

Dr Pepper Snapple Group

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Moderator: Our next presenting company is Dr. Pepper Snapple Group, and we're delighted to have Larry Young, the CEO, and John Stewart, the CFO, joining us today.

It's been about a year since Dr. Pepper Snapple Group was spun off from Cadbury. In the beginning, some had questioned DPS's integrative business model and its heavy exposure to a declining soda market in the US. Today, a CSD renaissance is getting under way, commodity outlook has turned more favorable, and the Company has gotten a big endorsement of the integrative business model recently from its key competitor.

So with that as a backdrop, I'll turn it over to Larry to get started. Larry?

Larry Young: Thank you, Judy, for the very kind introduction and for inviting us to speak here today. As I think about our business, three things give me confidence that Dr. Pepper Snapple will deliver strong returns for many years to come.

One, we are the No. 1 flavored CSD company in the United States, and consumers are still choosing flavors over colas.

Second, we are a brand owner with some of the most recognized marquees in the Americas, and our brands have tremendous room to grow.

And third, we have a very experienced leadership team that is focused on execution and building capabilities to support our long-term growth.

Before I begin, let me give you just a moment to review our Safe Harbor statement. I think we've all seen those; that's enough.

We have a very advantaged portfolio of well-loved, consumer-preferred brands. Our top six brands -- Dr. Pepper, Snapple, 7UP, Sunkist, Canada Dry, and Mott's, each generate retail sales in excess of \$500 million a year. Collectively, these 12 brands drive 85% of our branded volume, and we believe there is still significant opportunity to grow with.

Nine of these 12 power brands are No. 1 in their respective category, with Schweppes No. 2 to Canada Dry, 7UP No. 2 to Sprite, and now Crush No. 2 to Sunkist. In markets we track, 7UP is No. 1 with the Hispanic consumer. We hold six of the top 10 flavored CSD brands in the US, making us the undisputed flavored CSD leader.

Today, the CSD tea and juice segments are worth around \$87 billion in retail sales in the US. CSDs remain the favorite beverage choice with consumers. And for the first time ever, flavored CSDs, in measured channels, equal colas in size.

Over the last three years, DPS has solidified its leadership position in flavored CSDs, drawing dollar share 170 basis points. And in the growing tea and juice segment, we have maintained our share.

Dr. Pepper and our core four CSDs have strong national brand equities, averaging 1.6 to 2 times the all-beverage norm.

From taste studies, we know that Dr. Pepper scores equally across the entire US, whether you're in Philadelphia, Tulsa, or Seattle. However, our per capita consumption varies significantly.

Distribution and availability is the key to our success, and this is something we know how to do. Over the long term, our goal is to build Dr. Pepper from 62 servings per person per year to 100, and our core four from 10 up to 20. It's just a question of 500 million cases of incremental volume on our 1.6 billion case base.

Transformational changes in North American beverage reinforce the attractiveness and importance of this market. We believe these changes are positive and have the potential to return this category to healthy growth for many years to come.

Against this backdrop, DPS's strategic imperatives remain unchanged. We will continue to build and enhance leading brands, coastal and Hispanic programs, and fountain penetration in critical national accounts will fuel Dr. Pepper. Products with added functional benefits like 7UP Cherry Ox and Canada Tree Green Tea Ginger ale will bring consumers back to CSDs. And brands like Crush and Venom Energy will create new opportunities for growth.

Single-serve development and price pack architecture ensure we exploit channel and package opportunities to drive profitable growth.

We're in Year 1 of our five-year cold drink asset placement strategy and early results are very encouraging.

With a balanced franchise and company-owned model, we can exploit our flexible routes to market and share best practices to ensure our brands have the absolute best chance for long-term sustainable growth.

We're well on track with our Victorville facility, which will be LEED certified. And our hand-held roll-out is going smoothly. The 210 routes we just added in Mexico toward the end of last year are performing well despite an extremely challenging environment down there. These initiatives, as well as others, demonstrate our commitment to a strong and effective route to market.

Central to our strategic imperatives is a relentless focus on cost containment and driving efficiencies. Our supply chain teams have had tremendous success driving alignment with our key suppliers and this is delivering great results.

Our SAP 6.0 upgrade is progressing to the plan and without disruption, and our productivity office and Lean Six Sigma initiatives are providing the funding and process to implement ongoing efficiency programs.

Our strategy is working. We're delivering solid financial results and driving strong share gains. Over the long term, we believe this business is capable of delivering 3% to 5% net sales growth and high single-digit EPS growth. We will balance volume growth with price and mix to ensure we're always providing value to our consumers.

Our focus on execution will drive distribution gains and increase our share of immediate consumption.

