

Keurig Dr Pepper Inc. (KDP)

\$23.86 (As of 04/02/20)

Price Target (6-12 Months): **\$25.00**

Long Term: 6-12 Months

Zacks Recommendation:

Neutral

(Since: 02/19/19)

Prior Recommendation: Underperform

Short Term: 1-3 Months

Zacks Rank: (1-5)

3-Hold

Zacks Style Scores:

VGM:B

Value: D

Growth: B

Momentum: C

Summary

Keurig Dr Pepper has outpaced the industry year to date, owing to a robust earnings trend that continued in fourth-quarter 2019. Earnings gained from strong underlying sales growth across all segments, margin expansion and reduced debt. Underlying sales were aided by robust volume/mix and favorable currency. Moreover, the company is witnessing strong dollar consumption growth across the majority of its portfolio, with market share gains in several categories. It provided a strong view for 2020. However, it expects sales and earnings in the first half to be soft owing to several factors, including increased investments in the first half and lower productivity and synergies. Further, analysts expect the coronavirus crisis to result in lower demand for beverages. Meanwhile, the company has not provided any view on coronavirus impacts.

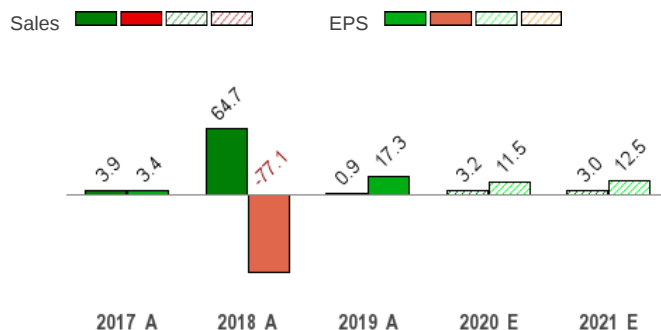
Price, Consensus & Surprise



Data Overview

52 Week High-Low	\$32.00 - \$18.98
20 Day Average Volume (sh)	5,817,764
Market Cap	\$33.6 B
YTD Price Change	-17.6%
Beta	0.60
Dividend / Div Yld	\$0.60 / 2.5%
Industry	Beverages - Soft drinks
Zacks Industry Rank	Bottom 41% (150 out of 254)

Sales and EPS Growth Rates (Y/Y %)



Last EPS Surprise	0.0%
Last Sales Surprise	-1.0%
EPS F1 Est- 4 week change	-2.1%
Expected Report Date	05/14/2020
Earnings ESP	-6.9%
P/E TTM	19.6
P/E F1	17.5
PEG F1	1.1
P/S TTM	3.0

Sales Estimates (millions of \$)

	Q1	Q2	Q3	Q4	Annual*
2021	2,654 E	3,002 E	3,089 E	3,139 E	11,817 E
2020	2,578 E	2,885 E	2,986 E	3,027 E	11,473 E
2019	2,504 A	2,812 A	2,870 A	2,934 A	11,120 A

EPS Estimates

	Q1	Q2	Q3	Q4	Annual*
2021	\$0.31 E	\$0.37 E	\$0.41 E	\$0.45 E	\$1.53 E
2020	\$0.27 E	\$0.32 E	\$0.37 E	\$0.40 E	\$1.36 E
2019	\$0.25 A	\$0.30 A	\$0.32 A	\$0.35 A	\$1.22 A

*Quarterly figures may not add up to annual.

The data in the charts and tables, including the Zacks Consensus EPS and Sales estimates, is as of 04/02/2020. The reports text is as of 04/03/2020.

Overview

With dual headquarters in Burlington, MA, and Plano, TX, Keurig Dr Pepper Inc. was formed with the merger of Keurig Green Mountain and Dr Pepper Snapple Group Inc. on Jul 9, 2018.

Keurig Dr Pepper plans to upgrade to the Texas co-headquarters by relocating the Plano, TX office to a new facility at The Star in Frisco, TX. It will begin operating from the new Texas headquarters after its completion in 2021.

Keurig Dr Pepper is a beverage and coffee company in the United States and Canada, with annual revenues of more than \$11 billion. It sells its products through at-home and away-from-home channels to retailers, including supermarkets, department stores, mass merchandisers, club stores and convenience stores; and restaurants, hospitality accounts, office coffee distributors and partner brand owners, as well as to consumers through its websites.

