

## Keurig Dr Pepper

# Something's Brewing: coffee slowly recovering as refreshment bevs carry FY24

Reiterate Rating: BUY | PO: 38.00 USD | Price: 30.20 USD

## Algorithm achievable despite slower Coffee rebound

KDP delivered mixed 4Q results including organic sales of +1.1% YoY vs +2.8%e (volume/mix dynamics in US Coffee) and EPS of \$0.55 vs \$0.54e including +100bps of C4-related incentives which helped deliver the +80bps of operating margin beat. The silver lining, in our view, came through in the on-algorithm FY24 guide despite outlook for Coffee recovery to no better than flattish organic sales growth in 2024. Assuming this slower trajectory, mgmt. sounded confident on delivering better volume and margin in FY24 citing: 1) a strong innovation pipeline in US Refreshments landing in 2Q; 2) benefits from carryforward and additional pricing actions; and 3) +200bps of 2H-weighted volume contribution from Electrolit. Sequentially better operating margin expansion of +200bps in 4Q ex-C4 benefit helps corroborate visibility on efficiencies, we see ample flexibility for KDP to deliver its EPS guidance and fund reinvestment.

## Q1 model assumptions

We forecast total organic sales of +2.5% (-0.1% volume/+2.6% price) including US Coffee down -3.0% YoY (-4.0% volume on -8% brewer decline and -3% Pod shipments, and +1% price). We forecast +180bps of gross margin expansion to 54.5% with operating margin up +120bps as KDP funds marketing. By segment, we expect operating margin expansion of +130bps in Refreshment Bevs (vs +160bps ex-C4 in 4Q), +90bps in Coffee (vs +260bps in 4Q), and +300bps in International (vs +340bps in 4Q). Our EPS of \$0.35 is 1c below our prior estimate including \$30mil of incremental interest expense.

## FY24 considerations

We now forecast FY24 organic sales up +4.5% (+2.0% volume/+2.5% price) which includes +5.8% growth in Refreshment Bevs, -0.3% in US Coffee, and +8.5% in International. We forecast +30bps and +130bps of gross/operating margin expansion factoring in 2Q/3Q margin leverage driven by innovation and raise interest expense by \$72mil (now \$572mil) as KDP continues to refinance \$1.15bil of debt due within one year. Our resulting EPS of \$1.93 is +3c vs our previous forecast and up +8% YoY.

## Reiterate Buy rating and \$38 PO

Our \$38 PO is still based on a target multiple of c.19x our FY25 EPS estimate, in line with non-alcoholic beverage peers, justified in our view by KDP's attractive portfolio and continued pace of underlying improvement to the Coffee segment and earnings power.

Estimates (Dec) (US\$)	2022A	2023A	2024E	2025E	2026E
EPS	1.68	1.79	1.93	2.05	2.20
EPS Change (YoY)	5.0%	6.5%	7.8%	6.2%	7.3%
Consensus EPS (Bloomberg)			1.91	2.03	2.17
DPS	0.76	0.81	0.86	0.86	0.86
Valuation (Dec)					
P/E	18.1x	17.0x	15.7x	14.8x	13.8x
Dividend Yield	2.5%	2.7%	2.8%	2.8%	2.8%
EV / EBITDA*	13.3x	12.9x	12.0x	11.5x	11.0x
Free Cash Flow Yield*	5.8%	2.1%	5.6%	6.7%	6.7%

\* For full definitions of *IQmethod*<sup>SM</sup> measures, see page 5.

