S&P Global Ratings

RatingsDirect®

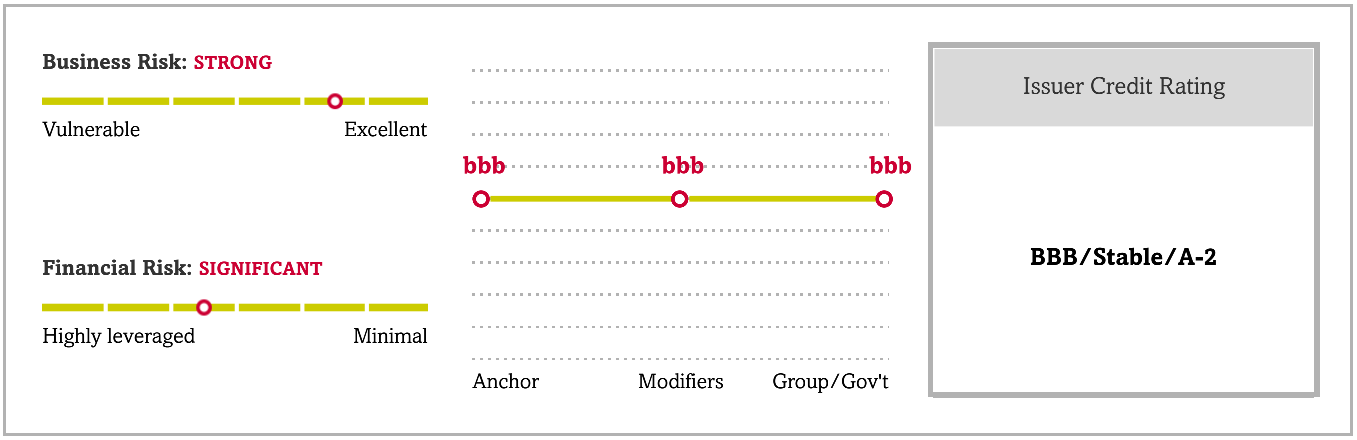
Keurig Dr Pepper Inc.

Primary Credit Analyst:
Diane M Shand, New York + 1 (212) 438 7860; diane.shand@spglobal.com

Secondary Contact:
Chris Johnson, CFA, New York + 1 (212) 438 1433; chris.johnson@spglobal.com

Table Of Contents

Keurig Dr Pepper Inc.



Credit Highlights

Overview

Key strengths	**Key risks**
Solid market positions in categories with good growth trends.	High leverage because of largely debt-financed merger in 2018.
Benefits from product diversification and a comprehensive distribution network.	Limited geographic diversity compared to global beverage and food peers.
Good negotiating power with retailers and suppliers because of scale and diversity.	Distant third market position in cold beverages.
Portfolio benefits from the COVID-19 pandemic because of increased at-home consumption.	Key competitors have greater financial wherewithal.
Strong cash flow because of high margins.	

Keurig Dr Pepper Inc. (KDP) is executing well in this unpredictable and difficult environment. The company was more consumer-centric and channel-agnostic coming into the COVID-19 pandemic because it has increased operating efficiency, improved the quality of its brewers, and brought down the prices of its coffee pod to broaden its customer base, all since the 2018 merger. The operational changes enabled KDP to meet the spike in demand and adapt to the shifting channel mix. KDP's volume grew 5.8% for K-Cup pods in the first nine months of 2020, despite a significant decrease in away-from-home business. The company's brewer volume jumped 17.7% in the same period. Moreover, its package segment increased 8.6%, with volume mix up 9% in the first nine months of 2020. Consolidated sales, excluding foreign exchange, rose 4.4%, and the EBITDA margin expanded to 31.5% from 30.9% in the same year-ago period because of productivity programs and merger synergies. KDP expanded margins, despite the negative mix shift from the loss of its beverage concentrate business and significant increase in lower-margin brewers, as well as additional costs it incurred related to COVID-19. We believe KDP will grow organic sales at a 3%-4% rate for at least the next five years because of its broad product portfolio and its scalable, multichannel selling and distribution system, as well as the acceleration of household penetration that has occurred this year.

KDP has industry-leading margins. The company's EBITDA margin expanded to 31.4% in the trailing 12 months ended Sept. 30, 2020, up from 29.2% in the year-ago period. This compares favorably to PepsiCo Inc.'s 2019 EBITDA margin of 20% and Molson Coors Beverage Co.'s 22.3%, as well as packaged goods peers such as General Mills Inc., The J.M. Smucker Co., Conagra Brands Inc., Campbell Soup Co., and McCormick & Co. Inc., which generate EBITDA margins in the low-20% area. The Coca-Cola Co.'s (Coke's) 2019 EBITDA margin of 33.8% is the highest among peers.

This is attributable to its large scale and asset-light business model. We used 2019 as a comparison to exclude pandemic-related effects.

Expanding margins and strong cash flow will rapidly reduce KDP's leverage. KDP's leverage was 4.2x in the trailing 12 months ended Sept. 30, 2020, down from 5.8x at the close of the merger in July 2018. We expect leverage will decline to 3.9x in 2020 and to the low-3x area in 2021 through a combination of debt paydown and EBITDA growth. In addition, we forecast that KDP will generate $1.3 billion of discretionary cash flow (DCF) in 2020 and $1.4 billion in 2021. We base the 2021 improvement on expected margin expansion from cost cutting and post-acquisition synergies, as well as the return of some of its higher-margin away-from-home business.

Outlook: Stable

The stable rating outlook on KDP reflects our expectations that it will grow earnings and cash flow and continue to reduce leverage. We believe KDP will generate 3%-4% top-line growth, maintain the EBITDA margin of over 32% over the next two years, and continue to generate strong cash flow. This should enable the company to reduce leverage to the low-3x area by year-end 2021.