The company is also a leader in soft drinks, specialty coffee and tea, water, juice and juice drinks and mixers, and markets the No.1 single-serve coffee brewing system in the United States. It offers a wide range of hot and cold beverages, including Keurig, Dr Pepper, Green Mountain Coffee Roasters, Canada Dry, Snapple, Bai, Mott's and The Original Donut Shop.

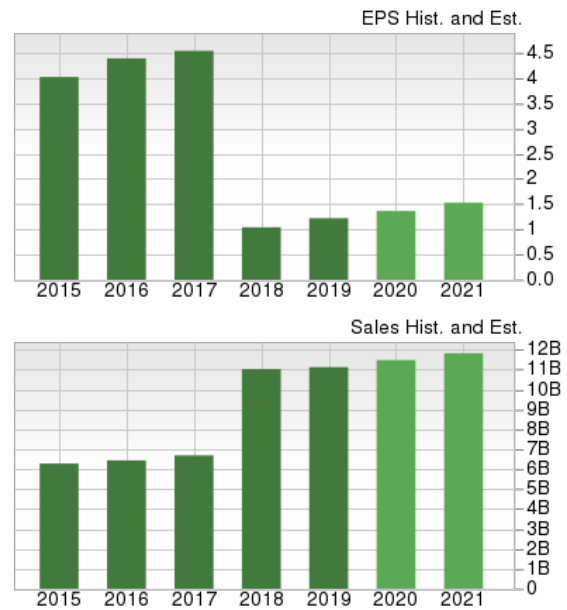
With over 25,000 employees, the company operates more than 120 offices, manufacturing plants, warehouses and distribution centers in North America. The company operates in four reportable segments:

Coffee Systems segment manufactures and distributes finished goods relating to its coffee system, pods and brewers, in the United States and Canada.

Packaged Beverages segment manufactures and distributes finished beverages and other products in the United States and Canada, through the Direct Store Delivery system and the Warehouse Direct system. Other products include the company's own brands and third-party brands.

Beverage Concentrates segment includes the sale of branded concentrates and syrup to third-party bottlers primarily in the United States and Canada. Most of the brands in this segment are carbonated soft drink brands.

Latin America Beverages segment manufactures and distributes concentrates, syrup and finished beverages in Mexico, the Caribbean, and other international markets.



Reasons To Buy:

▲ **Earning Trend Strong, Stock Outperforms:** Although shares of Keurig Dr Pepper have lost 17.6% year to date, it fared better than the industry's 19% decline. While earnings matched the Zacks Consensus Estimate in fourth-quarter 2019, it boasts a robust bottom line trend. Moreover, earnings improved year over year benefiting from strong underlying sales growth across all segments, margin expansion and reduced indebtedness. Net sales rose 4.3% year over year, backed by higher volume/mix of 5.3% and favorable foreign currency translation of 0.1%. The company's net sales increased 4.6%, excluding the one month of residual sales from BodyArmor prior to its exit in the fourth quarter of 2018 and the impact of foreign currency translation. Adjusted operating income grew 13% year over year driven by strong net sales growth as well as solid productivity and merger synergies. Adjusted operating margin expanded 210 basis points (bps).

Keurig Dr Pepper's earnings benefited from strong underlying sales growth across all segments, adjusted operating margin expansion and reduced indebtedness.

▲ **View for 2020, Long-Term Targets Intact:** Keurig Dr Pepper provided guidance for 2020. The company anticipates adjusted earnings per share growth of 13-15%, with net sales growth of 3-4% in 2020. Sales are expected to increase owing to the investments that the company is planning across the business, including in the areas of innovation, new partnerships, in-store execution, marketing and research and development. Moreover, the company remains on track with long-term targets set out at the time of the merger in July 2018. For the three-year (2018-2021) period, it continues to expect adjusted earnings growth in the range of 15-17%, with long-term sales growth target of 2-3%. Further, it anticipates capturing merger synergies of \$200 million in 2020. This is consistent with the long-term target of capturing \$600-million synergies, with \$200 million captured every year between 2019 and 2021.

