FINAL TRANSCRIPT

Cott Corporation

First Quarter 2018 Earnings Conference Call

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PRESENTATION

Operator

Welcome to Cott Corporation's first quarter 2018 earnings conference call. All participants are currently in listen-only mode. This call will end no later than 11:00 a.m. Eastern Time.

This call is being webcast live on Cott's website at www.cott.com, and will be available for a playback there until May 17, 2018.

This conference call contains forward-looking statements, including statements concerning the company's future financial and operational performances. These statements should be considered in connection with cautionary statements and disclaimers contained in the safe harbor 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 US 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 expressively required by applicable law.

A reconciliation of any non-GAAP financial measures discussed during the call with the most comparable measures in accordance with GAAP is available with the company's first quarter 2018 earnings announcement released earlier this morning, or on the Investor Relations section of the company's website at www.cott.com.

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

Please go ahead, sir.

Jarrod Langhans — Vice President, Investor Relations, Cott Corporation

Good morning, and thank you for joining our call. Today I'm accompanied by Jerry Fowden, our Chief Executive Officer; Jay Wells, our Chief Finance Officer; and Tom Harrington, the CEO of DS Services, as well as the head of our Route Based Services segment.

Jerry will start this morning's call by covering his vision of our company over the next few years. He will then provide his thoughts on our operational performance during the first quarter relative to expectations before turning the call over to Jay for a discussion of our first quarter consolidated financial performance, as well as the results of 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 update of our 2018 expectations before moving to Q&A.

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

Jerry Fowden — Chief Executive Officer, Cott Corporation

Thank you, Jarrod, and good morning, everyone. Before I comment on our performance during the first quarter of 2018, I wanted to spend a little time talking about the wider perspective of New Cott, now that the sale of our traditional business has been completed.

Over the last few years, we've been executing a strategy designed to reshape our business from a mature soft drink company with low margins and a high big-box retail customer concentration to a higher-margin, better for you growth-oriented company with low customer concentration and more of a reoccurring revenue business model.

During this process, we have not only changed the business model, but we've significantly improved our growth profile, gained exposure to better for you product categories, and meaningfully reduced our exposure to both commodity fluctuations and the big-box retail channel.

In addition, following the closure of the sale of our traditional business, we have also reduced our leverage and outstanding debt.

Although there is more work to be done, with the sale of our traditional business behind us we felt it the appropriate time to better communicate the scale of our transformation to all investors, potential investors, and corporate stakeholders. With this objective in mind, we have today initiated the rebranding of Cott with a new corporate logo.

This rebranding, inclusive of the new logo incorporated in our press release today, is designed to clearly emphasize that we are a water and coffee services business. Over the coming weeks and months, we'll progressively refresh all other elements of New Cott's corporate identity with new office signage, updated website imagery, in addition to various other new and updated corporate communication materials.

Part of the thought process behind this rebranding was the fact that we felt many new and potential investors were still not sufficiently aware of the scale of Cott's recent transformation. Thus, given our confidence in the potential New Cott offers investors, our broader management team felt that in addition to this rebranding, it was the right time to approve a new capital deployment strategy which reflects our stronger balance sheet and positive revenue and free cash flow outlook over the coming years.

Thus, having paid down over $1 billion in debt, lowered our net leverage to the mid 3 times range with all remaining debt being long-term with fixed coupons alongside an attractive revenue growth outlook, low customer concentration, and thus the ability to pass on pricing, our largely reoccurring revenue business model, and the expectation of generating over $150 million of free cash flow in 2019 with a compound growth thereafter, it was the appropriate time to launch our new capital deployment strategy.

The capital deployment strategy for New Cott is to continue to drive investment in innovation and organic growth, seek to accelerate our value-creating tuck-in acquisitions, and introduce the share repurchase program while continuing to delever into the 2 times EBITDA range by 2021.

This does not mean we will not continue to evaluate or execute any larger complementary transactions in parallel, as there will likely be opportunities to further strengthen our leading platforms. It purely demonstrates our confidence in the belief that New Cott has a positive business outlook, and that an opportunity exists to repurchase our stock at an attractive valuation while we accelerate our growth through tuck-ins, innovation, and other organic activity alongside continuing to delever.

So on that positive note, let's turn our attention to some of the other activity undertaken within the quarter.

In addition to the closing of the sale of our traditional business, we also announced the acquisition of Crystal Rock Holdings and I'm pleased to say this transaction, which strengthened our position in the northeastern part of the US, closed at the end of the quarter and thus will positively impact our revenue and earnings starting in Q2. In addition, we also entered into an agreement to sell our PolyCycle Solutions, or PCS business, during the quarter to the Consolidated Container Company, with Consolidated Container providing us with an associated ongoing supply agreement.

PCS is the partner of our Route Based Services operation that manufactures a proportion of the new returnable 3- and 5-gallon bottles we use within DS Services, as well as producing 3- and 5-gallon bottles for sale to third-party operators in specific regions within the US. This transaction closed a couple of weeks ago, and PCS will no longer be part of our revenue and earnings going forward. Tom will expand more on both of these transactions later.

