Celsius Holdings, Inc.

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Special Call

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CALL PARTICIPANTS	2
PRESENTATION	3
QUESTION AND ANSWER	6

Call Participants

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Peter K. Grom
UBS Investment Bank, Research Division

Robert Bain Moskow
TD Cowen, Research Division

Presentation

Operator

Good morning, and welcome to the Celsius Holdings Transaction Investor Conference Call. [Operator Instructions] I will now hand the call over to Paul Wiseman, Investor Relations. Please go ahead.

Paul Wiseman
Senior Vice President of Communications & Investor Relations

Good morning, and thank you for joining today's webcast. With me today are John Fieldly, Chairman and CEO; Jarrod Langhans, Chief Financial Officer; and Toby David, Chief of Staff.

We'll take questions following the prepared remarks. A press release related to today's conference call was issued this morning and is also available on our website, ir.celsiusholdingsinc.com. An audio replay of this webcast will also be accessible later today.

Today's discussion includes forward-looking statements based on our current expectations and information. These statements involve risks and uncertainties, many beyond the company's control. Celsius Holdings disclaims any duty to update forward-looking statements, except as required by law. Please review our safe harbor statements and risk factors in today's press release and in our most recent filings with the SEC, which contain additional information and a description of risks that may result in actual results differing materially from those contemplated by our forward-looking statements.

With that, I'll turn the call over to John.

John Fieldly
CEO & Chairman

Thank you, Paul. Good morning, everyone, and thank you for joining us. Today marks an important milestone for Celsius Holdings. We've announced a significant expansion of our long-term strategic partnership with PepsiCo, an agreement that strengthens our alignment, broadens our portfolio and positions us to create value for shareholders, customers and consumers over the long term.

Under the terms announced today, Celsius Holdings has been named PepsiCo's Strategic Energy Drink Captain in the U.S. This role deepens our partnership, fully aligns incentives and unifies the go-to-market strategies across our Energy portfolio.

Our Alani Nu brand will transition into PepsiCo's leading U.S. and Canada distribution system. This shift is expected to expand Alani Nu's geographic reach, increasing its availability across retail, and opens the brand up into new channels, particularly food service and convenience.

Celsius Holdings also agreed to acquire Rockstar Energy brand in the U.S. and Canada from PepsiCo. Rockstar brings classic energy flavors and format that is complementary to our performance forward Celsius; and modern lifestyle, Alani Nu brand. As consideration for the agreements, PepsiCo has received 585 million in newly issued convertible preferred stock, raising its ownership stake in Celsius Holdings to approximately 11% on an as-converted basis and gaining an additional Board seat.

The steps create near- and long-term opportunities for Celsius Holdings. First, Captaincy provides Celsius Holdings with strategic control over the allocations of the Celsius Holdings portfolio of Celsius, Alani Nu and Rockstar Energy brands and over their energy platforms, planograms, SKU prioritizations and promotional strategies, including certain priority periods.

Becoming PepsiCo's U.S. strategic energy drink captain is a pivotal milestone. It strengthens our relationships, brings greater alignment and allows us to lead with a unified commercial strategy across the Celsius Holdings portfolio. We believe this role will enhance category productivity for retail customers and deepens Celsius position as a leader in modern energy.

Second, Alani Nu has quickly become the fastest-growing brand in modern energy. By moving into the PepsiCo's distribution system, Alani Nu is positioned to achieve meaningful ACV expansion and accelerate its food service presence. We expect this transition will broaden Alani Nu's availability and further its appeal to young female and wellness-focused consumers.

Third, adding Rockstar strengthens our portfolio and expands our consumer reach. With Celsius and Alani Nu as the growth engines and Alani Nu extending into lifestyle and wellness, Rockstar allows us to serve the large traditional segment of the energy drink category. Our approach will be disciplined: stabilizing the brand, rationalizing SKUs and building on the brand's rich heritage.

Certain Pepsico employees who work on the Rockstar Energy brand will transition to Celsius Holdings, giving us unity and brand experience. Fourth, PepsiCo's alignment with the additional investment of $585 million in equity and the additional Board seat demonstrates their long commitment to Celsius. It's expanded alignment strengthens our governance and further aligns our strategies.

I'll now hand it over to Jarrod to deliver remarks on the financial elements of the transaction. Jarrod?

