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# FINAL TRANSCRIPT

## Cott Corporation

## Fourth Quarter and Fiscal Year 2016 Earnings Conference Call

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Length: 60 minutes

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## CORPORATE PARTICIPANTS

**Jarrod Langhans**
*Cott Corporation — Director, Investor Relations*

**Jerry Fowden**
*Cott Corporation — Chief Executive Officer*

**Jay Wells**
*Cott Corporation — Chief Financial Officer*

**Tom Harrington**
*Cott Corporation — Chief Executive Officer, DSS*

## CONFERENCE CALL PARTICIPANTS

**Derek Dley**
*Canaccord — Analyst*

**Judy Hong**
*Goldman Sachs — Analyst*

**John Zamparo**
*CIBC — Analyst*

**Amit Sharma**
*BMO Capital Markets — Analyst*


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## PRESENTATION

**Operator**

Welcome to Cott Corporation's fourth quarter and fiscal year 2016 earnings conference call. All participants are currently in listen-only mode. This call will end no later than 11:00 a.m.

This call is being webcast live on Cott's website at www.cott.com, and will be available for a playback there until March 10, 2017.

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 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 expressly 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 in the company's fiscal year and fourth quarter 2016 earnings announcement released earlier this morning, as well as on the Investor Relations

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

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**Jarrod Langhans** — Director, 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 water, coffee, tea, and filtration businesses.

Jerry will start this morning's call with some of his thoughts on our operations and free cash flows in 2016, as well as progress on our strategy as we continue to build shareholder value, and touch on our free cash flow outlook over the next few years before turning the call over to Jay for a discussion of our fourth quarter and physical year 2016 consolidated financial performance, and an overview of our reporting segments within our traditional business.

Tom will then cover our water and coffee solutions segment before turning the call back to Jerry, who will complete the call with expectations for 2017. Following our prepared remarks, we will open the call up for questions.

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

**Jerry Fowden** — Chief Executive Officer, Cott Corporation

Thank you, Jarrod. Good morning, and thank you all for joining our call today.

Before Jay comments on our 2016 financial results and our fourth quarter, I wanted to spend a little time discussing Cott's progress as we seek to both diversify and expand our business in order to create a higher margin, more cash-generative business that can look towards consistent compound growth in free cash flow from multiple drivers in the years to come.

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As I look back on 2016, it's not just been a very busy year in pursuit of this objective. With the acquisitions of Eden Springs and S&D Coffee & Tea, alongside all the diligence, financing, and integration associated with such transactions, it's also been a year of ups and downs as we have navigated through various business and economic factors not all anticipated at the start of the year.

That said, despite these various elements, such as Brexit, we did end the year a larger, more diversified, higher-margin business with strong free cash flow which came in ahead of our 135 million to 145 million adjusted free cash flow guidance despite almost $20 million of adverse predominantly Brexit-related foreign exchange impact, which provided $1 for $1 free cash flow headwind, especially in the second half of the year.

With that said, I'd now like to look at some of the key business and economic factors behind our 2016 performance in a little more detail, and then lay out the key free cash flow drivers that should support a mid-teen annual compound growth in adjusted free cash flow as I look out over the next three years.

So let's look at a snapshot of the key business activities, drivers, and achievements of 2016. We managed to deliver stable North American volumes in our traditional business, with double-digit growth in value added and sparkling water and close to double-digit growth in contract manufacturing, which offset the ongoing decline in both the market and private label sales of carbonated soft drinks and shelf stable juices.

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In the UK, despite the loss of volume from a key customer, the strong growth achieved to Aimia Foods, plus significant cost and supply chain actions, allowed our UK business to perform significantly better than expected, with 2016 local currency operating income almost flat and cash flow up on the prior year.

In DS, we saw exceptional growth in net new customer additions during the year, with over 55,000 net new customers in 2016 versus just 7,000 in 2015. In fact, this exceptional new, residentially biased customer growth turned out to be too much of a good thing with a combination of upfront marketing costs, as well as the operational implications of customer setup and installation on our route efficiency leading to higher costs and reduced DS profitability.

Now more on this later, but we believe the actions we have now taken and are putting in place on sales; marketing; pricing; SG&A; and route efficiency are working, and we will see improved DS performance as we go through the year reflected in increased EBITDA.

Against these business performance and drivers, the surprise Brexit vote in June saw the first of two major downward corrections in the international value of UK sterling, first from the 1.50s to the mid-1.30s, and then in late September to the low 1.20s. These changes led to an additional foreign exchange pressure on our EBITDA and free cash flow performance.

Hence, like many companies, we updated our 2016 foreign exchange guidance in the middle of the year to an adverse range of some 18 million to $19 million.


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However, despite this adverse and volatile foreign exchange environment and its impact on the European debt market, we successfully executed a €450 million bond placement in June, which both funded and effectively provided a natural hedge to our Eden Springs transaction, which alongside S&D Coffee & Tea closed during the third quarter of 2016.