▲ **Market Share Gains Reflect Strength:** Keurig Dr Pepper witnessed strong in-market performance across most of the business in the fourth quarter. The company witnessed dollar consumption growth, with market share gains across its major categories — including CSD's, shelf stable fruit drinks and shelf stable apple juice. The uptick was backed by strength in Dr Pepper and Canada Dry CSDs, Snapple juice drinks and Mott's apple juice. Further, in coffee, retail consumption for single-serve pods manufactured by KDP rose nearly 2% in channels tracked by IRI. The coffee business also witnessed robust growth in untracked channels. Further, dollar market share in tracked channels in the United States was 82% in the fourth quarter, which was even with year-ago quarter.

▲ **Partnerships & Acquisitions – Key Strategy:** Keurig Dr Pepper remains focused on partnerships and acquisitions, which form an important part of its growth strategy. The company continued with its roster of brand partnerships by signing a long-term deal with Nestlé USA to manufacture and distribute Starbucks branded packaged coffee in K-Cup pods in the United States and Canada. The new agreement replaces the existing agreement for K-Cup pods between Keurig and Starbucks after observing a transition period. In the third quarter, it had signed a long-term master licensing and distribution agreement for McCafé packaged coffee in the United States, which will be effective from the second half of 2020.

Since the completion of the merger, the company acquired Big Red and CORE Hydration. It also added Forto Coffee Energy Shots as a partner and expanded distribution terms with Peet's for ready-to-drink Iced Espresso. Additionally, it partnered with the Evian brand across the United States as well as Tim Horton's and Panera brands. Meanwhile, Keurig Dr Pepper exited FIJI Water and BODYARMOR drink brands as part of the recent reorganization of its allied brands.

▲ **Cash Flows & Debt:** Keurig Dr Pepper is displaying strength, with robust cash flow generation, which enables it to significantly pay down debt and offer shareholder value. In 2019, it generated operating cash flow of \$2,474 million, with free cash flows of \$2.4 billion, resulting in an impressive free cash flow conversion rate of 140%. Driven by the strong cash flow, it paid down structured payables of \$531 million and reduced bank debt by \$3.1 billion in 2019. This resulted in total payments between debt and structural payables of \$1.8 billion in 2019. Lowered debt and adjusted EBITDA growth resulted in a debt-to-adjusted EBITDA ratio (leverage ratio) of 4.5x at the end of 2019, compared with 5.4x at the end of 2018. This indicates that the company is on track to rapidly deleverage to reach the long-term target leverage ratio of less than 3x. For 2020, the company expects interest expenses of \$530-\$545 million, indicating ongoing deleveraging and gains from unwinding interest rate swap contracts. Additionally, it expects leverage ratio of 3.5x to 3.8x at the end of 2020.

Reasons To Sell:

- ▼ **Stock Looks Overvalued:** Considering price-to-earnings (P/E) ratio, Keurig Dr Pepper looks pretty overvalued when compared with the broader sector and the S&P 500 Index. The stock has a trailing 12-month P/E ratio of 19.6x, which is below the median level of 24.1x and the high level of 27.6x, scaled in the past year. On the contrary, the trailing 12-month P/E ratio is 17.5x for the sector and 15.4x for the S&P 500. Given these factors, we believe that the stock is quite stretched from the P/E aspect.
- ▼ **Soft First-Half 2020 Projections:** Although Keurig Dr Pepper provided a solid view for 2020, it expects sales and earnings in the first half to be soft owing to several factors. The company notes that the planned strategic investments for 2020 will be skewed towards the first half compared with the second half, resulting in higher investment costs. Further, it expects lower productivity and synergies in the first half as programs will be built throughout the year. Moreover, based on current input cost coverage, it anticipates inflation to be the highest in the first half, particularly in the first quarter, with moderation through the rest of the year. It also expects higher tariffs and elevated marketing investments for the coffee systems business in the first quarter. In Beverage Concentrates, it expects the timing of synergy capture and volume initiatives to be weighted toward the back half of the year. This will result in soft performance for these segments in 2020, reflecting a slow start and ramp up towards year-end.
- ▼ **Coronavirus Impacts on Beverage Industry:** Keurig Dr Pepper has not outlined any impacts of the coronavirus outbreak on its performance. However, analysts and other beverage makers expect to witness softness in demand for beverages amid the coronavirus outbreak, primarily due to light travel trends, conference cancellations, soft restaurant traffic and warnings against public gatherings.