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### Equity

#### Key Changes

(US\$)	Previous	Current
2024E Rev (m)	15,557.7	15,405.7
2025E Rev (m)	16,178.9	16,021.5
2026E Rev (m)	16,826.3	16,663.0
2024E EPS	1.90	1.93
2025E EPS	2.04	2.05
2026E EPS	2.17	2.20

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### Stock Data

Price	30.20 USD
Price Objective	38.00 USD
Date Established	15-Dec-2023
Investment Opinion	A-1-7
52-Week Range	27.66 USD - 36.23 USD
Mkt Val (mn) / Shares Out (mn)	42,908 USD / 1,420.8
Free Float	71.2%
Average Daily Value (mn)	249.75 USD
BofA Ticker / Exchange	KDP / NAS
Bloomberg / Reuters	KDP US / KDP.OQ
ROE (2024E)	10.2%
Net Dbt to Eqty (Dec-2023A)	50.3%
ESGMeter™	High

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# iQprofile<sup>SM</sup> Keurig Dr Pepper

## iQmethod<sup>SM</sup> – Bus Performance\*

(US\$ Millions)	2022A	2023A	2024E	2025E	2026E
Return on Capital Employed	6.1%	6.2%	6.7%	6.9%	7.2%
Return on Equity	9.6%	9.9%	10.2%	10.1%	10.1%
Operating Margin	25.2%	24.7%	26.0%	26.2%	26.6%
Free Cash Flow	2,484	904	2,395	2,884	2,892

## iQmethod<sup>SM</sup> – Quality of Earnings\*

(US\$ Millions)	2022A	2023A	2024E	2025E	2026E
Cash Realization Ratio	1.2x	0.5x	1.0x	1.1x	1.1x
Asset Replacement Ratio	0.5x	0.6x	0.5x	0.5x	0.5x
Tax Rate	22.6%	22.3%	22.0%	22.5%	22.5%
Net Debt-to-Equity Ratio	45.5%	50.3%	42.7%	34.2%	26.5%
Interest Cover	8.4x	7.9x	7.0x	8.1x	9.2x

## Income Statement Data (Dec)

(US\$ Millions)	2022A	2023A	2024E	2025E	2026E
Sales	14,057	14,814	15,406	16,021	16,663
% Change	10.8%	5.4%	4.0%	4.0%	4.0%
Gross Profit	7,568	8,190	8,560	8,942	9,300
% Change	7.5%	8.2%	4.5%	4.5%	4.0%
EBITDA	4,247	4,377	4,704	4,901	5,133
% Change	2.9%	3.1%	7.5%	4.2%	4.7%
Net Interest & Other Income	(441)	(417)	(532)	(500)	(460)
<b>Net Income (Adjusted)</b>	<b>2,397</b>	<b>2,518</b>	<b>2,708</b>	<b>2,868</b>	<b>3,079</b>
<b>% Change</b>	<b>5.1%</b>	<b>5.0%</b>	<b>7.5%</b>	<b>5.9%</b>	<b>7.3%</b>

## Free Cash Flow Data (Dec)

(US\$ Millions)	2022A	2023A	2024E	2025E	2026E
Net Income from Cont Operations (GAAP)	2,397	2,518	2,708	2,868	3,079
Depreciation & Amortization	709	720	700	700	700
Change in Working Capital	(275)	(1,747)	(652)	(324)	(526)
Deferred Taxation Charge	(289)	(4)	0	0	0
Other Adjustments, Net	295	(158)	0	0	0
Capital Expenditure	(353)	(425)	(360)	(360)	(360)
<b>Free Cash Flow</b>	<b>2,484</b>	<b>904</b>	<b>2,395</b>	<b>2,884</b>	<b>2,892</b>
<b>% Change</b>	<b>1.3%</b>	<b>-63.6%</b>	<b>165.0%</b>	<b>20.4%</b>	<b>0.3%</b>
Share / Issue Repurchase	(379)	(706)	0	0	0
Cost of Dividends Paid	(1,080)	(1,142)	(1,205)	(1,205)	(1,205)
Change in Debt	(118)	1,179	(1,100)	(1,600)	(1,600)