These transactions helped continue Cott's diversification and expansion away from sugar-sweetened beverages, such that today only around one-fifth of our pro forma EBITDA comes from carbonated soft drinks and shelf stable juices.

Despite everything going on throughout the year, we have stayed focused on our philosophy of the four Cs: covering customers; costs; capital expenditures; and as you know, we're especially focused on free cash flow.

We have stayed focused on the execution of our strategy in order to build a larger, more diversified, higher-margin, cash-generative business in the clear belief that as free cash flow grows our value valuation will follow.

I'm pleased to say that despite Brexit and various other bumps in the road, we ended the year with revenues up 10 percent, gross margin up 280 basis points, and adjusted free cash flow—the best measure of all for a business like ours—coming in ahead of our original guidance at $150 million. Or to look at it another way, around a 10 percent free cash flow yield.

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With that said, I know we still have a lot to do, and that I'd now like to turn our attention towards the multiple business drivers that should support our strong compound annual growth in adjusted free cash flow over the next three years.

As we look at 2017 specifically, we believe we can deliver some 155 million to $175 million of adjusted free cash flow, which will be a further step in the direction of our 2019 goal of delivering 225 million to $275 million of adjusted free cash flow, subject to the vagaries of continued foreign exchange volatility, of course.

This free cash flow objective is supported by six elements—all drivers—all of which collectively come together to support our expectation of a strong compounded mid-teen annual growth in adjusted free cash flow for the next three years. These six elements are: maintain roughly stable volumes and free cash flow and cash extraction from our traditional business; deliver organic growth of 1 to 3 percent from our various different water, coffee, and tea service businesses; receive full year contributions and associated free cash flow from Eden Springs and S&D Coffee & Tea; to capture some $22 million of synergy benefits from those businesses as they're integrated over the next three plus years; number five, execute on small, highly value-creative overlapping and synergistic tuck-in acquisitions that are de-leveraging in their own right now that we have the multiple platforms for HOD water, office coffee, and filtration services in some 20 markets to add to; and finally, six, refinance various existing high-coupon debt in 2017 with new debt at lower rates and better terms as the market and economics allow, and as the first call dates start to facilitate such possibilities.

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When you consider everything together, the greater scale, diversification, and improved shape of our business alongside the delivery of improved free cash flow, our investor confidence should grow and drive an increase in Cott's valuation and multiple, which we calculate as being some 2 turns below our peers.

On that note, I'll pass over to Jay and will return later to provide some additional detail around expectations for 2017 as a whole.

**Jay Wells** — Chief Financial Officer, Cott Corporation

Thank you, Jerry, and good morning, everyone. This quarter was much in line with what we had projected during our Q3 earnings call, where we continued to see some segments in our business grow, such as the delivery of 3- and 5-gallon water bottles to homes and offices at DS Services, growth in value added and sparkling waters at Cott North America, as well as growth in roasted custom coffee volumes at our recently acquired S&D Coffee & Tea business.

As you might expect, other parts of our business remain challenged, such as carbonated soft drinks and shelf stable juices at our traditional business, and brew basket coffee sales at DS Services. In addition, as previously indicated, we saw continued pressure within DS Services in the demand for and sourcing of small bottles of case pack water that we deliver to our HOD water customers and to supermarkets across the United States.

Consistent with our Q3 remarks, we believe these sourcing issues will not continue into 2017.

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Against this backdrop, consolidated revenue increased by 27 percent to $887 million, 30 percent on FX-neutral basis. Revenue increased primarily as a result of the additions of S&D and Eden, offset in part by adverse foreign exchange, and one less week of activity within DS Services.

Gross profit increased to $302 million, with gross margins up 240 basis points to 34 percent, driven primarily by the mix impact from the addition of Eden, as well as cost and efficiency initiatives within our traditional business, offset in part by the negative impact of foreign exchange rates, the competitive landscape within our traditional business, and one less week of operations at DS Services.

Adjusted EBITDA adjusted primarily for acquisition, integration, and unrealized noncash hedging losses in the quarter, increased 8 percent to $87 million, due primarily to the additions of Eden and S&D, offset by $5 million of adverse foreign exchange; $3 million associated with lower sales within office coffee services, retail, and case packed water at DS Services; $3 million of higher operational costs at DS Services, as well as $2 million as a result of having one less week of operations at DS Services in 2016.

As you all are aware, foreign exchange rates have impacted most, if not all, multinational consumer goods companies. And for Cott, the adverse impact of foreign exchange on Q4 EBITDA was approximately $5 million, predominantly from our UK operations. This drove an $18 million full year impact from foreign exchange, and we continue to anticipate an adverse foreign exchange impact on 2017 EBITDA of roughly 12 million to $18 million, predominantly in the UK and front-end weighted with nearly all of the adverse impact in the first half of the year.

