Cott Corporation

Fourth Quarter and Fiscal Year 2017 Earnings Conference Call

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PRESENTATION

Operator

Good morning, and welcome to Cott Corporation's Fourth Quarter and Fiscal Year 2017 Earnings Conference Call. All lines are currently in a listen-only mode, and this call will end no later than 11:00 a.m. Eastern Time. The call is being webcast live on Cott's website at www.cott.com, and will be available for playback there until March 15, 2018. That's www.cott.com.

This conference call contains forward-looking statements, including statements concerning the Company's future financial and operational performance. These statements should be considered in connection with cautionary statements and disclaimers contained in the Safe Harbour statements in this morning's earnings press release and the Company's Annual Report on Form 10-K and quarterly reports on Form 10-Q, and other filings with U.S. and Canadian securities regulators.

The Company's actual performance could differ materially from these statements and the Company undertakes no duty to update these forward-looking statements, except as expressly required by applicable law.

A reconciliation of any non-GAAP financial measures discussed the during the call with the most comparable measures in accordance with GAAP is available in the Company's fiscal year and fourth quarter 2017 earnings announcement released earlier this morning, or on the Investor Relations section of the Company's website at www.cott.com.

I'll now turn the call over to Jarrod Langhans, Cott's VP of Investor Relations.

Jarrod Langhans – Vice President, Investor Relations, Cott Corporation

Good morning, and thank you for joining our call today. Today, I'm accompanied by Jerry Fowden, our Chief Executive Officer, Jay Wells, our Chief Financial Officer, and Tom Harrington, who oversees our Route Based Services segment. Jerry will start this morning's call with some of his thoughts on the progression of our transformation and strategy over the last few years, and the operations of our continuing business in 2017. He will then turn the call over to Jay for a discussion of our fourth quarter and fiscal year 2017 consolidated financial performance, as well as our Coffee, Tea and Extract Solutions segment. Tom will then cover our Route Based Services segment, before handing the call back to Jerry to provide an overview of our 2018 expectations and new business, before moving to Q&A.

With that, let me turn the call over to Jerry.

Jerry Fowden – Chief Executive Officer, Cott Corporation

Thank you, Jarrod, and good morning, everyone. Before I comment on the performance of our continuing operations in 2017, and quarter four, more specifically, I wanted to thank all the employees of our traditional business for their tremendous effort over the years. Their commitment right up to the closing of the transaction was reflected in their Q4 performance, which saw traditional business revenues up 4 percent, driven by the continued execution of the strategy to grow contract manufacturing and sparkling flavoured waters in North America, alongside the delivery of Brexit-related price increases in the U.K. I wish the whole former Cott traditional team the very best for the future.

So, with the transaction to sell our traditional business now closed, let's turn our attention to our continuing business, where it's much easier to see the shape and potential of new Cott as a go-forward service business. New Cott is a company with higher margins, lower customer concentration, a significant degree of recurring revenue, predictable top line growth, and an attractive growing outlook for free cash flow generation. In effect, over the past several years, we have leveraged the free cash

flow from our mature soft drink manufacturing business to transform our Company into an international services company, focused on the healthy and growing categories of home and office water, coffee and coffee extracts, tea and filtration services. With the sale of our traditional business now completed, Cott is well positioned with a positive outlook for the future, supported by multiple external and internal factors.

Let's just look at a few of the attractive characteristics supporting our positive outlook. These include: multiple attractive platforms and positions in growing categories; positive top line momentum; gaining market share in U.S. and European home/office water, as well as U.S. coffee roasting; successful progress on integration; good synergy capture and additional synergy potential; reduced debt and a strengthened balance sheet; our remaining debt all being long-term with fixed coupons; improving employment levels in the workplace that support our business model; and significant further value-creating opportunities from synergistic tuck-ins.

Against this attractive backdrop, we believe the greatest value we can pursue will be in accelerating our revenue growth in the years to come. In order to execute this, we will focus on areas such as growth and innovation with, by way of example, our new roasting capacity, our Aqua Café roll-out, the introduction of the Storm cooler in Europe, the expansion of our Remington pure filtration business, and the use of improved handheld technology for our DS Services route sales representatives. We will also focus on increased vertical integration, leveraging our ability to internally provide higher quality, lower cost coffee and tea from S&D to DS Services, the provision of our brand-leading, Mill Fresh Milk from Aimia to Eden Springs, as well as the supply of compatible coffee, tea or hot chocolate pods to our Eden coffee business from our new pod line just installed in Aimia.

Additionally, we will execute our high-density area strategy, which is designed to improve the return and effectiveness of our new customer marketing dollars, by a refocused effort and expenditure

on a more limited number of major urban or selected areas, where historic data has shown that we can achieve a higher return or conversion rate from our marketing dollars. This HDA strategy should result in new customers being added in more geographically concentrated or specifically selected areas, thus providing route density and service enhancement where we have determined it is needed or is most beneficial.

In addition, as we've previously mentioned, we will seek to accelerate the level of customer list acquisitions and tuck-in activity we undertake. This activity strengthens our base business, has proven attractive returns, and can help us achieve route density in certain areas much more quickly than customer marketing activity alone. The recently announced Crystal Rock transaction is a good example of this. Once closed, it enhances our market position and route density in the Northeast and moves us to a number two position from a distance number three position.