Long-term earnings per share growth will come from healthy top-line growth as well as relentless focus on crushing costs and the below-the-line leverage as we pay down our debt.

2009 is our base year as a standalone company. As such, we see our long-term growth rates applied off of the 2009 base. With strong and predictable cash flows, we will first seek to invest in the business and then use free cash to pay down debt. As we achieve a solid investment-grade rating, we will look at opportunities to return cash to our shareholders.

So to summarize -- we have strong brands with leadership positions. We have an experienced management team that is building core competencies and capabilities. Distribution and execution opportunities are significant and support the confidence we have in our long-term growth of this business.

With that, let me turn it back to Judy for questions.

Judy: Great. Thanks, Larry. I'll start with a couple and then we can open it up to the audience. First, starting with the consumer, Larry. Yesterday on the call you have alluded to the LRB category stabilizing a little bit. Can you elaborate, maybe, on whether that's evidence of maybe the consumers bottoming in the US.

And then secondly, how are some of the changes in consumer behavior really affecting some of your key brands within your portfolio?

Larry Young: Absolutely. Like I said yesterday on the call, we're seeing it across all channels. More of a confidence with not only just the consumer but the customer. Our customers are seeing it also. I think one of the most exciting things about it as I get out and visit with customers -- and we do a lot of consumers insights -- is that a lot of people have looked at the pricing that we've had to take last couple of years due to commodities and other reasons; we've had to get the pricing to the right place.

But as people kind of move out of some of the premiums-- we've seen a little weakness in premium brands, but they're coming out of premiums and back into the CSDs. And even with the price increases we've had on CSDs, people are seeing there's truly value in that CSD. And I think our results show it. I mean, we've captured most of it in the CSD growth.

Judy: So on CSDs, the overall CSD category has been declining for years now and I think the long-term prospects have been maybe ratcheted down as a result of that. But from your perspective maybe in the next couple of years, do you believe that the CSD volume can grow again?

Larry Young: I do. I mean, I'm very optimistic on it. And if you look at the latest Niensens, like I just mentioned, flavored CSDs are now 50% of the CSDs. And you look at flavored CSDs --

Dr. Pepper Snapple has a 41% share of flavored CSDs. And I think we're going to see the growth still in the flavored CSDs. I think we're going to see-- I really believe in the next maybe five years or so we're going to see those flavored CSDs maybe get up to 55% of it.

But we're playing in the sweet spot, so it looks like it's going to be very positive for us. But I think the entire category of CSDs is going to start improving there. There's a lot of great activity out there. We're thrilled to death to see everybody in the industry has really gotten back onto the CSD bandwagon. As a lot of us say, whenever the tides rise, all the ships go up with them.

Judy: On pricing -- you talked about having confidence in the Memorial Day pricing being rational. What gives you confidence that relatively healthy pricing environment can be sustained, particularly as you get into maybe the second half of the year, as the commodities costs do moderate and the companies start to benefit from lower costs -- that that may give them incentives to get a little bit more aggressive on promotions and other types of discounting.

Larry Young: Yes. And I think all of us in our business, we do a lot of promotions, and it doesn't necessarily always have to be price off. I think we do much more with the promotions, as I mentioned a moment ago. I think it's done a lot for our retailers. I'm not seeing as much pressure to discount after they've seen the growth in CSDs with the prices and the consumer seeing value.

And that's what the consumer's looking for out there -- value. And when you go in and meet with a customer, you talk value, you've got their ear real quick. They want to hear about what you have in value.

There's a lot more ways to do it than just price off. A lot of people look at the commodities and say, "They've come down; I mean, it's going to open up opportunity for discounting." But I think if we all really watch those commodities, they've bottomed out, too, and they're doing the same thing -- they're starting to come back up. And they're moving up quite aggressively. So I think we've all got to be very cautious and look at that and say they can come up as fast as they came down.

Judy: And just following up on the cost, then, to John. Yesterday you talked about commodity outlook getting a little bit better. You said packaging and ingredients, together, are going to be down slightly, which is better than what you said about a month and a half ago. But if we look at spot prices, obviously there's a lot more room for that number to come down. So my first question is, is your guidance assuming that spot prices stay where we are, or are you assuming that the prices rise again?

And secondly, from a timing perspective, is a lot of the deflation -- if we assume that the spot prices do stay where we are -- really help more end of '09 and into 2010?

John Stewart: Right. The guidance I updated yesterday, to refresh everybody, we had previously guided to commodities being flat for the year. Packaging ingredients, which are about 60% of our cost of goods sold, as a basket would be flat to 2008. We updated that yesterday to say that that basket would be down in the zero to 1% range on a \$2.6 billion base.