Jarrod Langhans
Chief Financial Officer

Thanks, John. Good morning, everyone, and thank you for joining us with such short notice. Before John closes out our prepared remarks, I wanted to walk through some of the timing components of the transaction.

We signed and closed all agreements. In addition to the Alani distribution agreement, the Captaincy agreement, the preferred share issuance and the Rockstar acquisition, we've entered into a transition services agreement as well as a manufacturing agreement at the Pepsi-owned manufacturing facilities that manufacture Rockstar product.

These agreements will have different components that will be in place from 1 to 7 months. The accounting for the transition services will be like what we did with Alani and that we will pay a monthly rate while utilizing the transition services until we effectively transition off of the services being provided. Examples of such services would be working with our teams to transition key account calls, managing e-commerce and assisting with backshop support.

As it relates to the manufacturing agreements, we will utilize a variety of models as we transition Rockstar into our orbit structure, so there will be some noise in the system over the next 3 to 4 months. As we are likely to get modeling questions, I'd like to note that our intention is to transition a majority of the Alani Nu DSD to the Pepsi distribution system as of December 1. As a result, we would only have 1 month of activity with Alani in the Pepsi system prior to year-end.

So if we were to just look at Celsius and Alani, we wouldn't expect to see much change in Q3 relative to what we discussed on our call earlier in the month. As it relates to Q4, we will continue to have tariff pressure, as previously discussed, and I would expect to see some inventory write-offs in scrap as we do the transition into the Pepsi system resulting in some additional pressure on margins.

If you look back to our comments when we moved into the Pepsi system with Celsius, you'll see that we had a similar outcome in which we increased some of our inventory reserves and write-offs as a result of the transition.

Moving to Rockstar. We will only have 1 month of activity in Q3. And looking at the business as a brand separated from PepsiCo, we are looking at something like $250-plus million in annual sales to add to our portfolio, and therefore, we wouldn't recommend any significant changes to models for Q3. We will provide additional color on our Q3 earnings call in relation to Q4.

Let me provide a bit more detail on the financial impact. PepsiCo's $585 million preferred stock investment increases their stake in Celsius to about 11% on an as-converted basis and allows them to nominate a representative for a second Board seat. This is a strong endorsement of our long-term strategy.

The new preferred stock carries a 5% dividend consistent with their prior investment. Importantly, the structure is designed to maintain our flexibility while aligning PepsiCo's interest with our performance. From a financial standpoint, we expect this transaction to be accretive to cash EPS in the first full year. We also expect distribution to expand meaningfully as Alani Nu transitions into PepsiCo system and Rockstar Energy is integrated into our portfolio.

Our balance sheet remains strong with the liquidity to support integration and continued investment in growth as well as debt reduction.

Let me now turn it over to John for some closing remarks.

John Fieldly
CEO & Chairman

Thank you, Jarrod. This is an exciting next step for Celsius Holdings and PepsiCo. We step into the role of PepsiCo's U.S. energy captain, bringing new influence and alignment across the portfolio. Alani Nu will enter PepsiCo's distribution system, unlocking its next phase of growth.

Rockstar broadens our consumer reach, while Celsius and Alani Nu remain the engines of modern energy growth. And PepsiCo increased investment and the second Board seat strengthens our strategic alignment for the long term. Together, this agreement currently creates a 20% share portfolio in the U.S. energy drink category, expands our reach to more consumers in more places more often and positions Celsius Holdings for sustained growth in years ahead.
I want to thank our employees, our partners at PepsiCo and our shareholders for their continued support. We are excited what lies ahead. With that, Jarrod and I will take questions. Turn it back to the operator.

Question and Answer

Operator

[Operator Instructions] Your first question comes from the line of Peter Grom with UBS.

Peter K. Grom
UBS Investment Bank, Research Division

Congrats on the news this morning. One thing I was want to get some perspective on as it relates to the transaction. Just on what being the energy drink captain for Pepsi means and what this may unlock as you look ahead? So just any broad thoughts in terms of whether having control of the entire portfolio may do in terms of improving execution, shelf space, just relative to what we've seen, I guess, over the last several years?

John Fieldly
CEO & Chairman

Yes, absolutely, Peter. Thank you. The Captaincy really allows us to have an industry strategic control over the [play] portfolio and planograms and the go-to-market strategies. So it really aligns the synergies that Celsius and PepsiCo have on our go-to-market strategies. And when you look at kind of within different markets, within different channels, we're able to make sure we have the best planogram and the best flavors and SKUs within those locations to drive the optimal sales performance.