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Turning to income tax, as discussed during our Q3 earnings call, we made the determination to place a valuation allowance against our existing US net operating loss carry-overs and other tax assets as a result of how we structured the S&D acquisition. This valuation allowance increased our reported income tax expense by $44 million in Q4, resulting in income tax expense for the quarter of $31 million compared to a tax benefit of $6 million in the prior year.

Please note that these valuation allowances do not impact cash taxes, which were insignificant as we had a small tax refund of $400,000 for the quarter.

Looking to 2017, we are currently expecting our reported income tax expense to be in the 5 million to $10 million range.

As Jerry noted, free cash flow remains a key focus within our business and strategy. During the quarter, adjusted free cash flow was $75 million, as the addition of Eden and S&D and working capital benefits were only partially offset by adverse FX and increased interest costs.

Turning to fiscal 2016, revenue increased 10 percent to $3.2 billion, predominantly as a result of the additions of Eden and S&D, offset in part by foreign exchange rates; our ongoing product mix shift into contract manufacturing; a competitive traditional business landscape; and lapping the fifty-third week our DS Services business had in 2015.

Gross margin for the fiscal year was 33.2 percent compared to 30.4 percent, predominantly as a result of the higher-margin structure seen at Eden. We were pleased to see our traditional


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business hold margins flat in 2016 at 14.4 percent, which was our goal for 2016 following the good margin expansion we saw in 2015.

Adjusted EBITDA for the fiscal year increased 4 percent to $373 million. The increase in adjusted EBITDA was due primarily to the additions of Eden and S&D, offset in part by $18 million of foreign exchange headwinds, increased new customer and operational cost at DS Services, and the competitive traditional business landscape.

With respect to free cash flow, we continue to focus on the 4 Cs while controlling CapEx and rigorously managing working capital. This allowed us to deliver our eighth straight year of $100-plus million of strong free cash flow, with adjusted free cash flow for fiscal 2016 being $150 million.

I will now cover the operating performance of our traditional business. Let's start with Cott North America business unit.

For the quarter, we saw continued growth in value added and sparkling water of 10 percent, allowing the overall business unit to increase actual case volumes by 2 percent even with continued market declines in carbonated soft drinks and shelf stable juices.

Cott North America's revenue were down 2 percent at $299 million due to the ongoing mix shifts within the business and the competitive landscape. Gross margin was 11.6 percent as the operational leverage from increased actual sales case volume and cost initiatives were more than offset by lower revenue.

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As we have mentioned in the past, our goal is to hold our Cott North America volumes broadly stable, with growth in value added and sparkling water and contract manufacturing offsetting ongoing market and private label CSD and shelf stable juice declines.

Looking at fiscal 2016, I am pleased with the performance of Cott North America, as volume stability continued with value added and sparkling water volume up more than 15 percent in actual cases and contract manufacturing volumes up 9 percent.

Our Cott North America revenues were down 3 percent at $1.3 billion for the fiscal year, which reflects the continued business mix shift towards contract manufacturing and other products that we have discussed, as well as the competitive environment.

All in all, we continue to believe our Cott North America business unit is in a more stable position, and we look towards broadly stable volume in 2017, with revenues continuing to reflect the move towards more contract manufacturing and value added and sparking water.

Now turning to the UK. Looking back at our Q3 2015 financial results conference call, we had projected that 2016 would see roughly 10 percent volume decline, primarily from the loss of business from a large retailer that started during the second quarter of 2016.

This was expected to generate a 10 percent top-line reduction, and through cost and efficiency measures we anticipated that we would be able to keep the impact to EBITDA at a similar 10 percent level. When looking at the first three quarters of 2016, we were pleased that we were able

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to maintain relatively stable operating income from a US dollar perspective, even with the decline seen in foreign exchange rates.

During our last earnings call we noted that with the further devaluation of British sterling we would end the year in line with our original expectations from a year ago, albeit now due primarily to the adverse impact of foreign exchange rates.

From a local currency perspective, operating income was only slightly down relative to the prior year, with cash flow up. With that said, we were pleased with the full year local currency operational results of our UK traditional business, and appreciate all the efforts that was taken to overcome the loss volume.

I will now hand the call over to Tom to cover our water and coffee solutions segment.

**Tom Harrington** — Chief Executive Officer, DSS, Cott Corporation

Thank you, Jay, and good morning, everyone. Let’s start with DS Services.

Overall, the fourth quarter financial metrics were in line with the commentary from our Q3 earnings conference call. Revenue was roughly flat at $255 million, as the addition of the AquaTerra business offset the fifty-third week included in the prior year.

From a customer perspective, we ended the year with total net new customer additions of approximately 55,000 compared to 7,000 in 2015. In Q4, consistent with prior years, the customer base declined, although the decline in customers was lower than the prior year, as the strong organic

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customer additions continued during the first month of the quarter prior to reducing marketing activities during the holiday season.