Turning to our first quarter's financial results, it was nice to see our results coming in as expected despite the cold weather referred to by a number of others companies, and the reduced number of trading days within the quarter.

On a consolidated basis, first quarter revenue grew 4 percent, or 3 percent when you look at it on a comparable day basis and excluding foreign exchange impacts.

Adjusted EBITDA increased by $5 million, or 8 percent, to $65 million, even though as mentioned on our last quarter's earnings call, Q1 2018 had fewer trading days relative to last year as we aligned our Coffee, Tea and Extract Solutions financial calendar with Cott's, in addition to the higher freight and transportation cost we previously mentioned would predominantly impact the first half of 2018.

Thus, both our revenue and earnings got off to a good start in 2018 and grew in line with our expectations for the quarter.

So with Q1 behind us and various initiatives that will benefit Q2 and beyond in the pipeline, I believe we are well set up for the full year.

Key elements of our full year outlook are an increase in our full year revenue to over $2.35 billion, principally to reflect the Crystal Rock acquisition, PCS disposal, and green coffee market price changes.

We have also increased our adjusted free cash flow guidance to a range of 115 million to $120 million. Jay will walk through the drivers of these increases, as we have some puts and takes over the coming quarters.

As I look to the future, with three good quarters of continuing operations, revenue growth, and financial performance under our belt since we announced the sale of our traditional business, plus the outlook of over $150 million of 2019 adjusted free cash flow in addition to our plan to accelerate the number of small tuck-in acquisitions we undertake, as well as the stock repurchase program just announced and also the opportunity for larger strategic transactions in the future, I believe New Cott is very well positioned to provide value creation to our shareholders.

On that note, I'll pass over to Jay to cover the quarter's consolidated financial performance in more detail, as well as our Coffee, Tea and Extract Solutions segment's performance.

Jay Wells — Chief Financial Officer, Cott Corporation

Thank you, Jerry, and good morning, everyone. Overall, our results for the quarter were in line with what we had projected during our Q4 2017 earnings call.

We saw good top-line performance across our key segments, with revenue from continuing operations increasing by 3 percent on a foreign exchange neutral basis and comparable week basis and adjusted EBITDA up 8 percent at $65 million.

Revenue growth was driven by coffee volume growth within our Coffee, Tea and Extract Solutions segment, as well as top-line growth within our Route Based Services segment driven by growth in our returnable bottle water business, as well as growth in retail and filtration. As Jerry noted, we have increased our full year revenue expectations for 2018 to over $2.35 billion.

So let me break out the various components of our revenue growth for 2018. First, we have our base 2 to 3 percent top-line growth. Second, we anticipate around 1 percent foreign exchange benefit in 2018 relative to 2017. Next, with the acquisition of Crystal Rock and the sale of PCS, we are expecting a quarterly revenue benefit of around $10 million beginning in the second quarter. And finally, green coffee market prices have been declining over the last year, so when you look at current rates in conjunction with the timing of various customer coverage contracts and commitments, we would expect to see around a 0.5 to 1 percent headwind to quarterly consolidated revenue with an equal and corresponding reduction in our cost of goods sold.

The majority of our coffee purchases are made pursuant to our customer agreements and our hedging program, and the changes in pricing will operate similar to a pass-through agreement.

When you add up all the pieces, you get to a projection of $2.35 billion-plus of revenue for 2018.

Now back to Q1. Gross profit increased 2 percent to $274 million, driven primarily by overall revenue growth, offset in part by the previously mentioned higher freight cost within our Route Based Services segment alongside some incremental mix shift toward larger national accounts within our Coffee, Tea and Extract Solutions segment.

Interest expense from continuing operations was $21 million compared to 15 million. The $6 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 and continuing operations, but the debt that it refinanced is included in discontinued operations.

With the sale of our traditional business occurring during the quarter, we were able to pay off over $1 billion of debt, and in turn we would expect interest expense for the remainder of the year to be around $57 million for a total 2018 interest expense of $78 million. But please keep in mind that our 450 million 5.5 percent euro debt will fluctuate based on the latest euro to US dollar exchange rates, as will the US dollar interest expense associated with this debt

Adjusted EBITDA from continuing operations increased 8 percent to $65 million. We had a number of puts and takes that drove this growth during the quarter, including top-line growth from our key segments, as well as foreign exchange benefits, which were offset in part by poor weather Jerry mentioned, around $2 million of higher freight and transportation costs, and fewer trading days within our operating segments.

As a reminder, we will continue to see some increased rate costs in Q2, which will subside as we finish filling the open positions that we discussed on our last call.

Turning to income tax. Income tax expense was $1 million compared to 2 million. With regard to cash taxes, we still expect our cash taxes to be in the 7 million to $10 million range in 2018 and for a number of years to come. On a full year basis, we still have some work to do, but we would expect income tax expense to be in the 5 million to $10 million range.

