Keurig Dr Pepper, Inc.

Third Quarter 2023 Earnings Call

October 26, 2023, at 8:00 a.m. Eastern

CORPORATE PARTICIPANTS

Jane Gelfand - *VP, Investor Relations and Strategic Initiatives*

Robert Gamgort - *CEO & Chairman*

Sudhanshu Priyadarshi - *Chief Financial Officer*

PRESENTATION

Operator
Good morning, ladies and gentlemen, and thank you for standing by. Welcome to Keurig Dr Pepper earnings call for the third quarter of 2023. 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 and Strategic Initiatives, Jane Gelfand. Ms. Gelfand, please go ahead.

Jane Gelfand
Thank you, and hello everyone. Earlier this morning, we issued two press releases, the first detailing our third quarter results and the second announcing our sales and distribution partnership with Grupo PiSA for Electrolit.

During today's call and consistent with previous quarters, we will be discussing our Q3 performance on an Adjusted basis, which reflects constant currency growth rates and excludes items affecting comparability. The Company believes that the Adjusted basis, while not in accordance with GAAP, provides investors with meaningful comparisons and appropriate insight into our business and operating performance trends. 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.

We will also speak about the concept of underlying performance, which removes the impact of non-operational items in the current and prior years. These items include gains on asset sale leaseback transactions, reimbursement of litigation expenses related to the successful resolution of our BodyArmor lawsuit, a business interruption insurance recovery and a change in accounting policy for stock compensation.

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 can 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.

Here with us today to discuss our results are KDP Chairman and CEO, Bob Gamgort and our Chief Financial Officer, Sudhanshu Priyadarshi. I'll now turn it over to Bob.

Robert Gamgort
Thanks, Jane, and good morning, everyone.

We are pleased with our Q3 results. KDP's diversified beverage portfolio and strong execution continue to support consistent delivery of our company goals and commitments, even as the operating environment around us remains dynamic. In Q3, healthy organic sales growth and significant gross margin progress fueled reinvestment and bottom-line growth, reinforcing visibility to our full year outlook, which remains unchanged.

Third quarter constant currency net sales grew 4.1%. As expected, net price realization moderated from the first half, but remained the primary top-line growth driver, while volume/mix strengthened sequentially. Our performance reflected continued share gains in U.S.

Refreshment Beverages, gradual recovery in U.S. Coffee segment results, and strong momentum in our International business.

Gross profit margin expanded significantly -- up 100 bps year-over-year and the largest improvement in four years -- reflecting an improved balance between ongoing inflation, pricing and productivity. Our gross profit growth enabled us to continue reinvesting in the business, including increased marketing for the third consecutive quarter, while simultaneously driving bottom-line growth, which was slightly above the expectations we shared with you back in July. As we move through Q4 and plan for next year, we expect our revenue growth drivers to continue to normalize, as pricing moderates relative to recent history and volume/mix continues to improve. To be clear, pricing is expected to remain a key part of the top-line equation, especially considering that inflation is likely to persist -- albeit at more moderate levels than over the last couple of years. Simultaneously, our focus will be on supporting volume/mix by balancing margin flexibility between reinvestment in future top-line growth and earnings flow-through.

Let me take a step back and frame how we assess consumer health, our portfolio, and our strategy in the macroenvironment.

The consumer remains healthy, with demand resilient and category elasticities manageable. Even so, consumers are closely calibrating where and how they shop. For instance, growth in club and other value-oriented channels has accelerated, while the convenience of e-commerce and pick-up and delivery services continues to resonate well-after any pandemic-related uplift would have normalized. Consumers remain responsive to high-quality innovation and activation, but price and package architecture is another increasingly important dimension, including smaller pack sizes that hit key price points and multi-packs that offer value and convenience. On the margin, we also see some migration of lower-to-middle income households towards at-home meal and beverage occasions, which should benefit our more essential categories like CSDs and coffee.

Our business is well positioned against this backdrop, thanks to a compelling, all-weather growth model. The ability to seamlessly meet the consumer across all beverage need states and to service those occasions across all channels was at the heart of why we formed this Modern Beverage Company. Since then, we have made even more progress as we significantly grew the portfolio reach and strengthened our internal capabilities. Looking forward, our distribution prowess across retail is broad-based with very strong in-market execution, yet we also enjoy a scaled online business, particularly on the Coffee side. Our robust 2024 innovation pipeline has been well received by the trade and spans product, format and packaging news that captures a combination of value and premium price points, as well as low- and no- calorie and indulgent beverages. We also continue to price nimbly across the entirety of our portfolio, including by leveraging our strong mix management capabilities. In short, the consumer is resilient but choiceful, and KDP is positioned to drive attractive top-line growth through a combination of volume, mix and price levers.