While I believe in the short term we have a lot of opportunities in pursuing this list of priority actions, we also have the optionality with our improved balance sheet to evaluate larger transactions. However, I want to highlight that any such opportunity that we may choose to pursue will have to meet our rigorous value-creation requirements and be focused on building our scale and market position in our existing segments or categories, thereby providing attractive synergies to support value creation.

So, moving on to look at our results, as I look at 2017 as a whole, it's been a year of positive momentum on multiple fronts. It saw the announcement of the sale of our traditional business at an attractive valuation, the successful integration of Eden Springs and S&D Coffee & Tea, the success of our DS Services three-point revenue and profitability improvement plan, with over 3 percent full year revenue growth, as well as tremendous performance at S&D Coffee & Tea, with 8 percent pro forma revenue growth, and to cap things off, we also saw net customer growth of 1 percent at Eden Springs, turning around the negative trend of the past few years.

These achievements can be seen and are reflected in our Q4 performance, where revenues of $571 million were up over $50 million, or 5 percent, when you exclude foreign exchange favourability and some additional trading days at S&D Coffee & Tea. This 5 percent growth should be looked at against the between 2 and 3 percent growth guidance given. What's even more pleasing is this revenue growth was across all major businesses, with Q4 DS Services revenue up 5 percent, S&D Coffee & Tea's comparable revenues up 7 percent, and Eden Springs' comparable FX-neutral revenue up 2 percent, versus the 1 percent guidance given. In addition to this attractive revenue performance, Q4 Adjusted EBITDA came in at $70 million, bringing full year 2017 Adjusted EBITDA to $296 million, just above the top end of our guidance range, and 2017 adjusted free cash flow was $78 million.

On that note, I'll pass over to Jay and Tom to cover more of the specific business drivers behind our Q4 and 2017 financial performance for the business as a whole and each of our business segments, and then I'll return later to look at our outlook for 2018.

Jay Wells – Chief Financial Officer, Cott Corporation

Thank you, Jerry, and good morning, everyone. Overall, our results for the year were very much in line with what we had projected during both our Q3 earnings call, as well as our modeling call in September, during which we noted that we expected full year continuing operations revenue of $2.2 billion plus, as well as Adjusted EBITDA in the range of $290 million to $295 million. With full year revenue from continuing operations of $2.27 billion and Adjusted EBITDA of $296 million, you can see that we met or exceeded these expectations.

With respect to the fourth quarter results, we saw good top line performance across our key segments, with revenue from continuing operations increasing by 5 percent on a foreign exchange-neutral and comparable week basis to $571 million. Revenue growth was driven by strong coffee

volume growth within our Coffee, Tea and Extract Solutions segment, as well as good top line growth within our Route Based Services segment, driven by growth in consumption and customers, as well as increased pricing.

Gross profit increased 8 percent to $279 million, driven primarily by overall revenue growth, as well as margin expansion within our Route Based Services segment. Gross margin as a percentage of revenue was 48.8 percent, compared to 49.6 percent, as margin expansion within our Route Based Services segment was offset by a lower margin mix within our Coffee, Tea and Extract Solutions segment.

Interest expense from continuing operations was $23 million, compared to $14 million. The $9 million increase in interest expense from continuing operations versus prior year was because we are carrying interest expense from our $750 million senior unsecured notes in continuing operations, but the debt that it refinanced is included in discontinued operations. The important thing to remember is that, having closed the sale of our traditional business at the end of January, we have now redeemed our $250 million senior secured notes. Thus, our outlook for interest expense in 2018 is around $21 million in the first quarter and around $18 million per quarter for Q2 through Q4, but please keep in mind that our €450 million 5.5 percent euro debt will fluctuate, based on the latest euro to U.S. dollar exchange rates, as will the U.S. dollar interest expense associated with this debt.

For the quarter, Adjusted EBITDA from continuing operations increased 27 percent to $70 million, due to contributions from our two key reporting segments. With this good EBITDA performance in the quarter, we came in at the top of our EBITDA guidance for the full year, primarily driven by growth and continued success with our profitability improvement plan at DS Services, synergies and continued operational leverage within our European operating division, and ongoing growth within our Coffee, Tea and Extract Solutions segment.

Turning to income tax, income tax benefit was $31 million, compared to income tax expense of $26 million, as we recorded an income tax benefit in connection with U.S. tax reform in 2017, while income tax expense in 2016 was primarily related to a U.S. tax valuation allowance that was recorded in the fourth quarter of 2016.

Adjusted free cash flow from continuing operations was $78 million for the fiscal year. As we look at 2018, we remain confident that we will deliver around $115 million of adjusted free cash flow, driven by approximately $10 million to $15 million of lower interest expense, around $10 million to $15 million of increased cash from operations, supported by company-wide top line growth and margin expansion within our Route Based Services segment, plus additional benefits from small accretive tuck-in acquisitions and further synergy capture.

