November 14, 2014

Americas: Beverages: Soft Drinks

Equity Research

Will Keurig Cold be another disruptive innovation? Buy GMCR

We believe Keurig Cold has potential to be a disruptive innovation

We reaffirm our Buy rating on GMCR and maintain our above-consensus estimates in the out-years. Our bullish view is partly based on the potential sales and profit contribution from the upcoming launch of Keurig Cold system. We believe (1) the Cold adoption rate could be meaningfully higher than the 1% level SodaStream commands; (2) the economics of Cold pod could be compelling, with per unit profit similar to that of Hot and incremental $7.59-$12.69 in EPS from Cold alone by 2020. Our $185, 12-month price target (from $166) reflects roll forward of estimates and higher multiples (35X from 34X) due to an increase in peer multiples. **Our options strategists** highlight options price in less than a 10% chance of our bull case on shares, and recommend buying January 2016 $190 Calls ahead of the Cold launch.

Prior adoption barriers are not a hurdle for Keurig Cold

While SodaStream has achieved only 1% household penetration in the US, we believe the Keurig system has hurdled key barriers of adoption, including (1) instant cold, (2) integrated carbonation, (3) a deep bench of brands through the partnership with KO; and (4) the already well-known Keurig brand. We estimate Keurig Cold to reach 4.5% of household penetration by 2017 and increase further to around 14% by 2020.

System profit pool for cold could be 3X traditional RTD per serving

We believe the cold opportunity represents a sizable profit contribution opportunity for all parties involved. **Our analysis shows a potential system profit of $0.17/12-oz. serving (vs. 12-oz. packaged CSD of $0.06).** We estimate that GMCR will garner about 52% (or $0.09/pod) of the profit pool, with KO and the bottlers garnering the remainder ($0.08/pod).

Implications for other soft drink firms: modestly positive for KO; mixed for PEP/DPS/COT depending on the level of participation

KO should benefit from its equity investment in GMCR as well as potentially higher per unit economics around Cold pods.
PEP is planning to conduct limited testing with SodaStream but may need to seek a bigger presence if Keurig Cold system begins to gain traction.
DPS already has partnership with Keurig Hot System with Snapple, and could broaden the relationship to include CSD brands.
COT could be in position to contract manufacture concentrates over time.

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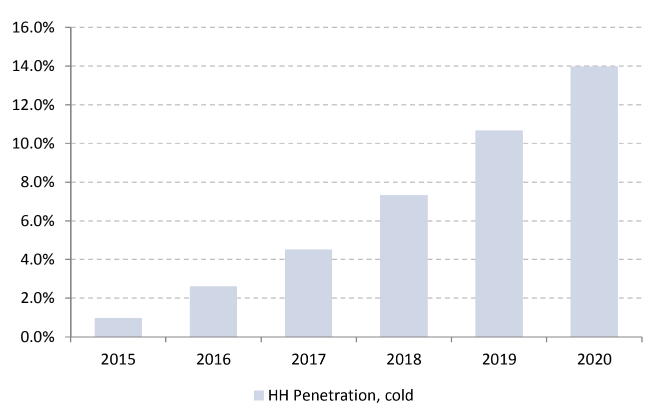
PM summary: Is Keurig Cold another disruptive innovation?

We continue to see GMCR pivoting to a multi-platform, multi-year growth story with robust sales and earnings growth over the next several years. A key driver behind our above-consensus estimates is the sales and profit contribution from the Keurig Cold platform that is expected to launch in FY15. In this note, we take a deep dive into the Cold pod opportunity and size up potential sales and profit impact for GMCR as well as other soft drink companies. We maintain our Buy rating on GMCR, Neutral rating on KO, PEP, and COT, and Sell rating on DPS.

The Cold opportunity is a key point of debate in assessing GMCR's future earnings power – One key push-back to our Buy recommendation on GMCR has been our bullish view on the Cold opportunity. Given the lack of details around the system itself and limited comparables, investors are asking questions about (1) the value proposition; (2) potential household penetration of the Cold system; and (3) the economics and potential profit impact for GMCR/KO and implications for other soft drink players. **Based on our analysis, we believe that Keurig Cold has potential to be a disruptive innovation, driving sizable sales and profit lift for GMCR in the coming years.**

- **Keurig Cold hurdles key barriers and could command a much higher adoption rate than SodaStream** – First, Keurig Cold will not need separate CO2 cartridges, but rather will have a built-in CO2 within the cold pod. Second, the system already has a global partnership with The Coca-Cola Company. Third, the pods should provide a consistency of product and the machine will ensure the convenience of making cold beverages in less than 60 seconds. Finally, the Keurig brand is already in more than 15% of all US households.
- **Pods could potentially generate a larger profit pool versus ready-to-drink (RTD) packaged beverage offerings** – We estimate that unit economics of the pod could be more favorable on a per serving basis than comparable RTD offering. Our analysis based on a retail Cold pod price of $0.50 per 12-oz. serving (admittedly speculative given the dearth of details at this point) points to nearly 3X larger profit per serving. We note that there are potentially more profit participants (GMCR/KO/bottlers), but all parties could end up with attractive economics given larger profit per serving potential.

Exhibit 1: We estimate Keurig Cold could reach 14% household penetration by 2020
HH Penetration (Keurig Cold)



Source: Goldman Sachs Global Investment Research

Exhibit 2: We estimate Cold economics could be attractive to GMCR/KO/bottlers
Cold pod economics analysis

Cold Pod Economics	*Coke 12-oz serv.*
Retail Sales Price	**$0.50**
GMCR revenue	**$0.35**
Gross Profit	**$0.16**
Operating Profit	**$0.09**
	Profit per 12oz
KO	$0.05
Bottlers	$0.03
GMCR	$0.09
System	0.17

Source: Goldman Sachs Global Investment Research

Evaluating discovery value: Bull case points to sales of $7-$12 billion, operating profit of $1.8-$3.1 billion, equating to $7.59-$12.69 of incremental EPS for GMCR from Cold alone by 2020 – We believe a bull case scenario for Cold is household penetration above 20%+ (SodaStream's household penetration in Sweden is 25%) and an attachment rate of 2.45X-2.95X. Our FY 16 EPS estimate of $5.58 is already 3.8% above consensus as we incorporate 2.5% household penetration, a 2.11X attachment rate and $0.06 in EBIT/cup.

Exhibit 3: Our Base case scenario analysis points to potential sales of $4-$5 billion by 2020…
GMCR Cold scenario analysis, Sales sensitivity

			Attachment rate				
			0.95	1.45	1.95	2.45	2.95
Bear case ->	HH Penetration	3%	472	721	969	1218	1466
		6%	945	1442	1939	2436	2933
		10%	1574	2403	3231	4059	4888
Base Case ->		14%	2200	3358	4516	5673	6831
		18%	2834	4325	5816	7307	8798
		22%	3464	5286	7108	8931	10753
Bull Case ->		25%	3936	6007	8078	10148	12219

Source: Goldman Sachs Global Investment Research

Exhibit 4: …Implying $255 share in value
Bull vs. Base vs. Bear case GMCR share value

	Bull	Base	Bear
GS 2016 Hot EPS baseline	$5.12	$5.12	$5.12
Cold scenario	$7.90	$3.68	$1.03
Combined EPS base	$13.02	$8.80	$6.15
Assigned multiple	32.0X	29.0X	20.0X
Blended value	$417	$255	$123
Upside	**170%**	**65%**	**-20%**

Source: Goldman Sachs Global Investment Research

For the major soft drink companies, we see mixed implications, depending on the level of participation in the Cold system:

- **Coca-Cola: A potential win/win** – We believe KO's equity investment in GMCR allows some participation in GMCR's profit growth. We further see potential for incremental consumption occasion, bringing some excitement to soda, as well as premiumizing the category. From a pure profit flow-through, our analysis points to a profit per serving of ~$0.05 for KO, vs. a profit per 12-oz. of $0.03 for traditional RTD beverages. Although there may be some cannibalization of sales as a result, we do not believe this is necessarily a negative from a profit contribution basis.
- **PepsiCo: Testing with SodaStream, but is it enough?** – PEP recently announced that it will be doing a limited testing of home-made Pepsi soda with SodaStream. Given the limited nature of the test at this point and SodaStream's new strategy of focusing on sparkling water, we do not envision the PEP/SODA relationship having a meaningful impact in the near term. We also believe GMCR has every incentive to get PEP on its platform; but whether or not KO could get in the way of that remains to be seen. Even if pods do not prove to be as disruptive as we expect, we think the potential halo and buzz effect of the platform is at least enough to warrant action on the part of PEP to make sure it is not left behind as pods become a competitive reality (particularly given the attractive system profit economics).
- **Dr. Pepper Snapple: Likely to get involved –** DPS already sells Snapple branded K-cups through the traditional Keurig coffee system. Given that DPS's soda brands are less of a direct threat to the KO portfolio, we believe DPS would get involved with the Keurig Cold.
- **Cott Corporation: A new opportunity? –** Cott is already a supplier of concentrate for SodaStream. While the prospects for that deal may be unclear pending the launch of Keurig Cold and SODA's new strategy, we believe Cott is likely to be involved in making private label concentrate for the Keurig system over time.