Our successful growth model rests on our exclusive focus on North American beverages and a winning strategy. It begins with KDP's powerful twin distribution assets: our multi-channel cold beverage distribution system, including DSD, and installed base of nearly 40 million active households using the Keurig system. This is an unparalleled combination in the industry which, enhanced by a strong R&D and commercial backbone, enables us to 1) grow our categories and gain share across our base business and 2) further build out our portfolio through high-value M&A and partnerships with counterparts who increasingly seek *us* out. When we fill in category white spaces, such as through our announcement today of the partnership for Electrolit, it fuels a virtuous cycle of growth, investment, and growing returns on that investment. As the new brands scale and our portfolio expands, our capabilities get stronger. Our drop sizes get bigger; our merchandizing gets more impactful; we service each store and household more frequently; and, our commercial and consumer relationships tighten. This enables further investment and growth that begins the cycle anew.

We have proven this model over multiple years. In U.S. Refreshment Beverages, we have consistently outperformed our categories, growing dollar share in at least 75% of our business in all but two quarters since the beginning of 2019. We also entered multiple strategic white spaces within past 12 months, such as RTD coffee, energy and, after today's announcement, sports hydration; All were achieved in a very capital efficient manner. The growth path ahead is increasingly evident, with both owned- and partner- brands, the latter where our relationships are strategic and long-term, growth and mix are positive, and our economics are attractive. In Coffee, the single serve segment has continued to steadily gain share of at-home coffee, cementing Keurig's leadership position with this important category. At the same time, we are expanding our Total Coffee strategy to encompass iced, RTD, and other forms of coffee within and beyond the K-cup format. And in Canada and Mexico, we have leveraged similar strategies across our Refreshment Beverages and Coffee businesses, as well as deeply experienced local teams, to build a combined business approaching $2B in revenue with a mid-20s operating margin. As a result, our International segment has become a scaled contributor to the overall portfolio with significant growth runway ahead.

I'll now briefly discuss how this strategy played out in Q3, with Sudhanshu to follow with greater detail and guidance.

In U.S. Refreshment Beverages, 82% of our business outpaced category growth in the quarter. The CSD business is healthy, with Dr Pepper building on the momentum of Strawberries & Cream earlier in the year with a successful sixth season of its iconic Fansville marketing campaign. Other brands such as Canada Dry and Squirt also saw strong gains, and Polar's momentum continued in sparkling water, where it now commands the #2 volume share position. Core and Evian remain strong drivers in premium waters, with Core, in particular, seeing great traction from our partnership with U.S. Gymnastics. That said, we have work to do elsewhere in the still portfolio, including with Bai which is undergoing a significant restage and reformulation next year.

Importantly, our partnership with Nutrabolt on C4 is proceeding very well. In Q3, C4's market share and earned display accelerated, while velocities remained strong, across those regions where KDP has taken control of the brand's route-to-market. Even as the C4 rollout continues in its first year, we have significant room for future growth in energy, where KDP's market share is only 3% and C4 has tremendous potential.

With the Electrolit announcement today, we are extending our portfolio into the large and important sports hydration category, another quickly growing, mix-accretive white space for KDP. Electrolit is a brand that has established a strong regional foothold thanks to its unique product attributes, scientific heritage, and extremely loyal customer base. The brand is the market leader in sports hydration in Mexico, and that popularity extends to the U.S. where Electrolit enjoys broad multicultural appeal but overindexes with Hispanic consumers and in the southern states. Though it has good scale today in the U.S. and already generates more than $400 million in retail sales, representing more than a ten-fold increase over the past five years, Electrolit has significant upside potential. We are excited to partner with Grupo PiSA, Electrolit's parent company, to meaningfully expand the brand's distribution breadth and depth in the U.S. and across all channels, while leveraging KDP's commercial expertise to further enhance the brand's position at retail.

With C4, La Colombe and Electrolit having entered our portfolio over the last 12 months, we have meaningfully increased the growth potential for each of these brands, while extending a positive halo on the rest of our business. For example, our total volume in chain convenience stores will increase by approximately 50% after incorporating these brands, providing scale and efficiency benefits across the entirety of our portfolio. This is the virtuous cycle that I described just a few minutes ago and which will continue to fuel KDP's success.

Turning now to U.S. Coffee, where our back half focus on driving a segment margin inflection in the context of gradually improving at home coffee category volumes. With visible progress on both fronts, let's address each in turn.

I'll start with the segment margin improvement, which we have a greater ability to control in the short-term than we do with category trends. In Q3, we began to deliver against our objective, with a strong inflection in segment margins and operating income, which meaningfully improved both sequentially and year-over-year. Importantly, we expect the margin improvements to continue. We previously said that delayed pricing would flow through on our partner brands, and it has. We have now strengthened the pricing protocols across these long-term partnerships and do not expect any significant lag between inflation and pricing to recur in the future. Plus, commodity cost headwinds are now moderating and productivity is building across the segment, enhancing our visibility to continuing to grow the bottom-line even with ongoing reinvestment.