So really a strategically aligned SKU prioritization, promotional strategies and then priority periods as well throughout the year. So really just truly deepens the overall long-term partnership that we have within PepsiCo. And I think it really positions us for continued growth, especially with the incorporation of the Alani portfolio and then the opportunities we have with Rockstar.

Operator

Your next question comes from the line of Kevin Grundy with BNP Paribas.

Kevin Michael Grundy
BNP Paribas Exane, Research Division

Great. Congratulations on the deal. Could you maybe comment on the deal structure, which I think, in some ways, maybe to many is a bit reminiscent of the Coke and Monster deal from over a decade ago. So maybe just comment on why this was the right structure? Comment why perhaps just a distribution deal more similar to what you have currently with Celsius and the Pepsi system, why taking on the Rockstar brand, which has struggled for a very long time, as you guys know, as part of the consideration, why that was appropriate?

John Fieldly
CEO & Chairman

Yes. No, absolutely. I think what this does is really lands on a few things. And when you look at the overall thesis and the agreements and I talked about the Captaincy before is an important aspect. The additional investment within the organization and the additional enhancement of the Board seat just further [indiscernible] aligned Celsius strategically with PepsiCo, provides us a unified front and better collaboration as we continue to move forward.

Now I think it's a really good model. Somewhat similar, you could say, to Monster and Coke, and it seems to be a proven model for them as well. And we're really excited about the future together. The more we can further collaborate, better execution, better prioritization. The category continues to grow and scale.

We see great opportunities that this category will not -- is not planned to slow down at all. And with our modern portfolio and the enhancements of it with Rockstar coming on the portfolio, we're able to offer it to a much broader consumer base and really optimize our planograms going forward to capture the greatest share and dollars in revenue.

Jarrod Langhans
Chief Financial Officer

I'll jump in on kind of the structure. From a -- the way it was structured is we will be moving a lot into the Pepsi distribution system to join Celsius and Rockstar for a full portfolio. As a part of that, Pepsi will fund the termination fees of the -- moving out of the current distribution system and into their distribution system.

We will be acquiring the Rockstar brand in the U.S. and Canada. We've already talked about kind of the captains concept. And then we also have some other ancillary things like transition service agreements and things like that.

In terms of that, what Pepsi is getting is that we are going to extend the preferred As to mirror what we call in the preferred Bs. So the preferred Bs will be $585 million of value through preferred convertible shares. And then the preferred As remain what they were. So you'll have a strike price on the preferred as at $25, a strike price on the preferred Bs at $51.75, and they'll have the same features that the preferred As had back when we set them up in '22 with the 6-year automatic convert and then the 7-year conversion feature as well.

Operator

Your next question comes from the line of Robert Moskow with TD Cowen.

Robert Bain Moskow
TD Cowen, Research Division

Congratulations. I wanted to know the retail data for Rockstar indicates $600 million in retail sales. You described $250 million to your P&L. Can you help us explain the difference between those 2? Is there going to be some rationalization for Rockstar?

John Fieldly
CEO & Chairman

Yes. We will -- absolutely, a great question, Robert. We do anticipate some rationalization within the portfolio. There's a big opportunity there. We're going to continue to optimize. And so we anticipated that into our numbers as we're anticipating that SKU rationalization to take place as we're entering in and going through resets for 2026.

Jarrod Langhans
Chief Financial Officer

Yes. So it's -- there's -- you got to remember where we are on the cycle. So there's the retailer, there's the distributor and then there's the brand. And just like if you look at Celsius last year, I think the scanner data was something like $2.7 billion, and we were around $1.4 billion. So there is going to be somewhat of a delta. The $250-plus million is kind of a pro forma number that we came up with.

It's not exact because it's pulling the number out of the Pepsi system and then saying roughly what do we think we'll get net of promos and contra revenue and things like that. So it was a ballpark number. That's why we kind of just called out roughly $250-plus million.

Robert Bain Moskow
TD Cowen, Research Division

Okay. And just one quick follow-up. What can you do to mitigate any kind of friction or noise during this transition away from the current distribution network and into yours? Normally, there's some -- either risk of inventory loading or loss of sales.