The Cold pod opportunity could be significant

Our base case calls for the Keurig Cold system to account for 14% household penetration by 2020. Clearly, this is a significant adoption rate compared with the roughly 1% penetration that SodaStream commands today. However, in our view, SodaStream's trajectory as a niche product may be due to the lack of mass market brands as well as a product positioning and value equation miss-execution.

Our optimism around the Cold system is based on several factors – We believe the addressable market for the Cold at-home dispensing system is significantly larger than that for Hot owing to substantially higher consumption occasions (including tap water). In addition, GMCR's partnership with Coke will be critical in driving adoption rates growth. We are further positively inclined as GMCR is well positioned with key brand points of differentiation (the KO brand portfolio) vs. competitors.

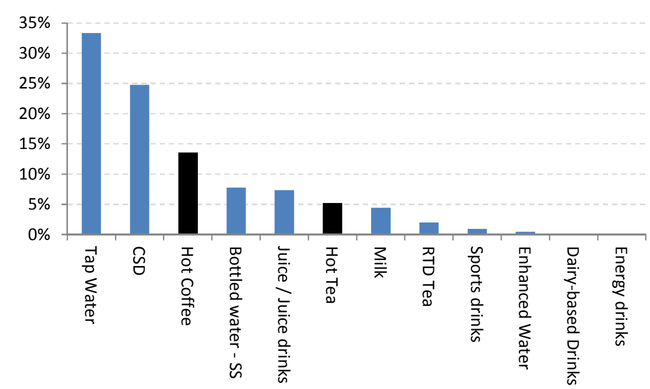
(1) **Sheer size: The addressable market for Cold is much larger than that for Hot** – We estimate that the total cold beverage market is roughly 4X the size of the hot market (when including adjacent beverage categories). This implies that cold beverages currently account for 80% of beverage occasions. Tap water is the single largest beverage occasion, at 33%. Although we do not believe that the cold platform could fully displace the tap water category, we see the possibility for some share shift from tap water – as well as the remaining 48% of beverage occasions – as a potential opportunity for GMCR (excluding the Hot opportunity).

Exhibit 5: Keurig Cold could go after a broad-based addressable market
Estimated daily servings, per household (at home), * grey shading indicates Hot opportunity

	Daily serv.	% of total	Carbonation	SODA	GMCR Cold (E)
Tap Water	4.63	33%	X	√	√
CSD	3.44	25%	√	√	√
Hot Coffee	1.88	14%	X	X	X
Bottled water - SS	1.08	8%	X	X	X
Juice / Juice drinks	1.02	7%	√	√	√
Hot Tea	0.72	5%	X	X	X
Sports drinks	0.13	1%	X	√	√
Milk	0.61	4%	X	X	X
RTD Tea	0.28	2%	X	√	√
Enhanced Water	0.07	1%	X	√	√
Dairy-based Drinks	0.02	0%	X	X	X
Energy drinks	0.01	0%	√	X	√

Source: Goldman Sachs Global Investment Research

Exhibit 6: CSD is the second-most-consumed beverage in the at-home channel
Estimated daily servings, per household (at home), percentage ranked



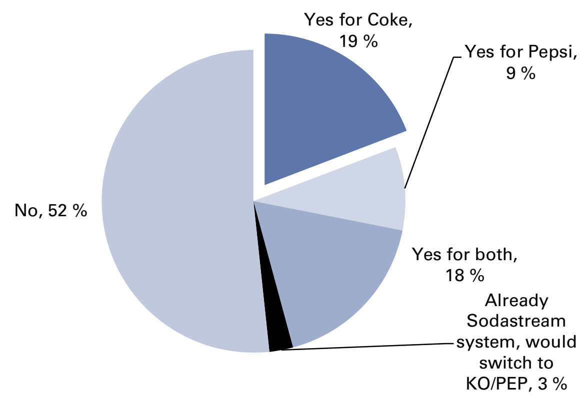
Source: Goldman Sachs Global Investment Research

(2) **Relatively high level of purchase intentions: Our proprietary consumer survey points to a 50% purchase intent for Cold** – We are encouraged by a relatively high purchase intent level, and believe that an already-high brand awareness of the Keurig system provides a greater likelihood of success for the Cold platform. We conducted two separate surveys of 2,000 consumers in June and September of this year. Both surveys point to ~50% purchase intent as well as demographic and geographic underpinnings.

- **Demographic underpinnings encouraging –** The survey points to the 18-44 age demographic over-indexing within purchase intention. Notably, the 35-44 demographic in particular tends to consume an above-average number of pods within the Hot platform, a potential positive if this similar demographic yields high adoption rates within the Cold platform.

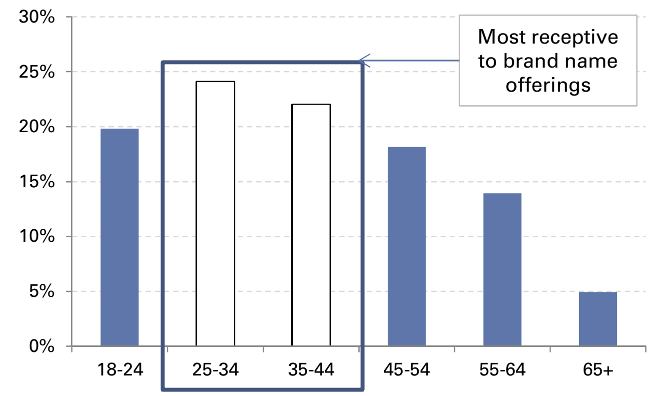
- **Geographic underpinnings encouraging –** Digging deeper in the survey data reveals that purchase intentions appear relatively evenly spread out across geographies. We believe this speaks to the broad national appeal of the Coke and Pepsi platforms – a key driver of potential adoption levels.