Moving to category performance, at home coffee category volume growth accelerated relative to Q2, but the pace of recovery is admittedly gradual. From Q2 to Q3, volume trends across the broader category strengthened by about 100 basis points in measured channels, though volumes are still modestly lower year-over-year. Single serve continues to gain share of at home coffee, with our proprietary data – which is more comprehensive, spanning both measured and untracked channels – indicating that Q3 Keurig-compatible pod consumption volume was approximately flat versus year ago, improving from down about 3% in Q2. These green shoots are encouraging, and we will continue to nurture them as the single serve market share leader. During the quarter, we saw our competitors begin to lean more aggressively into price promotions in the single serve category, resulting in some share shifts across the various brands in the ecosystem. As a reminder, because we manufacture nearly 80% of all Keurig-compatible pods in the U.S. we tend to participate even as share changes occur between our branded- and private label- partner brands and our owned and licensed brands. Nevertheless, we must responsibly manage our owned and licensed brands' price gaps within the category and intend to stay nimble to the changing operating conditions around us. Importantly, as we choose to surgically respond to the recent price activity, we expect segment margins to accelerate in Q4.

We also do not expect the competitive pricing activity to meaningfully accelerate at-home coffee category volumes, which we know are far more responsive to high quality activities that influence consumer choice and lean into emerging trends. As the single serve leader, KDP will continue to drive category growth as we always have – through innovation, renovation and white space expansion that build penetration with new households and increase usage among our existing consumers. With 90 million U.S. households drinking coffee at home, of which fewer than 40 million actively using Keurig brewers, there is a significant multi-year opportunity ahead. In 2024, we will continue pursue that growth through:

- New consumables like cold brew and expanded iced varieties and refreshers;
- New brands like La Colombe – which, by the way, begins to ship in RTD and K-Cup formats starting in Q4;
- Significant new innovation in brewers;
- All supported by strong marketing and brand activation activity, including exciting, new collaborations across our owned and licensed brands.

Moving on to our International performance in Q3, which remained impressive with revenue growth once again in double digits and continued segment margin expansion. Both our Coffee and Refreshment Beverages businesses performed well. In Canada, the ready-to-drink alcohol and no-alcohol segment is growing and we are contributing to that growth. Atypique gained significant share as velocity and distribution built, and a "blast from the past" vodka-based Tahiti Treat RTD generated exceptional consumer demand. In Mexico, our powerhouse Penafiel and Squirt brands both grew at a double-digit rate, leveraging our strong go-to-market and DSD capabilities behind which we continue to invest. In Mexico, like in the U.S., we have significant growth potential ahead across both our core portfolio and through partnerships as we leverage these unique distribution assets.

KDP's strong balance sheet and cash generation profile are powerful enablers of our broader growth strategy, with today's Electrolit announcement yet another example of how we can grow our portfolio and market reach in a highly capital efficient manner. As a result, our financial policy approach can be flexible and dynamic. This year, we are deploying some of our cash flow to strategically reduce our supplier financing program. Simultaneously, we announced a 7.5% increase in our annual dividend, furthering our track record of regularly growing dividend income for our shareholders. With over $3 billion remaining on our share buyback authorization and, having already repurchased 24 million shares of KDP stock over the last 2 years, we have substantial flexibility to opportunistically lean in when we see compelling value in the business we know best.

Wrapping up, our third quarter results represented another period of consistent delivery against our commitments. Our top-line growth was strong and resilient, and we reinvested in our brands and differentiated capabilities. We also achieved important proof points in our margin recovery journey this quarter, as visible in our consolidated gross margin progress and in U.S. Coffee segment results. Our Q3 results provide enhanced visibility to our unchanged 2023 outlook for constant currency net sales growth of 5% to 6% and adjusted EPS growth of 6% to 7%. We expect to close out 2023 having significantly improved the composition of our earnings profile, lending further support to our aspiration to be on-algorithm in 2024.

I'll now turn it over to Sudhanshu.

Sudhanshu Priyadarshi
Thanks, Bob, and good morning, everyone.

Our consolidated third quarter results were solid. Top-line growth was resilient; we supported future momentum by reinvesting in the business; and we delivered modest EPS upside relative to the expectations we shared with you last quarter.

Revenue advanced 5.1% to $3.8 billion, with healthy constant currency sales growth of 4.1%. Pricing remained the primary growth driver, contributing 5.5 points. As expected, this was a

moderation from the second quarter, as prior year pricing actions were lapped. Volume/mix strengthened sequentially, posting a modest 1.4% decline year-over-year.
Gross profit margin inflected positively in the quarter and expanded a strong 100 basis points year-over-year, as pricing and efficiency gains began to offset input cost inflation.
Total SG&A deleveraged 130 bps year-over-year, reflecting our focus to reinvest in our brands and capabilities while combatting sustained inflation. SG&A saw another quarter of double-digit increases in marketing spending, while transportation, warehousing and other corporate costs, such as labor, remained headwinds.