Although disappointing, the quarter ended in line with our expectations, as we had noted that a number of costs that Jay described would continue into the fourth quarter. These costs are partly a result of the significant customer growth that we saw throughout the year.

Against this backdrop, we worked diligently and have implemented a three-point plan based around customer profitability and pricing; sales, marketing, and routing; as well as further executing the 4 C model of Cott within our business as we work to get DS roughly back to 3 percent top-line organic grower and back towards 18 percent EBITDA margins, as we had seen in 2015. Our plan is already underway, and I'm pleased by the progress I have seen thus far.

The three areas within this plan in a little more detail include, one, customer profitability and pricing. With the significant changes we have seen in our marketing partnerships and the increased utilization of online marketing that led to a significant lift in new customer sign-ups over the last year, we've undertaken an intensive review of our customer base and all of the methods in which we can acquire new customers.

We've mapped out a plan for growing customers in 2017 based on cost to acquire, customer profitability, and our ability to effectively and efficiently service these customers. Based on this work, we've developed a plan for a more conservative growth rate in net new customers for 2017 to one that increases our focus on commercial customers and individual customer pricing and profitability.

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Number two, sales, marketing, and logistics. Based upon our deep-dive analysis of the appropriate targets, we developed a preplanned mapping of our retail partner booth program, as well as targeting regional and city-specific marketing programs to drive customer growth in the most beneficial geographic areas.

With the pre-mapped targeted sales and marketing channels, we will now have new routes and route sales representatives in advance of our marketing events in each region so that our current routes in these areas will not be impacted as the new customers come on board. Once these routes are full, we will then reroute each location, similar to what we do with the tuck-in acquisitions in order to ensure the routes are efficient. We feel confident that this will reduce overtime, and improve both the service and route efficiency as we add new customers in 2017.

And number three, further executing Cott's 4 Cs. Cott is well-known for its top-notch customer service, low-cost capabilities, and lean approach to operations. We have taken actions to further implement these processes and procedures within the customer service, manufacturing, and production areas of our operations, where appropriate, in order to further drive costs out of our system while maintaining and continuously improving customer service levels.

With a billion-dollar business, well over 200 distribution locations, and over 30 manufacturing plants in North America, the rollout of this plan will be phased over the year with some progress in the first half and momentum building in the second half of the year.


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We look forward to getting DS Services back into EBITDA growth, and as I said earlier, we have already started to see some of the fruits of our labour.

Now turning to Eden and S&D. We remain excited about the platforms we are building in HOD, water, coffee, and tea.

Looking back over the course of 2016, we have added two very good businesses which are leaders within their categories; that being the leading foodservice provider in coffee, roasting, and tea blending in the US and the largest HOD water business in Europe.

S&D and Eden have set synergy and integration plans, and both groups have blended well with our DS Services and traditional business teams as we form various task forces associated with integrating each business and driving synergy capture. In addition, Eden has already executed a number of initiatives, including reorganizing their business into a less complex and more robust structure that we have seen good results from thus far.

On a local currency basis, Eden and S&D continue to perform in line with our expectations, and we look forward to growing these businesses through a combination of organic customer growth, broader product portfolios, as well as through small HOD water tuck-ins.

In addition to this growth, we will benefit from synergy capture and vertical integration, which should further support growth in the EBITDA and free cash flow.

In looking at the quarter, we are pleased with the $228 million of revenue that these businesses contributed to our consolidated results. As noted on our Q3 call, our S&D team landed a

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number of new contracts which they have successfully begun onboarding in 2017. This provides us with increased confidence in seeing them meet their long-term and short-term goals.

Looking out over 2017, the impact of the reduced British pound and euro relative to the US dollar will have some impact on the Eden business. However, we believe that we're well on our way to meeting and exceeding our synergy plan for 2017, and therefore we should be able to offset this currency effect and meet our acquisition model.

For modelling purposes, total D&A for Eden and S&D was $13 million for the quarter, and we are expecting it to be roughly 55 million to 60 million for the full year, split roughly two-thirds to Eden and one-third to S&D.

I'll now hand the call back to Jerry to cover our outlook for 2017.

**Jerry Fowden**

Thank you, Tom. I'd now like to start to wrap things up and look at our 2017 outlook and some of the key metrics and data points you will wish to know and include in your models.

As I said earlier, I believe free cash flow or adjusted free cash flow is the very best metric to look at in order to assess Cott's progress and performance, given the significant noise that transactions as well as acquisition and purchase accounting makes to reported results. I believe it is increasingly the key valuation metric that many of you look towards.

In 2016, with the benefit of strong working capital control, we delivered $150 million of adjusted free cash flow, or around a 10 percent adjusted free cash flow yield. And as we've highlighted

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today, we expect to deliver between 155 million and $175 million of adjusted free cash flow in 2017 on our way towards 225 million to 275 million of adjusted free cash flow by the end of 2019, foreign exchange rates willing, of course.