Exhibit 7: Just under 50% of consumers indicated interest in purchasing a branded Cold beverage system
Question: "If Coca-Cola or Pepsi-Cola branded disks, cups or pods were available for single serve machines that make cold beverages, would you be interested in buying a machine?", Percentage responding:



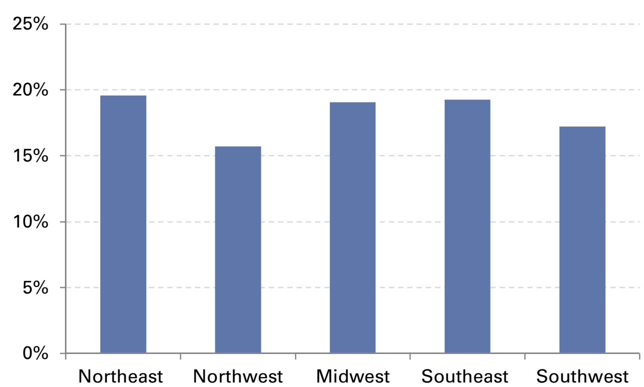
Source: Goldman Sachs Global Investment Research

Exhibit 8: Brand name CSD offerings resonate well with the 25-44 age bracket
Question: "If Coca-Cola or Pepsi-Cola branded disks, cups or pods were available for single serve machines that make cold beverages, would you be interested in buying a machine?", % responding: "I would purchase a machine to make either Coke or Pepsi branded beverages at home", by age segmentation:



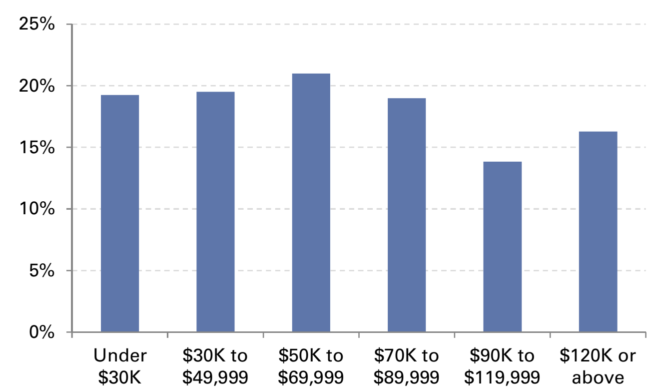
Source: Goldman Sachs Global Investment Research

Exhibit 9: Respondents indicating interest in a Pepsi or Coke platform are evenly spread geographically
Question: "If Coca-Cola or Pepsi-Cola branded disks, cups or pods were available for single serve machines that make cold beverages, would you be interested in buying a machine?", % responding: "I would purchase a machine to make either Coke or Pepsi branded beverages at home", by geographic segmentation:



Source: Goldman Sachs Global Investment Research

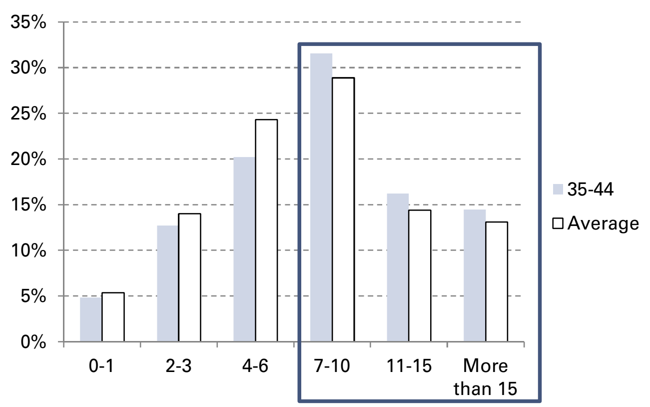
Exhibit 10: Relatively high interest level from lower income consumers for the Cold system
Question: "If Coca-Cola or Pepsi-Cola branded disks, cups or pods were available for single serve machines that make cold beverages, would you be interested in buying a machine?", % responding: "I would purchase a machine to make either Coke or Pepsi branded beverages at home", by income segmentation:



Source: Goldman Sachs Global Investment Research

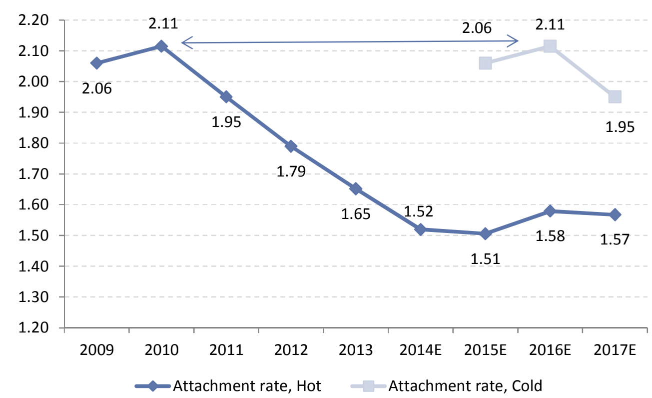
(3) **Daily usage rate for the Cold system could also be higher given broader beverage occasions for Cold versus Hot.** About 50% of survey respondents indicated that they would purchase a Cold system if the Coke or Pepsi brands were available. This suggests that having well-established brands in the system is a key purchase consideration for the Cold system. In addition, the Cold system will allow a variety of offerings, ranging from carbonated to non-carbonated, flavors to colas, and beverages with functional benefits (energy drinks, RTD tea).

Exhibit 11: We are encouraged that this demographic over indexes in Hot pod consumption, and believe similar drivers exist to drive Cold attachment rates
Question: "How many disks, cups or pods does your household consume per week?", Hot, indicated frequency



Source: Goldman Sachs Global Investment Research

Exhibit 12: Our model anticipates similar levels of attachment rates for Cold as Hot during the launch period
Cold vs. Hot Attachment rate forecast, 2009-2017E



Source: Goldman Sachs Global Investment Research

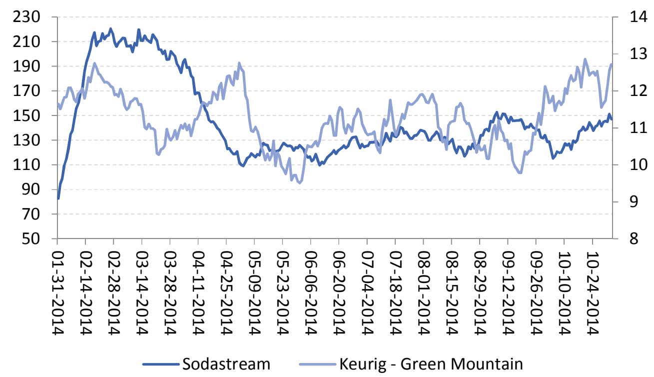
Some points to consider from SODA's trajectory – While SodaStream has achieved only 1% household penetration, we believe the Keurig system has hurdled many key barriers of adoption. Importantly, Keurig Cold does not require CO2 cartridges (the carbonation is in the pod). Second, the pods provide a consistency of product that is crucial for the major branded players, as well as instant cold technology. Our analysis also points to a few important issues that may have arisen with the SodaStream brand:

- **SodaStream's quality scores have been declining recently** – Our analysis of YouGov's BrandIndex data (which measures real-time consumer perception of various brands) points to the declining quality scores for SodaStream versus the Keurig system. SodaStream's quality scores have been in decline though 2014, and remain well below year-ago levels. Notably, quality scores have remained low within the core income demographic of 25K to 100K, which we believe is the key target market for the SodaStream system. GMCR's launch of the Cold platform with an integrated carbonation system, could shield the platform from similar perception issues. In addition, a broader and well-known portfolio of brands could also help support quality perception with consumers.

- **Value scores are also falling –** In addition to a decline in positive quality perception; we note that consumers have also indicated an eroding value proposition for the SodaStream system. As with quality scores, we have seen a noticeable discrepancy in trends vs. the Keurig system when segmented by income.

Exhibit 13: The SodaStream system appears to be suffering from a quality perception issue

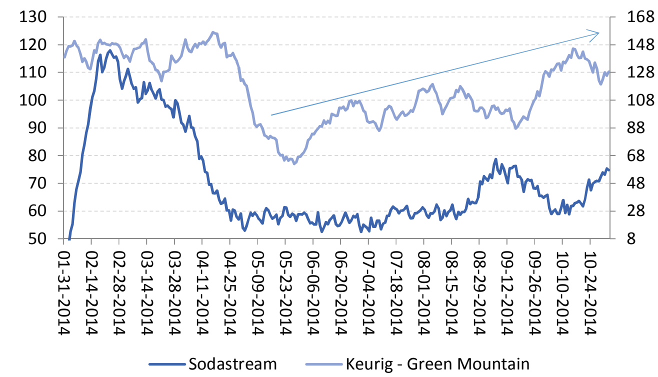
SodaStream (LHS) vs. Keurig Green Mountain (RHS) – Positive quality scores, aggregate



Source: Goldman Sachs Global Investment Research, Yougov

Exhibit 14: This is particularly noticeable within the companies' core 25k-100k income demographic