Adjusted operating income grew 3.1% which, combined with below the line leverage, resulted in mid-single-digit EPS growth to $0.48, slightly ahead of the guidance we shared last quarter. We achieved this result without the benefit of any non-operational gains in the quarter, as we continue to make progress on reinforcing our earnings base looking out to next year.

Moving to the segments, U.S. Refreshment Beverages grew net sales 5.9%, led by 7.1 percentage points of pricing. The price contribution moderated quarter-over-quarter as anticipated, as we began to anniversary some of the last year's pricing activity. Volume/mix declined 1.2%, reflecting outperformance versus our categories across the vast majority of our portfolio and the growth contribution from C4 Energy.

As Bob said, we expect price to remain a continued driver of the top-line growth algorithm in Q4 and into next year, even as growth rebalances across volume, mix and pricing contributions. The consumer is resilient, category elasticities are manageable, and inflation – though moderating – remains a headwind.

Segment operating income grew 6.1% in the quarter and segment margins were approximately flat year-over-year. This performance reflected the favorable impact of pricing and productivity net of inflation, offset by increased investment in marketing.

In U.S. Coffee, net sales decreased 3.2%, improving versus the second quarter trough, as expected. Pricing sequentially strengthened and contributed 3.1 percentage points of growth. Some of this reflected pricing that lagged realized inflation across our partner portfolio and is now flowing through after a delay. In future cycles, we expect the pricing pass-through necessary to offset inflation to be more seamless.

Volume/mix declined 6.3% year-over-year in Q3. Brewers grew 8%, as we moved past destocking in the first half and shipped in for the important holiday period. For the back half as a whole, we expect brewer shipments to track point of sales trends, which remain softer in today's macro environment and are still declining in the mid-to-high single digits compared to last year. Importantly, Keurig brewers continue to gain share within the coffee maker category, and we still expect to finish the year having grown penetration to approximately 40 million households in the Keurig ecosystem, as compared to approximately 38 million at the end of 2022.

Pod shipments declined 8%, similar to last quarter. However, by our measure, category consumption volumes in single serve were flat year-over-year across all channels – a sequential improvement relative to Q2. As we previewed would happen last quarter, shipments lagged category consumption in the period due primarily to two factors: first, the comparison against a year-ago channel inventory build and second, the volume impact from our decision to exit certain low-margin private label contracts. We anticipate a smaller combined impact from these factors in Q4 and expect pod shipments to sequentially strengthen relative to Q3.

Coffee segment operating income grew 5.7% and operating margins expanded strongly. At nearly 33%, segment operating margins increased 280 basis points versus the prior year and also compared very favorably relative to 30.4% in the first half. This significant inflection was driven by pricing, productivity, and moderating inflation, and we expect it to sustain. As Bob mentioned, the path of the expected revenue recovery is slightly altered relative to our original plan, due to some prudent price reinvestment in a competitive environment. Nevertheless, margin trends are expected to accelerate further in Q4, as fundamental progress is expected to drive continued solid operating income growth year-over-year even as we lap a difficult comparison given non-operational benefits partially contributed to U.S. Coffee operating income last year.

International segment sales increased 20.8% in the third quarter, against a double-digit growth comparison in the year-ago period. Constant currency sales growth was very strong at 12.9%, with volume/mix increasing 9.0% and pricing up 3.9%. Our top-line momentum was broad-based across Mexico and Canada. Segment operating income grew very strongly at 39.4% on a reported basis and 31.7% in constant currency terms, thanks to operating leverage and efficiency gains netting favorably against inflation.

As anticipated, our free cash flow conversion strengthened sequentially in the third quarter to $459 million, reflecting the combination of profit growth and moderating working capital uses, and consistent with our expectation for free cash flow conversion to strengthen in the second half.

Our capital allocation approach remains unchanged. Our priorities include organic and inorganic investments to support our growth, further strengthening our balance sheet consistent with our long-term net leverage ratio target of 2-2.5x,and returning cash to shareholders through our dividend and opportunistic share buybacks.

We dynamically adjust between these priorities on an ongoing basis. In Q3, we closed on the highly strategic La Colombe partnership first introduced in July, which included a $300 million equity investment. Today, we announced another important partnership with Grupo PiSA to sell, distribute and merchandise Electrolit in the U.S. This is a meaningful step forward into sports hydration for KDP and establishes another mix-accretive growth platform, even as it comes with minimal capital commitments. As Bob pointed out, with entries into energy, RTD coffee, and sports hydration over the past twelve months, we have penetrated three large and important white spaces for a relatively modest capital outlay of less than $1.3B.

We also have the ability and the desire to continue to return cash to our shareholders. In September, we announced a 7.5% dividend increase, marking our third consecutive year of growing our dividend and representing a cumulative 43% increase over that time. Our share repurchases will remain opportunistic and we have demonstrated a willingness to step in when our share price becomes dislocated from the long-term value we expect to create. With approximately $3.2 billion remaining on our share repurchase authorization, we will continue to assess the market for such opportunities.