Let me now cover the operating performance of our Coffee, Tea and Extract Solutions segment. For the quarter, we continued to see strong volume performance, with a 5 percent increase in combined coffee and tea pounds on a like-for-like basis; that is, after adjusting out the benefit of an additional week of operations S&D had in the quarter to align S&D's year end with Cott's year end. Like-for-like revenue grew over 7 percent to $162 million. On a full year comparable basis, combined coffee and tea pounds were up 7 percent, with revenues growing by 8 percent to $602 million. The key drivers of growth were new SKUs, additional customer locations, and business wins primarily within the national account side of the quick serve restaurant and convenience retail channels. With the pipeline full and buildup of new contracts starting in Q4 2016, we have seen total 2017 volume and revenue comfortably exceed our 3-plus percent growth target for the year.

As we look at the first quarter of 2018, I want to mention that we will have a year-over-year comparison issue, as there will be three fewer business days in the first quarter of 2016, versus the first quarter of 2017, as we have now fully aligned the S&D reporting periods. This is likely to result in a $5 million impact to revenue in Q1 2018.

Our gross profit in the quarter grew 6 percent to $44 million, but we did see some margin contraction due to the mix shift of volume and business coming from large national accounts.

I am pleased to say that our new roaster is now operational and we are currently evaluating whether to accelerate capex spend in certain areas, such as extract production, as the ability to continue to grow our extract solutions division is a key driver of our top line growth.

Stepping back and reviewing the progress of integration and synergy capture over the first full of S&D operating under the Cott umbrella, we are pleased with the cultural fit between S&D and the rest of our business, as well as the strength of the Management Team, and we can confidently say that the S&D team has delivered on our expectations. In regards to synergy capture, S&D was slightly ahead of their year one goal and, overall, they delivered well on their acquisition model targets for 2017.

I'll now hand the call over to Tom to cover our Route Based Services segment.

Tom Harrington – Chief Executive Officer DS, Cott Corporation

Thank you, Jay, and good morning, everyone. In order to provide some additional context, I'm going to discuss our North America and European operations separately, as I know that many of you track them that way, but as we move into 2018, our plan will be to treat the businesses as one segment.

The North America business unit hit its profitability improvement plan, finishing 2017 with full year revenue up 3 percent, even with a $4 million reduction in revenue due to a change in the way we

calculated our bottle deposit liability. For the quarter, revenue was up 5 percent, driven by five-gallon water growth, the continued success of our profitability improvement plan, and growth within our water filtration and retail divisions. Gross profit for the quarter was up 5 percent at $161 million, and for the year was up 3 percent to $668 million.

On that note, let me give you an update with regard to our three-point profitability improvement plan.

First, on customer profitability and pricing, with our more controlled customer growth plan for 2017, we did not see the inefficiencies that we experienced in 2016. In addition to the regular customer anniversary pricing that we took, we fully implemented the other pricing actions we identified as part of our improvement plan. In addition, we continue to bring on new commercial sales associates to focus on small commercial office customer growth in key high-density areas, with a focus on customer service, route density and profitability. In 2018, we will continue the expansion of our sales force, with a focus on small commercial businesses in selected high-density areas—more on that in a minute—as these customers generate higher monthly revenues and have longer average lives.

Second, sales, marketing and logistics. As a reminder, with our targeted sales and marketing initiatives, we had our route sales representatives in place in advance of our marketing activities in each region. This enabled our current routes in these areas to not be negatively impacted as the new customers came on board and to provide a better onboarding experience. With the learnings that we gained from this new approach, as well as through the utilization of some additional route logistics software that we are implementing, we believe we've made good progress in managing the process of customer onboarding.

Similar to the high-density area focus at our European operations, we have found there are many regions or markets throughout North America where our teams are able to offer superior service and generate higher returns from our new customer growth. As a result, we will further target our marketing expenditures in 2018 to focus increased efforts and spend on certain programs in certain regions, while doing less and spending less on other programs in other regions. For example, as just mentioned, we intend to increase our sales force. In fact, we will more than double our sales force that is dedicated to winning small commercial customers in certain high-density and selected regions, as these types of customers have better returns due to their higher revenue and longer lives. At the same time, we will reduce our residentially-focused, in-store marketing programs by approximately 30 percent, which will continue to optimize the mix within our customer base. We will take a similar approach with our media spend, spending more on some programs and regions, while cutting out or reducing our spend on other programs and regions.

While marketing has never been a precise science, we believe this more selective and targeted approach to allocating our marketing dollars will lead to an overall improvement in our marketing effectiveness, new customer mix, customer service and returns. That said, we look at this as an ongoing process, which we will continue to adjust as needed and refine over time.

In addition to his reallocation of new customer marketing spend, we also intend to roll out our Storm water cooler during 2018, which is a bottom-loading water cooler. Historically, we focused this product within our in-store marketing program. We've had significant positive customer feedback on this cooler and have, thus, decided to expand its availability to all customer segments across North America.

As an update to our Aqua Café roll-out, we ended the year placing just under 8,000 units and see a good opportunity for additional placements in 2018.

Third, further executing Cott's four Cs. We took actions to further implement Cott's four Cs, which drove more efficient production and operations throughout the year, which contributed to meeting our profit growth target, as well as expanding EBITDA margins by roughly 90 basis points.

At this point, let me concentrate on transportation costs, as we've had a number of inbound inquiries recently on this topic.

First, let me say that 90 percent of our transportation costs are linked to our routes and our route sales representatives who drive the local delivery vehicles. Here, we have an energy surcharge on customers' invoices, that increases or decreases each period, based on the Department of Energy On-Highway Diesel Price, and, in effect, acts as a pass-through mechanism, both up and down, for changes in the prices of gas. Thus, we see no issue here.