This strong compound growth in free cash flow does not rely on any one single factor, but is supported by multiple, in fact six key drivers that we discussed earlier.

When it comes to capital expenditures, we expect to spend roughly 165 million to $175 million of CapEx per year as we look out over the next two to three years.

As it relates to cash taxes, we continue to expect our cash taxes to be low for several years to come; Jay often says more than five. And in 2017, with some work still to be done, we expect cash taxes to be give or take $10 million.

On commodities, if you take foreign exchange out of the equation then it currently looks like we will see some pressure on a net basis, as small declines in certain categories are projected to be more than offset by increases in others, such as PET resin. That said, we do see the potential for commodities to become more of an issue for our traditional business as the year progresses. And thus, we will look to further cost-saving measures and pricing in certain geographic regions to act as an additional partial offset to this risk.

On foreign exchange, as we noted in our Q3 earnings call, we anticipate 2017 foreign exchange headwinds to be in the 12 million to $18 million range, and very front-end weighted. If you look at this FX headwind in more detail, the impact will be approximately one-third from translation

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of earnings and two-thirds from the embedded transactional impact of foreign exchange from the strength of both the US dollar and the euro on the commodities our UK traditional business uses.

For Cott this means almost all the FX impact will be in the UK early in the year. And although we intend to take pricing to help offset this embedded foreign exchange commodity impact, as we've said in the past, such action has a natural lag effect and can take several quarters to be implemented. Thus, you should expect around a $10 million adverse first quarter impact to our traditional business mainly from foreign exchange in the UK, although the lost customer volume will continue to be a bit of an additional drag until the end of Q2.

With regards to foreign exchange impact on revenue, it'll drive around a 2 percent revenue headwind in the first half, again mainly UK, reducing to around 1 percent in the second half. In order to further assist you in modelling revenue, I would use just over $3.7 billion for the year.

So now let's move to 2017's outlook for our various business segments, starting with Water and Coffee Solutions. As it relates to DS Services, we see improvement in 2017 from the three-point plan discussed earlier, such that our outlook is positive and should lead to at least $20 million of recovery.

This is from around 3 percent revenue growth with a more conservative approach to new customer growth, plus ongoing HOD water consumption growth and an increased emphasis on water consumption growth, and an increased emphasis on pricing and customer profitability; a continuation of our very small HOD water, coffee, and filtration tuck-ins; plus tight control of costs, which all

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together lead to the $20 million-plus recovery mentioned and our goal of moving back towards the 18 percent EBITDA margin levels seen in 2015.

In looking at Eden Springs, we ended the year with revenues of €350 million plus on a pro forma basis, and we're looking for the business to grow top line at roughly 1 percent in local currency in 2017 and capture around $2 million in synergies.

For S&D, we ended the year with revenues of $555 million-plus on a pro forma basis. And we're looking for the business to grow its top line over 3 percent in 2017 at constant coffee prices, that is, and to capture a further $2 million in synergies.

So when you look at these two businesses together in US dollar terms, it adds up to around $65 million of higher EBITDA in 2017 versus the past year 2016 EBITDA contribution.

At this point, please note the seasonality of these two businesses, which we did lay out in some detail in our August modelling call, which showed around 20 percent of full year EBITDA is contributed in the first quarter.

Moving to our traditional business, for Cott North America we see volume stability in 2017 as we continue to grow value added and sparkling water alongside manufacturing, contract manufacturing growth to offset the carbonated soft drink and shelf stable juice declines. This will drive a similar mix shift within the business that we've seen in recent years from the lower revenue per case on contract manufacturing versus private label, yet similar dollar profitability, such that we would expect revenues to be lower by around 2 to 3 percent.

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Now for our Cott UK business, we were very pleased, as you know, with our final 2016 performance where the growth in Aimia Foods and our various cost actions held local currency operating income almost flat, and saw free cash flow grow despite the customer loss we discussed. As we look at 2017, this customer loss will continue to impact Q1, and to a lesser degree, Q2. But as mentioned, the largest UK impact will be from the adverse foreign exchange headwind we've discussed, with UK sterling down just under 20 percent in the 1.20s versus the 1.45 to 1.50 range, and also down some 15 to 18 percent versus the euro, which impacts other UK ingredient costs, such as sugar in our traditional business, and various powdered ingredients used by Aimia Foods.

As we get to the second half of the year in the UK, we would expect a return to a more normal volume trend by the beginning of Q3, and for the FX headwind to reduce in late June as we lap Brexit; then be almost gone by late September.

As a result, we expect our first quarter UK revenues to be impacted the most, with the situation progressively improving as we move through the second and third quarters with the ability to look towards stable to positive revenues for the fourth quarter.