Moving now to guidance. We are reaffirming our consolidated outlook for 2023 and continue to target constant currency net sales growth of 5 to 6% and adjusted EPS growth of 6 to 7%. Our EPS outlook assumes minimal benefits from non-operational items in 2023, implying double-digit EPS growth on an underlying basis.

Our guidance for below-the-line items is consistent with last quarter. For the year, we continue to expect interest expense in a $470 to $475 million range; an effective tax rate of 22%; and, approximately 1.41 billion diluted weighted average shares outstanding.

We expect a strong end to the year in Q4, with similar top-line dynamics to Q3 and even stronger gross margin expansion. At the same time, we will be lapping approximately $67 million of non-operational gains in last year's fourth quarter, primarily concentrated in the U.S. Coffee segment, which creates a challenging comparison. Netting these factors together, we expect Q4 Adjusted EPS of approximately $0.54, or 8% year-over-year growth. On an underlying basis, this represents strong double-digit EPS growth.

With that, I will now turn the call back to Bob for closing comments.

Robert Gamgort
I'd like to close by saying how excited we all are that Tim Cofer is joining KDP as Chief Operating Officer on November 6th. From there, we are looking forward to a smooth CEO transition between Tim and me in Q2 next year and continuity as I serve as KDP's Executive Chairman thereafter.

Upon joining KDP, Tim's immediate focus will be immersing himself in the business. He will also partner with Sudhanshu, the full Executive Leadership Team and me to drive our annual operating planning process for 2024. A lot of robust work is underway, and we expect to provide you with a detailed outlook when we report our Q4 results. For now, let me just say that our entire organization is focused on delivering a strong finish to 2023.

We expect that Tim will join Sudhanshu and me in this forum in February and I know you will enjoy meeting him after that.

I'll now turn the call back to the operator for questions.

QUESTION AND ANSWER

Operator
We will now begin the question-and-answer session. To ask a question, you may press "*" then "1." If you see a speakerphone, please pick up your handset before pressing the keys. To withdraw your question, please press "*" then "2." We ask that you ask one question and one follow up. At this time, we will pause momentarily to assemble our roster. Our first question will come from Andrea Teixeira with JP Morgan. You may now go ahead.

Drew Levine
Hey, good morning. This is Drew Levine on for Andrea. Thank you for taking our question. So first wanted to ask on US coffee, if you could talk more specifically to the trends during the quarter, both in tracked and untracked channels if the recovery sort of playing out sequentially as you expected, and what we could think about the exit rate for September and October being.

And then secondarily, I think the expectation was for pod volumes to perhaps see moderating declines in the quarter. They were pretty flat. So anything changed incrementally during the quarter from pod shipment perspective? Thank you.

Robert Gamgort
Sure, Drew. Thanks for the question. On our last call, we talked about two drivers of improved coffee performance going forward. One was margin improvement, and the other one was rebound in the total at home coffee category. And so that goes beyond single serve to all forms of coffee consumed at home.

Obviously, as you saw in the results, we've received…or we've experienced the inflection that we expected in the margin side, and that's largely under our control and big driver of our performance. The category is experiencing sequential improvement, but admittedly, it is gradual. When we take a look at consumption of single serve, and we use our proprietary data, which looks at tracked and untracked channels, and remember, the track channels represent roughly 60% of total consumption, we're seeing that the volumes are flat, which is an improvement sequentially, but a bit slower than we expected.

And so that's really the core of any shipment shortfall versus expectations is really driven by the category. I would remind you within that that single serve and KDP continues to grow share within that category. So the theme that we've talked about before about controlling the controllables margin share performance are all are really quite good. The challenge is really this total at home coffee category, which is moving in the right direction, albeit at a slower pace. My last comment on that is what we're experiencing on at home coffee in the US is not unique to the US. It's a trend that we're seeing in most developed markets as well.

Operator
Our next question will come from Dara Mohsenian with Morgan Stanley. You may now go ahead.

Dara Mohsenian
Thanks. So just to follow up, do you expect the category will continue to recover going forward sequentially from here? Can we get back to growth going forward? And maybe, can you detail what's driven the acceleration and untracked channels and how sustainable that is going forward?

And then just second, if you could take a bit of a look out to 2024, you mentioned on algo for the total company, does that apply to the coffee business in terms of a more normalized organic sales growth and profit growth pace as you look out to 2024? Thanks.

Robert Gamgort
Sure. I think that when you take a look at the shipment trend, or the trajectory of the coffee category, I think it speaks for itself. We talked a lot about mobility as a big driver, and we certainly weren't the only ones that were looking at that. So mobility is no longer a factor. It's gone back to more of a normalized environment. And so I think that the trajectory that we're seeing right now on improved coffee consumption will continue.

