and earlier this year in quarter one, and towards the end of quarter two as well.

And when you look to the numbers that we have announced, for example, on the quarter, you will see that almost 6% of the price realization that we have successfully achieved across our coffee portfolio. And when you look to the either IRI or Nielsen data, you will see several action plans that the other industry players decided to take place. And when you look to the private label part, which is also important, but as Bob said, let's make sure that we remind ourselves that we still produce for the most part of the private label category that we also contribute to the economic benefits of that, at the same time, private label initially was a little slow to take the pricing actions. But when you look to the latest data, that part also has gone up.

Therefore, overall, we are very happy with the resiliency of our owned and licensed brands that have shown and how the consumption is moving across the portfolio with regards to the pricing actions. And as we have seen, there are besides the single serve the other segments or the sub-segments of coffee, and I will also say have also taken the pricing in line with more or less what's going on, especially with regards to the coffee bean prices.

Bob Gamgort
Let me just add one thing to it just as a reminder of a concept that we discussed in the past, which I will admit, is a bit complex. And that is the fact that our pricing realization on our P&L understates that gap between what you're seeing at retail and what we're seeing, in large part, it's not the only reason, but in large part because we're not responsible for the green coffee purchases of our partners. So the biggest inflationary impact within coffee right now is the green coffee impact. Our partners take that on their P&L; we're just doing the conversion for them. And so what happens is it understates what feels like our pricing realization relative to the market, because a big part of the cost structure does not flow through our P&L.

Chris Carey
Got it. That's very helpful. Then just a quick follow-up on coffee as well. The expectation last quarter was for pod shipments to remain below consumption. It does feel like pod volumes came in ahead of expectations this quarter. Did you catch up quicker than you had thought? Are you in a better position going into the back half than you were thinking at the end of last quarter? And is there any over-shipment dynamics that we should be keeping in mind as we go into the back half as well? So thanks for just that contextualizing the supply chain and the pipelines as well.

Bob Gamgort
Yes, I mean, the good news is, as we said in our remarks, that our coffee recovery was accelerated and we made an investment to do so. It cost us on the P&L to do so. But we're in a position as we exited Q2 where we have good inventories, full service to our partners and our retailers. And what that enabled us to do is to catch up in the second quarter on some of that missed opportunity in the first quarter. And so we said that we were going to be below consumption in the first half and then above consumption second half. We've largely caught up in the second quarter as a result of that. So going forward, our consumption and shipments should be largely balanced.

Chris Carey
Okay, thanks, Bob.

Operator
The next question comes from Brett Cooper with Consumer Edge Research. Please go ahead.

Brett Cooper
Good morning. Just [background noise] from me. On coffee, can you update us for South Carolina, how much capacity that opens up to you and how that fits into your ability to bring in new customers? And then second question, Bob, your comment on M&A that's focus primarily on portfolio expansion relative to prior comments which were broader. So just wanted [background noise] on how [background noise] relative to just an example. Thanks.

Ozan Dokmecioglu
So thanks for the question, Brett. Let me take the first part with regards to the South Carolina coffee plant that we have been building. As we said previously, Spartanburg is now planned for 2023. And as a reminder, as we also spoke before, we began, in fact, production of the K-Cup on our first line in June 2021. But let's make sure that this is a large facility that will take multi-year startups due to the several lines that we are putting. And as we discussed before, there were some slow ramping up due to 100% related to COVID issues that primarily our line manufacturer that run into, in Europe, that we have agreed to buy. Therefore, those times are being catching up as we speak right now, and we are still scheduled to put some of the lines into service starting 2023 onwards, which was in line with our expectations.

Bob Gamgort
Yes, I think on the M&A question your point is correct in that the conversation that we just had was primarily on portfolio whitespace. But I would say that our total landscape that we're looking at across the whole M&A opportunity is portfolio whitespace, new platforms, geographic expansion and new capability. That's very consistent with what we talked about at Investor Day; it still is the case.

And my examples of our two most recent small, but very strategic add ons, Atypique is both filling in whitespace. It's also Canada. And we've got these great Canadian, Mexican businesses that we can add to through M&A. And then Tractor is a great example as well, because again, is it whitespace? Yes, but it really leverages new capabilities and new strength in our Fountain and Foodservice business. We've got good capabilities that we can build with scale.

So we look across that entire landscape and are finding that, as I said in my remarks, quite a few, I think, very productive conversations.

Operator
The next question comes from Andrea Teixeira with JPMorgan. Please go ahead.