As I look at our traditional business as a whole, it's clear the market environment, retail landscape, and foreign exchange movements in particular have not been helpful to our business. But against this backdrop we have maintained strong cash extraction and cash flow, and we intend to continue to do so in 2017.

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On that note, I'd like to finish by reiterating my belief that we have a very clear strategy and direction, one that should generate strong compound growth in adjusted free cash flow over the next three years from a business that is much more diversified and much less dependent on any one customer, product category, or geography.

Today we are a business with multiple drivers in support of our forecasted growth in free cash flow that supports an attractive free cash flow yield, and one that continues to see opportunity to build scale in water, coffee, tea, and filtration solutions.

While it's hard to say or precisely pinpoint where we are on our journey towards a higher margin and/or higher growth, more predictable and dependable business, I believe we have made great strides in that direction, and that we will continue to execute against this strategy as we integrate Eden and S&D and become a larger, stronger leader in water, coffee, tea, and filtration solutions.

I'd now like to 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.

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## Q&A

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**Operator**

If you'd like to ask a question, please press the *, then the number 1 on your keypad. If you would like to withdraw your question, press the # key. We will pause for just a moment to compile the Q&A roster.

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

**Derek Dley** — Canaccord

Yeah. Hi there, guys. Thanks for—

**Jerry Fowden**

Good morning, Derek.

**Derek Dley**

Good morning. Thanks for the colour there. Can you just give me a little bit more colour just on DS here in the front half of the year? When we talk about the three-point plan and reducing some of the inefficiencies that we've had there, I believe in the last couple quarters it's been roughly around a 3 million to $4 million headwind from new customer sign-ups and another 3 million or 4 million on customer inefficiency costs. Can you just talk about the magnitude of how we expect that to evolve over the course of 2017?

**Jerry Fowden**

Yeah. So I mean we would expect to see—and Tom can always chip in and expand—but we would expect to see progressive improvement as we go throughout the year as we implement the

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new routing and the new programs and the cost inefficiency program progressively throughout the year.

That said—and I'd like to be clear because you were just about spot-on, Derek, on the kind of 3 million from extra customers and 3 million from inefficiency each quarter—I said we're looking for a $20-plus million improvement '17 over '16 and that while that will grow as we go throughout the year, we are expecting to see improvement in Q1 as well. It's just a bit more improvement as we go into Q2, 3, and 4.

So positive improvement in Q1 building as we go through the year. And perhaps, Tom, if you expand on the three-point plan or some of the key drivers and the early indications and our confidence behind that?

**Tom Harrington**

Yeah. So we're seeing—good morning, Derek—we're seeing progress in the first, call it, six or seven weeks of the year in terms of the implementation of that three-point plan. As an example, we have routes that are in place today in the markets most affected by the retail partner program. Happy to say that that work is started and progressing along how we would think. And then to Jerry's point, that will then lead to further improvements as we move through the quarters across the year.

Further, we're seeing the type of operating friction reduction on a year-over-year basis as we have a more disciplined approach to how we're growing the customer base in 2017 manifesting itself early on.

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**Jerry Fowden**

Does that manage to fill in the gaps, Derek? Or anything else on that you'd like to highlight or pick up on?

**Derek Dley**

No, no. That's perfect. Thank you. And just one follow-up, if I can; can we just talk about the current leverage? I've got about on a pro forma around 4.5 times net debt to EBITDA. Is your target still to be in the low 3s by 2019 directing, I'd imagine, the bulk of the free cash flow over the next three years towards de-leveraging?

**Jerry Fowden**

I can see Jay kind of—we're pulling a couple of bits of paper together and working up on that, so I'll pass it over to Jay.

**Jay Wells**

Good morning, Derek. Thank you for asking a question on cash that I can answer and leverage. So yeah, I mean I think we've been pretty clear that cash is our focus of our strategy. We've been generating very good cash; very happy with the outcome of 2016 and the guidance we've given for 2017.

And our focus is to continue to track toward our guidance of 225 to 275 in 2019 with the bulk of that free cash flow going to de-leverage. So I think you're accurate. I think on a pro form basis we're maybe 4.6, 4.7; net net where we stand right now on a non pro forma maybe the higher 4

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times, but you're accurate. But our goal is through the end of 2019 to continue to work our net leverage down to the low 3 times.

**Derek Dley**

Great. Thank you very much.

**Jerry Fowden**

Thanks, Derek.

**Operator**

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

**Judy Hong** — Goldman Sachs

Thank you. Good morning.

**Jerry Fowden**

Hi, Judy.

**Judy Hong**

Hi.

**Jerry Fowden**

Good morning, Judy.

**Judy Hong**

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Good morning. So I guess my question around free cash flow outlook for 2017, so 155 million to $175 million of adjusted free cash flow, do you have an estimate of the onetime costs that you adjust out of the adjusted number for '17?