The drivers of that, I think there are multiple contributors to the slower but steady improvement in the category, including really a change in work routines where you're looking at more hybrid work. The afternoon occasion, for example, changes on that. On the margins, we could see some impact from pricing and inflation and also some of the trends in cold coffee, which also indexes to out of home.

But there's nothing structural going on right now. And you can imagine we spent a lot of time digging into the fundamental consumer drivers of coffee. The tailwinds are incredibly strong, that the movement towards improving growth looks to be right in front of us here. But we're being honest and saying that the total at home coffee category has been more gradual than we originally expected, although we don't, like I said, we don't see anything as structural.

With regard to the untracked channels, why is that stronger, it's really driven by club and e-commerce. e-commerce, which was growing prior to the pandemic accelerated significantly during the pandemic, and it really has shown no signs of pulling back from that. And we've talked before about the importance of e-commerce in our total business. But you can imagine when you look at individual segments, that single serve coffee is really an ideal segment for e-commerce. It's lightweight, high value, long shelf life, not fragile to ship, so you can really have a quite a good business on e-commerce.

In addition to that, remember, we've been increasing our own subscription business as a business and services to the consumer. And as we put more smart brewers out there that allows for smart consumption-based reordering, I think that ecommerce will continue to grow. And I think club, you know, as the overall consumer shift towards that channel, it represents a good value. I also think that some of the changing away from home coffee trends, meaning office coffee trends, have also benefited the club channel as well as people in small and midsize offices are picking up their supplies there as well as in e-commerce.

And then with regard to 2024, I mean, we've given you our macro-outlook. We're not going to break it down by individual segments. The one thing I would say that I believe is important is this gradual or more gradual rebound in coffee is something that we've been able to factor in our thought process as we think about our total company algorithm. And obviously, it's something that we've digested and built into our expectations.

Operator
Our next question will come from Bryan Spillane with Bank of America. You may now go ahead.

Bryan Spillane
Thanks, operator. Morning, everyone. Maybe, Bob, maybe just to pick up on that last point and maybe a little bit higher level just thinking about the consumer, you know, as we've gone through this earning season, it's you know, there just seems like economizing behavior and a lot of different forms has, you know, kind of evolved more as we've moved through, you know, the back half of this year. And you know, Hershey talked a little bit about it this morning as well.

And so can you give perspective on two things? One, just, you know, how you're thinking or how KDP is thinking about the consumer next year, you know, stronger, weaker, and how maybe you're adjusting your plans, you know, across all businesses for that. And then the second, just because it's been so topical, just, you know, kind of how KDP is digesting all of the sort of information about GLP-1 and, you know, is that something you're beginning to factor into your longer-term plans? Thank you.

Robert Gamgort
Yeah. Thank you, Bryan. Thanks for those questions. You know, we plan our business on a range of outcomes. We said that before. We've been very watchful of the consumer and concerned about trade down behaviors as a result of financial pressures. As we said, the consumer today remains incredibly resilient, but we're thoughtful about how that might shift into the future.

We look across our entire portfolio. We have the ability to shift across formats, mix, channels, price pack architecture, on both the refreshment beverage side and the cold beverage side, I mean, the coffee side to be able to react to any of those changes. And as of right now, we haven't really seen that. There is a potential cascade that happens where you can talk about within traditional retail where consumer looks to lower priced items and shops in more value-oriented channels.

There's another piece as well, which is a cascade from away from home to in home. And some of the surveys that I've looked at recently is, you know, if you are pinched, these are consumer surveys, if you're pinched, what do you give up first? And what the consumer gives up first is dining out of home and travel. And so I think that what happens is that moves those occasions in home where we benefit from them. And you can take a look at the broad portfolio across all formats, but also specifically within coffee, we've been working really hard to provide the consumer with options to produce specialty coffee, cold coffee, coffee of any form that they get out of home, in home. And so I actually think that's a benefit for the category going forward.

So the conclusion is nothing as we sit here today. Very possible in the future and certainly in our range of planning, but lots of flexibility for us to deal with it and potentially some upside on certain segments, including coffee.

With regard to GLP-1, we've had the opportunity to look at every trend possible from a consumer perspective, for opportunities and risks, we've spent a lot of time digging into the most robust data that's available. And I would caution everybody that the data that is actually available is really limited at this point.

What we would want to see, as an industry before you came up with any conclusions is you'd want to see known GLP-1 users and be able to match their behavioral data over time. Self-reported data, survey data, trying to figure out who might be a GLP-1 consumer is really dangerous. The data that we're able to get into which is quite limited on actual GLP-1 users and their known consumption for us is neutral. May even be different than that by meaning more positive but let me just say neutral right now.

And here are the facts. I think it actually makes sense with just plain good sense, which is there's no evidence that people drink less in terms of beverages. So unless you believe the consumption of tap water is going up, and there's no indication that, then somebody in the beverage industry is picking up those sales. Are mix shifts possible? Absolutely. But we haven't seen anything significant in the data that we have in front of us within the world of beverage.