Adjusted free cash flow from continuing operations was $7 million for the quarter compared to $9 million, as we were lapping the onetime extension of payment terms in the prior year as a result of integration activities associated with our 2016 acquisitions. As we look at the full year 2018, we are confident that we will deliver around 115 million to $120 million of adjusted free cash flow.

On CapEx, we expect 2018 CapEx to be 115 million to $120 million.

Turning to our new capital deployment strategy. This week our board approved a share buyback program, and we obtained approval from the TSX. As a result, the share buyback program will be effective Monday next week.

We will utilize this program on an opportunistic basis as an additional and complementary component of our capital deployment strategy. We believe that there is still somewhat an information gap within the market, whereby a number of investors are not fully aware of the transformation that we have undertaken. And in turn, we believe that there is an opportunity to undertake a share buyback at favourable prices while we continue to communicate our business transformation to a larger subset of the market.

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 7 percent increase in coffee pounds sold on a like-for-like basis. That is, after adjusting for the three fewer days of operations of S&D in the quarter as a result of aligning S&D's year-end with Cott's year-end, like-for-like revenue grew around 5 percent.

We see the key drivers of growth during the year coming from a variety of areas, including new channels such as hospitality, government offices, and hospitals; increased penetration into the menus of our current customers in the areas of cold brew coffee extracts, ingredients, and additional specialty product offerings; as well as ongoing growth from our customer base within the on-the-go coffee and tea market.

As we look forward, we have a robust pipeline of new business, and remain confident in generating 3-plus percent top-line growth on a constant coffee commodity price basis.

As I just mentioned, we will have some top-line headwinds in regard to green coffee pricing, but this will have limited impact on our profit expectations for the year. As we have stated in the past, the business model for our Coffee, Tea and Extract Solutions business is one in which we basically add a fixed fee on top of the coffee commodity price.

As it relates to operating income, our Coffee, Tea and Extract Solutions segment delivered $4 million of operating income compared to $6 million in the prior year, due to a $2 million unrealized commodity hedging gain recorded in the prior year. If you exclude the effect of these unrealized commodity hedges, our operating income would be up slightly in the quarter.

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

Tom Harrington — Chief Executive Officer, DS Services, Cott Corporation

Thank you, Jay, and good morning, everyone. The Route Based Services segment saw revenue increase 5 percent, over 2 percent when excluding FX and on a comparable-period basis.

As many of you know, the first quarter is historically a quarter where we focus on preparing for the summer selling season by setting up our marketing programs, implementing CapEx and cost reduction projects, as well as implementing technology upgrades and rollouts in advance of the busier summer selling periods.

For the first quarter, key drivers of revenue growth, in addition to favourable foreign exchange rates, included 5-gallon water growth and growth within both our water filtration and retail divisions.

Gross profit increased 3 percent to $220 million, driven primarily by revenue growth, offset in part by increased freight transportation costs that we've discussed on last quarter's results call. On that note, let me give you an update on some of our other 2018 initiatives.

During the quarter, we placed over 30,000 Storm coolers in the US and Canada. These coolers are bottom-loading water coolers, which we plan to roll out to certain European markets later in 2018.

We also placed an additional 2,500 AquaCafés in the US during the quarter, with a full year goal of placing approximately 10,000 coolers. So we are well on our way after the first quarter.

In Europe, we saw positive activity in most of our markets as it relates to our customer growth plan focused in high-density areas, and we continue to see improvement and reduction in our overall customer churn, which although not a significant driver of short-term profitability, will be instrumental in driving sustained profit growth over the coming years.

Turning to Crystal Rock and PolyCycle Solutions. A couple of weeks ago, we announced that we closed on the Crystal Rock acquisition. This is a business that we are very familiar with, having worked with them as a production and distribution partner for many years. We're projecting for them to generate around 37 million to $38 million of revenue for the balance of this year, Q2 through Q4, with annual run rate revenues of around $50 million, as we do plan on continuing to deemphasize various low-margin noncore products that Crystal Rock has been exiting over the last few years.

Crystal Rock generated $5 million of full year EBITDA, and we would therefore expect to generate approximately 3 million to 4 million of incremental EBITDA, and expect to generate in the remaining three quarters of 2018 with synergies increasing EBITDA to around 6 million to 7 million in 2019, with the potential of getting close to the $8 million in 2020.

These Crystal Rock synergies will come from a combination of the elimination of Crystal Rock’s public company costs; our scale and procurement advantages; and route, depot, and other infrastructure consolidations.

With regards to integration costs, I would assume 1 million to $2 million spread over the next 18 to 24 months.

Turning to PolyCycle Solutions. As Jerry mentioned, the business is a manufacturing business formerly within DS that produced 3- and 5-gallon returnable bottles for DS’s internal use, as well as sales to third parties. The business has been sold to Consolidated Container Company with whom we have entered into a long-term supply agreement, so there will be no disruption to our ongoing operations and supply chain.