John Fieldly

CEO & Chairman

Yes. I mean, Robert, we worked with our partners, mainly the ABI distributors, they're great partners, great executors and we have a good working relationships with all of our customers and distribution partners, and they supported the transition of Celsius into the network, and we expect the same.

And we have our SOPs, our processes and our oversight with all of our team members that have experience doing this. And we're going to continue to work through this extremely diligently to mitigate any impact on that, and we have controls in place and oversight to try to limit that as much as possible.

Operator

Your next question comes from the line of Kaumil Gajrawala with Jefferies.

Kaumil S. Gajrawala
Jefferies LLC, Research Division

Congratulations. Just the first question is making sure I understand what sort of captaincy means. Does that also mean exclusivity?

John Fieldly
CEO & Chairman

The captaincy piece is an incentive program that would align strategic initiatives and really revolves around really the strategic alignment within being the energy captain lead over planograms within energy of the Celsius Holdings portfolio as well as enhanced priority periods and further collaboration strategically within the PepsiCo organization.

Kaumil S. Gajrawala
Jefferies LLC, Research Division

Okay. Got it. So -- all right, we'll figure that out. The -- on the sort of the decision to go this route versus leaving the brands where they were, can you maybe just walk through all the things that you guys were working through and where sort of like the real background of the decision-making process?

John Fieldly
CEO & Chairman

Yes. I'll touch highly on that. I mean the strategic decision is really around not only when you look at synergies, the opportunities of running and really collaborating and working with one network just the opportunities of additional adjacent categories with expanding Alani distribution, not only to all of the independent channels but also food service, the breadth and depth of distribution and the support within the world-class PepsiCo distribution network.

So we are -- have a lot of capabilities and alignment within our sales organizations. We really have tied into a Pepsi, not only from a sales and organizational standpoint, but also from a supply chain standpoint as well as we continue to drive efficiencies, which you started to see that in our gross profit margins over the last several quarters as well.

So it has a variety, not only from an operational go-to-market commercial reasonings, but also from a financial reasonings as we continue to optimize driving greater shareholder value.

Operator

Your next question comes from the line of Jim Salera with Stephens.

James Ronald Salera
Stephens Inc., Research Division

To dig into how you guys are thinking about what Rockstar adds to the portfolio? Obviously, around the Alani acquisition, you guys really emphasized female focus and that opens up kind of the new consumer cohort. Did the Rockstar brand bring anything that you've been unable to access with the Celsius and the Alani brands? Or is it going to kind of fit more of a niche consumer appeal?

And then, Jarrod, I appreciate all the thoughts around the transition service agreements. Once we move past that, just any thoughts around long-term margin profile for Rockstar relative to Alani and the core Celsius brand?

John Fieldly
CEO & Chairman

Yes, I'll take the first part of that, Jim. I mean, when you look at the Rockstar portfolio, it does really well in the Pac Northwest that has historically been more of a weaker area for our portfolio. So that does open that up as opportunities to leverage our total portfolio continue to build in the Pac Northwest.

Also, if you look at Rockstar, it's more of a traditional energy drink offering with traditional flavors, that is an area that between Celsius and Alani, that is not our core consumer base. So it does broaden our portfolio. It broadens our breadth and opens us up for a total portfolio approach as we continue to execute within these divisions of Pepsi in particular markets, we were able to customize our portfolio to drive the greatest velocities, the greatest revenues for the consumer base that is in those particular markets. So really gives us additional levers to pull and strategic opportunities for our commercial teams. Jarrod?

Jarrod Langhans
Chief Financial Officer

Yes. I guess in terms of kind of a margin profile, as we're going through the TSA, we're not going to be able to see some of the benefits that we'll see once we get it fully integrated into our sales infrastructure, our commercial infrastructure and our operations infrastructure within our 6 orbit model.

So you're probably looking more like a margin profile back in kind of 2020, 2021, 2022 with Celsius, that will then migrate to the 2023, 2024, 2025 over a period of time somewhere in the 12- to 18-month time frame.

Operator

Your next question comes from the line of Michael Lavery with Piper Sandler.

Michael Scott Lavery
Piper Sandler & Co., Research Division

Just was wondering if you could give us any update on what Alani transitioning into Pepsi might mean for an update to the synergy figure you've been giving around the deal previously and if there's any incentive changes or updates that come with the new arrangement compared to where you were previously?