## Balance Sheet Data (Dec)

(US\$ Millions)	2022A	2023A	2024E	2025E	2026E
Cash & Equivalents	535	267	357	436	523
Trade Receivables	1,484	1,368	1,634	1,756	2,054
Other Current Assets	1,785	1,740	1,872	1,995	2,151
Property, Plant & Equipment	2,491	2,699	2,659	2,619	2,579
Other Non-Current Assets	45,542	46,056	46,056	46,056	46,056
<b>Total Assets</b>	<b>51,837</b>	<b>52,130</b>	<b>52,578</b>	<b>52,861</b>	<b>53,364</b>
Short-Term Debt	895	3,246	3,246	3,246	3,246
Other Current Liabilities	7,181	5,670	5,415	5,336	5,265
Long-Term Debt	11,072	9,945	8,845	7,245	5,645
Other Non-Current Liabilities	7,564	7,593	7,593	7,593	7,593
<b>Total Liabilities</b>	<b>26,712</b>	<b>26,454</b>	<b>25,099</b>	<b>23,420</b>	<b>21,749</b>
<b>Total Equity</b>	<b>25,125</b>	<b>25,676</b>	<b>27,479</b>	<b>29,442</b>	<b>31,615</b>
<b>Total Equity &amp; Liabilities</b>	<b>51,837</b>	<b>52,130</b>	<b>52,578</b>	<b>52,861</b>	<b>53,364</b>

\* For full definitions of iQmethod<sup>SM</sup> measures, see page 5.

## Company Sector

Soft Drinks

## Company Description

On July 9, 2018 Keurig Green Mountain and Dr Pepper Snapple merged to form Keurig Dr Pepper (KDP). KDP is a leading producer of 1) specialty coffee and single-serve brewing systems available in more than 20mn homes and offices in North America. Keurig has partnerships with many global coffee, tea and cocoa brands. 2) Dr Pepper is the 3rd largest carbonated beverage producer in the US with strength in flavored (non-cola) carbonated beverages. It also has a diverse portfolio of non-carb beverages.

## Investment Rationale

In our view, KDP offers an opportunity to tap into the US non-alcoholic beverage market with a broad array of products that address multiple need states and day parts with a selling and distribution platform with scale across all retail channels. We expect KDP shares to outperform the broader market as we forecast solid free cash flow and deleveraging.

## Stock Data

Average Daily Volume 8,269,908

## Quarterly Earnings Estimates

	2023	2024
Q1	0.34A	0.35E
Q2	0.42A	0.48E
Q3	0.48A	0.54E
Q4	0.55A	0.57E



## Price objective basis & risk

### Keurig Dr Pepper (KDP)

Our \$38 PO is based on an unchanged 19x P/E ratio off of our FY25 EPS estimate which represents an even multiple with non-alcoholic beverage peers. Our PO factors in an extended recovery in the US Coffee segment and still reflects KDP's attractive portfolio that we believe is well equipped to grow sales and earnings, particularly with the recent additions of the C4 energy drink and Electrolit hydration brands. Potential upside risks to our PO are: 1) Additional synergies. 2) Less volatility in the coffee business. 3) Increased adoption of Keurig brewers/pods. 4) Attractive M&A candidate. Potential downside risks to our PO are: 1) Industry shifts away from single serve coffee, which could lead to slower than anticipated de-leveraging. 2) Weak consumer spending around the holiday season will negatively impact sales of the Keurig brewers.

## Analyst Certification

I, Bryan D. Spillane, hereby certify that the views expressed in this research report accurately reflect my personal views about the subject securities and issuers. I also certify that no part of my compensation was, is, or will be, directly or indirectly, related to the specific recommendations or view expressed in this research report.