Downside scenario

We could lower our rating on KDP if:

- Management's financial policies become more aggressive, resulting in an inability to reduce debt in line with our base-case forecast such that leverage remains above 4x;
- Leverage remains above 4x because it does not achieve anticipated cost-cutting goals; or
- Operating performance deteriorates (possibly because of competitive incursions).

Upside scenario

We could raise the rating over the next two years if:

- KDP achieves long-term benefits from the current increased consumption of its products and reduces debt using its strong cash flow;
- KDP demonstrates EBITDA improvement by increasing operating efficiencies and achieving $600 million in planned synergies, resulting in EBITDA margins expanding to close to 35% and leverage declining to below 3x; and
- Management adheres to a financial policy consistent with maintaining leverage below 3x.

Our Base-Case Scenario

S&P Global Ratings believes there remains a high degree of uncertainty about the evolution of the coronavirus pandemic. Reports that at least one experimental vaccine is highly effective and might gain initial approval by the end of the year are promising, but this is merely the first step toward a return to social and economic normality; equally critical is the widespread availability of effective immunization, which could come by the middle of next year. We use this assumption in assessing the economic and credit implications associated with the pandemic (see our research here: www.spglobal.com/ratings). As the situation evolves, we will update our assumptions and estimates accordingly.

Assumptions

- U.S. GDP declines 4% in calendar year 2020 and grows 3.9% in 2021. Canada's GDP contracts 5.6% in 2020 and grows 4.5% in 2021.
- Sales of KDP's cold beverages grow 5% in 2020, well above GDP growth and reflecting the company's market share gains in carbonated beverages. The strength of its packaged goods business more than offsets declines in its beverage concentrate and Latin American businesses.
- Hot beverage revenue grows about 4% in 2020 because of strong sales of coffee pods and good growth of KDP's coffee machines, given the shelter-in-place mandates earlier this year and an increase in the number of consumers working from home.
- The cold beverage business grows more than 3.0% in 2021 because of strength in its core business, brand innovation, and the return of most of its on-premise business.
- Coffee sales grow 5% in 2021, supported by KDP's increased household penetration and some return to its office business.
- EBITDA margin expands to about 32.6% in 2020, up from pro forma 31.4% in 2019, reflecting the benefit from cost-savings initiatives and synergies. Productivity improvements will more than offset the negative shift in price mix in its coffee business because of the high sales of its low-margin coffee machines and loss of sales of its high-margin on-premise beverage concentrate. We believe the margin will rise to about 33.6% in 2021, reflecting the company's full achievement of its $600 million benefit from cost-savings initiatives and synergies, as well as positive product mix shift because of positive sales in its on-premise business.
- Capital expenditure (capex) of about $425 million in 2020 and $560 million in 2021.
- Dividends of about $850 million annually in 2020 and 2021.
- DCF of $1.3 billion in 2020 and $1.4 billion in 2021, compared with $1.3 billion in 2019. The flat cash flow in 2020 reflects the loss of its higher-margin away-from-home business and expenses related to COVID-19.
- No benefit from extending accounts payable days.
- No share repurchases.
- Limited mergers and acquisitions (M&A).

Key metrics

Table 1

Keurig Dr Pepper Inc.--Key Metrics*

	--Fiscal year ended Dec. 31--				
(Mil. $)	**2018a**	**2019a**	**2020e**	**2021f**	**2022f**
Revenue	7,442.0	11,120.0	11,546.6	11,973.3	12,379.8
Revenue growth (%)	11.2	49.4	3.8	3.7	3.4
EBITDA	1,801.5	3,497.0	3,760.1	4,013.4	4,206.6

Table 1

Keurig Dr Pepper Inc.--Key Metrics* (cont.)					
	--Fiscal year ended Dec. 31--				
(Mil. $)	**2018a**	**2019a**	**2020e**	**2021f**	**2022f**
EBITDA margin (%)	24.2	31.4	32.6	33.5	34.0
Net debt	16,760.9	15,886.1	14,646.2	13,325.8	13,124.0
Debt to EBITDA (x)	9.3	4.5	3.9	3.3	3.1
FFO to debt (%)	8.0	15.9	17.7	21.0	22.6

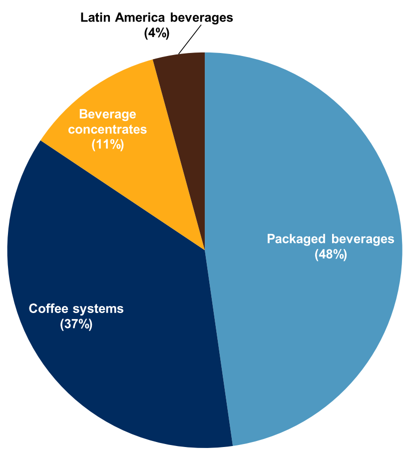
*All figures adjusted by S&P Global Ratings. a--Actual. e--Estimate. f--Forecast. FFO--Funds from operations.

Company Description

KDP is a major beverage company in North America with a diverse portfolio of flavored (non-cola) carbonated soft drinks (CSDs), specialty coffee and non-carbonated beverages, and the No. 1 single-serve coffee brewing system in North America. KDP has a national distribution system that provides its portfolio of more than 125 owned, licensed, and partner brands to consumers. Its coffee business is modestly more profitable than its cold beverage business.

Chart 1

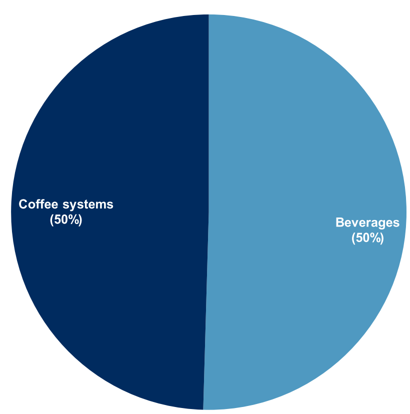
Keurig Dr Pepper Inc.'s Product Mix
September 2020 year to date



Source: Company data.

Chart 2

Keurig Dr Pepper Inc.'s EBITDA Mix
September 2020 year to date



Source: Company data.