The decision to sell PCS to Consolidated Container was a relatively easy one, as they are better able to maximize production at the facilities, given their larger customer base where we will benefit from an attractive long-term supply agreement, and we can deploy the funds received towards higher-return-in acquisitions that further improve our route density and base business.

The sale of PCS will result in the loss of approximately $8 million of revenue and 1 million to $2 million of EBITDA in the balance of 2018 and around $10 million of revenue and $2 million of EBITDA on a full year basis.

Looking at Crystal Rock and PCS together for the balance of 2018, DS Services should see around $30 million of incremental revenue and 2 million to $3 million of incremental EBITDA, with the full year 2019 combined transactional impact, including Crystal Rock synergies, being around $40 million of revenue and around $5 million of EBITDA.

I'll now turn the call back to Jerry.

Jerry Fowden

Thank you, Tom. As I move towards the end of our call and our Q&A session, I'd like to spend a little more time on the key drivers of New Cott and our outlook for 2018 and beyond.

We have during this call outlined our expectations with regard to the incremental transactional impact of the Crystal Rock acquisition, PolyCycle Solutions disposal, and green coffee pricing, thus lifting our revenue guidance to over $2.35 billion and our free cash flow guidance to 115 million to $120 million, both up since our last call.

The makeup of this higher 2018 revenue outlook is approximately 2 to 3 percent FX-neutral revenue growth from our Route Based Services segment and 3-plus percent constant coffee commodity price revenue growth within our Coffee, Tea and Extract Solutions segment. So for that, think volume growth in pounds sold as the best underlying indicator of growth.

In addition in 2018, we anticipate a 1 percent overall benefit to New Cott revenues from favourable foreign exchange, partly offset by the green coffee pricing mentioned. In addition, we'll have around $30 million of incremental revenue from the net impact of the Crystal Rock and PolyCycle Solutions transactions.

Thus, all in all we anticipate full year consolidated revenues to grow 3 to 4 percent in 2018, inclusive of all puts and takes.

Key drivers of revenue and EBITDA growth within Route Based Services include ongoing modest increases in consumption, net customer numbers, and pricing; the continued rollout of the AquaCafé in the US; the increased availability of our bottom-loading Storm cooler within North America, as well as its introduction into certain European markets late in 2018; the execution of our high-density area strategy; the capture of further synergies; and our small complementary tuck-in acquisition strategy.

Key drivers of revenue and EBITDA growth within our Coffee, Tea and Extract Solutions segment include an attractive pipeline of customer wins from the introduction of an increased focus in channels that we've not historically focused on, such as hospitality, government and hospitals; exceptional growth in liquid coffee and extract coffee and cold-brewed coffee; as well as ongoing market growth from the on-the-go coffee and tea channel.

As you consider this 2018 revenue growth, I'd just like to remind everyone once again that this is on top of the segment's outsized revenue growth of 8 percent in 2017 and the lower coffee commodity price environment we've discussed today.

As a way of tracking our progress, we'll continue to report volume, as well as revenue for our Coffee, Tea and Extract Solutions segment, as it's the best underlying indicator of growth versus revenue, which will move with coffee commodity prices.

With that said, we remain excited about the growth prospects of both our Route Based Services and our Coffee, Tea and Extract Solutions segments in 2018 and beyond.

In looking at the market in general, there still seems to be a number of investors who are not fully aware of the transformation we've undertaken from old Cott to New Cott, and thus we need to continue to work hard not just on the rebranding of New Cott, but also to ensure we fully communicate the many positive attributes of New Cott to investors, which includes delivering consolidated revenue growth of 3 to 4 percent each year; being a reoccurring revenue business service model; having strong route based barriers to entry; demonstrating attractive margins, low customer concentration, and the ability to take price when needed alongside strong cash conversion and a growing free cash flow outlook; and having a strong balance sheet with long-term fixed-coupon debt which alleviates exposure to rising interest rates, plus net leverage in the 3 times folding to the 2 times range by 2021, while also having the optionality to further strengthen one or more of our leading platforms if the right, larger-scale opportunity presents itself.

It's this growth outlook and further deleveraging following the completion of the sale of our traditional business, as well as the expectation of over $150 million of adjusted free cash flow in 2019 and a compound 10 percent growth thereafter that led us to announce our new capital deployment strategy, which includes continued investment in innovation and organic growth; seeking to accelerate our rate of value-creating tuck-in acquisitions; the introduction of our share repurchase program, which can all be done at the same time as deleveraging.

Alongside this capital deployment strategy, we will continue to review larger complementary acquisition opportunities within the market. But rest assured, we plan to continue to vet all such potential opportunities against our stringent financial criteria.

I believe as the next few quarters unfold and people get to better understand the attributes of New Cott's business, and as confidence grows in our ability to deliver against our positive outlook for growth, coupled with the capital deployment strategy announced today, our current share owners have a great opportunity for value creation, and new shareholders have an excellent entry opportunity.

So on that note, thank you. And I'll now turn the call back to Jarrod.

Jarrod Langhans

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. At this time, if you would like to ask a question, please press *, 1 on your telephone keypad. Again, that is *, 1 on your telephone keypad.