The other 5 percent, a much smaller element of our transportation costs, is the longer haul or freight lanes between regional production centres and our depots or distribution centres. Here, unlike others, we use many more in-house long-haul drivers and use less third-party carriers. Thus, the impact on us from the current spike in third-party carrier costs is much smaller than others or what you might expect. As we see things today, it is probably around a $3 million full year headwind, weighted to the first half, due to long-haul driver wages and third-party carrier costs.

Turning to acquisitions, as you all are aware, we announced a couple of weeks ago that we signed an agreement to acquire Crystal Rock Holdings, and that we anticipated closing at the end of March. This is a business we are very familiar with, having worked with them as a production and distribution partner for many years. Crystal Rock currently generates around $59 million of revenue and roughly $5 million of EBITDA. Given that Crystal Rock has been de-emphasizing various low-margin, non-core products, we are modeling revenue of $50 million. We also expect synergies of $2 million to $3

million from a combination of the elimination of Crystal Rock's public company costs and from our scale and procurement advantages over the next couple of years, creating a post-synergy EBITDA multiple of around 5 times.

Now, turning to Eden Springs and Europe, we were again pleased with the results in Eden Springs and remain excited about the platforms we are building in water, coffee and filtration services. During the quarter, Eden Springs grew revenue 2 percent, excluding the impact of foreign exchange, to $100 million. On a full-year basis, our total customer base grew over 1 percent, and we are confident in obtaining our targeted growth rates for 2018. In addition, we saw our churn rate improve by 10 percent, which I was pleased to see, as it proves that our team could keep their eye on the ball even during the transition of our European headquarters from Switzerland to Spain, and multiple other synergy and cost saving actions undertaken.

As we discussed on our third quarter call, we've developed a focused high-density area program, where we focus our efforts, both organic and tuck-in acquisitions, on specific high-population areas, which should help drive route density and increased operational leverage within our European footprint. While this project will take time and build cumulatively over the years, with another quarter behind us, we're pleased with the initial results and indications, and believe that this will assist us in building a more solid base business and drive profitable growth going forward. In addition, we will also introduce our Storm water cooler in Europe during 2018, and believe that it will be provide our European team with another advantage in soliciting new customers.

As we look at synergies, the team was very successful in capturing synergies during 2017. As you know, the team pulled some synergies forward in 2017 that were previously scheduled for 2018. As we look to 2018, we're confident in capturing the balance of the synergies that we're expected in 2018,

with the large part driven by procurement projects around items such as brewers, cups, coolers, and other products, where we can leverage scale between North America and Europe.

I'll now turn the call back to Jerry.

Jerry Fowden – Chief Executive Officer, Cott Corporation

Thank you, Tom. I'd now like to spend a little time on our 2018 outlook and the key activities in support of our expected growth in revenue, EBITDA and free cash flow. Our underlying expectations for 2018 have not changed since the modeling presentation we provided in September. So, as we look at 2018, our 2-plus percent foreign exchange-neutral revenue growth goal for our Route Based Services segment—that's DS Services and Eden Springs—will be driven by ongoing modest increases in consumption, net customer numbers and pricing, the continued roll-out of our Aqua Café in the U.S., and increased availability of our bottom-loading Storm cooler outside of our install marketing program, as well as its introduction to certain European markets in 2018. This foreign exchange revenue neutral growth, alongside maintaining our four Cs cost focus, and the capture of additional Eden synergies, will support continued EBITDA growth and modest margin expansion.

As we look at the current exchange rates within the 20 countries that we operate, we see benefits from the strengthening euro in converting Eden Springs' revenue from euros to U.S. dollars, but within Eden itself, we see a negative FX impact, as many of the currencies throughout its system have weakened versus the euro. As a result, we would expect to see up to a 1percent positive impact of foreign exchange on a total consolidated full year 2018, outlook due to the overall mix of foreign exchange rates across the entire business.

For our Coffee, Tea and Extract Solutions segment—that's S&D Coffee & Tea—we continue to expect market share growth and 3-plus percent plus comparable revenue growth on a constant coffee

commodity price basis. As you consider this 3-plus percent 2018 revenue growth, you need to remember this is on top of S&D's outsized revenue growth of 8 percent in 2017. That said, we continue to see the U.S. on-the-go coffee and tea market as an attractive growth market and we expect to see continued market share gains as well, alongside coffee volume growth, as well as momentum in our liquid and coffee extract business, alongside some benefit from our establishment of a new division which focuses on the provision of coffee to hospitals and government offices.

In looking at our All Other segment, here we have two different businesses. Aimia will continue to focus on growing its hot beverage and food service supplies business in areas such as hot chocolate, malted beverages, micro-ground coffee, creamers and whiteners, as well as its recent installation of a compatible pods line which can support their food service customer base and Eden Springs' coffee business through the supply of coffee, tea and hot chocolate pods.

With regards to our RCI and Columbus concentrate plant, we will be providing, and invoicing, Refresco with soft drink concentrates and various other technical support services at cost under the Transition Re-services Agreement, as well as supporting the RC brand and the ongoing supply of concentrates to our existing and new customers. Thus, 2018 will be a busy year for this business, as it supports the TSA and it restructures its operations to remove around $1 million of costs per quarter previously allocated to the traditional business. We expect these costs to be eliminated prior to the end of 2018.