Peer Comparison

KDP has several close beverage peers, including Coke and PepsiCo. Both Coke and PepsiCo are larger and have greater product and geographic diversity. Their credit protection measures are stronger than KDP's.

KDP's business strength is greater than Molson Coors' because it has more product diversification and higher margins.

KDP's DCF to total debt exceeds that of all of its peers we've mentioned, except for Molson Coors, which has a ratio slightly better than that of KDP.

In comparison to its packaged goods peers, KDP is rated the same as J.M. Smucker, General Mills, and Kellogg Co. (as of Dec. 10, 2020). These peers have similar business risks given their leading market positions, diverse brand and product portfolios, good margins, and cash flow generation. In addition, these peers generate most of their sales in the U.S. KDP competes directly with J.M. Smucker in the coffee category. KDP's DCF to total debt is higher than that of all of these peers.

Table 2

Keurig Dr Pepper Inc.--Peer Comparison

Industry sector: Beverages

	Keurig Dr Pepper Inc.	The Coca-Cola Co.	PepsiCo Inc.	Molson Coors Beverage Co.
Ratings as of Dec. 3, 2020	BBB/Stable/A-2	A+/Negative/A-1	A+/Stable/A-1	BBB-/Negative/A-3
	--Fiscal year ended--			
	Dec. 31, 2019	**Dec. 31, 2019**	**Dec. 28, 2019**	**Dec. 31, 2019**
(Mil. $)				
Revenue	11,120.0	37,266.0	67,161.0	10,579.4
EBITDA	3,497.0	12,649.0	13,434.0	2,360.1
FFO	2,520.2	9,560.2	10,069.6	2,002.8
Interest expense	676.8	987.8	1,197.4	296.2
Cash interest paid	543.8	962.8	1,138.4	300.3
Cash flow from operations	2,533.2	10,756.2	10,060.6	1,953.0
Capital expenditure	365.0	2,054.0	4,232.0	585.5
FOCF	2,168.2	8,702.2	5,828.6	1,367.5
DCF	1,324.2	754.2	(2,589.4)	943.1
Cash and short-term investments	75.0	11,175.0	5,738.0	523.4
Debt	15,886.1	37,598.0	32,351.1	8,940.3
Equity	23,257.0	21,098.0	14,868.0	13,673.1
Adjusted ratios				
EBITDA margin (%)	31.4	33.9	20.0	22.3
Return on capital (%)	6.7	21.4	23.0	6.2
EBITDA interest coverage (x)	5.2	12.8	11.2	8.0
FFO cash interest coverage (x)	5.6	10.9	9.8	7.7
Debt/EBITDA (x)	4.5	3.0	2.4	3.8
FFO/debt (%)	15.9	25.4	31.1	22.4
Cash flow from operations/debt (%)	15.9	28.6	31.1	21.8
FOCF/debt (%)	13.6	23.1	18.0	15.3
DCF/debt (%)	8.3	2.0	(8.0)	10.5

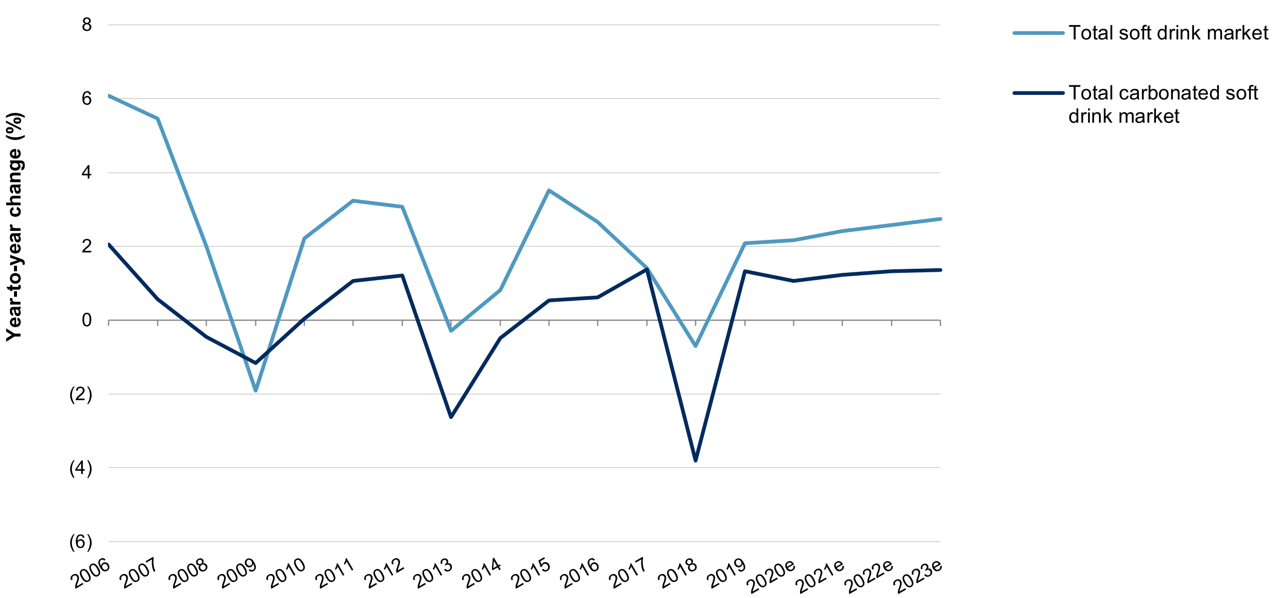
FFO--Funds from operations. FOCF--Free operating cash flow. DCF--Discretionary cash flow.