Andrea Teixeira
Thank you. Good morning. I have a question and two follow-ups, please. First, for Bob, how are the pods rate of growth away from home versus home phasing? And then can you speak about the volume mix, but now more focused on the Packaged Beverage business? Are you seeing any signs of more cautious consumer on the premium water side and as you exit the quarter any signs of increased elasticity?

And I understand you don't break down volume mix but in this environment perhaps mix running faster than volumes in this scenario and any signs of reversal ahead of us.

And the one for Ozan, I'll just put it out there, on the phasing of margins that you provided, the math of the guidance implies obviously both cost margin and EBIT margin will likely be down in Q3 year-over-year but perhaps to make the math work for the guidance you inflect in Q4. I just want to make sure that we got it right. Thank you.

Bob Gamgort
Yes, let me start with the Cold beverage in terms of any trade down or a change in behaviors, we're not seeing anything right now. Theoretically, as you move into a recession, you would see small outlets, convenience channels being more pressured; gas prices always do that. And you'd see more sensitivity around packs and in sizes. But if there's any change, it's very, very small right now, so nothing that we would be able to report that's concrete based on the data. It's all things that may happen in the future.

With regard to coffee, we don't specifically break out are away-from-home business as aside but it's been a heavy drag on our business since the beginning of COVID. In fact, we gave some feedback, we gave some very specific numbers about how much it was down, and how much of a drag that put on our total growth. The recovery on that has been incremental quarter-by-quarter but we're still well below pre-COVID levels on the away-from-home business. So that represents a future upside to us.

And the mobility that I was talking about before is really people consuming in-home versus consuming out-of-home, in other words like a coffee shop. And that's still recovering back to the COVID levels, but it's all built into our expectations and all of our guidance reflects everything I just talked about there.

Do you want to talk about the margin piece?

Ozan Dokmecioglu
Yes, exactly. So it's important to reiterate what I just said a few minutes ago that on the input cost side, we are largely covered for the remainder of the year, which we do also have a good line of sight with regards to the price realization. So these are two important points. And when we step back and look at it, because you asked the question on the margins, it's important in relation to the inflation, and the pricing and the productivity equation. In quarter one, inflation came in at 15%. As we just spoke, quarter two inflation came in at 17% and we also expect quarter three to be a little bit higher than quarter two. So we are getting more pricing benefit in Q3 due to the actions that we have successfully implemented that would help us to offset these further inflation headwinds that we are expecting to happen in our business.

At the same time, we also expect quarter four inflation to be more or less half rate versus what we have seen in Q3 versus last year. Why? Because last year in quarter four, in 2021, we have seen a significant spike across the board in most of our input costs that drove a big inflationary number. So we are lapping against that one. So that's very important to figure that out as well.

So what does this leave us? This tells us that we will realize the full benefits of pricing that we have already taken, which will enable us to offset the inflation and deliver the margin growth in quarter four.

That would be our expectations in order to sum up by second half as well as the split between quarter three and the quarter four.

Andrea Teixeira
Super helpful. Just one clarification on the rate of the index that Bob had said away-from-home. Is that still about 80% of what it was back prior to COVID?

Bob Gamgort
We haven't talked about that specifically.

Andrea Teixeira
Okay, that's fair. Thank you. I'll pass it on.

Operator
The next question comes from Steve Powers with Deutsche Bank. Please go ahead.

Steve Powers
Hi, thanks. Good morning. Two questions for me, too, the first one on beverage concentrates, just maybe a little bit of clarification. I was hoping you could parse out more of the underlying run rate and realized pricing versus the trade accrual impacts this quarter. Clarification if that trade accrual impacted something that we should expect will reverse or if it's discrete for the quarter?

Ozan Dokmecioglu
No. Hi, Steve. Let me take the beverage concentrates your specific trade accrual question. First of all, it would be helpful to talk about that the trade accruals are basically part of our normal daily lives; some quarter is plus, some quarters is a negative. And obviously we do our best in order to estimate as close as possible but as you know, because of all this ever-changing macroeconomic situation it's really making difficult to get almost 100% precision. First of all, that's the reason of this trade accrual. And the trade accrual timing also accounted, let's say, for more than or around half of the price realization that we have experienced in quarter two and as we have seen in our numbers. Do we expect this to trade to come back as a negative in the other quarters? No, absolutely. That's not the expectation, or that's not the reality of what's going to happen.