That refers to what we have locked today. So it doesn't take account of spot today on what we have unlocked. Obviously, the forward curve on many of the commodities for the periods we have uncovered is quite high. And we've got to look at the relative value equation of how far we want to cover versus those higher-priced out periods.

We went through last summer and fall very close to just spot coverage on many of our major commodities because we did believe fundamentally those values were going to stay at those prices, aluminum being probably the best example. We've of course always said we can't call the bottom, and we've been layering on commodity cover, especially in the major commodities like aluminum, HFCS, and heating oil since the dips began, since fall of last year.

So we're clearly starting to benefit from that. And as we lock more cover at favorable prices, there is potential for a continued improvement. So the guidance we have today is based on what we've got locked today. And if the spots today continue for uncovered areas, you should expect to see future benefit from that.

But that's a big if. And as Larry just said, with oil pushing \$60 again and aluminum up significantly, I'm not prepared to take that to the bank. So I think we've got to be very conservative on the up side, just as we were cautious as prices increased.

Judy: Can you tell us what percentage of your commodities you've covered so far?

John Stewart: We've never broken that out. What I will tell you is we're longer on the major ones and we're longer on the ones that have benefited with the most significant declines. So aluminum, we've taken longer positions than certainly we've ever had since May of last year, since we were spun off. With high fructose corn and apple juice, we also have pretty significant cover. Less so on heating oil. And as you know, areas like PET, we can't cover that much beyond three months because of the purchasing through the Camdada [ph] index. So I believe that is the level of detail we'd like to give on that.

Judy: Okay. We can open to the audience for some questions. Mark?

Mark: Hey, Larry, one of the controversial parts of your business plan was the investment in cold drink. I wonder if you could just put, first of all, some perspective to the size of the annual investment you're making in the cold drink business.

And kind of what you're seeing as you've gone out and gotten into that program in terms of the returns on it and why you really think that that has some worthwhile capital expenditures.

Larry Young: Right. Kind of a background on why it's part of our strategy is whenever I came on board and started and looking at the business, we had around 12 pieces of cold drink equipment for 10,000 people. And for brands-- to build brands and to have product to really sell, you have to have them available; you have to have the availability. I imagine my-- I used to be at Pepsi years ago -- we built a huge base in cold drink.

I think our competitors were probably setting somewhere around 60 pieces. So I looked at it and said, "This is a great opportunity." I looked at the markets where we were very strong, the markets where we had our greatest share and our best profitability were markets that had 40 to 50 pieces of cold drink equipment for 10,000. Our markets that were the lowest developed and the hardest to make money in might be four to five pieces of cold drink equipment.

So we looked at it and said, "You've got to take all the findings of what is a successful market -- how do you build it. Take those out and put them across." Because you hear me talking about building our per caps, especially on Dr. Pepper, from a 62 to a 100. I mean, we've got to get it out there where people are working, playing, going to school. If you

buy our products while you're at work or play, when you go to the supermarket, you're probably going to buy a 12-pack and take it home with you.

So that was why we put the strategy together, went after it. This is our first year. We have been very pleased with what we're seeing. A lot of our teams are ahead of schedule. Our plan is to place an incremental 35,000 pieces of equipment per year -- that net new -- for the next five years. That'll take basically our 12 per 10,000 up to about 20, 25, somewhere in that neighborhood.

At that time, we'll look at it again. I mean, the biggest thing I like to watch on that is that you get the right penetration levels so that your throughputs don't start dropping down.

I mean, I wouldn't even want to share with you the returns we're getting on them right now because the guys never had coolers before, so they're out there-- they're getting the best ones. We know we're not going to get that forever. They're going to get-- it's going to be easy the first three years. I mean, these guys operated a long time under different ownership, some of them under private equity, some of them under Cadbury, and there was no capital. They knew where they could place these coolers. They knew, up and down the street, that the price of entry was a cooler. They didn't have it so we weren't in those accounts.

So they're getting the low-hanging fruit first, so first three years, it's going to be pretty simple, and then the work starts year four, year five, and watching those throughputs and making sure it's possible.

Unidentified Participant: Larry, I was wondering if you could talk through some of the volume performance, maybe by channel, a little bit from the first quarter and kind of how single serve looked relative to retail. If you'd kind of just talk about the trends there and maybe how that trended, also, through the quarter.