Your first question comes from Derek Dley from Canaccord Genuity Corp. Your line is open.

Derek Dley — Canaccord Genuity

Hi, guys. Congrats on a strong quarter.

Jerry Fowden

Thanks, Derek. And nice to hear your voice. I hope you're well.

Derek Dley

I am, yeah. Thank you. Just at DS, can you just give us an update on where you're at in terms of customer additions during the quarter? What your target customer additions are for the year? And when I look at the EBITDA that you guys disclosed in your segmented statements, we had a strong jump here, about 15 percent. So can you just describe some of the initiatives that you're doing there to improve the profitability?

Jerry Fowden

Yeah. And I've got Tom with me, so I'll make a few comments, and ask Tom maybe to pick up on some of the drivers behind the profitability improvement in the first quarter.

As you know, our first quarter, Derek, is normally the kind of slower one for customers, and most of the customer growth we've seen, or the impacts on customer numbers in the first quarter have been linked to the AquaCafé rollout where I think Tom mentioned that we had placed about 2,500 in the first quarter, with a goal of placing about 10,000 in the year. And approximately half of all the AquaCafé placements have tended to be brand-new customers to DS altogether. The other half are upgrading a water customer to a coffee customer.

And then in addition to that, there's obviously the customers that come through small tuck-in acquisitions. We haven't set externally a specific goal for net new customer growth for this year. As you know, following the significant customer growth in 2016, we pulled back our expectation on the number of new customers we wanted to add, and we also wanted to shift that customer growth more towards small independent individual commercial customers and make it less about adding new residential customers.

And in that regard—Tom will correct me on the number—I think the plan was to get up to somewhere between 150 and 200 dedicated sales people for calling, cold calling on commercial customers this year from a number that was around 50 last year. And while we haven't got them all in place yet because we recruit in the first part of the year, I think we're meaningfully north of 100 of those people already on board.

And I'll ask Tom just to expand on that, plus what was behind the profitability lift in the quarter.

Tom Harrington

Yeah. Thanks. Jerry not surprisingly has the numbers correct. So we're on our way to between 150 and 200. You may recall last year we had on the order of 50 as we ended the year, and we are filling those positions as we work through the first quarter and expect to be at the right headcount level to drive that small commercial customer base as we move into the summer selling period. And that was lot of the work that we historically do in Q1.

In terms of profitability, we continued to see the benefit of incremental volume from the customer base that we have, oftentimes referred to as consumption. We continue to get the benefit of pricing initiatives that we took last year in terms of the role forward, and continue to take pricing increases this year, offset by the headwinds that we discussed in the last quarter call in terms of transportation and freight costs. We expect that to continue into the second quarter, but we are targeting to have those costs mitigated over the course of the next 90 to 120 [audio gap].

Jerry Fowden

So I'd say, Derek, really for having not put out an official goal for this year, if we were to say how do we look at the balance of things, I would look at 2018 as a year where we'll continue to see some pricing benefits from the actions of last year and what we have in place for this year. We'll continue to see consumption growth per customer.

And for existing cooler, we'll continue to follow a more modest overall new customer additions, but we will bias that towards the commercial sector where the average IRR of those customers is more than double a residential customer. That's often driven by the volume, which is more in the kind of 5-plus jugs versus the 3-plus jugs sort of environment of residential.

Derek Dley

Okay. That—

Jerry Fowden

So hope that gives you a bit of color. Anything else, Derek?

Derek Dley

No, that's great. Such switching gears quickly, just outside of coffee do you guys foresee any material movements in some of your other commodities this year?

Jerry Fowden

There's a little bit of inflation going on in HDPE, which is the kind of cloudy plastic that you use in milk jugs. But as you know, that's a relatively small part of our business. So overall, with the traditional business gone, we're really down to polycarbonate. But we use the bottles 50, 60 times, so the commodity impact is minimal.

Diesel and gas for the route fleet, but we have a pass-through mechanism in our energy surcharge that covers that. So we're pretty neutral there.

And then coffee where, as Jay mentioned, our business model is that of a fixed fee for converting that raw coffee into a roast and ground finished product, and therefore some 90-odd percent of our S&D business in effect has a pass-through mechanism. And the last 10 percent is the route business we have ourselves, where we have all the flexibility on pricing to price in line with the market.

So we do not see anything on the commodity outlook in the business model in total or where we stand today, other than that little bit of revenue headwind with a corresponding lower cost of goods that Jay covered.

Derek Dley

Okay. Thank you very much.

Jerry Fowden

Thanks, Derek.

Operator

Your next question comes from Mark Petrie from CIBC. Your line is open.

Mark Petrie — CIBC

Hi. Good morning.

Jerry Fowden

Good morning, Mark.