Steve Powers
Okay, perfect. That's helpful. And then I guess I think, Bob, or Ozan, either one, just to build on Lauren's question on household penetration, I think you addressed 2022 comprehensively. But as you said, you get asked every year. So just looking ahead, to the extent that consumer confidence and discretionary spending continues to come under pressure, I guess I'm just curious how the playbook changes on household acquisitions in a truer recessionary environment, whether that comes in terms of just a more precise value messaging, a different emphasis on the assortment of brewers you might bring to market or however you think about that playbook in a recession to the extent that it is different.

Bob Gamgort
Yes, excellent question. You think about our capabilities here, we have a wide range of price points on brewers and we have a wide range of price points on pods and we cover the entry level price points all the way up to now super-premium as we talked about on the call, dollar per pod, coffee all the way down to entry level price points which are around $0.30 per cup. And the same applies to brewers where we have brewers that are now around $50; they used to be below $50, but due to inflation around $50, all the way up to about $200, $250. And so we're able to take that range and have the right mix by retailer and target consumers with the appropriate price points.

The other point is that you think about these new brewers that we're introducing that are much more capable of producing specialty coffee, and actually iced coffee, we're able to deliver messages that do have a value message to them because the price comparison between cups and grounds is one thing, but the price comparison between cups and out-of-home coffee is dramatic. It's 5x to 10x the cost to go out-of-home. So the more that we're able to allow consumers to replicate the coffee shop experience in-home that actually allows us to dial up this away-from-home to in-home value messaging in our communications it's very compelling.

So we have a number of options within our toolkit. And it's exactly the way we're thinking about it is the way that you laid it out.

Steve Powers
Yes. Okay. Thank you very much. That helps. Appreciate it.

Bob Gamgort
Okay.

Operator
The last question today will come from Robert Ottenstein with Evercore. Please go ahead.

Robert Ottenstein
Great, thank you very much. I'm just wondering if you can give us an update on the CFO search, and maybe remind us what you're looking for in terms of experience and skill set. And then there's also been some other management changes, so maybe just kind of give us a sense of what the team looks like today, the kind of changes that you've made and how you see the organization from a senior management perspective going forward. Thank you.

Ozan Dokmecioglu
Yes. Good morning. Good morning, Robert. So let me take the CFO part and a couple of follow-up your questions on that one. First of all, we are where we want it to be with regards to the CFO search. And as we said before, we are looking forward to recruit a world-class CFO that not only will manage today's complexity and the size of our business but for also the future that we are building the modern beverage company. So that's important and is going well.

At the same time, I am also happy to say and we are fortunate to have a deep bench of talent, and have a very skilled and experienced executive, in fact, George is sitting next to me today on this call. And George Lagoudakis, as we have announced publicly stepping in on as interim CFO. So that's very important to note. So there is no gap and we carry the experience as well as the necessary knowledge to perform the duties without creating any gap.

With regards to the other positions that we may be looking for, as well as the internal promotions that took place, at this point in time, let's be clear on one thing, we do not have any open position. We have people on the jobs that we will be either looking for external or the promotions that took place on an internal basis and there will be a healthy handover when we have the external candidates in place. So it's not a situation that someone left, position is open and we are looking to recruit externally. So that's important to make sure that the continuity is 100% there.

Robert Ottenstein
And just in terms of the CFO, I mean, there's CFOs who are more financially oriented and other ones that are more operationally oriented. Any thoughts along those lines?

Ozan Dokmecioglu
I mean, absolutely I agree with you, it is important to focus on the CFO and the necessary credentials and the knowledge and the experience. But there is also another fact that we should not forget, which would be the overall finance team that supports the CFO. When we step back and look at it to the several finance leadership team executives that we have at KDP today, all those roles are being occupied, and serviced by the really world-class expertise. Therefore, we do have a very strong finance team below the CFO, which is definitely helpful to perform the CFO activities.

And we are not necessarily looking for to grab or find one specific expertise. What matters for us is to be able to operate on a cross-functional basis across our company, and most importantly, contribute to the growth agenda of our company that we are very excited given all the opportunities that lie ahead of us.

Robert Ottenstein
Terrific. Thank you very much.

Ozan Dokmecioglu
You're welcome.

CONCLUSION

Operator
This concludes our question-and-answer session. I would like to turn the conference back over to the company for any closing remarks.

Steve Alexander
Thank you, operator, and thank you everyone for joining us this morning. If you have any questions or follow ups, Chethan and I are around all day, please reach out. We'd be happy to talk to you and answer any questions. Thank you very much.

Operator
The conference has now concluded. Thank you for attending today's presentation. You may now disconnect.