Larry Yong: Our volume growth was very balanced across the channels. Like I said, we were up 5%. You take out the Crush; Crush was about 3 points. So our business grew, the base business, 2%. Very balanced across C&G and large format, so we're very pleased with that. I mean, our cold drink, we're seeing up-ticks there. We're seeing more traffic coming in. If you get traffic and have some promotions you can get some activity there. And we're doing things to still help people to drive them in. But traffic's picking up because it's not the \$4 gas and that shock at the pump and get back in the car and drive off. So balanced growth.

Unidentified Participant: Distribution opportunities -- you've had some wins recently with the other Crush going into the Pepsi system. The McDonald expansion was another win there. Are there additional opportunities for different brands or different customers that you could be looking at? And how big an incremental opportunity would those distribution opportunities be?

Larry Young: Yes, we really do believe they're-- I mean, if you look at our portfolio, we have 58 top brands in that portfolio. And whenever we first put our portfolio strategy together, we said we're going to kind of put this in three segments and we're going to look at what we're going to really get behind, invest in. I think you saw those brands, the 12 I put up there, the powerhouses. And you've got to focus and go after those hard.

We've kind of got our second tier that you look at it and you don't have to do a lot because sometimes it's more regional in scope. But they're great brands; they have great volume, great opportunity for growth.

The third bucket is looking at the brands and saying, "What are we going to do with these brands?" And that was one where, as we did the strategy, we looked at Crush; and there's others besides Crush in that. But had 40% distribution across the United States. And we started to challenge that, saying, "Why do we only got 40%? Why is it just sitting there?"

And the rest is kind of history. We got it in the blue system and we now have it up to-- I think our HCV [ph] right now is above 95%. So it was a-- I looked at and said at first, "This could be a home run." It turned out to be a grand slam.

And we've got other brands there and our teams are looking at them now, seeing where are the opportunities? Another one, just playing off of McDonald's, just the halo effect of what you can do with McDonald's, and not only other QSRs but also in the retail. We all know you don't make a lot of money in fountain -- you've got to get that halo effect, over into the bottle and can. Get people drinking your product and buying your product to take it home.

Unidentified Participant: Does a potential combination of Pepsi and Pepsi bottlers make you think a little bit differently about some of the brands that you potentially could think about going into either the Pepsi system or the Coke system?

Larry Young: No, I really haven't. I mean, I don't-- probably won't speculate a lot on their deal right now because they're still working on it. But it really hasn't changed the way I look at it. I mean, in the business, when-- you've got trucks out there, you've got sunk costs. And the best way to run that business -- make sure you've got all the boxes you can on those trucks.

And we're very happy with the franchise agreements, the footprint, the way we do our business right now. If things change -- which I'm sure they will. I mean, our industry has to change some. I mean, we've done an awful lot of things the same way we did it back a hundred years ago when we started the franchise agreements. And so we're always looking at it, but right now I'm really not thinking any different about any of our brands.

And when I do-- the No. 1 thing our entire company does is that first thought always in our mind is that we protect our brands. And we want our brands where they're growing. Because we talk about building and enhancing our leading brands. So our brand is our first thought. Second is our consumer and our customer. So we always make decisions that are best for those three.

Unidentified Participant: Just to follow up on that. To the extent that Pepsi is successful in buying in the bottlers and integrating them, do you have any thoughts about sort of broadly how the industry competitive dynamics might change, including pricing?

Larry Young: Well, I think if they get it done, I'll finally get people to quit beating me to death for putting-- buying bottlers. I was an idiot for four years, doing that. So that'll be the up side. (Laughter)

No, I think we will see changes out there. I can say this -- if it does happen, it takes time to get it working. I mean, it's not something you do overnight. Cadbury and Carlyle brought me in in '05 -- and it's a lot of work to get the plan together, get the strategy. But I think everybody's looking more at, now, the hub and spoke. And how can you get some of these costs out? How can we do things different? So it'll take some time.