Although Keurig Dr Pepper provided a solid view for 2020, it expects results in the first half to be soft owing to several factors including increased investments and lower productivity and synergies.

Last Earnings Report

Keurig Dr Pepper Q4 Earnings Meet Estimates, Rise Y/Y

Keurig Dr Pepper reported fourth-quarter 2019 results, wherein sales missed the Zacks Consensus Estimate while earnings matched the same. Notably, the company's top and bottom lines improved year over year. Results reflected strong underlying sales growth across all segments, margin expansion and reduced debt.

Adjusted earnings of 35 cents per share improved 16.7% year over year and came in line with the Zacks Consensus Estimate. This improvement was driven by strong underlying growth across all segments, adjusted operating margin expansion and reduced indebtedness.

Net sales of \$2,934 million marginally missed the Zacks Consensus Estimate of \$2,964 million but were up 4.3% from net sales of \$2,813 million in the year-ago quarter. The increase was driven by higher volume/mix of 5.3% and favorable foreign currency translation of 0.1%. These gains were partially offset by unfavorable net price realization of 0.7%. The company's net sales increased 4.6%, excluding the one month of residual sales from BodyArmor prior to its exit in the fourth quarter of 2018 and the impact of foreign currency translation.

In the fourth quarter, the company benefited from strong in-market performance. Keurig Dr Pepper witnessed dollar consumption growth, with market share gains across its several major categories — including CSD's3, shelf stable fruit drinks and shelf stable apple juice. The uptick was backed by strength in Dr Pepper and Canada Dry CSDs, Snapple juice drinks and Motts apple juice. Further, in coffee, retail consumption for single-serve pods manufactured by KDP rose nearly 4% in channels tracked by IRI. The coffee business also witnessed robust growth in untracked channels. Further, dollar market share in tracked channels in the United States was 82% in the fourth quarter, which was even with year-ago quarter.

Adjusted operating income grew 13% year over year to \$813 million, driven by strong net sales growth as well as solid productivity and merger synergies. This was partly offset by inflation, primarily in input costs and logistics, and higher marketing. Meanwhile, adjusted operating margin expanded 210 basis points (bps) to 27.7%.

Segmental Details

Sales at the **Beverage Concentrates** segment rose 8% year over year to \$380 million compared with \$352 million in the year-ago period. Net revenues primarily benefited from 3.8% higher net price realizations and a 4.2% increase in volume/mix.

Sales at the **Packaged Beverages** segment totaled \$1.21 billion, up 2.9% from net sales of \$1.18 billion in the year-ago quarter. This can be primarily attributed to a 3.8% increase in volume/mix and 0.2% higher net price realizations. This was offset by 1.1% due to unfavorable impact from the exit of BodyArmor during the fourth quarter of 2018.

Sales from the **Latin America Beverages** segment improved 11% to \$133 million compared with net sales of \$120 million in the prior-year quarter. This was on account of 4.9% rise in price realization, increase in volume/mix of 2.6% and favorable foreign currency translation of 3.3%.

The **Coffee Systems** segment's sales increased 4% to \$1.21 billion from \$1.16 billion recorded in the year-ago quarter. The increase was backed by improved volume/mix of 7.6%, offset by net price realization of 3.5% and unfavorable foreign currency translation of 0.1%. Volume/mix grew 7.6%, benefiting from a 10.3% increase in pod volume and 0.9% rise in brewer volume.

Financials

Keurig Dr Pepper ended the fourth quarter with cash and cash equivalents of \$75 million as of Dec 31, 2019, compared with \$83 million as of Dec 31, 2018. Long-term obligations totaled \$12,827 million and total stockholders' equity was \$23,257 million. Net cash provided by operating activities totaled \$2,474 million as of Dec 31, 2019.

Outlook

Keurig Dr Pepper provided guidance for 2020. The company anticipates adjusted earnings per share growth of 13-15%. For the three-year (2018-2021) period, it continues to expect adjusted earnings growth in the range of 15-17%, which is in line with the long-term target.

The company expects net sales growth of 3-4% in 2020 compared with its long-term sales growth target of 2-3%. Sales are expected to increase owing to the investments that the company is planning across the business, including in the areas of innovation, new partnerships, in-store execution, marketing and research and development. Further, it anticipates capturing merger synergies of \$200 million in 2020, consistent with the long-term target of capturing \$200-million synergies every year between 2019 and 2021.

