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# Why Keurig Is Acquiring Dr Pepper

## *Breaking Down the Walls Between Coffee and Soft Drinks*

### Summary

- The strategic basis for the Keurig – DPS combination is clear: to create a company that combines hot/cold beverages and retail/office/e-commerce distribution in order to match the way its consumers experience the beverage world. The strategic side of the combination will take significant execution skill, while the financial side (creating synergies and an exit strategy) looks to be more straightforward.

### Details of the acquisition

On January 29, 2018 Keurig agreed to a merger with Dr Pepper Snapple to form Keurig Dr Pepper (KDP). Dr Pepper Snapple shareholders will receive USD 103.75 per share (for a total cash value of USD 19 billion) and retain a 13% stake in the new public company. The total value to DPS shareholders represents an EV/EBITDA multiple of 17.6x. JAB, together with its partners, will make an equity investment of USD 9 billion to help finance this transaction.

### Coffee + soft drink opportunities and challenges

KDP integrates hot and cold beverages to a degree we haven't seen before, but we see this as a step towards a more combined coffee and soft-drink world. The most concrete example presented by the company of top-line synergies is the ability to increase distribution of ready-to-drink coffee products, with access to the broader JAB coffee portfolio. We wrote about the blurring lines between coffee and soft drinks in our note [Coffee Joins the Beverage Party: What Happens when a Can of Coffee Looks Just Like a Can of Soda?](#) We are bullish on the potential for ready-to-drink coffee in North America – and believe the new KDP could build a real challenger to Starbucks/Pepsi in this space.

Beyond ready-to-drink coffee, the potential top-line growth opportunities for KDP become fuzzier. Is there room to leverage Keurig online sales to ship an extra case of Dr Pepper or Bai? Can Dr Pepper Snapple's distribution strength in the convenience channel, for example, create extra room for hot coffee? It is difficult to see short-term top-line benefits, and we consider any additional revenue growth to be dependent on exceptional sales execution and to be more relevant over a five to ten-year horizon.

One of the potential challenges for growing top-line revenue in the future comes from the DPS distribution model. DPS has a unique distribution model, combining company-owned distribution in key markets with ~40% of total distribution going through third-parties, mainly Coke and Pepsi. Coca-Cola and Pepsi bottlers already distribute coffee brands like Starbucks, Dunkin, illy and Java Monster, and the integration of KDP coffee brands may not be completely plug and play.

### The financing side looks good

The financial rationale behind the creation of KDP looks clear and strong. The company announced USD 600m in synergies to be achieved by 2021 and we believe this is on the

conservative side, both in timing and scale. Increasing efficiency is where the Keurig/JAB expertise lies. On its conference call about the merger, Keurig highlighted its 2015-2017 turnaround—driven almost exclusively by cost cutting and efficiency initiatives. Adjusted operating income at Keurig grew 14%, even as revenues fell 3% over this time period.

A 13% public stake looks like an exit strategy. To understand the deal, we consider why Keurig left a public stake of 13% as opposed to going completely private. Management spoke of having a bigger financial toolkit as a public company. Additional avenues towards raising capital are certainly a positive. More significantly, we see a public stake as a potential way for private equity investors to potentially cash out, over time.

### **The future of coffee and soft drinks**

Cross-investment between coffee and soft drinks has been happening for some time, including the Starbucks/Pepsi JV, Coca-Cola taking a minority stake in Keurig in 2014, and Coke's success with the Georgia coffee brand in Asia. The coffee segment is an increasingly important growth segment for beverage companies and one that offers access to their consumers during different drinking occasions.

The same consumer buys hot coffee, cold coffee, and soft drinks. We expect to see further deals that bring both hot and cold coffee more fully into the broader non-alcoholic beverage world. KDP is a North American deal that could point the way for future deals around the world. Coffee is a natural, healthy beverage which provides new innovation, stories, and drinking occasions to complement a traditional soft-drink portfolio. Looking even further, once you add coffee, perhaps almond milk is next?

# Imprint

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