Thus, all in all, we're looking at between 3 and 4 percent revenue growth in 2018, inclusive of the up to 1 percent additional foreign exchange revenue favourability just discussed. On the closing of the Crystal Rock transaction, we will have further additional part year revenue and income benefits above these just mentioned, and we will provide additional Crystal Rock details once the transaction is closed.

We continue to expect capex to be in the $115 million to $120 million range and we anticipate free cash flow for our continuing business growing to approximately $115 million in 2018, remembering, as Jay pointing out, that this free cash flow improvement incorporates the business growth from the actions discussed, along with synergies and small tuck-ins, but not Crystal Rock, as well as lower interest costs, with this adjusted free cash flow growing further to $150 million in 2019.

On that note, I'd like to wrap things up by highlighting that, with the sale of our Traditional business closed and the excellent progress on integrating our new businesses, new Cott is now a growing international services company with a strong balance sheet that displays many of the same attractive characteristics typical of the service sector, such as predictable revenue growth with a large proportion of recurring revenue, strong route-based barriers to entry, attractive margins and low customer concentration, strong cash conversion and a growing free cash flow outlook, plus multiple platforms to leverage scale and provide additional tuck-in opportunities. Thus, I believe, as we demonstrate the potential of new Cott over the coming quarters and years to grow its top line and deliver against these objectives, our shareowners have further opportunity to be rewarded through value creation on multiple expansions.

On that note, let me thank you for joining us and I'll turn the call back to Jarrod.

Jarrod Langhans – Vice President, Investor Relations, Cott Corporation

Thank you, gentlemen. During the Q&A, so that we can hear from as many of you as possible, we would ask for a limit of one question and one follow-up per person. Thank you for your time. Operator, please open up the line for questions.

Q & A

Operator

Certainly. If you do want to ask a question, just press star, one on your telephone keypad. Your first question comes from Derek Dley from Canaccord. Derek, your line is open.

Jerry Fowden – Chief Executive Officer, Cott Corporation

Good morning, Derek. Hello? Are you on mute, Derek?

Operator

Derek, your line is open now.

Derek Dley – Analyst, Canaccord Genuity, Inc.

Hi, guys. Can you hear me?

Jerry Fowden – Chief Executive Officer, Cott Corporation

We can now, Derek. A bit of a pause there. Nice to hear your voice.

Derek Dley – Analyst, Canaccord Genuity, Inc.

Yes, sorry about that. In terms of just the commentary on focusing the Route Based business on more of the office customers, can you just remind us what is the average life of one of those customers versus the typical four-year average life for the residential customers?

Tom Harrington – Chief Executive Officer DS, Cott Corporation

Yes. If we look at commercial and the small commercial, they would be closer to 6 and 7, compared to that current, frankly, four-and-a-half-year average life. Derek, that's specific to—think the small office customer, which is the sweet spot that we're focused on, with the addition of the sales reps focused on that growth.

Derek Dley – Analyst, Canaccord Genuity, Inc.

Your commentary on the returns being better, or slightly better than the residential customer within that business, is that solely due to the average life or are the margins in that business higher, as well?

Tom Harrington – Chief Executive Officer DS, Cott Corporation

Yes, I think about the pricing power that we have when we deliver good customer service and the life of the customer, so it's a combination, and then, of course, route density and average drop size all factor in to the benefit of that customer base.

Derek Dley – Analyst, Canaccord Genuity, Inc.

Okay, got it, that makes sense, and then just one more. In terms of—and I appreciate you guys' commentary on the inflation that you're seeing in terms of driver wages. Are you seeing any other inflation across the business, whether it be other commodities, PET, resin, anything of that nature?

Jerry Fowden – Chief Executive Officer, Cott Corporation

Our commodities, I mean, I think the real issue, Derek, and then we'll come back to the kind of other salaries and wages, on commodities, new Cott, as we look at ourselves today, frankly, except for coffee, has hardly any kind of commodity exposure. There's the diesel for the fleet, which, as Tom outlined, we have our energy surcharge that's a pass-through mechanism up and down, so that's

neutralized out. If you think of the polycarbonate for the five-gallon returnable bottles for water, they have 50 to 60 trips in them as an average life and then they're ground down and we reuse that polycarbonate to make a new bottle. So, really, it's only coffee where we would have a commodity exposure. The vast majority of our customer agreements in the S&D coffee space are where the customer commits to volume or the customer provides a hedge, and that would cover roughly 90 percent of the coffee volume we do. You've got to remember, the other 10 percent is in our small mom-and-pop proud routes where we control the pricing and we just move it. So, I think for commodity exposures, there aren't really much in the way of those at all anymore for new Cott, which is part of all the efforts we've been trying to make over the years.

On transportation, which you mentioned, it's a small proportion of our total cost that's long haul, and even there within long haul, which is where the overall market is seeing some inflation, we have a policy whereby we do most of that ourselves with our own fleet or our own drivers. The real pressure is just a little bit of salary inflation for our drivers, and on that small piece where we use third-party carriers, we have inflation there, like the current market has a spike, and that's what Tom was referring to as probably something like a $3 million-ish full year headwind, a little bit weighted to the front half. We say a little bit weighted to the front half, because we're going to try and take on a few more of our own drivers to further squeeze down that third-party carrier spike in price that's gone on recently.