Adjusted other net expenses are projected to be \$30 million in 2020. Adjusted interest expenses are likely to be \$530-\$545 million, indicating ongoing deleveraging and gains from unwinding interest rate swap contracts. Adjusted effective tax is expected to be 24.5-25%, with outstanding shares estimated at 1,425 million. Additionally, the company expects leverage ratio of 3.5 to 3.8 at the end of 2020. Further, it reiterated its leverage ratio target of less than 3.0 in two to three years, since the closing of the merger in July 2018.

Quarter Ending **12/2019**

Report Date	Feb 27, 2020
Sales Surprise	-1.01%
EPS Surprise	0.00%
Quarterly EPS	0.35
Annual EPS (TTM)	1.22

Recent News

Keurig Partners With Nestle to Market Starbucks K-Cup Pods – Feb 27, 2020

Keurig Dr Pepper has signed a long-term manufacturing and distribution agreement with Nestlé USA for Starbucks branded packaged coffee in K-Cup pods in the U.S. and Canada. Keurig had acquired rights to market and distribute Starbucks CPG and Foodservice products globally, excluding Starbucks coffee shops, in Aug 2018. The new agreement replaces the existing agreement for K-Cup pods between Keurig and Starbucks after observing a transition period.

Keurig's strategic partnership with Nestle is as old as 2011. The new agreement represents an extension of this long-standing relationship and provides avenues to capture untapped opportunities in the single serve coffee category in North America.

Keurig Dr Pepper Declares Dividend – Feb 13, 2020

Keurig Dr Pepper declared a quarterly cash dividend of 15 cents per share, payable in U.S. dollars. The dividend will be paid out on Apr 17, 2020, to shareholders of record as of Apr 3, 2020.

Valuation

Keurig Dr Pepper shares are down 17.6% in the year-to-date period and 12.5% for the trailing 12-month period. Stocks in the Zacks sub-industry and the Zacks Consumer Staples sector are down 19% and 21% in the year-to-date period, respectively. Over the past year, the Zacks sub-industry and sector are down 10.2% and 15.1%, respectively.

The S&P 500 index is down 23.1% in the year-to-date period and 14.3% in the past year.

The stock is currently trading at 16.6X forward 12-month earnings, which compares to 19.36X for the Zacks sub-industry, 16.55X for the Zacks sector and 15.37X for the S&P 500 index.

Over the past five years, the stock has traded as high as 24.56X and as low as 4.18X, with a 5-year median of 20.38X. Our Neutral recommendation indicates that the stock will perform in-line with the market. Our \$25 price target reflects 17.39X forward 12-month earnings.

The table below shows summary valuation data for KDP

Valuation Multiples - KDP					
		Stock	Sub-Industry	Sector	S&P 500
P/E F12M	Current	16.6	19.36	16.55	15.37
	5-Year High	24.56	23.2	22.37	19.34
	5-Year Low	4.18	18.37	16.55	15.18
	5-Year Median	20.38	21.42	19.68	17.44
P/S F12M	Current	2.89	3.85	7.99	2.7
	5-Year High	24.43	5.31	11.16	3.43
	5-Year Low	2.2	3.64	7.99	2.54
	5-Year Median	2.67	4.5	9.89	3
EV/EBITDA TTM	Current	13.07	16.44	31.58	9.15
	5-Year High	30.27	21.04	45.9	12.88
	5-Year Low	6.08	12.21	27.86	8.27
	5-Year Median	13.17	17.55	39.07	10.78

As of 04/02/2020

Industry Analysis Zacks Industry Rank: Bottom 41% (150 out of 254)



Top Peers

Campbell Soup Company (CPB)	Neutral
Coca-Cola Company (The) (KO)	Neutral
Monster Beverage Corporation (MNST)	Neutral
Nestle SA (NSRGY)	Neutral
PepsiCo, Inc. (PEP)	Neutral
Starbucks Corporation (SBUX)	Neutral
The J. M. Smucker Company (SJM)	Neutral
The Kraft Heinz Company (KHC)	Underperform