And I would remind you that we have a very, very broad portfolio. And in fact, more than 60% of our products, as in our corporate responsibility report, are classified as positive nutrition. So it's very similar to the conversation on recession. Consumers don't drink less if they change their mix in terms of which formats and types of beverages they consume. We have one of those occasions. And also, we have the ability to innovate, should we choose to.

We've had some questions on coffee. Specifically all the data that we can see right now, there's no impact on coffee consumption as a result of that. So when we step back, we are surprised by the reaction. And quite honestly, we're surprised that the conversation is about food and beverage. We don't participate in the food industry, but I can tell you in the beverage industry, I really think that there's a little to be concerned about here.

Having said that, we're going to continue to study. We'll get more robust data, we'll be able to see what I said before, which is known GLP-1 users and their actual consumption patterns over time. And I think that picture will become much clearer, but that's our conclusion today.

Operator
Our next question will come from Robert Ottenstein with Evercore. You may not go ahead.

Robert Ottenstein
Great, thank you very much. Two questions. First, congratulations on the deal with Electrolit. When I was at NACS a month or so ago, it was all the rage. A lot of talk about it. You mentioned that it was accretive to your mix. Can you talk about what that means? Because I would have thought this is just a distributor margin that you're getting. So maybe talk to us about, you know, the impact on your business.

And then the second question is, and this is kind of outdated, if you go back before Keurig and you talk to the old management team about the smaller pack sizes, you know, Dr Pepper was lagging. And there was, you know, a little bit of pushback saying that going into these, you know, different variety of pack sizes and canned sizes would add, you know, unneeded complexity. And I know a hell of a lot has changed since then. I'm just wondering where you are in terms of your manufacturing and canning capabilities today in terms of meeting that greater variety of pack sizes. Thank you.

Robert Gamgort
Yeah. So, Robert, I'm glad that you saw Electrolit at NACS and the excitement about it. This is a business that we've been tracking for some time. And we've been really impressed with their, you know, their strong growth, the fact that their consumer target is multicultural. And it's a perfect example, as we've discussed with C4, with La Colombe, with Polar where we can take a brand that is very strong and has a clear consumer base and opportunity and help them grow through expanded distribution, improved merchandising, and access to our RGM capabilities, category management capabilities, and more. And so this one, I think, is another one of these win-win structures.

When we think about Electrolit coming into our business and its implications on 2024, clearly, it's a contributor to revenue growth. Similar to what we talked about with C4, in its first year of incorporation, we don't think about it is as much of a driver of profit growth. But when you get into its second year, it will be able to contribute profitability, and we'll provide framing around that at that time. And that's because we make significant investment in the first year to get the brand on board.

And also, as we discussed earlier, this gives us a wonderful opportunity to put more investment in our route to market system to be able to improve coverage with the fact that we now have larger job sizes and increased frequency. And as we said a number of times, that benefits all brands within our system. And the fact that we put in the prepared remarks about the 50% growth in large outlets, C stores for us is a very significant consideration here in terms of our ability to cover our convenience stores for our entire portfolio. So this is yet another great example of how we're able to build our capabilities.

Your point about smaller pack sizes, yeah, the world has changed quite a bit. We have substantial distribution, and we have good manufacturing flexibility on small pack sizes. We see them as an incremental driver of growth. They happen to also be margin creative. They're very much in line with consumer trends where, if somebody wants to treat themselves and a portion of our portfolio is in the treat needs state, that we give them an opportunity to do so in a smaller pack size. And that's been the case in other CPG industries. And as we think about our manufacturing base going forward, flexibility in formats and pack sizes is a critical capability that we continue to invest in to give us the optionality of price pack archaic architecture moving forward.

Operator
Our next question will come from Bonnie Herzog with Goldman Sachs. You may know go ahead.

Bonnie Herzog
All right, thank you. Good morning, everyone. Bob, I was hoping you could give us some more color on the exiting of certain private label contracts in terms of maybe, you know, how big these customers are and if there's an expectation for more to come. And then you call that a tough comparison on your pod volumes in the quarter, you know, given the trade inventory builds in the year ago period. So just trying to understand how big of an impact you think that was. And could you just confirm, I thought you said this, that you're already starting to see pod volume improve in Q4. Thanks.

Robert Gamgort
Yeah. So on the first one on the exit of some private label partners, that really began in Q2. I mean, the best way for you to size it is you can take a look at the tracked data for the most part and just see KDP manufacturing share and it's going to show you where unlicensed versus licensed private label is. And I don't think that that's a, you know, it's definitely not a driver of profitability. And it's a minor contributor to revenue but it's the right thing to do over the long term.

We offer significant value to our partners. And we're also the driver and the player who invest in brewer innovation, brewer launches, which is the catalyst for the entire industry. And from time to time in these negotiations, we find partners the other side who don't want to pay for the value added. And there's a point in which we don't drop price because we know that we add that value.