John Fieldly
CEO & Chairman

Yes. We're not going to make any forward comments today, but we're excited about the opportunity. When you look at where Celsius was entering the PepsiCo distribution system and you look at where Alani is, it's a little bit further developed than when Celsius went into the PepsiCo distribution network.

But there's a lot of opportunities within additional channels, small format, convenience and the food service opportunities. So we're not going to provide any forward information, but we're going to maximize the value we can with our total portfolio approach, working closely with PepsiCo.

Michael Scott Lavery
Piper Sandler & Co., Research Division

And is the -- are the incentive terms the same as they were with just brand Celsius or is there any change when you bring Alani in now?

Jarrod Langhans

Chief Financial Officer

It's restructured from a -- the incentive. So it is more around -- tied around the captaincy and the unified strategy, commercial strategy going forward and really expanding and tightening the partnership. .

Michael Scott Lavery
Piper Sandler & Co., Research Division

Restructured to be more favorable?

Jarrod Langhans
Chief Financial Officer

Well, you've got 3 brands into it now.

Operator

Your next question comes from the line of Andrea Teixeira with JPMorgan.

Andrea Faria Teixeira
JPMorgan Chase & Co, Research Division

Congrats again. Just as you mentioned broadly now that you revised the terms of the distribution now, obviously, 3 brands over 1 brand before. So I was hoping if you can give us comfort on how this distribution transition will be less disruptive than before?

And then going back to, in the beginning of the call, you said that there would be some inventory reserves and write-offs that are obviously part of the deal into the fourth quarter. So how can we think about those impacts? And any pull forward as the ABI distributors had -- I mean, anything that we're seeing here? Obviously, the numbers for Alani are fantastic in the track channel data, but just thinking if there were any shipment dynamics we should be aware of ahead of the transition or anything to note?

And then just as we think about valuation for the deal, the $585 million, just thinking of the synergies and all of that, how can we think about like the increase in stake and what it means in terms of valuation against -- all being said and done against post synergies this deal came out at? We can do, obviously, EBIT to sales, but in terms of EBITDA or profitability, it's hard to gauge the valuation metrics.

John Fieldly
CEO & Chairman

Yes. Just one -- I'll start off with the first one, the disruption that you mentioned with the Celsius distribution moving into and integrating into PepsiCo. We were actually we're told the opposite. It's one of the best transitions that they've seen. And quite frankly, we've received a lot of positive feedback from our distributors on how professional we handle that transition.

So I would expect this Alani transition to be held and transferred in the same manner with great commercial oversight business acumen and execution. So we feel confident in that within -- as I talked about, we have processes and procedures, and we're excited about the opportunity. And we really appreciate all of the ABI distributors out there for all their support and what they've done.

When Jarrod mentions write-offs, we did see some write-offs when we entered into the PepsiCo system, and you will have some. There's different pack sizes, there's some residual products. as you continue -- as you're transitioning. So we do expect that, and it'd probably be somewhere similar to what we saw within the Celsius portfolio on the transition.

But it's -- it won't be material -- not extremely material, but there will be some write-downs that take place.

In regards to Alani, it has done phenomenal extremely well. that just launched most recently within the quarter as a limited time offering has just extremely performed. The flavor profile is great. The social media, the look and feel, the excitement that's taken place within the product has really done phenomenal.

And we have more LTOs coming for the back half, not only on Alani, but also within the Celsius portfolio or we'll be launching our first LTO for the first time. And so I think when you're looking at pipe fills, looking at what you should experience, once again, we don't provide forward-looking information, but I would go back to 2022, you can kind of see some of the pipe fills we experienced within the Celsius portfolio. We would expect something similar, but we'll know more as we continue to progress. So thank you for all your questions.

Operator

That concludes our question-and-answer session. I will now turn the call back over to John Fieldly for closing remarks.

John Fieldly
CEO & Chairman

Thank you, everyone, for joining the call in such short notice. We're excited and thank you for joining us today for the continued support in Celsius Holdings. We're proud of the progress we've made, energized by the next chapter with PepsiCo and we're confident in our ability to drive long-term growth and value. We look forward to updating you on the momentum in the quarters ahead. Go grab a Celsius and live fit and enjoy the long weekend.

Operator
Ladies and gentlemen, this concludes today's call. Thank you all for joining. You may now disconnect.