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Research Update:

Keurig Green Mountain Inc. And Dr. Pepper Snapple Group Inc. Ratings Placed On CreditWatch Following Merger Announcement

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

Overview

Rating Action

Rationale

CreditWatch

Related Criteria

Ratings List

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(**Editor's Note:** The original version of this release misstated the expected merged company's pro forma adjusted debt. A corrected version follows.)

Overview

- U.S.-based Keurig Green Mountain (KGM) is merging with Dr. Pepper Snapple Inc. (DPS).
- As part of the merger, DPS shareholders will receive a one-time cash distribution of roughly $18.8 billion and own 13% of the merged company. JAB Holding Company S.a r.l. (JAB) and its partners will contribute $9 billion of new equity. JAB will be the controlling shareholder. Mondelez International, JAB's partner in Keurig, will hold an approximately 13%-14% stake in the new company.
- At close, the combined company's pro forma funded debt will be about $16.6 billion.
- We are placing all of our ratings on KGM, including our 'BB+' corporate credit rating, on CreditWatch with positive implications, indicating the likelihood that we would raise the ratings at the close of the transaction.
- We are placing our 'BBB+' long-term corporate credit and issue-level ratings on DPS on CreditWatch with negative implications, indicating the likelihood that we would lower the ratings at the close of the transaction. At the same time, we are affirming the 'A-2' short-term and commercial paper ratings
- Based on currently disclosed merger and financing terms, we anticipate the new combined company, Keurig Dr Pepper, will likely be rated 'BBB'.

Rating Action

On Jan. 29, 2018, S&P Global Ratings placed all of its ratings on Burlington, Mass.-based single-serve coffee manufacturer Keurig Green Mountain Inc., including the 'BB+' corporate credit rating, on CreditWatch with positive implications.

At the same time, we placed our ratings on Plano, Texas-based Dr. Pepper Snapple Group Inc., including the 'BBB+' corporate credit ratings, and senior unsecured ratings on CreditWatch with negative implications. Concurrently, we affirmed the 'A-2' short-term and commercial paper ratings.

We estimate KGM had about $3.8 billion and DPS had roughly $4.7 billion in adjusted net debt outstanding as of Sept. 30, 2017. We estimate the merged company's pro forma adjusted net debt will be approximately $16.8 billion at close based on current merger terms and financing expectations.

Rationale

Both CreditWatch listings follow KGM's announcement of plans to merge with DPS. The merger will include roughly a $18.8 billion distribution to DPS shareholders, whom we expect will own 13% of the merged company (Keurig Dr Pepper). JAB and its partners will contribute $9 billion of new equity. JAB will be the controlling shareholder of the new company. Mondelez International, JAB's partner in Keurig, will hold an approximately 13-14% stake in the new company. At close, the combined company's funded debt will be about $16.6 billion, composed of $4.2 billion funded rollover debt from DPS and about $12.4 billion of new debt.

The CreditWatch negative listing on DPS reflects our expectation that the combined company will likely be rated 'BBB'. The lower rating than the current 'BBB+' on DPS reflects the substantial debt obligations of the combined entity.

We forecast the combined company's pro forma adjusted leverage will be high at about 5.8x at the close of the transaction, but that it will quickly de-lever to the 4.0x area by year-end 2019 and to about 3.5x by mid-2020 (assuming the transaction closes in mid-2018). Supporting our forecast is the new company's strong cash flow generation capability and management's willingness to de-lever following the transaction. We forecast the combined company's discretionary cash flow to adjusted net debt will be strong--close to 9.5% in 2018 and 12% in 2019. We assume the new company will not repurchases shares, that any additional acquisitions will have an immaterial impact on credit metrics, and that the company will likely focus on lowering leverage to below 3.5x within 24 months following the close of the transaction. Management has stated it targets deleveraging to 3.0x within 2-3 years after the closing.

The higher combined company's leverage will be somewhat mitigated by its increased scale and diversity and strong profitability of the merged company. We see DPS' competitive position strengthening with the inclusion of KGM products and distribution channels, and the increases to its overall scale. KGM adds single-serve coffee to DPS' portfolio, which has a better growth trajectory than carbonated beverages. KGM is also highly accretive to DPS' margins. Combined, the new company could have margins exceeding 30% by 2020, making them the industry leader and the only beverage company that manufactures cold and hot beverages. Moreover, the company should be able to accelerate sales growth as it will have additional distribution channels and be well positioned to roll out ready-to-drink coffee, a fast-growing category. Each company's strong market shares and demonstrated ability to grow organically also support our favorable view of its competitive position. However, compared with other global beverage and food peers with higher business risk assessments, such as Nestle and Coca-Cola, we believe the company has more limited geographic diversity and less scale.

CreditWatch

The CreditWatch listings reflect our expectation that we will raise our KGM ratings and lower our DPS ratings as a result of this transaction.

We will resolve both CreditWatch listings following our review of the financial and business impact of the merger, including the finalized capital structure and the combined company's ability to reduce leverage and improve credit protection measures.

Based on current information, we would likely assign a 'BBB' corporate credit rating to the new combined entity. We would also lower the rating on DPS' unsecured rollover debt and affirm the 'A-2' short-term and commercial paper ratings. We will also withdraw the corporate credit and issue-level ratings on KGM if all of its debt is repaid at the close of the transaction.

Related Criteria

- Criteria - Corporates - General: Reflecting Subordination Risk In Corporate Issue Ratings, Sept. 21, 2017
- General Criteria: Methodology For Linking Long-Term And Short-Term Ratings , April 7, 2017
- Criteria - Corporates - General: Recovery Rating Criteria For Speculative-Grade Corporate Issuers, Dec. 7, 2016
- 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
- Criteria - Corporates - General: Corporate Methodology: Ratios And Adjustments, Nov. 19, 2013
- General Criteria: Country Risk Assessment Methodology And Assumptions, Nov. 19, 2013
- General Criteria: Group Rating Methodology, Nov. 19, 2013
- Criteria - Corporates - General: Corporate Methodology, Nov. 19, 2013
- General Criteria: Methodology: Industry Risk, Nov. 19, 2013
- General Criteria: Methodology: Management And Governance Credit Factors For Corporate Entities And Insurers, Nov. 13, 2012
- General Criteria: Use Of CreditWatch And Outlooks, Sept. 14, 2009

Ratings List

Ratings Affirmed; CreditWatch Action

	To	From
Dr Pepper Snapple Group Inc.		

Corporate Credit Rating	BBB+/Watch Neg/A-2	BBB+/Stable/A-2
Dr Pepper Snapple Group Inc.		
Senior Unsecured	BBB+/Watch Neg	BBB+

Ratings Affirmed

Dr Pepper Snapple Group Inc.	
Commercial Paper	A-2

Ratings Affirmed; CreditWatch Action

	To	From
Keurig Green Mountain Inc.		
Corporate Credit Rating	BB+/Watch Pos/--	BB+/Stable/--

Ratings Affirmed; Recovery Rating Unchanged

Keurig Green Mountain Inc.		
Senior Secured	BBB-/Watch Pos	BBB-
Recovery Rating	1(95%)	1(95%)

Certain terms used in this report, particularly certain adjectives used to express our view on rating relevant factors, have specific meanings ascribed to them in our criteria, and should therefore be read in conjunction with such criteria. Please see Ratings Criteria at www.standardandpoors.com for further information. Complete ratings information is available to subscribers of RatingsDirect at www.capitaliq.com. All ratings affected by this rating action can be found on the S&P Global Ratings' public website at www.standardandpoors.com. Use the Ratings search box located in the left column.