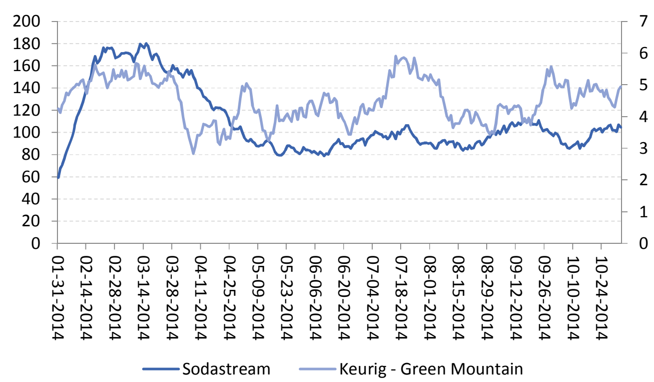
SodaStream (LHS) vs. Keurig Green Mountain (RHS) – Positive quality scores, Household income 25K-100K



Source: Goldman Sachs Global Investment Research, Yougov

Exhibit 15: SodaStream has also seen a relative decline in value scores

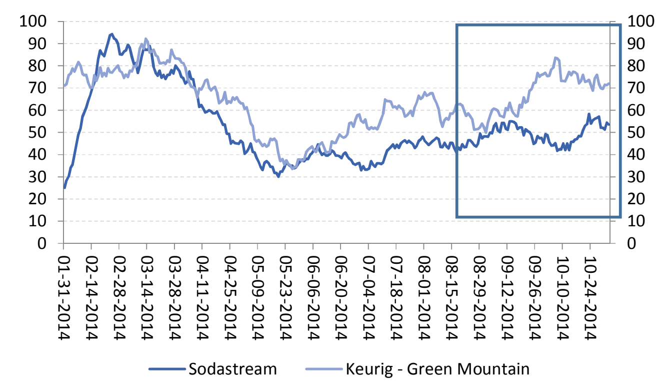
SodaStream (LHS) vs. Keurig Green Mountain (RHS) – Positive value scores, aggregate



Source: Goldman Sachs Global Investment Research, Yougov

Exhibit 16: Although this has improved recently, gains within the GMCR system have outpaced SODA within core income demographics

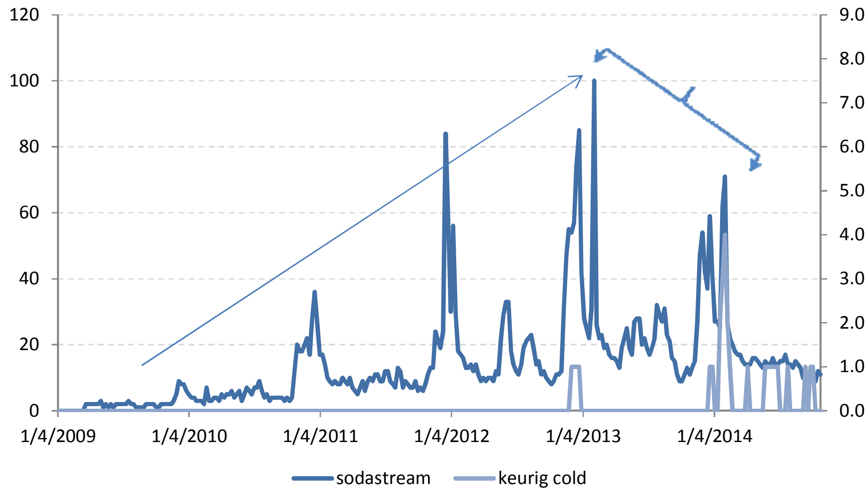
SodaStream (LHS) vs. Keurig Green Mountain (RHS) – Positive value scores, aggregate



Source: Goldman Sachs Global Investment Research, Yougov

- **Opportunity for Keurig Cold to step in? –** We view SODA's recent pivot away from the at-home CSD opportunity as an opportunity for the Keurig Cold launch. Google trends indicate that search frequency for SodaStream declined at its peak during the holiday 2013 period, following several years of fresh highs. In contrast, though "Keurig Cold" has not launched formally, search terms for it have increased in recent months, potentially indicating preliminary interest from consumers searching for an alternative to current products within the at-home beverage space.

Exhibit 17: SodaStream's product cycle might be turning, offering an opportunity for GMCR to step in and fill the void
SodaStream Google Trends, Keurig Cold Google Trends, 2009 to present



Source: Goldman Sachs Global Investment Research, Google Trends

Assessing the value proposition for Cold pods

In our view, how GMCR/KO prices the pods at retail in the context of its value proposition will be a key determinant of the adoption rate for the Cold system. While coffee tends to benefit from a ritualistic consumption pattern and the rise of gourmet coffee bars, soft drink consumption is already an affordable, familiar and easy process; thus we think other value drivers are needed to justify premium price point for Cold pods.

What we know about Keurig Cold:

- **Both carbonated and non-carbonated beverage functionality**
- **Instant cold** – The Keurig Cold is expected to use a flash chilling system, dispensing cold beverages within 60 seconds.
- **No CO2 cartridges** – The pods for carbonated beverages are going to be filled with a pre-form carbonation in a separate chamber from the beverage syrup

Understanding the value proposition from a consumer's standpoint – SodaStream calls out five major "mega-trends" that its product proposition attempts to meet. Below we look at those trends in the context of Keurig Cold and whether they are truly met.

1. **(+/-) Convenience**:
   - ***Consumption:*** *<u>less</u> convenient* – Making a soda is more cumbersome than opening a ready-to-drink offering. However, Keurig Cold is expected to make a significant leap forward versus SodaStream in this area by eliminating the need for CO2 cartridge.
   - ***Purchasing:*** *<u>more</u> convenient* – Pods are small and light, making a grocery trip far less strenuous versus carrying home the traditional 2-liter format. Additionally, pods lend themselves very well to E-commerce, which could cut out the grocery store purchase of soft drinks altogether.

- ***Variety:*** *<u>more</u> convenient* – It is far easier to commit to buying a pod of a new or often bypassed offering than it is to buying a 12-pack or 2-liter. Pods lend themselves to variety.

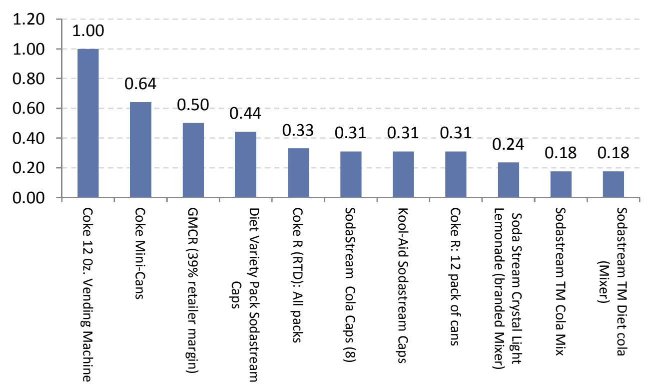
2. **(+) Sustainability**:
   - The surface area of a 12-oz. PET bottle is about 3.5X greater than that of a K-cup yielding the same serving size. Also, K-cups would reduce both the amount of distribution needed and the weight of the load a truck has to carry, as the water volume is de facto eliminated.
3. **(+/-) Health & wellness**:
   - Pods cannot make Coke healthier on an absolute basis or reduce the artificial sweetener component in Diet offerings. Additionally, there may be some push-back against having a CO2 cartridge within the pod. On the positive side, consumers should be able to choose from additional health & wellness varieties that have lower calories, all-natural sweeteners and functional benefits (vitamins, antioxidants, etc).
4. **(+) Personalization**:
   - While pods will likely start out with simply a Coke pod or a Diet Sprite pod, we believe that, over time, suppliers such as KO will try to replicate the experience of something like their KO Freestyle vending machine, which allows mixing of flavors and soda types.
5. **(+/-) Value for money**:
   - Soft drink pods will not be like coffee pods in that we do not believe they will be selling at multiples higher prices vs. their traditional (drip brewing in the case of coffee) offering. In addition, there is still the upfront cost of the machine. Whether the intangible benefits of convenience, personalization, and sustainability are enough to offset the upfront cost will depend on the individual consumer.