Business Risk: Strong

KDP is a formidable competitor in the beverage industry. It is the No. 1 player in the North American single-serve coffee sector, and it holds the No. 3 position in the North American liquid refreshment beverage industry. We expect single-serve coffee to continue as the fastest-growing segment of the coffee market, and we expect non-cola carbonated beverages to grow faster than the overall carbonated beverage market. We believe KDP's diversified portfolio of hot and cold beverages and single-serve hot coffee, as well as its scalable, multichannel selling and distribution system, should enable it to steadily grow sales and profits. Its demonstrated ability to pivot operations to address changes in demand and channel mix also supports our expectation that the company can grow organic sales by 3%-4% annually for at least the next five years.

Chart 3

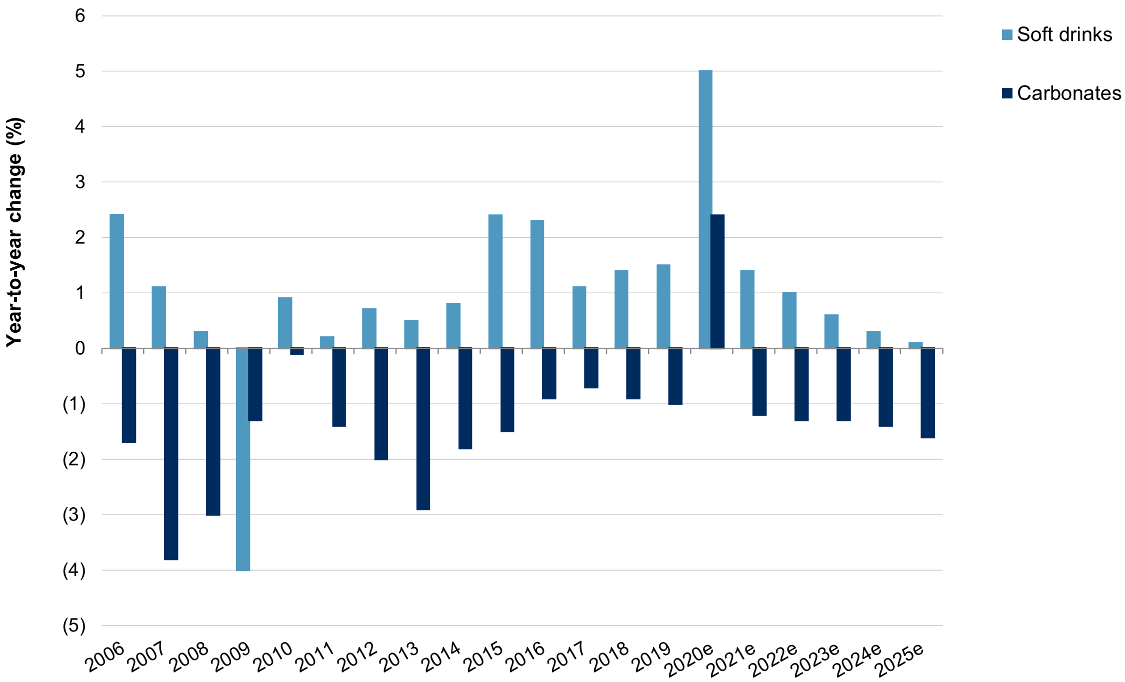
The North American Soft Drink Market Continues To Have Good Growth
Soft drink market should grow 2%-3%



e--Estimate. Source: Euromonitor.

Chart 4

Since The 2008 Recession, Overall Industry Volume Has Been Positive As Consumers Shift To Non-Carbonated Beverages



e--Estimate. Source: Euromonitor.

On the cold beverage side, KDP has very defendable market positions, given the strength of its core and difficult-to-replicate Dr Pepper brand, customer loyalty, and favorable demographic trends across many of its flavored carbonated drinks, as well as its strong brands in non-carbonated drinks (including Motts and the Core and evian water brands). Moreover, its core CSD business does not overlap much with that of its large competitors, Coke and PepsiCo. KDP's strategy focuses on fragmented categories. The North American off-premise soft drink category is large, at $154 billion in 2019, according to market research firm Euromonitor. We believe industry sales in off-premise channels will grow 2%-3% annually over the next five years because of price mix. This is an acceleration in growth from our 2019 forecast that had projected 1% annual growth. We expect the on-premise channel, which represents about 10% of KDP's sales, to plunge about 40% this year and rebound 35% in 2021. We forecast the channel will grow 4%-6% annually in 2022 through 2024.

The non-cola flavored carbonated market has been growing faster than the cola market, and KDP's portfolio has benefited from the strength of its Dr Pepper and Canada Dry brands. According to Euromonitor, off-premise retail sales in the North American carbonated beverage market have declined about 1%-2% annually for the past 13 years. This trend, with the exception of 2020, should continue over the next five years because of consumers' shift toward drinks with lower sugar contents as well as energy drinks. Moreover, growth trends in non-cola carbonated drink share outpaced those of the industry. The Dr Pepper brand's market share increased to 18% in 2019, up from 15% in 2010, which compares favorably to Coke's less than one-percentage-point gain and a three-percentage-point decline in PepsiCo's market share. We attribute this to the difficult-to-replicate taste of KDP's Dr Pepper brand and the popularity of its Canada Dry brand as mixers in alcoholic beverages.

Table 3

KDP And Small To Medium Brands Have Been Gaining Market Share In The Carbonated Beverage Market

											Share change
	2010	**2011**	**2012**	**2013**	**2014**	**2015**	**2016**	**2017**	**2018**	**2019**	**2019 versus 2010**
The Coca-Cola Co.	36.6	35.9	35.9	36.0	36.1	36.0	36.3	36.4	36.6	36.9	0.3
PepsiCo Inc.	31.7	30.9	30.1	29.8	29.9	29.4	28.8	27.8	27.0	26.3	(5.4)
Keurig Dr Pepper Inc.	15.0	15.9	16.1	16.2	16.5	16.8	17.2	17.7	17.9	18.0	3.0
Private label	8.6	8.8	8.5	8.1	7.6	7.5	7.2	6.9	6.7	6.6	(2.0)
Others	8.0	8.5	9.3	9.8	10.0	10.6	10.6	11.4	11.7	12.2	4.2

Source: Euromonitor.