Industry Comparison Industry: Beverages - Soft Drinks				Industry Peers		
	KDP Neutral	X Industry	S&P 500	KO Neutral	MNST Neutral	PEP Neutral
VGM Score	B	-	-	F	C	D
Market Cap	33.57 B	108.59 M	17.16 B	188.56 B	29.56 B	172.11 B
# of Analysts	7	2	13	9	7	8
Dividend Yield	2.51%	0.00%	2.5%	3.73%	0.00%	3.08%
Value Score	D	-	-	F	D	C
Cash/Price	0.00	0.12	0.06	0.06	0.04	0.03
EV/EBITDA	15.20	5.70	10.80	15.64	19.06	15.18
PEG Ratio	1.13	3.03	1.74	3.49	NA	3.34
Price/Book (P/B)	1.44	2.56	2.33	8.93	7.10	11.62
Price/Cash Flow (P/CF)	13.84	9.34	9.11	17.99	25.25	16.92
P/E (F1)	17.37	15.72	14.73	21.51	24.74	21.61
Price/Sales (P/S)	3.02	0.84	1.81	5.15	7.04	2.56
Earnings Yield	5.70%	5.76%	6.71%	4.64%	4.05%	4.63%
Debt/Equity	0.55	0.44	0.70	1.30	0.00	1.96
Cash Flow (\$/share)	1.72	0.40	7.01	2.44	2.18	7.32
Growth Score	B	-	-	C	B	C
Hist. EPS Growth (3-5 yrs)	-23.83%	5.35%	10.92%	0.87%	19.63%	5.35%
Proj. EPS Growth (F1/F0)	11.83%	7.26%	1.02%	-3.16%	9.64%	3.64%
Curr. Cash Flow Growth	26.76%	9.45%	5.93%	4.40%	9.91%	-2.46%
Hist. Cash Flow Growth (3-5 yrs)	22.17%	1.86%	8.55%	-1.10%	18.17%	1.04%
Current Ratio	0.35	1.30	1.24	0.76	3.50	0.86
Debt/Capital	35.55%	31.41%	42.33%	56.60%	0.00%	66.22%
Net Margin	11.28%	0.24%	11.67%	24.38%	26.37%	10.89%
Return on Equity	7.50%	6.73%	16.70%	44.39%	27.63%	54.16%
Sales/Assets	0.22	0.84	0.54	0.42	0.84	0.88
Proj. Sales Growth (F1/F0)	3.18%	0.59%	1.54%	-0.07%	7.49%	2.90%
Momentum Score	C	-	-	D	C	D
Daily Price Chg	0.85%	0.00%	1.45%	4.34%	3.69%	4.86%
1 Week Price Chg	3.61%	3.61%	12.29%	11.78%	8.23%	15.90%
4 Week Price Chg	-11.63%	-21.82%	-21.33%	-22.54%	-17.98%	-10.31%
12 Week Price Chg	-14.39%	-31.41%	-28.56%	-20.58%	-14.30%	-8.11%
52 Week Price Chg	-12.47%	-41.36%	-22.55%	-5.44%	4.14%	1.97%
20 Day Average Volume	5,817,764	182,602	4,257,668	32,086,938	5,682,311	10,044,119
(F1) EPS Est 1 week change	-0.31%	0.00%	-0.04%	-2.60%	-0.64%	-0.63%
(F1) EPS Est 4 week change	-2.11%	-2.22%	-4.30%	-9.07%	-2.32%	-2.62%
(F1) EPS Est 12 week change	-1.94%	-2.72%	-5.47%	-8.92%	-1.08%	-3.50%
(Q1) EPS Est Mthly Chg	-2.41%	-2.37%	-5.91%	-13.64%	-3.53%	-2.33%

Zacks Style Scores

The Zacks Style Score is as a complementary indicator to the Zacks rating system, giving investors a way to focus on the highest rated stocks that best fit their own stock picking preferences.

Academic research has proven that stocks with the best Value, Growth and Momentum characteristics outperform the market. The Zacks Style Scores rate stocks on each of these individual styles and assigns a rating of A, B, C, D and F. We also produce the VGM Score (V for Value, G for Growth and M for Momentum), which combines the weighted average of the individual Style Scores into one score. This is perfectly suited for those who want their stocks to have the best scores across the board.

Value Score	D
Growth Score	B
Momentum Score	C
VGM Score	B

As an investor, you want to buy stocks with the highest probability of success. That means buying stocks with a Zacks Recommendation of Outperform, which also has a Style Score of an A or a B.

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