Derek Dley – Analyst, Canaccord Genuity, Inc.

Okay, terrific, really appreciate the colour. Thanks.

Jerry Fowden – Chief Executive Officer, Cott Corporation

Thank you, Derek.

Operator

Your next question comes from Amit Sharma from BMO Capital Markets. Amit, your line is open.

Amit Sharma – Analyst, BMO Capital Markets

Hi. Good morning, everyone.

Jerry Fowden – Chief Executive Officer, Cott Corporation

Good morning, Amit.

Jay Wells – Chief Financial Officer, Cott Corporation

Good morning.

Amit Sharma – Analyst, BMO Capital Markets

Jarrod, just to be clear, the fee cash flow guidance for 2018, now $115 million, but that doesn't include Crystal Rock, and did you say lower interest expense, as well, not included?

Jerry Fowden – Chief Executive Officer, Cott Corporation

No, it includes the lower interest expense. Now, the reality is we only get the favourability of that lower interest expense one month later than we might have thought, but we're still sticking with the $115 million. It's about $10 million to $15 million of lower interest expense contributes to that, $10 million to $15 million increased contribution from our operations, and then there's some little bits on further synergies and small tuck-ins that contribute to that. But, Crystal Rock will be incremental. What we've said is once that's closed, because there's still a tender offer there going on across the Crystal Rock shareholder base, we will provide more information on Crystal Rock, albeit, we have covered today that we see the revenue going forward at around $50 million, because Crystal Rock has been de-

emphasizing certain non-water, non-coffee items they sell, and we see an additional $2 million to $3 million of synergies. So, you're looking at about a five times post-synergy EBITDA multiple for that business. But, we will provide further details on our expected revenue phasing, synergy capture after the transaction has closed, Amit.

Amit Sharma – Analyst, BMO Capital Markets

Got it, and just two more for me. One, Jay, on the capital structure, you talked about that a little bit from a euro debt perspective. Can you just walk us through where we are from leverage and is there opportunity to further lower the interest expense as you look at your high yield debt?

Jay Wells – Chief Financial Officer, Cott Corporation

Jerry mentioned it, and one thing we look at beneficial—I mean, we really have two tranches of debt remaining. We have our USD$750 million at 5.5 percent, that's an eight-year fixed tranche, and we have our €450 million 5.5 percent fixed. As we see the potential for interest rates to start rising, we locked in long-term interest, and there's no intent to pay a significant May call to redeem that debt early. That is going to be our capital structure on a go-forward basis.

As regards to free cash flow and use it, we just finished closing the traditional business and deleveraging the debt we can, with redeeming debt associated with our discontinued ops and the remaining $215 million on the 10 percent DS notes, and we're evaluating areas where we can increase capital spend or best allocate our resources to create value with increased number of highly synergistic tuck-ins, and we're evaluating our overall capital deployment strategy as part of our strategic planning process during the course of this year.

Amit Sharma – Analyst, BMO Capital Markets

Got it, and if I may just ask one more, both for Jerry and Tom. So, a lot more pronounced focus on high-density customers in the Route Based business, greater profitability as well, obviously. When do you think you'll be in a position to maybe update some of the longer term targets, both on the top line and from EBITDA perspective as you convert more of these customers to more profitable mix?

Jerry Fowden – Chief Executive Officer, Cott Corporation

Yes, I mean, I think the way you need to look at this, Amit, is this is a continual process that I think we've said in the prepared remarks will be something that cumulatively we'll build over the years. I think we've historically said looking at about 10 bps, maybe 20 on a good year, of margin expansion from this kind of improved focus in high density areas is the rough scale of that. We were pleased with the way our corrective action plan panned out in 2017, finishing the year with 5 percent revenue growth in DS in Q4, and with a full year revenue growth that hit the 3 percent we promised when we set out on this profit improvement plan at the backend of '16.

So, everything seems to be going to plan, not fancying being sucked into upping all the targets yet, but obviously we just had a good quarter and you can start to see the shape and size of new Cott coming through in our results, and we're all feeling pleased about that.

Amit Sharma – Analyst, BMO Capital Markets

Got it. Thank you so much.

Jay Wells – Chief Financial Officer, Cott Corporation

Thanks, Amit.

Jerry Fowden – Chief Executive Officer, Cott Corporation

Thank you, Amit.

Operator

Your next question comes from George Doumet from Scotiabank. George, your line is open.

George Doumet – Analyst, Scotiabank

Good morning, guys, and thanks for taking my questions.

Jerry Fowden – Chief Executive Officer, Cott Corporation

Good morning, George.

George Doumet – Analyst, Scotiabank

On the last call, you guys gave a bit of a breakdown in terms of—I think you mentioned the organic growth is going to come from a third new customer growth, a third pricing and a third consumption, which was pretty helpful. If we were to look at those parameters kind of going forward, '18, '19, in Europe and Canada, are there any small nuances or changes to those? Is one category going to outweigh the other one vis-à-vis the other one?