- Judy: Does that maybe give you some pause in terms of how the Dr. Pepper brand can be handled during that transition period if there's some of the innovation or distraction as they--?
- Larry Young: No, I don't think so. I mean, if it all happens, there have to be lots of conversations and we've not had any. But you've always got to see-- whenever we have any franchise that changes hands, first thing we do is you've got to meet with who's going to have it, and what are the plans, and what are you going to do with the brand? And this is what we expect. And if there's a commitment. If there's not-- The beauty of owning bottling-- Our company-owned DSD covers almost 80% of that footprint. And where I'm not there, I've got a tremendous amount of very good, strong, third party bottlers out there that we have great relationships with.
- Judy: And potentially, if you do bring the volume to 80% of territories that your CSD business covers, would there be additional incremental investment that you would have to make to handle the capacity?
- Larry Young: Oh, there'd have to be some. Absolutely. I mean, it's not that big. We could kind of reallocate some of the things, but that's really not what we're looking at or planning on right now. We're very happy with the way we're set up today.
- Judy: Thanks. There's a question right there.
- Unidentified Participant: Just wondered if you could talk about what your thoughts are on the timing to get to what you call the solid triple-D rating?
- John Stewart: That's a good question. It is, obviously, in the hands of the rating agencies. We've-- just three weeks ago, Larry and I met with both Moody's and S&P, and essentially they both reaffirmed their current ratings, although there's been a moderation to the positive from what they previously said. So we're going in the right direction; we're well ahead of schedule.
- But I think it's also fair to say that compared with the dates we debuted a year ago, the marketplace and the credit markets are significantly worse. So the goalposts have moved a bit during the game for us, here. And that probably pushes it out a bit from where our initial expectations were.
- I would love to think that it was something we could expect toward the end of this year or the early part of next year, but our focus has got to be just keep beating our cash expectations, paying down the debt ahead of schedule, executing against our strategy, which hasn't changed, really, one iota since we debuted, and doing everything we possibly can to make that re-rating happen.
- And when it does, as we've said, that will give us the opportunity to look at alternative uses of our cash.
- Judy: Alex?
- Alex: Larry, I was curious. I'm not aware of the level of involvement you've got on the resizing, or the repackaging that's going on in the C-store channel with a lot of your competitors and how they're trying to hit certain price points, everyday value. What is your thought process around that -- strategy? What are you seeing in terms of the efficacy of that and the overall economic benefits, if any, from doing that?

Larry Young: How many of those Venoms have you had this morning? Stop at two. (Laughter) No, the great thing about the way our route to market is set up -- in all the tests, even with our bottling partners, we're a part of that. Our Dr. Pepper and our other brands, our piece of it. So we get to participate, see the results.

And you see very mixed results, and it's very geographic, very regional. So I don't know if we have found the perfect one yet, but one of the things I'm seeing in our markets where we cover everything-- we haven't really moved a lot because we have the 12, the 16, the 20, the 24, the 1 liter-- there's quite a broad span out there.

We're still, in our markets, very heavy 20 ounce and as the convenience store traffic had dropped, we did more promotion, doing two 4s and under-the-cap promotions and different things to drive traffic into the accounts. So don't know which one's going to be the ideal position, but I think it's one of the things that's helping us drive our growth back into the convenience channel.

Alex: But are you-- do you look at it as an economically viable way to go about it? In other words, the profit contribution from downsizing is questionable, so do you look at it as maybe the promotional route that you're talked about as a better way to do it?

Larry Young: That's my opinion. I've done this my entire life and whenever I started out, we were selling little returnable glass bottles. It's been a lot of years getting it bigger, so I'd much rather see if we could keep the 20 ounce. But it may tell us we do need to come down on the size or something. But I think there's a lot of room for both of them out there. But I still like the-- in our company-owned, I like to keep a strong focus on the 20 ounce.

Judy: I think we have time for one last question.

I'll ask the last question, then. On Snapple, you're doing a lot of things to reinvigorate the brand -- the mainstream launch, the premium makeover. Any sense that any of these initiatives are gaining traction? And I guess, what takes it to get the brand going again?

Larry Young: Well, I think we're doing a lot of stuff. If you're watching our commercials, we're doing a lot of stuff.

Everybody knows the history of Snapple; it's sad to let a brand that was the original new age beverage sit out there for a long time and nothing done with it. So I said if we didn't do anything else, nobody could say we didn't do anything with the brand. We've completely remade it. I mean, we did a complete facelift. New packaging, new bottles. The bottle now will even fit in the cup holder in your car. They wouldn't before because the bottle was made in '83; cars didn't have cup holders.

So I mean, we've done the right things-- and the new ingredients. And that's why the commercials; this is the first time we've had national media running out there telling our story. And we've got better ingredients. It is a great quality product.

Now, we thought we would be, probably towards the second half, back into a volume increase -- kind of find the floor and get it growing back. Now, with the economy hitting the way it was, premium brands losing a little bit more of the volume than anyone else-- it's probably going to push me back a quarter or two. But we're very pleased with it. We get great response from our customers, from our consumers. And a lot of people just thrilled seeing we're doing something. Our customers were telling us "It's tired, it needs something." Now they're saying, "You guys are doing the right things." So I'm very optimistic on getting it moving.

We've also got our mainstream going and it's more of a strategic defensive play out there where we need it in certain markets. I've told people before I've never looked at saying our value tea's going to be No. 1, but it helps me on getting the premium piece of our business fixed.

Judy:

Great. Thank you, Larry and John, for your answers.

Larry Young:

Thank you very much. (Applause)