### US - Consumables Coverage Cluster

Investment rating	Company	BofA Ticker	Bloomberg symbol	Analyst
<b>BUY</b>				
	BellRing Brands Inc	BRBR	BRBR US	Bryan D. Spillane
	Coca-Cola Europacific Partners plc	CCEP	CCEP US	Bryan D. Spillane
	Colgate-Palmolive Company	CL	CL US	Bryan D. Spillane
	Constellation Brands	STZ	STZ US	Bryan D. Spillane
	Coty Inc.	COTY	COTY US	Anna Lizzul
	e.l.f. Beauty	ELF	ELF US	Anna Lizzul
	Freshpet, Inc.	FRPT	FRPT US	Bryan D. Spillane
	Kenvue Inc.	KVUE	KVUE US	Anna Lizzul
	Keurig Dr Pepper	KDP	KDP US	Bryan D. Spillane
	Kraft Heinz Company	KHC	KHC US	Bryan D. Spillane
	Lamb Weston Holdings Inc	LW	LW US	Peter T. Galbo, CFA
	McCormick & Co.	MKC	MKC US	Peter T. Galbo, CFA
	Mondelez International	MDLZ	MDLZ US	Bryan D. Spillane
	Monster Beverage Corporation	MNST	MNST US	Peter T. Galbo, CFA
	PepsiCo	PEP	PEP US	Bryan D. Spillane
	Philip Morris International	PM	PM US	Lisa K. Lewandowski
	Pilgrim's Pride Corp.	PPC	PPC US	Peter T. Galbo, CFA
	The Coca Cola Company	KO	KO US	Bryan D. Spillane
	The Procter & Gamble Company	PG	PG US	Bryan D. Spillane
<b>NEUTRAL</b>				
	Altria Group	MO	MO US	Lisa K. Lewandowski
	Celsius Holdings Inc	CELH	CELH US	Jonathan Keypour
	Church & Dwight	CHD	CHD US	Anna Lizzul
	Clorox	CLX	CLX US	Anna Lizzul
	Conagra Brands, Inc.	CAG	CAG US	Peter T. Galbo, CFA
	Estee Lauder Companies Inc.	EL	EL US	Bryan D. Spillane
	General Mills	GIS	GIS US	Bryan D. Spillane
	JM Smucker Company	SJM	SJM US	Peter T. Galbo, CFA
	Kellanova	K	K US	Peter T. Galbo, CFA
	Molson Coors Beverage Company	TAP	TAP US	Bryan D. Spillane
	The Hershey Company	HSY	HSY US	Bryan D. Spillane
	Tyson Foods, Inc.	TSN	TSN US	Peter T. Galbo, CFA
	Utz Brands	UTZ	UTZ US	Peter T. Galbo, CFA
	WK Kellogg Co	KLG	KLG US	Peter T. Galbo, CFA
<b>UNDERPERFORM</b>				
	Brown-Forman Corporation	BFB	BF/B US	Bryan D. Spillane
	Campbell Soup Company	CPB	CPB US	Peter T. Galbo, CFA

**US - Consumables Coverage Cluster**

Investment rating	Company	BofA Ticker	Bloomberg symbol	Analyst
	Canopy Growth	YWEE	WEED CN	Lisa K. Lewandowski
	Canopy Growth	CGC	CGC US	Lisa K. Lewandowski
	Cronos Group	YCRON	CRON CN	Lisa K. Lewandowski
	Cronos Group	CRON	CRON US	Lisa K. Lewandowski
	Dole plc	DOLE	DOLE US	Bryan D. Spillane
	Herbalife Ltd	HLF	HLF US	Anna Lizzul
	Hormel Foods Corp.	HRL	HRL US	Peter T. Galbo, CFA
	Kimberly-Clark	KMB	KMB US	Anna Lizzul
	The Duckhorn Portfolio, Inc.	NAPA	NAPA US	Peter T. Galbo, CFA
<b>RSTR</b>				
	The Vita Coco Company, Inc.	COCO	COCO US	Bryan D. Spillane

**iQmethod<sup>SM</sup> Measures Definitions****Business Performance**

Return On Capital Employed

Return On Equity

Operating Margin

Earnings Growth

Free Cash Flow

**Quality of Earnings**

Cash Realization Ratio

Asset Replacement Ratio

Tax Rate

Net Debt-To-Equity Ratio

Interest Cover

**Valuation Toolkit**

Price / Earnings Ratio

Price / Book Value

Dividend Yield

Free Cash Flow Yield

Enterprise Value / Sales

EV / EBITDA

**Numerator**

NOPAT = (EBIT + Interest Income) × (1 – Tax Rate) + Goodwill Amortization

Net Income

Operating Profit

Expected 5 Year CAGR From Latest Actual

Cash Flow From Operations – Total Capex

**Numerator**

Cash Flow From Operations

Capex

Tax Charge

Net Debt = Total Debt – Cash &amp; Equivalents

EBIT

**Numerator**

Current Share Price

Current Share Price

Annualised Declared Cash Dividend

Cash Flow From Operations – Total Capex

EV = Current Share Price × Current Shares + Minority Equity + Net Debt +

Other LT Liabilities

Enterprise Value

**Denominator**

Total Assets – Current Liabilities + ST Debt + Accumulated Goodwill

Amortization

Shareholders' Equity

Sales

N/A

N/A

**Denominator**

Net Income

Depreciation

Pre-Tax Income

Total Equity

Interest Expense

**Denominator**

Diluted Earnings Per Share (Basis As Specified)