We attempt to determine what may be an appropriate price point for a Cold pod and estimate a retail price of $0.50 per 12-oz. serving Cold pod, though we acknowledge that the ultimate price point GMCR chooses may be very different.

- **We believe Cold pods are likely to be priced at a significant premium to KO's take-home, value pack pricing** – Average retail price per 12-oz. servings for KO's CSD brands is $0.53 across all channels, but price per servings vary across pack sizes and channels. The 2-liter bottle and a case of 12-oz. cans typically command the lowest price per servings, ranging from $0.25 to $0.30 per 12-oz. servings; meanwhile, mini-cans are priced at around $0.64 per 12-oz. serving and immediate consumption bottles sold in convenience stores or vending machines range from $0.85 to well over $1.00 per 12-oz. servings. Given that Cold pods are likely to be for at-home consumption, we do not envision price points mirroring those of the immediate consumption channel. However, we see GMCR/KO pricing at a significant premium to 2-liter, multi-pack 12-oz. cans given the convenience and immediate cold value proposition.
- **SodaStream's price per servings** – We estimate that SodaStream comparable products are currently priced at a range of $0.44 to $0.18 per 12oz. serving. Our estimates for pricing focus on a range from SodaStream branded products to external branded offerings (Kool-Aid). We note that delta between SodaStream branded product and externally branded products is ~35% to 40%.

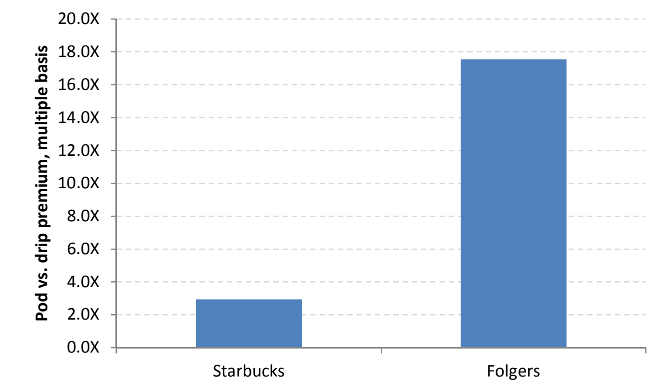
We do not expect Keurig Cold pods to be priced at massive premiums to RTD offering, such as the premiums prevailing for K-cups versus drip coffee options – We estimate that Folgers drip coffee costs $0.04 per 8-oz. serving, versus $0.69 (17.5X multiplier) for its equivalent K-cup offering. Premium brands such as Starbucks Donuts command a lesser premium but K-cups are still 2.9X times higher than drip coffee offerings.

Exhibit 18: We expect Keurig Cold pods to be priced above take-home, value CSD packs but below immediate consumption packs
Average cost per 12-oz. serving, across channels



Source: Goldman Sachs Global Investment Research

Exhibit 19: We do not expect Keurig Cold pods to be priced at the massive premiums seen in coffee
K-cup cost vs. drip brewing cost; estimated multiple premium vs. tradition drip brewing cost per cup



Source: Goldman Sachs Global Investment Research

Pod Profit 101: The economics of pods could be compelling

We believe the economics of the Cold pods could be compelling, with system-wide economics similar to those for the Hot pods on a 12-oz. serving basis. This implies that profit contribution from Cold could be meaningful for GMCR (particularly since most of it should be incremental) over time if adoption rates ramp up as we expect. In addition, the pod economics also appear attractive to KO and the bottlers, even if we assume that the Cold pods fully cannibalize the packaged beverage offerings.

Evaluating unit economics – There are many ways the economics of KO's relationship with GMCR could potentially be structured, but we make our best estimation and make the following assumptions:

- The pod sells at around $0.50 per 12-oz. servings at retail
- The bottler either acts as a distributor or takes in a "territory fee" even if it is not directly involved in the value chain
- GMCR manufactures the concentrate (vs. purchasing it from KO), adds the carbonation, and packages the syrup in the pods, but pays a brand licensing fee to KO

Our analysis points to attractive per unit profitability – Based on the $0.50 per pod retail price, we estimate $0.17 of profit per Cold pod for the system over time, similar to the profit per K-cup on the Hot side. Our analysis is based on our understanding of the Hot K-cup economics as well as the packaged CSD economics. Key assumptions include:

- **Retail price per Cold pod of $0.50** and retail mark-up of 28%
- **GMCR's revenue per pod of $0.35**, after paying KO and bottlers licensing and territory fees

- **Total COGS of $0.19/pod**: we estimate concentrate costs on par with traditional KO CSD ($0.03), but include $0.04 of carbonation within the cup and packaging costs that are 50% higher than the packaging costs for the hot platform given a dual chamber carbonation pod integrated into the pods. Labor and overhead is expected to be similar to that for the hot system, particularly as GMCR ramps up its manufacturing capabilities and levers fixed costs. Distribution costs could be lower as GMCR utilizes KO/bottlers for distribution of pods.
- **Operating expenses of $0.07/pod**: we estimate that operating expenses could be lower than the current $0.09/K-cup cost as GMCR is able to get some leverage from the Hot infrastructure. Indeed, we believe even $0.07/cup operating costs could come down over time as GMCR builds scale for both Hot and Cold systems.

Exhibit 20: We estimate total profit of $0.17 per 12-oz. serving, with GMCR's EBIT/pod of $0.09 and KO/Bottlers' EBIT/pod of $0.08
Cold Pod unit economics

Cold pod CSD analysis	*Cold Pod - 12oz Serving*
Retail Sales Price	**$0.50**
Retail Markup	$0.14
% of retail price	*28%*
Wholesale Revenue	**$0.43**
Wholesale mark-up	$0.03
KO royalty fee	$0.05
GMCR revenue	**$0.35**
Concentrate costs	$0.03
Carbonation costs	$0.04
Packaging costs	$0.06
Labor/Overhead	$0.04
Distribution/Logistics	$0.01
Others	$0.01
Total COGS	**$0.19**
Gross Profit	**$0.16**
Gross Margin	*45%*
Operating Expenses	$0.07
Operating Profit	**$0.09**
Operating Margin	*25%*

	Profit per 12oz
KO	$0.05
Bottlers	$0.03
GMCR	$0.09

Source: Company data, Goldman Sachs Global Investment Research

Profit split likely to be relatively equitable, with GMCR taking in $0.09/pod – We forecast system profit of $0.17, with GMCR garnering ~52% of the profit pool ($0.09/pod), KO garnering 29% ($0.05), and bottlers receiving 19% ($0.03). The bottlers are in the position of lowest leverage as they are not necessarily needed, but we believe KO will keep them involved in some fashion to manage relationships and the legacy CSD business. For now, given that KO owns a majority of the North American bottling operation, KO should be in position to enjoy higher profitability per pod from the Cold system.

Comparing Cold economics to Hot and traditional packaged CSDs – Overall, we estimate that the Cold profit pool should be comparable to the Hot profit pool, while higher than the traditional packaged CSDs.