We believe KDP will also benefit from its non-carbonated drinks portfolio. The company should be able to compete in the water segment, which is the second-largest segment of the soft drink market and has better growth prospects compared to all other subcategories of the soft drink industry, given consumers' shift toward healthier beverages. KDP purchased Bai in 2017 and Core in 2018, and it has a long-term distribution agreement with Danone Waters of America to sell, distribute, and merchandise evian in North America. According to Euromonitor, Nestle S.A. is the clear branded leader in the category, with its portfolio of water brands commanding a 20.1% share of the industry. Coke is the next-largest player; its water brands have a 10.1% share. PepsiCo has a 7.8% water brand market share. Still, the category is very fragmented, and no individual brand has more than an 8% share. Most brands have less than a 1% share. KDP has a 0.4% share of the market. The company has an advantage over smaller and regional brands, given its national distribution capabilities. We expect KDP to build on the premium water segment, as well as other faster-growing categories such as sport and energy, as well as ready-to-drink (RTD) tea and coffee. Although KDP is a small player in the fast-growing energy segment, we consider it a major participant, given consumers' use of coffee as an energy booster. Overall, we believe KDP's cold beverages will gain share because of the company's focus on non-cola beverages, its water offerings, its RTD Peet's coffee, and its allied brands.

Table 4

Bottled Water Should Continue To Take Share From Carbonated Beverages

Share of off-trade volume

	2010	2011	2012	2013	2015	2016	2017	2018	2019	2020e	2021e	2022e	2023e	2024e	2025e	Share change: 2019 to 2010	Share change: 2025 to 2019
Bottled water	28.2	28.3	29.6	31.4	34.5	36.0	37.4	38.3	39.1	39.9	40.2	40.6	41.0	41.5	42.0	13.8	2.9
Carbonates	44.1	43.3	42.2	40.8	38.2	37.0	36.4	35.5	34.7	33.8	33.0	32.2	31.6	31.0	30.5	(13.6)	(4.2)
Concentrates	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	(0.0)
Juice	17.5	17.4	16.6	15.9	14.5	13.9	13.4	13.0	12.5	12.5	12.6	12.6	12.6	12.4	12.2	(5.2)	(0.3)
RTD coffee	0.2	0.3	0.3	0.4	0.5	0.5	0.6	0.6	0.6	0.6	0.7	0.7	0.7	0.8	0.8	0.6	0.2
RTD tea	3.3	3.4	3.5	3.6	3.9	4.0	4.1	4.1	4.0	4.0	4.0	4.1	4.1	4.1	4.1	0.8	0.1
Energy drinks	1.5	1.7	2.0	2.2	2.4	2.4	2.5	2.6	2.9	2.8	2.9	3.1	3.2	3.3	3.4	2.0	0.5
Sports drinks	5.2	5.7	5.7	5.8	5.9	6.0	5.6	5.8	6.1	6.4	6.6	6.8	6.8	6.9	6.9	1.7	0.7

e--Estimate. RTD--Ready-to-drink. Source: Euromonitor.

Table 5

Keurig Dr Pepper Inc. Participates In Faster-Growing Categories Such As Bottled Water, RTD Coffee And Tea, And Energy Drinks

Year-to-year growth rates based on retail selling prices

	2005	2006	2007	2008	2009	2010	2011	2012	2013	2015	2016	2017	2018	2019	2020e	2021e	2022e	2023e	2024e
Soft drinks	4.3	2.4	1.1	0.3	(4.0)	0.9	0.3	0.7	0.5	2.6	1.5	3.0	3.7	3.9	3.7	3.9	3.4	3.0	2.8
Bottled water	18.5	13.6	9.9	5.3	(10.4)	1.8	0.5	5.5	6.5	6.9	2.6	4.0	5.2	6.2	3.7	4.0	3.8	3.6	3.6
Carbonates	(0.7)	(1.7)	(3.8)	(3.0)	(1.3)	(0.1)	(1.4)	(2.0)	(2.9)	0.6	1.5	2.2	2.0	3.5	1.4	1.7	1.8	1.7	1.6
Concentrates	2.8	6.8	(8.9)	4.2	2.7	10.4	27.1	44.4	16.0	(3.2)	(2.0)	(0.9)	(1.0)	1.5	1.3	1.3	1.1	0.9	0.7
Juice	(2.1)	(5.0)	(1.7)	0.1	(1.3)	(2.2)	(0.4)	(3.5)	(4.0)	(0.9)	(1.6)	(1.1)	(1.7)	6.5	4.2	3.8	2.7	1.8	1.4
RTD coffee	23.0	29.2	20.8	1.9	3.4	2.4	16.4	21.4	24.0	11.6	11.4	8.7	5.1	3.1	8.0	9.2	8.9	8.3	8.1
RTD tea	3.9	11.4	12.6	1.9	6.9	10.0	0.8	5.0	2.9	8.1	5.5	3.8	1.3	2.4	4.8	3.9	3.4	2.9	2.3
Energy drinks	63.9	41.7	26.6	14.9	2.1	7.6	16.8	17.6	11.0	2.8	4.1	8.2	12.5	(2.7)	7.4	8.4	7.4	6.4	5.7
Sports drinks	21.9	8.5	0.1	(1.8)	(6.4)	8.3	9.4	1.5	1.1	4.7	(3.6)	5.3	10.0	6.4	6.2	4.7	3.0	2.4	2.1

e--Estimate. RTD--Ready-to-drink. Source: Euromonitor.