Jerry Fowden – Chief Executive Officer, Cott Corporation

Yes. One, I've got something that roughly is prepared to answer that, which I'll cover, George, but let me just off the top of my own mind give you a couple of comments. We would normally see that 2 to 3 percent, if we think of the Route Based Services segment, coming a little bit more, kind of closer to the 3 percent in DS services and closer to 1 percent at Eden Springs, which blends together into the 2 to 3 percent for Route Based Services, and that reflects the market in those two different geographies.

Then, if you think of 2017, that we've just finished, we did make it clear at the start of that year

that we were going to set out on our profitability improvement plan, that included some pricing adjustments in various channels and sectors. Therefore, for 2017, you saw a little bit more on price and a little bit less on customers and volume, as we said was our plan. On average, if you said there'd be kind of 0.5 to 1 percent of volume, 0.5 to 1 percent of price and 0.5 to 1 percent of increased consumption through placing more coolers out in the marketplace, so 0.5 to 1 percent for more coolers, that's the generic way to look at it. Then, with any individual year, we might adjust our marketing plans and our levers to shift it a little bit more in one direction than the other, but roughly evenly spread between volume per cooler, new coolers or customers, and price.

Then, I can go on with more detail, breaking down within the business segments here, but I think the only thing I'll pull out of the notes I've got in front of me is—and as we just said for this year, we're looking about and up to 1 percent additional revenue from the mix benefit of foreign exchange. That's really driven by Eden Springs, with a little smidge in Aquaterra in Canada, and there, you have to remember Eden Springs has got half-a-dozen different currencies inside it, pounds, rubles, shekels, Swiss francs, etc., and while there's a bigger benefit in that converting euros to dollars, there is adverse foreign exchange impacts inside Eden Springs that probably takes what some people might think is a 2 percent top line benefit down to about a 1 percent. So, you've got that 2 to 3 underlying, and for this year an extra 1 percent on foreign exchange full year, that you'll probably sees coming through in the first three quarters. I think that will be burned out as we lap Q4, or where euro had already strengthened.

George Doumet – Analyst, Scotiabank

Okay, and just a clarification. In terms of those three categories, there's not going to be one that's going to be predominant at the expense of the other in 2018 or '19?

Jerry Fowden – Chief Executive Officer, Cott Corporation

In 2018, no, we do not see that. We see '18 as a balanced year, foreign exchange obviously lifting Europe, and as we get closer to the end of '18 and layout our plans for '19, we would be comfortable, and we'll make sure we highlight if we see ourselves adjusting that mix through our own actions to try and drive one area more than the other. But, normally 0.5 to 1 percent each from new customers or coolers, pricing, and increased consumption per cooler, which, of course, is aided by the low unemployment we have at the moment, which means, on average, there's a few people extra in each office, so there's a little bit more consumption per cooler.

George Doumet – Analyst, Scotiabank

Okay, that's really helpful. Just shifting gears to—I do appreciate you guys just announced the Crystal Rock acquisition and it hasn't been closed yet, but just looking at kind of Crystal Rock similar type deals, so the $30 million to $60 million kind of midsize deal out there in Europe and North America, can you maybe give us a sense of the fragmentation of targets out there and maybe the different kind of categories that you're looking at?

Jerry Fowden – Chief Executive Officer, Cott Corporation

Yes. I mean, one, we do have an Investor Day for next week, so people that join that or look up the information after we've done it on the website, will see that we are laying out pie charts and graphs on the fragmentation of the industry, both in North America and in Europe. But, the simple answer would be there's not an awful lot of those $30 million to $60 million targets, but there are hundreds of targets, let's say, in the under $10 million sort of area. Roughly 39 percent of the North American market is still in independent or fragmented ownership, of which Crystal Rock, as a public company, was probably the largest player out there, after ourselves, and Nestle. Then, when you move to Europe,

there is over 60 percent of the market is still fragmented and independent. If you treat Europe as a whole, obviously in individual countries, that $60 million can be up and down. But, an awful lot of targets, and we are setting out to accelerate the pace with which we do these complementary and overlapping tuck-ins, because we believe they're very attractive in their own right. Again, we'll be providing the detailed history on our Investor and Analyst Day next week, that shows that these complementary overlapping smaller transactions, where you don't keep the infrastructure of the original company, kind of come down to about a three times post-synergy EBITDA.

Now, the reason Crystal Rock is five times is, as Tom pointed out, given we were a distant number three in that geography, we were already using them for certain manufacturing and distribution on our behalf. So, when it comes to Crystal Rock boosting us from our distant number three to a good number two in that geography, we will be keeping more of their infrastructure, plants, depots, than you might in a normal, small customer-less (phon) tuck-in, and that drives the difference. When they're bigger, you tend to keep more of the infrastructure.

I hope that helps, George.

George Doumet – Analyst, Scotiabank

It does. Thanks a lot, Jerry, appreciate it.

Operator

Your next question comes from Judy Hong from Goldman Sachs. Judy, your line is open.

Jerry Fowden – Chief Executive Officer, Cott Corporation

Good morning, Judy.

Judy Hong– Analyst, Goldman Sachs

Good morning. I had a few follow-up questions. First, just on the revenue growth in the Route Based Services, obviously, price mix being more of a positive factor in the fourth quarter, are you able to break out the fuel surcharge piece of that within the fourth quarter price mix? Then, as you think about '18 also, just given where fuel prices are, are we going to also see that as a tailwind for revenue, at least in the first part of '18?