Exhibit 21: We estimate $0.17 in system profit from hot pods
Estimated GMCR pod level profitability analysis, Hot pods

Hot - pod analysis	GMCR Pod, 8oz Serving
Retail Sales Price	**$0.57**
Retail Mark Up	0.16
% of retail price	*28%*
Wholesale Revenue	**$0.48**
Wholesale mark-up/net adj	$0.11
GMCR Revenue	**$0.37**
Coffee/Ingredient cost	$0.07
Packaging	$0.04
Labor/Overhead	$0.04
Distribution/Logistics	$0.03
Others	$0.01
Total COGS	**$0.19**
Gross Profit	**0.19**
Gross Margin	*50%*
Operating Expenses	$0.09
Operating Profit (GMCR)	**$0.10**
Operating Margin	*27%*

	Profit per 8oz
GMCR	0.10
Partners	0.07
System	0.17

Source: Goldman Sachs Global Investment Research

Exhibit 22: We estimate $0.06 in system profit from packaged KO CSDs
Estimated KO CSD profitability analysis

Bottle/Can CSD Analysis	Coke - 12oz Serving
Retail Sales Price Per 12oz can	**0.53**
Retail Markup	0.15
% of retail price	*28%*
Bottler Revenue	**0.38**
Bottler GM	*44%*
Concentrate Revenue	**0.08**
Concentrate costs	0.03
Packaging costs	0.08
Sweetener	0.02
Others	0.04
Total COGS	**0.17**
Gross Profit	**0.22**
Gross Margin	*56%*
Operating Expenses	0.16
Operating Profit	**0.06**
Operating Margin	*15%*

	Profit per 12oz
KO	0.03
Bottlers	0.03
System	0.06

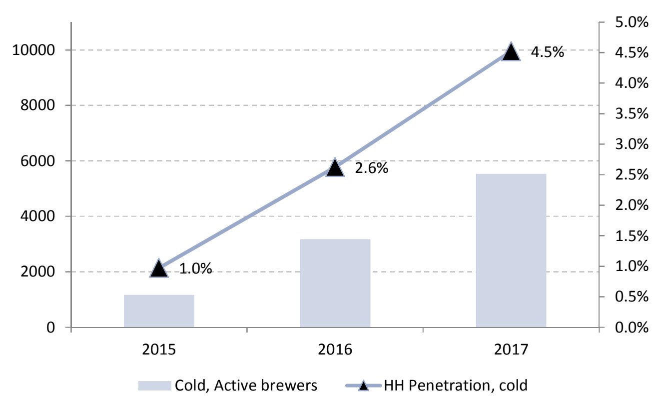
Source: Goldman Sachs Global Investment Research

- **Hot system profit pool is compelling –** We estimate Hot system profit pool of $0.17/cup, with GMCR's share of $0.10 per K-cup. Our analysis assumes an average retail price of $0.57 for an 8-oz. serving (based on the Nielsen data), incorporating a 28% retail mark-up. Based on GMCR's reported revenue/cup of $0.37, we estimate roughly $0.11 in wholesale mark-up as well as the licensing fee that GMCR pays to its partners across the system. GMCR discloses pod level COGS, including ingredient costs (38%), packaging (22%), labor/overhead (19%), distribution/logistics (16%) and other (5%). From this cost structure our analysis points to a ~50% GPM, and a 27% EBIT margin at a pod level, or $0.10 per cup profit for GMCR. We assume wholesale mark-up of $0.03-0.04, leaving $0.07 in average profit/K-cup for GMCR's partners, by our estimate.
- **Traditional RTD system carries a more modest system profit pool –** We estimate system profit for traditional RTD 12-oz. servings to equate to ~$0.06, split evenly between bottlers and KO. Within this structure, KO generates $0.03 in profit through the sale of concentrate (~65% margin). We estimate concentrate costs of $0.03, based on bottler economics, packaging costs of $0.08, sweetener costs of $0.02, and other costs of $0.04. We estimate this yields a system profit of $0.06, or 15%, which compares to KO's current North American margins of 12.8% (assume CSD margins are higher than non-CSDs).

Bull case on Cold points to $400+ share price for GMCR

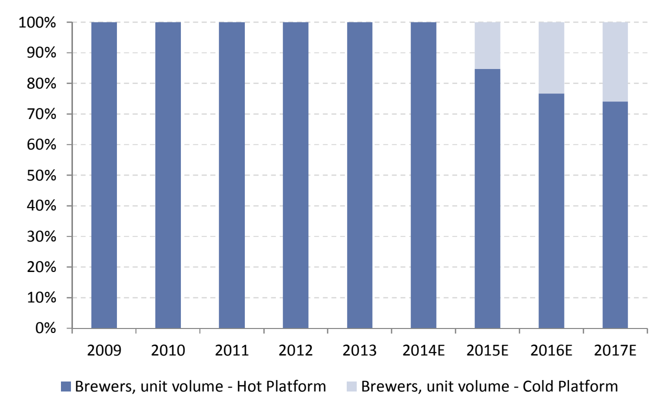
Our base case calls for Keurig Cold penetration of mid-single-digits and accounting for 15% of total pod volumes for GMCR by 2017 – We remain primarily differentiated vs. consensus on our assumptions for the Cold platform, which is expected to launch in FY15. Notably, we model a more conservative adoption rate for the Cold platform versus Hot, and assume a penetration rate of 4.5% of all households by FY17. This equates to roughly 5.6 million Cold units within GMCR's installed and active base, and would account for roughly 25% of brewer sales by 2017. Based on an attachment rate of 1.95X and EBIT/cup of $0.06 (versus Hot attachment rate of 1.57X and EBIT/cup of $0.08), we estimate Cold pod sales could be around $1.8 billion and EBIT of about $200 million-plus by 2017.

Exhibit 23: We expect household penetration to achieve mid-single digits by 2017
Estimated cold household penetration vs. Cold installed base



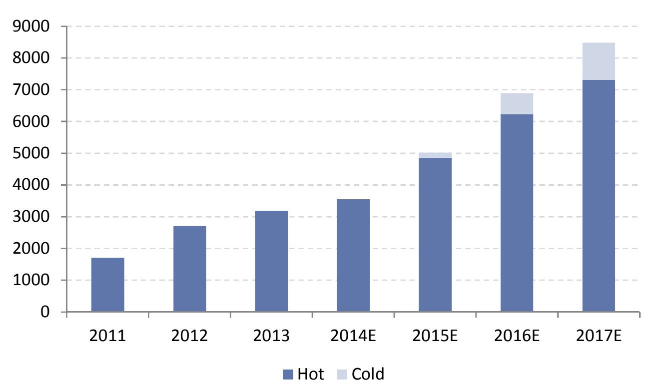
Source: Goldman Sachs Global Investment Research

Exhibit 24: Cold system could account for 25% of brewer volumes by 2017
Brewers Cold, vs. Hot % of brewer sales



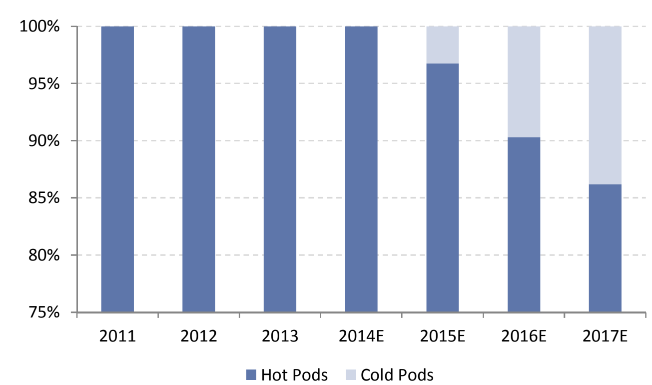
Source: Goldman Sachs Global Investment Research

Exhibit 25: We expect pod sales to reach $1.1 billion by 2017…
Hot Pods vs. Cold Pods, Sales



Source: Goldman Sachs Global Investment Research

Exhibit 26: …Representing ~14% of Pod $ sales
Hot Pods vs. Cold Pods, % of sales



Source: Goldman Sachs Global Investment Research

Our 2016 baseline EPS estimate is composed of $5.12 for Hot and $0.46 for Cold – Our estimate indicates $5.12 in underlying EPS power from Hot, and $0.46 in value for the Cold opportunity, vs. consensus of $4.70. Our estimates are predicated on EBIT/Cup of $0.06, which is significantly below our estimate of long-term profitability of $0.09 based on the above analysis.

Exhibit 27: Our 2016 estimate implies a $0.46 EPS contribution from Cold, below our long-term estimate of profitability, as we see EBIT/Cup of $0.06 vs. potential of $0.09
Sum-of-the-parts P&L (Hot/Cold)

	GS 2016 Estimate		
	Hot	Cold	Total
Sales (Pod Only)	6222	668	6890
EBIT	1301	117	1418
Net Inc.	814	73	887
Shares	159	159	159
EPS	$5.12	$0.46	$5.58

Sources: Goldman Sachs Global Investment Research

Evaluating the long-term earnings algorithm

We evaluate the ultimate earnings power algorithm below in order to estimate potential upside using a range of potential assumptions around (1) HH penetration and (2) attachment rate, within the parameters of a fully ramped EBIT cup contribution rate of $0.09. Importantly, this analysis is different from our published estimates, with the key differentiator being EBIT/Cup of $0.09, which is $0.03 (50%) higher than our 2017 estimate of $0.06.