Mark Petrie

Morning. I wanted to just ask with regards to the capital deployment strategy that you talked about, could you just talk a little bit more about how you want to balance off tuck-in deals and potentially accelerated tuck-in deals with the share buyback? And I know you typically do sort of 10 million to 20 million of tuck-ins and that's obviously easily managed, but there had been sort of an example of potentially accelerating that up to, I think, the $60 million level that you talked about. So anyways, just curious about how you sort of balance that off?

Jerry Fowden

Yeah. And as always, Mark, you're spot-on. We believe these are not mutually exclusive. We can do them all at the same time and we can continue to delever. So the basic building blocks are continue to drive innovation and growth through things like rolling out the Storm and the AquaCafé. So probably work on something like at least doubling our small tuck-in acquisitions, so from that overall global 20 million to 30 million to more like 40 to 60. And you can see this year with Crystal Rock and a few other things we'll do that we're probably well set up for that. But we see that as the backdrop for this year, next year, the year after.

And then in addition to that—and I can always have Jay expand on it—the announcement of our share repurchase program, which has a $50 million maximum ticket set against it, frankly because we believe there's not sufficient understanding of the changes we've made and our stock is good value and that's good use of funds. And we believe we can do all three of those while still deleveraging from the 3 times to the 2 times range between now and 2021.

But, Jay, do you want to—

Jay Wells

I think, Mark, Jerry covered the bulk, but I mean the key is you look at the cash we have on our balance sheet, you look at the free cash flow that we're generating and that's going to continue to grow, really all three of these can be accomplished in addition to paying our stable dividend really out of our free cash flow that we're generating.

So as Jerry said, really have the ability to do up to the 50 million opportunistically of a share buyback, to double at least the size of our tuck-ins, to continue to pay our stable dividend, and invest behind CapEx all out of the cash we have and the cash flow that we're generating.

Mark Petrie

And then assuming that the share price moves up and so you're talking about the buyback being opportunistic and so maybe the buyback falls down on the priority list, is the intention then that the deleveraging may pick up a little bit and then maybe you just bide your time for larger M&A or larger tuck-ins?

Jay Wells

Yeah. I mean, you've got to keep in mind we've got two tranches of eight-year term fixed period debt at 5.5 percent. That is very good debt to have with rising interest rates, so we really do not have any further debt that we can pay down.

Really, the deleveraging is going to occur is more through comparison to EBITDA. As we grow EBITDA, we will deleverage. But keep in mind that we've got very good fixed debt for the next six, seven years at good rates that we will not look to redeem.

Mark Petrie

Okay.

Jerry Fowden

And otherwise we'd just be building up cash on the balance sheet at the moment, so we think with our stock price where it is that's an attractive opportunistic addition to our capital deployment strategy alongside the accelerated growth and tuck-ins that we are planning.

Mark Petrie

Yeah. Okay. Got it. And then just if I could just with regards to the coffee business—and thank you for the commentary with regards to pricing—but could you just give a little bit more colour in terms of the impact of mix in your business? And then the outlook for volume growth for 2018?

Jerry Fowden

Yeah. I think on a comparable day basis we just came in somewhere around 6 or 7 percent—

Jay Wells

—coffee pounds.

Jerry Fowden

Our guidance is this 3-plus percent constant coffee commodity price revenue growth, which in effect is code for at least 3 percent volume growth because when you say constant coffee commodity price and we have a fixed conversion cost on top of that that's really what it means.

Obviously, we've got off to the year in a good start in that regard. Within the mix there we've had some exceptional growth in cold-brewed coffee, liquid, and extract coffees within S&D.

Jay Wells

Yeah. And it's—no, no, it's really a lot of our growth is coming from the larger national accounts. And as you can understand, we have our own routes that we can take price, and of course we get a very good price on that type of business. But for the large national accounts with the scale of buy they do, as you would expect, the spread on top that we have on the coffee prices is lower. And as that part of the business grow it's good business, it's profitable business, but it does provide a mix to our overall profitability.

We're still retaining our highly profitable business, but we're just growing much faster with these large national accounts, and that's what's really providing the mix impact.

Jerry Fowden

Yeah.

Mark Petrie

Okay. Appreciate all the colour. Thanks a lot.

Jerry Fowden

Thanks, Mark.

Operator

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

Amit Sharma — BMO Capital Markets

Hi. Good morning, everyone.

Jerry Fowden

Good morning, Amit.

Jerry Fowden

Good morning, Amit.

Amit Sharma

Tom, question for you. You talked about some technology upgrade in the Route Based system. Can you talk about that a little bit? And I'm just trying to get from a context if you think about your route density or the opportunity to increase drop sales, or sales per drop, I mean where are we in that cycle? How much more could we do in addition to adding more customers there?

Tom Harrington

In terms of the technology, I'll go backwards. And we continue to develop what we refer to as C CFLi, Customer 4 Life. That's the technology in our Lakeland call centre. So that is an ongoing effort in terms of using that technology in terms of enhancing the customer experience.

We completed the implementation of iDeliver, which is a handheld application, which frankly takes our route drivers to the 21st century. And that is now in the process of being linked back to the call centre so that we can have things like closed-loop communication, which actually will help us get to your larger question, which is about the ability to up-sell.