KDP has the No. 1 position in the single-serve coffee segment in North America. It is successful because it has more than 125 brands and large distribution. The company's dollar share of pods manufactured in the U.S. was 82% in 2019. The North American coffee market is large; it accounted for $19.7 billion of sales (excluding retail coffee shops) in 2019, according to Euromonitor. Single-serve constituted a 40% share in 2019 on a dollar basis in North America, up from 2% in 2008. The category is benefiting from an expansion of work-from-home policies because of the pandemic, as well as the company's good execution. Generally, the Keurig brand consistently grows household penetration by 2 million households per year. This year, it expects to add about 3 million new households. Moreover, the number of cups of coffee consumer per brewer has increased. Typically, that number has remained steady. Overall household penetration in the U.S. was 30 million at year-end 2019, up from 21 million in 2015. We believe demand for at-home coffee occasions will be higher for at least the next five years compared with 2019, given the acceleration of household penetration, the shift in employers' work-from-home policies, and an increase in consumers' desire to work remotely. According to Euromonitor, coffee pod volume should grow more than 8% in 2020 and about 2.5% annually in 2021 and 2022. The overall coffee category's volume should grow 6% in 2020, decline 3.7% in 2021, and grow 2% annually from 2022 to 2024. This is above growth expectations prior to the pandemic, which forecast no growth.

Table 6

Volume Growth Of Single-Serve Coffee Has Led The Market And Should Accelerate

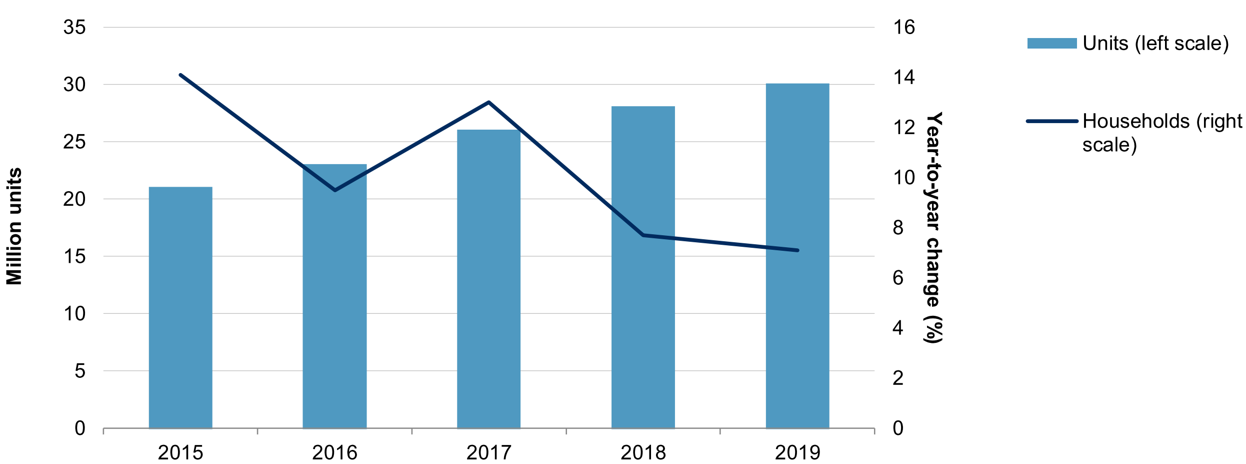
	2015	2016	2017	2018	2019	2020e	2021e	2022e	2023e	2024e	2025e
Coffee	1.3	(0.2)	(1.5)	1.4	1.3	5.6	1.8	1.4	0.4	(0.2)	(0.5)
Fresh coffee beans	2.7	4.4	(0.8)	2.9	3.2	5.0	(0.2)	1.5	1.3	1.1	1.1
Fresh ground coffee pods	17.5	11.6	3.5	6.4	5.8	8.3	2.5	2.6	1.5	1.2	0.9
Standard fresh ground coffee	(0.3)	(1.8)	(2.1)	0.7	0.5	5.3	2.2	1.3	0.2	(0.5)	(0.8)

e--Estimate. Source: Euromonitor.

KDP still needs to grow household penetration, given its large share. Household penetration increased to about 23% in 2019, up from 17% in 2015. Still, there is plenty of room for growth, given there are 128 million households in the U.S. and 89 million at-home coffee drinkers. The company has strategic initiatives to grow household penetration above 50%. This is still below household penetration in France and the Netherlands, which have 65% and 63% penetration, respectively. We think KDP can increase household penetration in the North America because it has reduced the price of pods to broaden its customer base, improved the quality of its brewers, and invested in advertising. Its brewer volume jumped 17.7% in the first nine months of 2020. Its sustainability policies should also support growth. The company's pods in North America are 100% recyclable. This should help increase household penetration among environmentally conscious consumers.

Chart 5

Number Of U.S. Households Regularly Using Keurig Brewers Is Still Growing



Source: Company data and Omnibus Study 2019.

In its hot coffee business, KDP competes against large brands with deep financial resources, such as Kraft Foods Group Inc.'s Maxwell House and J.M. Smucker's Folgers, as well as coffee retailers such as Starbucks Corp. and Dunkin' Brands Inc. In the single-cup coffee segment, KDP competes against companies such as Nestle, which leads the global category with about $9 billion in coffee sales. KDP also competes against coffees and teas sold through supermarkets, club stores, mass merchants, specialty retailers, and food service accounts. In the single-serve coffee segment, KDP has a competitive advantage, because it controls innovation on brewers and pods, and it has multiyear strategic relationships with Starbucks, Dunkin' Donuts, Kraft-Heinz, Smucker, Eight O' Clock Coffee, and others. KDP has more than 125 brands in its system, including 18 of the top 20 brands, which creates a significant competitive advantage because no other single-serve system offers more choices for consumers. We believe KDP will maintain a very strong share in the U.S. and Canadian markets because of its successful history of developing innovative products. Its pipeline of new innovative brewers and marketing initiatives should enable it to gain additional share.