- **Base case –** At our baseline assumptions of (1) 1.95X attachment rate, (2) EBIT/cup of $0.09 in 2020, and (3) household penetration of ~14%, we estimate GMCR could generate pod volumes of ~13 billion, equating EBIT of $1.2 billion, or $4.69 in 2020 EPS; discounted back this would yield $3.68 in 2016 present value EPS value. We note that earnings power is highly sensitive to EBIT/Cup. At similar volume assumptions, we estimate Cold could generate aggregate EBIT of $83 million (3% HH penetration) to $3.5 billion (25% HH penetration), holding attachment rates constant at 1.95X. At our baseline estimate of potential long-term earnings power, we estimate GMCR cold could yield $3.68 in incremental EPS in 2020 EPS discounted back to 2016. If we include our Hot EPS contribution estimate within the framework of our analysis, applying a 29X multiple (basis: we see modest multiple compression from our current 35X valuation multiple as the business matures), we see potential long-term value equating to $255.

Exhibit 28: Pod volumes are driven linearly by the relationship between attachment rate and household penetration
GMCR Cold scenario analysis, pod volume (billions) sensitivity

HH Penetration	Attachment rate 0.95	1.45	1.95	2.45	2.95
3%	1349	2059	2769	3479	4189
6%	2699	4119	5539	6959	8379
10%	4498	6865	9232	11598	13965
14%	6286	9594	12901	16209	19517
18%	8097	12357	16617	20877	25137
22%	9896	15103	20309	25516	30723
25%	11245	17162	23079	28995	34912

Source: Goldman Sachs Global Investment Research

Exhibit 29: We assume a long-term potential of $0.09 in EBIT contribution per Cold pod, vs. current Hot of $0.10
GMCR Cold scenario analysis, baseline EBIT$ sensitivity

HH Penetration	Attachment rate 0.95	1.45	1.95	2.45	2.95
3%	121	185	249	313	377
6%	243	371	499	626	754
10%	405	618	831	1044	1257
14%	566	863	1161	1459	1756
18%	729	1112	1496	1879	2262
22%	891	1359	1828	2296	2765
25%	1012	1545	2077	2610	3142

Source: Goldman Sachs Global Investment Research

A bull case scenario for Cold points to $7.59 to $12.69 in EPS contribution by 2020

- **Bull case –** We further evaluate the case for a bull scenario unfolding. We define the parameters of this scenario as HH penetration of 18% to 25%, and attachment rates of 2.45X to 2.95, with EBIT/Cup constant at $0.09. We estimate this could yield 2020 EPS discounted back to 2016 of $5.95 to $9.95 (2020 of $7.59 to $12.69). We estimate that at a forward multiple of 32X, this could yield consolidated value per share of $417.

Exhibit 30: We estimate this could generate 2020 EPS ranges of $0.49 to $12.69
GMCR Cold scenario implied 2020 EPS at baseline EBIT/cup ($0.09) vs. HH penetration vs. Attachment rate sensitivity

HH Penetration	Attachment rate 0.95	1.45	1.95	2.45	2.95
3%	$ 0.49	$ 0.75	$ 1.01	$ 1.26	$ 1.52
6%	$ 0.98	$ 1.50	$ 2.01	$ 2.53	$ 3.04
10%	$ 1.63	$ 2.49	$ 3.35	$ 4.21	$ 5.07
14%	$ 2.28	$ 3.49	$ 4.69	$ 5.89	$ 7.09
18%	$ 2.94	$ 4.49	$ 6.04	$ 7.59	$ 9.13
22%	$ 3.60	$ 5.49	$ 7.38	$ 9.27	$ 11.16
25%	$ 4.09	$ 6.24	$ 8.39	$ 10.54	$ 12.69

Source: Goldman Sachs Global Investment Research

Exhibit 31: Underlying profitability is highly levered to EBIT/Cup
GMCR Cold scenario implied EBIT at EBIT/Cup vs. HH penetration vs. baseline Attachment rate (1.95X) sensitivity

HH Penetration	EBIT/Cup, 1.95 Attachment rate 0.03	0.07	0.09	0.11	0.15
3%	83	194	249	305	415
6%	166	388	499	609	831
10%	277	646	831	1015	1385
14%	387	903	1161	1419	1935
18%	499	1163	1496	1828	2493
22%	609	1422	1828	2234	3046
25%	692	1616	2077	2539	3462

Source: Goldman Sachs Global Investment Research

Exhibit 32: Discounted back to 2016, our baseline assumptions yield EPS outcomes of $5.95 to $9.95 for a Bull case scenario
GMCR Cold scenario implied 2016 EPS at baseline EBIT/cup ($0.09) vs. HH penetration vs. Attachment rate sensitivity

HH Penetration	Attachment rate 0.95	1.45	1.95	2.45	2.95
3%	$ 0.38	$ 0.59	$ 0.79	$ 0.99	$ 1.19
6%	$ 0.77	$ 1.17	$ 1.58	$ 1.98	$ 2.39
10%	$ 1.28	$ 1.96	$ 2.63	$ 3.31	$ 3.98
14%	$ 1.79	$ 2.74	$ 3.68	$ 4.62	$ 5.56
18%	$ 2.31	$ 3.52	$ 4.74	$ 5.95	$ 7.17
22%	$ 2.82	$ 4.31	$ 5.79	$ 7.27	$ 8.76
25%	$ 3.21	$ 4.89	$ 6.58	$ 8.27	$ 9.95

Source: Goldman Sachs Global Investment Research

Exhibit 33: At different multiple assumption rates, we see potential upside/downside of +170% to -20% from current levels
Bull vs. Base vs. Bear case GMCR share value

	Bull	Base	Bear
GS 2016 Hot EPS baseline	$5.12	$5.12	$5.12
Cold scenario	$7.90	$3.68	$1.03
Combined EPS base	$13.02	$8.80	$6.15
Assigned multiple	32.0X	29.0X	20.0X
Blended value	$417	$255	$123
Upside	**170%**	**65%**	**-20%**

Source: Goldman Sachs Global Investment Research

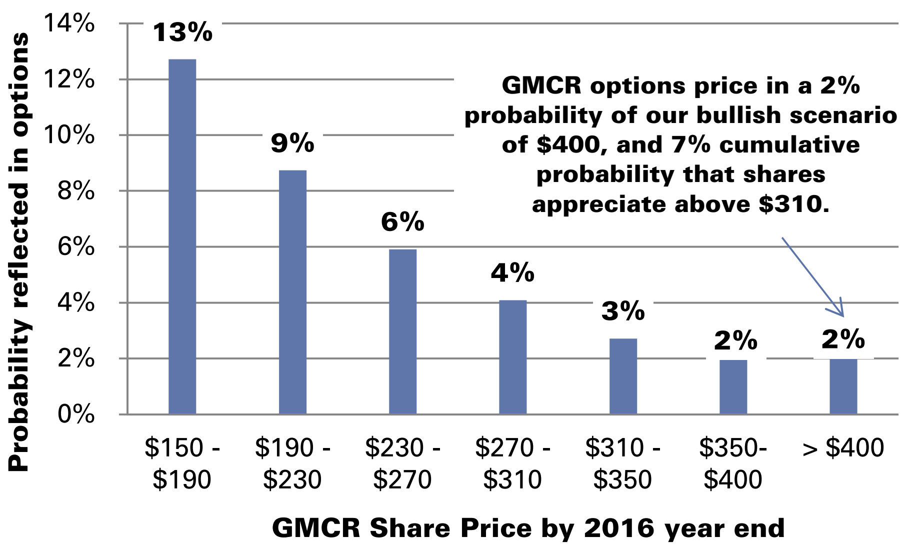
GMCR options reflect just a modest potential for success in cold

This section authored by GS Option Strategists Katherine Fogertey & John Marshall.