So we'll soon be at the stage where the call centre agent and the RSR will be on the same page in terms of inventory available to sell to the customer. We think that link will help us enhance the customer experience. We expect to conclude that work later this year.

The other piece of technology that we've just begun to implement is on our route planning and logistics, which is going to give us the ability to further enhance route density using this new technology. And the early reports is it's going to produce the intended benefit in terms of greater density, more customers per stop, obviously higher revenue per customer, and a better customer experience because we're spending more time in front of the customer and less time driving.

Amit Sharma

Can we put some bands around or at least give us a ballpark like what does it do to your margin? Or what really is the opportunity size or size of opportunity (phon) here once you go through most of these—

Jay Wells

Yeah. Amit, we're right at the beginning of doing this. But for me, I always ask the same questions as you do, Amit, on getting into the details. But the easiest way for me is, within the first month or two of doing this in the areas we're doing it we were able to eliminate I think it was about 15 routes. And that's the easy way of just making it more dense, operate better, so we're early on. But to be able to eliminate 15 routes of the 2,200 plus we have, that's a small amount, but it's a very good start in this area, and it shows the potential of what we're doing in this area.

Jerry Fowden

I would have thought a good time to give you an update, Amit, on that would be around the end of first quarter 2019. Then we'll have it rolled out, in place, and we'll have sufficient of a database behind us that we can give you an answer that we can statistically to a high degree of confidence rely on rather than our early tests.

Amit Sharma

Got it. We'll take early projections as well, so you don't have to wait for a full year.

The other one, Jerry, you're very clear about the capital allocation, the priorities for cash. Can you also address what the pipeline looks like and not just from a tuck-in perspective, but perhaps larger, chunkier transactions?

Jerry Fowden

Yeah. I would say on the tuck-in transactions, this idea of on an ongoing basis for the next two or three years doubling that 20 to 30 that we had talked about. So I think 40 to 60 is something that we feel very comfortable about. It really is how many of the pipeline do we select and choose to do.

There might occasionally be one in five that we can't make the numbers versus the seller work, but we're normally looking for those that provide the best strengthening of our base business and the best overlapping and complementary synergies. So I don't see any concern with working on that 40 to 60 instead of 20 to 30.

With regards to larger transactions, we must have more than half a dozen in our strategic plan that we constantly track and update our view on. Some are not available. Some are available, and the price expectations of seller versus buyer don't quite line up to meet our stringent financial criteria. And on others, the timing isn't this week, but it doesn't mean it won't be in 6, 12, or 18 months' time.

So I think it would be wrong to assume there's going to be anything next quarter. But it would be right to assume that somewhere within the next 12 to 36 months we would have done something.

Amit Sharma

Got it. Thank you so much.

Jerry Fowden

Thank you, Amit.

Operator

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

Judy Hong — Goldman Sachs

Thank you. Good morning.

Jay Wells

Good morning, Judy.

Jerry Fowden

Good morning, Judy. And I hope I've got rid of my stinking cold by the time I see you next Tuesday.

Judy Hong

Yeah. I hope so, too. While speaking of maybe weather or cold, so the revenue growth performance on your Route Based segment in Q1 just seemed like it was a little bit softer than at least I expected. So I know you called out weather in your comment. And both US and Europe had pretty poor weather. So just wondering if you think that that had an impact on your sales growth? And then if you can quantify the fuel surcharge impact that you saw for your revenue growth in Q1?

Jerry Fowden

Yeah. I'll ask Tom to talk about fuel surcharge and expand on my view on weather. Predominantly on weather, I'd say this is a European factor. And I know that because that's where I caught my cold. It's been a pretty miserable first quarter to the point that even I think one of our UK water businesses couldn't get trucks out of the door. The facility is not in the most hospitable part of the UK. It's on the kind of Welsh border and some mountains. But we couldn't even get trucks out the door for three days. So there is a weather impact in there.

That said, we do not want to use weather as an excuse for our revenues being light. As you know, our model was built on about 1 percent revenue growth for Eden Springs and 2 to 3 percent revenue growth for DS Services. And when you blend that together, the fact that we had 5 percent revenue growth, or over 2 percent on a fully comparable day FX-adjusted basis—Tom will correct me on the number; I think in the back of our schedules it was 2.4 percent—is exactly in line with everything that we've indicated.

So obviously can't talk about every analyst's individual model. I do have a sheet with 11 of them in front of me, and they do all vary a bit. But we think we were pretty spot-on the guidance we've given. Now obviously as we go through the year, Judy, we do better in the summer than we do in the spring and the winter. But we think we've laid out on this call how our revenue for the full year comes in. And that 3 to 4 percent overall is a good figure.

So I don't know if I can say anymore on that really, but please feel free to follow up.

Judy Hong

Got it. Okay. Thank you. And then just a quick follow-up. Just the free cash flow guide increased this year. That's all related to the acquisition impact, I would assume. So if you can confirm that? And then for 2019, if you think about just accelerating some of the tuck-in acquisitions, are there thoughts to perhaps including some of that in when you give the free cash flow guidance inclusive of some of these, I guess, increased tuck-in acquisitions?