Shareholders' Equity / Current Basic Shares

Current Share Price

Market Cap = Current Share Price × Current Basic Shares

Sales

Basic EBIT + Depreciation + Amortization

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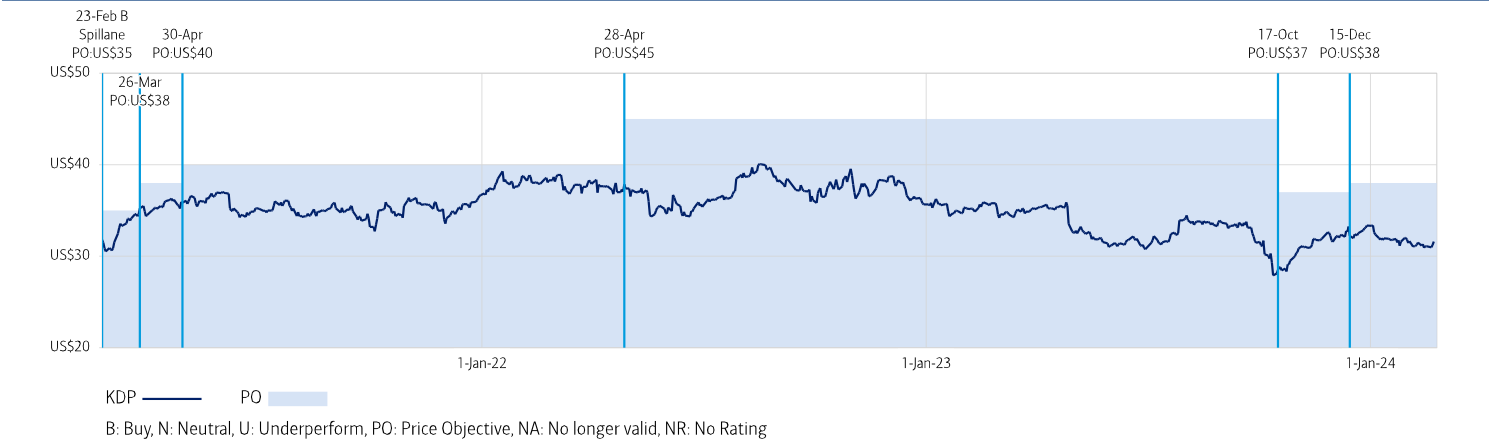
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Keurig Dr Pepper (KDP) Price Chart



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Equity Investment Rating Distribution: Beverages - Soft Drinks Group (as of 31 Dec 2023)

Coverage Universe	Count	Percent	Inv. Banking Relationships <sup>R1</sup>	Count	Percent
Buy	11	78.57%	Buy	6	54.55%
Hold	0	0.00%	Hold	0	0.00%
Sell	3	21.43%	Sell	1	33.33%

Equity Investment Rating Distribution: Global Group (as of 31 Dec 2023)

Coverage Universe	Count	Percent	Inv. Banking Relationships <sup>R1</sup>	Count	Percent
Buy	1895	53.62%	Buy	1083	57.15%
Hold	832	23.54%	Hold	454	54.57%
Sell	807	22.84%	Sell	383	47.46%

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Investment rating	Total return expectation (within 12-month period of date of initial rating)	Ratings dispersion guidelines for coverage cluster <sup>R2</sup>
Buy	≥ 10%	≤ 70%
Neutral	≥ 0%	≤ 30%
Underperform	N/A	≥ 20%

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the report: Keurig Dr. Pepper.

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