And I would also point out this in almost every circumstance, most partners will come back to us over the long term because they miss what they get from KDP. So you'll see it in the track channels, and I don't think it's a big deal.

Second, part of the question was about the, you know, you asked a bit about inventory, and that's really a question about the gap between shipments and consumption. You know, the best way to characterize that is that if we tell you that the category rebound is going in the right direction but not at the pace that any of us expected, and when I say any of us, anybody who operates in the coffee industry and develop markets globally, then there's always going to be a disconnect between shipments and consumption. And there may be some shipments ahead of consumption based on those expectations.

That happened. That's normalizing. Expect that gap to narrow further in Q4. So to me, that's a lagging indicator. It's a contributor to the shipment piece, which you know, is worthy for a conversation this quarter. But over the long term, the pieces to really watch are how's the category at home coffee category performing, because that really drives everything, how is our share meaning total single serve and total KDP share of at home coffee, that continues to expand. And then the last part of it is our margin against that volume, which also is very high and improving. The combination of those three really does create value. But again, it's created some short-term disruption as we get out of, you know, the aftereffects of the rebound from the pandemic piece.

Operator

Our final question will come from Chris Carey with Wells Fargo Securities. You may now go ahead.

Chris Carey
Hey, everyone.

Robert Gamgort
Morning, Chris.

Chris Carey
I know you're not going to, you know, specify what drove the margin improvement in the quarter specifically, but can you maybe help frame the relevant contribution of pricing, of productivity, of easing commodity inflation, or maybe it was even a benefit? And also, you've been quite adamant that the mixed impact of your own portfolio underperforming is not as great as what is sometimes, you know, debated.

And so, you know, I wonder how that impacted the quarter as well. And you're clearly looking for an acceleration in margins in Q4. And I think really what I'm trying to do is, you know, get some confidence that well, okay, pod volumes could be volatile, within your portfolio, they could be volatile, but as you go into next year, here's why we're going to continue to have visibility on margin, even if shipments or otherwise are a bit different than maybe what we would expect, you know, one quarter or two quarters out, right. So really trying to help frame the Q3 margins and, you know, to kind of get some help on the go for it. Thanks so much.

Robert Gamgort
Yeah, let me talk about the margin inflection that we've seen in the quarter. And we talked about prior to that. And then I'll ask Sudhanshu to take a look at where we are on from a segment OI perspective and a forward outlook on that.

We had a number of conversations in the past, as you'll recall, about the gap between pricing to partners and private label versus the inflation that we were experiencing that had never been contemplated in the prior years in which we had signed those agreements. And remember, that's very different than pricing that you see at retail, just to be clear, because I know when I say pricing, people immediately go to retail pricing. What I'm talking about is the contractual pricing that we have with partners and private label, who then in turn set their own retail pricing as a result of that.

And so we said that there was a lag, but it would flow through. It's flowing through. We have great visibility to it going forward, to answer your question, because it's contractual. And I think the other point to make and it's an emphasis of the prepared remarks is that we've now adjusted all of those agreements going forward and we don't expect a substantial lag between pricing and inflation to occur in the future.

So lessons learned from the past. A bit of pain that we had to incur over the past couple of years. But that's all catching up right now and you're seeing that flowing through. In addition to that partner, private label pricing flowing through, we're also seeing some moderation and inflation. And we're experiencing an increase in productivity. As we said, a couple of times, when we were in a supply chain disruption mode, and we were trying to get every case out the door, productivity takes a backseat. We're in really good shape on our supply chain, from a capacity standpoint, and we have the ability now to focus on productivity and dial that up.

So it's the combination of partner private label pricing, productivity, and moderating inflation, that is contributing to the margin inflection you're seeing now and also our confidence and visibility into the future. But Sudhanshu, why don't you take a minute and talk more about that last piece.

Sudhanshu Priyadarshi
Thanks, Bob. Chris, if you think about Q4 and beyond, in Q4, we are expecting a sequential improvement in port shipment as category is gradually recovering. We are also planning to have margin expansion in quarter four higher than quarter three. We talked about that before. And we will also see a solid operating income growth in quarter four.

Even stronger underlying, as you all know, we had a lot of non-operating benefits in coffee. So you'll have a stronger underlying growth because of your planning minimal non-operating thing. And as you think through 2024, our plan is to continue to gradually rebuild margin in the coffee category which started with quarter three. You saw we went from 30% roughly for the past half to 33%. Q4 will expand further. And you will see this gradual build-up or rebuild-up our margin in 2024.

CONCLUSION

Operator
This concludes our question-and-answer session. I'll turn the conference back over to Jane Gelfand for any closing remarks.

Jane Gelfand
Thanks, Anthony. And thank you, everyone. We appreciate your time and attention this morning. And as always, the investor relations team is available to answer any follow up questions you may have. Have a great day.

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