Jerry Fowden

Yeah. Let me kind of comment on that a bit, and then pass back to Tom to pick up the second part of your earlier question. And then Jay might want to expand on tuck-ins and free cash flow as well. Yes. The update from 2.3 billion to 2.5 billion, coupled with the update of 115 to 120 versus around 115 purely reflect the combination of the Crystal Rock acquisition, the PolyCycle Solutions disposal, and incorporates on the top line—although there's no free cash flow or profit impact from that—the lower green coffee prices. So that's all in that updated guidance.

I think as we've said in the past, these small tuck-ins are included in our go-forward free cash flow guidance, but anything that was more material we would treat as an on-the-top. And that's partly why we've come out and upped this year's view with the Crystal Rock transaction because that was larger than these 1 million, 2 million, 3 million, 4 million tuck-ins that we consider, frankly, very similar to other ways, marketing programs, partnerships of winning new customers.

But, Jay?

Jay Wells

No, I think Jerry covered it. And you asked about 2019. We did say that 2019 is 150 million plus. I mean, if you look at overall the net EBITDA being added at 5 million for next year less 1 million or 2 million of CapEx associated with this business, you're not talking about a significant increase in free cash flow from the net of these acquisitions.

So that's why you're not seeing us upping significantly our free cash flow guidance for next year. We've just added a plus to the number versus changing the guidance. And we'll update it more as we get toward the end of the year, as always.

Judy Hong

Got it.

Jay Wells

And, Tom, you want to say a little bit more on …

Jerry Fowden

Yeah. And I think Tom's got—and you might need to remind him—the second half of your first question, but I think Tom's now ready to pick up on that, Judy.

Judy Hong

Oh, the fuel surcharge impact?

Tom Harrington

Yeah. So think of that as about $1 million higher than prior year in terms of flow-through. And it does adjust every period based on the input costs that we get. So it's intended to offset, obviously, largely the variations that we see in fuel input costs, but there are other energy charges that will add to that.

Judy Hong

Got it. Okay. Thank you.

Jerry Fowden

Thanks, Judy.

Operator

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

George Doumet — Scotiabank

Good morning, guys. Thanks for taking my questions.

Jerry Fowden

Good morning. You’re welcome, George.

George Doumet

Just a quick one for me. Focusing on the Route Based Services, you guys mentioned some transitory issues—I think it was the vacancy side—that will probably be behind in the back half of the year, but just wondering if you’re seeing any longer-term trends in that segment as it relates maybe to wages or cost structure that you think could persist a little bit more going forward?

Jerry Fowden

Yeah. We did cover some of this on the last call, so let me just refresh where we were on the last call, then Tom can update us on exactly how we’re tracking on vacancies. About 95 percent of our drivers are route drivers on the individual 2,200 routes. And there the energy surcharge covers the variation in diesel prices. And the way they’re paid tends to be commission-based by far and away to the largest degree based on a percentage of what they sell. So you haven’t even got base wage movements.

The other 5 percent of our drivers are the drivers we use for long-haul transportation, and we tend to do the majority of that in-house having our own rigs and our own drivers. And we do have some vacancies there, and therefore we are using spot that has increased the most with this much-talked about transportation cost across most US industry.

And our goal, which is why we said first half, is we were adjusting wages up for that 5 percent of our drivers that are long haul in order to try and fill those vacant positions to cut down on the amount of spot long haul we buy, and therefore alleviate the higher transport costs.

But, Tom, how's it going and how many have we found and how many vacancies have we got or whatever?

Tom Harrington

Yeah. We've filled—if we have 20 vacancies at the beginning of the year, we're down to 15. We just towards the end of the quarter implemented higher wage rates in some of the affected markets. So we're optimistic that we'll close the gap by the end of the second quarter.

The other action we're taking is shifting from a spot buy with third party to captive capacity. So that means I contract with someone that says, I'm first on their list, so it's a commitment, but it also avoids the high incremental cost of buying on the spot market. So it's our hope that we'll have the bulk of this behind us.

Long term, obviously, those wages aren't going to go backwards, so we'll have to mitigate those wages, obviously. But at the scheme of it at 5 percent of the workforce, it's a relatively small number once we have those positions filled.

Jerry Fowden

And I think the incremental transport cost in the first quarter was about 2 million. There's probably 1 million to 2 million-ish in the second quarter and then, look, nothing ever totally disappears, but it is a few hundred thousand dollars each quarter in the back end of the year, but that's the scale of it.

George Doumet

That's helpful. Thank you very much.

Jerry Fowden

You're welcome.

Operator

There are no further questions at this time. I'll turn the call back over to the presenters.

Jarrod Langhans

Thank you very much for joining our call today. This will conclude Cott Corporation's first quarter 2018 call.

Thank you for attending.

Operator

This concludes today's call. You may now disconnect.

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