Jerry Fowden – Chief Executive Officer, Cott Corporation

Yes, I mean, basically consider the energy surcharges an offset to where the price of gas is. It can certainly move revenues up and down as we increase it and decrease it, but it's pretty neutral on the income line. As gas did rise during the year, it will have been a higher element in Q4 than it was earlier in the year. People are scurrying around here looking at different sheets of paper, Judy, to see if we can get you an answer on that, but I would say, if we strip out any little bit of Canadian FX, if we strip out anything to do with tuck-ins, if we strip out energy fuel surcharge, you're probably looking at DS being in the 3 to 4 percent revenue growth rather than 5, if you take out all those different bits, so still a good underlying position.

Judy Hong– Analyst, Goldman Sachs

Yes, okay. Maybe, Tom, just on sort of your strategy of going after more profit in the business, and obviously the price mix has been more positive, if you kind of look back in '17, how do you feel about your volume performance in light of the implementation of this? Are you happy with kind of the volume growth or the consumption growth you got, or has there been any pushback on some of the price changes that you've implemented in the marketplace?

Tom Harrington – Chief Executive Officer DS, Cott Corporation

Yes, we enjoyed a good churn rate, which is one of the indicators I look at vis-à-vis pricing and ability to execute it in a market. We didn't see any spike relative to those actions. So, generally pretty pleased with the way the mix came. A lot of our profit improvement plan, frankly, was around some of the investments we made in things like route logistics software, and it's about the customer experience. If we can give that customer the right experience, they'll stay with us and less likely to fire us, which leads to that higher revenue longer life over the long haul. So, we're pretty pleased with the combination of the price action, the retention rate in '17, and then the actions we took to build route density and more profitable route density.

Jay Wells – Chief Financial Officer, Cott Corporation

I mean, Judy, keep in mind, and one thing Tom talked about and Jerry talked about, is getting back to our focus on marketing more to the small commercial type customers, because we do have bigger drops, bigger volumes to those customers, and as we focus on that, it will improve our overall mix of customers, that will improve our revenue growth, just because there is more volume that goes to those types of customers than residential, where, with the big adds we had in 2016, those were much more residential customers, which just are lower volume type customers.

Jerry Fowden – Chief Executive Officer, Cott Corporation

We still want them, Judy. It's still profitable.

Jay Wells – Chief Financial Officer, Cott Corporation

Still profitable.

Jerry Fowden – Chief Executive Officer, Cott Corporation

But we've got to keep the mix of our customers right in order to maintain the overall average EBITDA margin profile.

Judy Hong – Analyst, Goldman Sachs

Right, right, okay, and then if I can just sneak in one last question. So, appreciate all the colour you've given on the cost exposure on the Route Based Service side of the equation. I'm wondering if you can speak to any exposure on the S&D side, because I think you do have more third-party distribution for that part of the business, so I'm just wondering if there's any additional exposure on that part of the business. Then, just as you think about the $3 million to $4 million cost exposure, it sounds like you're fully offsetting because your EBITDA or free cash flow targets haven't really changed, so maybe just elaborate on kind of what's offsetting the additional cost pressure that at least you're seeing in the near term.

Jerry Fowden – Chief Executive Officer, Cott Corporation

Yes, I mean, on the last part of that question, we obviously finished the year strong, so that kind of puts us in a position that we're comfortable to kind of keep the targets we had before, even though there might be $2 million or $3 million more interest costs in 2018 than we thought from the one-month later delay, and the kind of up to $3 million headwind that we see on long-haul, for the small part of long-haul that we use third-party carriers for, but I think we're coming into the year with some good overall momentum in all the businesses, so that leaves us comfortable sticking with that target, and we'll obviously update you each quarter as the year unfolds.

When it comes to S&D and are there any real cost drivers there, we don't see that as an issue. Obviously, an awful lot of the transport in S&D, some of it is customer pick-up into their depots rather than ours, so that's not on our side of the equation. We finished the year with 8 percent revenue growth

versus 3-plus. I think I stated on the call I expect us to continue to grow market share in that area in 2018, like we grew market share in 2017, so we think we've got good actions in the pipeline.

What we saw in 2017, I'd say if you were kind of hunting for, you know, could there be any small negative in S&D, and I think I'd say it's no bigger than an acorn, it would be that we shifted our mix more towards large national QSR and convenience chains through some big customer wins and that drove the outsize 8 percent full year revenue growth, but our pricing with those large customers is different to our pricing with the small mom-and-pops and much smaller customers. Therefore, there is an overall margin mix impact, but it's been more than offset by the very strong top line and the market share growth.

Judy Hong– Analyst, Goldman Sachs

Got it. Okay, thank you very much.

Jerry Fowden – Chief Executive Officer, Cott Corporation

Super. Thank you, Judy.

Operator

That's all the time there is for questions today. I'd now like to turn the call back over to Jarrod Langhans.

Jarrod Langhans– Vice President, Investor Relations, Cott Corporation

Thank you very much for joining our call today. This will conclude Cott Corporation's Fourth Quarter and Fiscal Year 2017 Call. Thanks for attending.

Operator

This does conclude today's conference call. You may now disconnect.