The options market is pricing in a very low probability for GMCR to be successful in Cold, as we show in exhibit 34 below. Here, we analyze the price of a digital option that expires on December 31, 2016 to back into the probability reflected in the options market of shares actually reaching this price. A digital (binary) option pays investors if the stock reaches a level, regardless of how far above it settles. Therefore, as we show below, a $185 one year call costs 26% means that investors can pay $0.26 to make $1.00 if shares close at or above $185. We use this metric as a probability that shares close to that level.

Exhibit 34: GMCR option investors are missing the opportunity from Cold, as options reflect just a 2% probability that shares could trade up to our analyst's bullish scenario of $400

Price of binary options, OTC, expiring December 31, 2016



Source: Goldman Sachs Research, pricing as of November 13, 2014.

Upcoming catalyst to watch for:

Earnings 19-November: Options are implying a +/-9% move on earnings, which is significantly below the 8 quarter average move of +/-15%. While some investors may be wary of holding GMCR shares for earnings due to high multiple and high growth profile, we note that this has been a very important time to hold shares historically. In fact, looking back to 2004, owning shares for the one week earnings period (5 days before to 1 day after) has averaged 32% returns, and as been profitable in 9 out of 11 years. This is the same return that was generated for holding the stock in all days outside of earnings; however the return outside of earnings was less consistently profitable.

Holiday sales, particularly of Keurig 2.0: Keurig revamped its hot machine to allow for larger brew sizes. Sales could be driven by holiday demand.

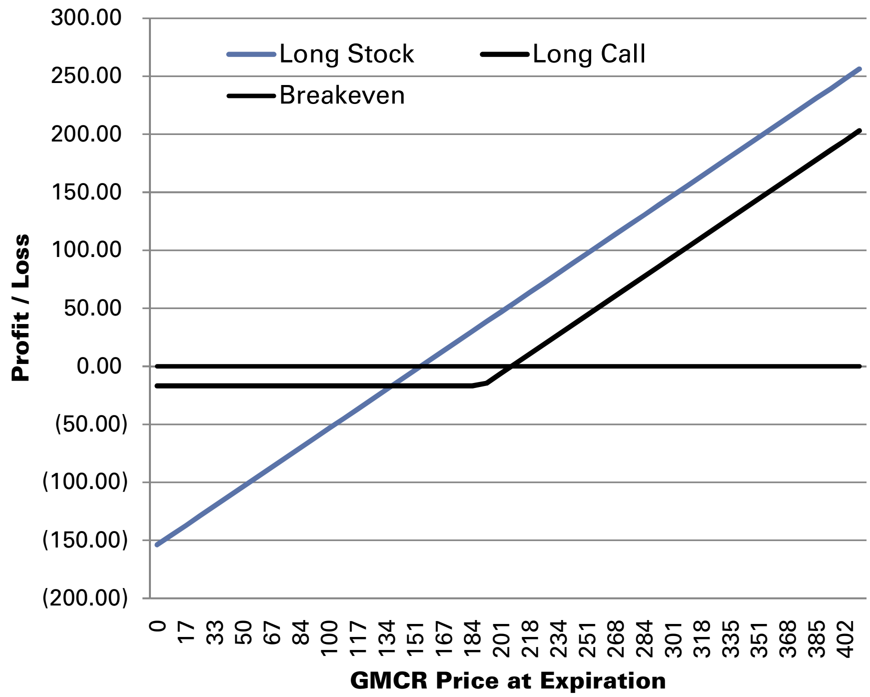
Launch of Cold Beverage Machine in 2015. We look forward to this launch, and a potential event for the investor community.

Buy GMCR Calls for earnings, holidays + cold launch

Buy January 2016 $190 calls, pay $16.95 (11%, stock $153.91). As we outline above, we believe the options market dramatically underestimates the potential for the bull case on shares to materialize. As such, we see value in owning longer dated options to capture earnings and holiday, but also the launch of Keurig Cold. While this premium might shy some investors away, we note that this is a one year option, and the implied vol of 41% is below average levels for the year of 45%, and 4 points below 1 yr realized ahead of a key product launch in FY15. Further, despite our analyst's view that Cold could represent a significant disruptive innovation for the company and industry, this implied volatility is trading inline with larger cap consumer stocks DDS, LULU, and AVP. We chose this strike as these calls could return 12 to 1 in our analyst's bull case that shares trade above $400, and 4 to 1 payout if shares trade up to our analyst's base case of $255, by January 2016 expiration. Call buyers risk losing premium paid if shares close below the strike price at expiration.

Exhibit 35: Buy GMCR January 2016 $190 calls to benefit if the company's Cold offering is successful, potential 12 to 1 payout if shares hit our analyst's bull case of +$400 by expiration

Profit / Loss at expiration



Source: Goldman Sachs Research, pricing as of November 13, 2014.

Valuation

Exhibit 36: 12-month price target methodology

Ticker	Rating	Methodology	Target Price (12-mo)	Risks
KO	Neutral	P/E (18.5x 12-24mo EPS)	41	Weaker than expected volumes; better forex; higher commodity costs
PEP	Neutral	P/E (18x 12-24mo EPS)	93	Higher than expected volumes; higher than forecasted input cost inflation
DPS	Sell	P/E (15.5x 12-24mo EPS)	63	Higher than expected volumes; higher than forecasted input cost inflation
GMCR	Buy	P/E (35x 12-24mo EPS)	185	Launch of cold
COT	Neutral	EV/EBITDA (6.7X 12-24mo EBITDA)	8	Execution risk around the Aimia and DS acquisitions, higher cost savings

Source: Goldman Sachs Global Investment Research

Rating and pricing information

The Coca-Cola Company (N/N, $42.71), Cott Corporation (N/N, $6.47), Dr Pepper Snapple Group (S/N, $70.66), Keurig Green Mountain Inc (B/N, $152.73) and PepsiCo, Inc. (N/N, $97.16)

Disclosure Appendix

Reg AC

We, Judy E. Hong, Ivan Holman, Katherine Fogertey, John Marshall and Freda Zhuo, hereby certify that all of the views expressed in this report accurately reflect our personal views about the subject company or companies and its or their securities. We also certify that no part of our compensation was, is or will be, directly or indirectly, related to the specific recommendations or views expressed in this report.

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The precise calculation of each metric may vary depending on the fiscal year, industry and region but the standard approach is as follows:

Growth is a composite of next year's estimate over current year's estimate, e.g. EPS, EBITDA, Revenue. **Return** is a year one prospective aggregate of various return on capital measures, e.g. CROCI, ROACE, and ROE. **Multiple** is a composite of one-year forward valuation ratios, e.g. P/E, dividend yield, EV/FCF, EV/EBITDA, EV/DACF, Price/Book. **Volatility** is measured as trailing twelve-month volatility adjusted for dividends.

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Disclosures

Coverage group(s) of stocks by primary analyst(s)

Judy E. Hong: America-Beverages US, America-Tobacco US.

America-Beverages US: Boston Beer Company, Brown-Forman Corp., Coca-Cola Enterprises, Inc., Constellation Brands, Cott Corporation, Dean Foods Company, Dr Pepper Snapple Group, Keurig Green Mountain Inc, Molson Coors Brewing Co., Monster Beverage Corporation, PepsiCo, Inc., The Coca-Cola Company, The WhiteWave Foods Company.

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Price target methodology: Please refer to the analyst's previously published research for methodology and risks associated with equity price targets.

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Selling Options - Investors who sell calls on securities they do not own risk unlimited loss of the security price less the strike price. Investors who sell covered calls (sell calls while owning the underlying security) risk having to deliver the underlying security or pay the difference between the security price and the strike price, depending on whether the option is settled by physical delivery or cash-settled. Investors who sell puts risk loss of the strike price less the premium received for selling the put. Investors who sell put or call spreads risk a maximum loss of the difference between the strikes less the premium received, while their maximum gain is the premium received.

For options settled by physical delivery, the above risks assume the options buyer or seller, buys or sells the resulting securities at the settlement price on expiry.

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Goldman Sachs Investment Research global coverage universe

	Rating Distribution			Investment Banking Relationships		
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Price target and rating history chart(s)

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