**Jerry Fowden**

Well, it will actually depend on where they come in. As you know, we do try and provide a detailed schedule of that. And it will also depend on exactly where we end up on any 2017 refinancing, which Jay can always expand on, because as you know, we do have some high coupon debt, but we have very clearly signalled we would like to find the right time and place, subject to what the bank holds are and when that's callable to refinance both lower coupon and better terms.

So obviously if we do that in one quarter versus another quarter that will drive an adjustment. So our adjustments are predominantly from the transaction cost of doing acquisitions where we do not see particularly a lot of that in 2017 because you know our focus is small tuck-ins, generate free cash flow and de-leverage, not big transactions.

And also from the integration costs to capture the synergies of S&D and Eden and I think we did provide some numbers—although they would be spread over two to three years—in our August modelling call on that. And then it would be is there anything linked to any refinancing. So at the moment we're not looking at the level of adjustments for '17 particularly being bigger than '16, but it depends where things pan out.

**Judy Hong**

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Got it. Okay. And then—

**Jerry Fowden**

So sounds like a bit of a waffly answer to me where I've not been as precise as I should be, but it depends on the moving pieces, Judy.

**Judy Hong**

Yeah. Yeah. No, that's helpful. So I mean maybe more importantly just kind of looking at the range in '17, it looks like at the low end you're not really expecting a lot of growth. So maybe talk about some of the key headwinds that sort of is driving you to kind of put the low end at that 155 million, which kind of implies just not that much growth for the '16 level. Is it more FX driven? Is it some of the other factors? Or is it just sort of conservatism and just wanting to have a relatively wide range?

**Jerry Fowden**

Oh, I think you've partly answered the question yourself because, look, there is no doubt, as I said in our prepared remarks, that foreign exchange has not been kind or helpful to our business, particularly our traditional business where we've highlighted that FX has tended to fall about one-third in the straightforward translation of sterling earnings into dollar—and a couple of years ago it was the same factor going on in the Canadian dollar versus the US dollar—and two-thirds from the translational impact of embedded FX impacts on commodities.

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And actually when you take $12 million of adverse foreign exchange in 2015 and you add on $18 million of adverse foreign exchange in 2016, and another anticipated 12 million to $18 million of adverse foreign exchange in ’17, that’s a blooming $50 million foreign exchange headwind that’s all come dollar-for-dollar off our free cash flow.

So my personal view is I actually think delivering mid-teens compound annual growth in free cash flow each year for the next three years is a pretty attractive outlook for free cash flow. And we always try and provide a range that we think is a pretty fair range, middle of the fairway, and I think as we look back to our beat on 2016, Jay did comment in his remarks that we had a good working capital controls at the end of the year that kind of helped that beat.

But, Jay?

**Jay Wells**

It’s hard for me to add anything with everything you went over, Jerry, so I would just reaffirm what Jerry said.

**Jerry Fowden**

So, Judy, we think mid-teen compound growth per year for the next three years is—

**Jay Wells**

I mean we are confident with our long-term growth through 2019—and I think Jerry said it—and the range is there based on FX and working capital implications throughout the year. But we’re confident in our operating working capital and that we can deliver what we’re guiding on.

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**Judy Hong**

Got it. Okay. Thank you.

**Jerry Fowden**

Thank you.

**Operator**

Your next question comes from John Zamparo from CIBC. Your line is open.

**John Zamparo** — CIBC

Thanks. Good morning, guys.

**Jerry Fowden**

Hi, John. Good morning.

**John Zamparo**

Jerry, you commented a bit on commodities and PET in particular. I was wondering if you could highlight any other particular commodities where you think inflation might be most impactful in 2017?

**Jerry Fowden**

Good question because the commodity landscape has been relatively benign as we consider the recent past. And I guess if we were looking at the scale of things today, we have seen PET resin rising.


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What's the order of magnitude of that for our traditional business? It's probably somewhere in the 5 million to $10 million range on a full year basis. But there are some small, not fully offsetting reductions in an alternative direction. If things stayed as they are today, we're not, John, trying to send any big signals or concerning signals. It's just if things continue to move forward from that one might have a bit more of a concern of a rising future commodity landscape.

So as it stands today, little bit of pressure. You've obviously got the FX pressure in the UK. We are in the midst of the process of taking pricing in the UK across the first couple of quarters of the year. As I mentioned, there's a lag effect on that; there always is.

So I wouldn't want anyone to get too alarmed about commodities, but I also want to state it as we see it.

**John Zamparo**

Okay. That's helpful. On the M&A environment on tuck-ins, any commentary you can provide there? And should we still be expecting the I think it's 10 million to 20 million in US and 10 million in euros for 2017? Have I got that right?

**Jerry Fowden**

Yeah. I'm kind of looking at Jay on that one because he tends to keep an eye on the watching brief of what the pipeline of that is, John.

**Jay Wells**

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I mean, we have a good pipeline in North America, and we're working through it. As you know with these, we're very disciplined with our pricing mechanism where we are basically the price setter, as we're really the only buyer in the market. But we have a good pipeline.