Financial Risk: Significant

Although KDP's leverage remains high because of its largely debt-financed merger with Dr Pepper Snapple Group, it has meaningfully decreased. Its debt to EBITDA is 4.2x, down from pro forma leverage of 5.8x following the merger in July 2018. We forecast KDP will focus on reducing debt over the next two years. The company has paid down $702 million of debt as of Sept. 30, 2020, and it paid down $1.3 billion in 2019. KDP is steadily improving cash flow and prioritizing debt repayment. We believe KDP will reduce leverage to the low-3x area by year-end 2021, given its strong DCF. We estimate DCF to adjusted debt will be strong at about 9% in 2020 and 10.5% in 2021. We consider this a key factor in our rating. Our forecast assumes no share repurchases, no benefit from working capital, and we expect M&A activity to be leverage neutral. KDP has shown a willingness to use equity to finance acquisitions (e.g., Core).

Financial summary

Table 7

Keurig Dr Pepper Inc.--Financial Summary

Industry sector: Beverages

	--Fiscal year ended Dec. 31--				
	2019	**2018**	**2017**	**2016**	**2015**
(Mil. $)					
Revenue	11,120.0	7,442.0	6,690.0	6,440.0	6,282.0
EBITDA	3,497.0	1,801.5	1,697.5	1,699.0	1,633.5
FFO	2,520.2	1,345.2	1,280.2	1,135.5	1,179.7
Interest expense	676.8	467.3	179.3	164.5	130.8
Cash interest paid	543.8	246.3	157.3	132.5	107.8
Cash flow from operations	2,533.2	1,646.2	1,063.2	965.5	1,022.7
Capital expenditure	365.0	180.0	207.0	179.0	179.0
FOCF	2,168.2	1,466.2	856.2	786.5	843.7
DCF	1,324.2	1,234.2	43.2	(118.5)	(32.3)
Cash and short-term investments	75.0	83.0	61.0	1,797.0	920.0
Gross available cash	75.0	83.0	61.0	249.0	920.0

Table 7

Keurig Dr Pepper Inc.--Financial Summary (cont.)

Industry sector: Beverages

	--Fiscal year ended Dec. 31--				
	2019	**2018**	**2017**	**2016**	**2015**
Debt	15,886.1	16,760.9	4,692.9	4,515.5	2,783.5
Equity	23,257.0	22,533.0	2,451.0	2,134.0	2,183.0
Adjusted ratios					
EBITDA margin (%)	31.4	24.2	25.4	26.4	26.0
Return on capital (%)	6.7	5.5	20.5	24.1	26.8
EBITDA interest coverage (x)	5.2	3.9	9.5	10.3	12.5
FFO cash interest coverage (x)	5.6	6.5	9.1	9.6	11.9
Debt/EBITDA (x)	4.5	9.3	2.8	2.7	1.7
FFO/debt (%)	15.9	8.0	27.3	25.1	42.4
Cash flow from operations/debt (%)	15.9	9.8	22.7	21.4	36.7
FOCF/debt (%)	13.6	8.7	18.2	17.4	30.3
DCF/debt (%)	8.3	7.4	0.9	(2.6)	(1.2)

FFO--Funds from operations. FOCF--Free operating cash flow. DCF--Discretionary cash flow.

Reconciliation

Table 8

Keurig Dr Pepper Inc.--Reconciliation Of Reported Amounts With S&P Global Ratings' Adjusted Amounts (Mil. $)

	--Rolling 12 months ended Sept. 30, 2020--									
Keurig Dr Pepper Inc. reported amounts										
	Debt	**Shareholders' equity**	**Revenue**	**EBITDA**	**Operating income**	**Interest expense**	**S&P Global Ratings' adjusted EBITDA**	**Cash flow from operations**	**Dividends**	**Capital expenditure**
Reported	13,889.0	23,296.0	11,431.0	3,175.0	2,493.0	615.0	3,595.0	2,337.0	846.0	535.0
S&P Global Ratings' adjustments										
Cash taxes paid	--	--	--	--	--	--	(568.0)	--	--	--
Cash interest paid	--	--	--	--	--	--	(498.0)	--	--	--
Reported lease liabilities	964.0	--	--	--	--	--	--	--	--	--
Operating leases	--	--	--	105.0	24.8	24.8	(24.8)	80.2	--	--
Postretirement benefit obligations/deferred compensation	17.4	--	--	--	--	--	--	--	--	--
Accessible cash and liquid investments	(181.5)	--	--	--	--	--	--	--	--	--
Share-based compensation expense	--	--	--	79.0	--	--	--	--	--	--
Nonoperating income (expense)	--	--	--	--	(13.0)	--	--	--	--	--

Table 8

Keurig Dr Pepper Inc.--Reconciliation Of Reported Amounts With S&P Global Ratings' Adjusted Amounts (Mil. $) (cont.)										
Noncontrolling interest/minority interest	--	1.0	--	--	--	--	--	--	--	--
Debt: Other	588.6	--	--	--	--	--	--	--	--	--
EBITDA: Restructuring costs	--	--	--	281.0	281.0	--	--	--	--	--
EBITDA: Derivatives	--	--	--	(7.0)	(7.0)	--	--	--	--	--
EBITDA: Other	--	--	--	(38.0)	(38.0)	--	--	--	--	--
Depreciation and amortization: Impairment charges/(reversals)	--	--	--	--	(24.0)	--	--	--	--	--
Total adjustments	1,388.5	1.0	0.0	420.0	223.8	24.8	(1,090.8)	80.2	--	--
S&P Global Ratings' adjusted amounts										
	Debt	**Equity**	**Revenue**	**EBITDA**	**EBIT**	**Interest expense**	**Funds from operations**	**Cash flow from operations**	**Dividends**	**Capital expenditure**
Adjusted	15,277.5	23,297.0	11,431.0	3,595.0	2,716.8	639.8	2,504.2	2,417.2	846.0	535.0

Liquidity: Adequate

We assess KDP's liquidity as adequate, reflecting our expectation that projected sources will cover uses by more than 2.5x over the next 12 months. We expect sources will continue exceeding uses even if forecast EBITDA declines 30%. Although KDP's ratio of sources to uses would qualify for a more favorable liquidity assessment, we don't believe KDP could absorb high-impact, low-probability events without refinancing. KDP recently increased the size of its 364-day credit facility and issued notes to increase liquidity because of macroeconomic uncertainties. The company has debt maturing next year, and it could use these funds to repay a portion of the maturities. We believe KDP has a strong standing in the credit markets, strong relationships with its banks, and EBITDA cushion of over 15% on its debt-to-EBITDA covenant.

Principal liquidity sources	Principal liquidity uses
• Cash of about $191 million as of Sept. 30, 2020; • Full availability under its $2.4 billion revolving credit facility maturing 2023 and $1.5 billion available under its 364-day facility; • Funds from operations of about $2.6 billion; and • Debt issuance of $1.5 billion.	• Repayment of almost $1.1 billion of debt including commercial paper, other debt maturities, and amortization in 2020; • Seasonal working capital requirement of more than $100 million; • Capex of $445 million in 2020; and • Dividends of about $850 million in 2020.

Debt maturities

As of Sept. 30, 2020:

- 2020: $0
- 2021: $2.25 billion
- 2022: $250 million
- 2023: $3 billion
- Thereafter: $8.23 billion

Covenant Analysis

Compliance expectations

We forecast KDP will maintain a covenant cushion of above 15% over the next two years. This calculation includes pro forma synergies.

Requirements

KDP is subject to maintenance financial covenants under its senior unsecured revolver, 364-day credit facility, and term loan executed in 2019. The company is subject to a leverage covenant of 4.5x that tightens to 4x beginning March 31, 2021.

Environmental, Social, And Governance

We view environmental and social credit factors for KDP as broadly in line with those of industry peers, especially given its coffee business and portfolio of non-carbonated drinks, which add diversity to its CSD portfolio. Ongoing changing consumer tastes away from traditional CSDs and societal efforts to reduce the sugar content of beverages have reduced demand for certain soft drinks. In response, KDP is investing in diversifying its portfolio toward categories such as premium water, sports, and energy. This strategy has yielded good organic sales growth while improving the portfolio mix toward faster-growing, more socially acceptable offerings. KDP so far has not been significantly affected by government efforts to raise taxes on sugary foods and drinks. These efforts tend to temporarily reduce sales and consumption, but sales typically rebound after a year or so. For example, Mexico enacted a sugar tax in 2014, and consumption did fall in the subsequent year, but it stabilized thereafter. The global anti-plastic movement is also an inherent environmental risk factor, and KDP is focusing on using fully recycled and recyclable products in its packaging. The company's coffee pods are 100% recyclable in North America.

Issue Ratings - Subordination Risk Analysis

Capital structure

KDP's capital structure consists of senior unsecured debt, all of which is issued at the holding company. The company has no secured debt or priority subsidiary debt.

Analytical conclusions

We rate KDP's unsecured debt 'BBB', the same as the issuer credit rating, because we believe that any subordination risk that may exist is not significant enough to warrant a notch down.

Ratings Score Snapshot

Issuer Credit Rating

BBB/Stable/A-2

Business risk: Strong

- **Country risk:** Very low
- **Industry risk:** Low
- **Competitive position:** Strong

Financial risk: Significant

- **Cash flow/leverage:** Significant

Anchor: bbb

Modifiers

- **Diversification/portfolio effect:** Neutral (no impact)
- **Capital structure:** Neutral (no impact)
- **Financial policy:** Neutral (no impact)
- **Liquidity:** Adequate (no impact)
- **Management and governance:** Satisfactory (no impact)
- **Comparable rating analysis:** Neutral (no impact)

Stand-alone credit profile : bbb

- **Group credit profile:** bbb

Related Criteria

- General Criteria: Group Rating Methodology, July 1, 2019
- Criteria | Corporates | General: Reflecting Subordination Risk In Corporate Issue Ratings, March 28, 2018
- General Criteria: Methodology For Linking Long-Term And Short-Term Ratings, April 7, 2017
- Criteria | Corporates | Industrials: Key Credit Factors For The Branded Nondurables Industry, May 7, 2015
- Criteria | Corporates | General: Methodology And Assumptions: Liquidity Descriptors For Global Corporate Issuers, Dec. 16, 2014
- General Criteria: Methodology: Industry Risk, Nov. 19, 2013
- Criteria | Corporates | General: Corporate Methodology, Nov. 19, 2013

- General Criteria: Country Risk Assessment Methodology And Assumptions, Nov. 19, 2013
- General Criteria: Methodology: Management And Governance Credit Factors For Corporate Entities, Nov. 13, 2012
- General Criteria: Use Of CreditWatch And Outlooks, Sept. 14, 2009

Business And Financial Risk Matrix

	Financial Risk Profile					
Business Risk Profile	Minimal	Modest	Intermediate	**Significant**	Aggressive	Highly leveraged
Excellent	aaa/aa+	aa	a+/a	a-	bbb	bbb-/bb+
Strong	aa/aa-	a+/a	a-/bbb+	**bbb**	bb+	bb
Satisfactory	a/a-	bbb+	bbb/bbb-	bbb-/bb+	bb	b+
Fair	bbb/bbb-	bbb-	bb+	bb	bb-	b
Weak	bb+	bb+	bb	bb-	b+	b/b-
Vulnerable	bb-	bb-	bb-/b+	b+	b	b-

Ratings Detail (As Of December 11, 2020)*

Keurig Dr Pepper Inc.	
Issuer Credit Rating	BBB/Stable/A-2
Commercial Paper	
Local Currency	A-2
Senior Secured	BBB
Senior Unsecured	BBB
Issuer Credit Ratings History	
14-May-2018	BBB/Stable/A-2
29-Jan-2018	BBB+/Watch Neg/A-2
13-Nov-2013	BBB+/Stable/A-2

*Unless otherwise noted, all ratings in this report are global scale ratings. S&P Global Ratings' credit ratings on the global scale are comparable across countries. S&P Global Ratings' credit ratings on a national scale are relative to obligors or obligations within that specific country. Issue and debt ratings could include debt guaranteed by another entity, and rated debt that an entity guarantees.