But you can never tell when you will land these based on our disciplined pricing, but feel comfortable on continuing to meet our guidance in that area.

And Eden, we're just finishing up getting really comfortable with the integration. We spent a lot of time with the team. We've done our restructuring that we wanted over there to take out some synergies, and really feel we're set up well with a very good pipeline over there to start working on the process.

But I don't want to tell you we'll hit our guidance this year, but I think we have a good pipeline to work on. And we will deliver what we can.

**Jerry Fowden**

Yeah. I think the numbers were about €10 million a year—

**Jay Wells**

For Eden.

**Jerry Fowden**

—for Eden. And $20 million in the US. Pretty confident, John, if we were—stood here in three years' time and we looked back at our three-year average, yes, we'd be somewhere in that range. In any single year could it be above or below? Yes, it could.

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But on average as you look out over the future that's still a very sensible guidance range.

**John Zamparo**

Got it. Okay. Thanks. And lastly, if I can, maybe I can just ask this question a bit off the board. I was curious about your thoughts on the new soda tax in Philadelphia? I know it's early going, but some reports I've read seem to suggest a fairly significant impact, so I'm curious what you think about this—I know your views on the subject in general—but are you seeing this impact you in that particular market? And how do you see it playing out across the US?

**Jerry Fowden**

Yeah. Because of the nature of our business, which is in the area of sodas which is predominantly a sugar tax area, we aren't seeing any particular—any form of material impact on our overall traditional business from the various sugar taxes, Philadelphia, or that being in California.

As you know, we're up to 20, whatever it is, 26 percent, 27 percent, or 28 percent of that traditional cold-fill business now is unsweetened flavoured sparkling waters. We have historically always overtraded in the lower no-calorie side of that business. And we have already had for several years quite a range of, let's call it, hybrid lower, no-sweetened products in order to offer a value offering because the enhanced sweeteners are lower cost than full sugar. So we're not seeing an impact there.

That said, I do feel for the bottlers that are in that specific geography with an awful lot of concentration in that area, such as the Honickmans. I consider it an inappropriate and unjust tax that


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is disproportionately targeting product that when it comes to nutrition—and I did a food science degree—are absolutely no different, in fact, less of an impact on rising obesity than consumption of ice creams; cookies; fast food; high-fat content foods.

And that the proportion of calories in the US diet that comes from soft drinks has declined in excess of 10 percent over the last decade. So it's pretty clear this rising obesity has absolutely nothing to do with soft drinks.

So this is a tax. It's local, regional, and national government that want to add this tax, and it's wrong. So sorry, you did say you knew my view on this and I—

**John Zamparo**

No, that's great. Appreciate the colour. Thanks very much. I'll leave it there.

**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.

**Amit Sharma**

Guys, a couple of clarification questions and then a bigger one; of the 3 million and $3 million cost of customer acquisition and efficiencies for the DS business, as you take some of these measures

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what percent of those costs we should expect to be eliminated? And how much will be left as you're looking towards the back half of this year?

**Jerry Fowden**

Yeah.

**Amit Sharma**

Go ahead.

**Jerry Fowden**

Okay. Yeah. If you've got a list of questions, Amit, let's maybe do them one at a time, and I won't forget them.

**Amit Sharma**

Got it.

**Jerry Fowden**

As we've said, we've looking for a $20-plus million improvement in DS over the year, so that gets you the full year kind of quantum of that. We've said we see it progressively building as we go through the year as we implement things like route efficiency operations.

I think the easiest or more specific answer therefore for your view of 3 and 3, what you've got is 3 million from the higher customer growth, and we've clearly laid out that we are going to go for a more cautious approach of less aggressive customer growth for 2017 versus '16. Let me still say

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we see it as being better than 2015, but we just want a level of customer growth that has us growing and building our business and not causing so much friction.

So you will see that cost from the high level of incremental customer growth reduced, and that will reduce in Q1, as well as Q2, Q3, and Q4. That's less of a build item. That's more of a constant item.

And then it's the other 3 million of costs that we see progressively reducing as we go through the year. So we do see improved profitability and performance in Q1 compared to Q1 last year, and we see that improving as we go through the year.

**Amit Sharma**

All right. So about three-fourths of that, or maybe half to three-fourths comes from elimination of those costs and the rest from organic growth in the business that 20 million?

**Jerry Fowden**

I'm not so sure we particularly want by quarter and by which element of where all the costs are going to come out because something will always—

**Amit Sharma**

All right.

**Jerry Fowden**

—Amit, but I think the concept of $20-plus million over the year phased and progressively building would be a sensible way to build it in the model.

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**Jay Wells**

And, Amit, if you look back last year, each quarter we were pretty precise on the additional costs we were incurring, and they did build as the year went on too. So that will also give you a pretty good feel of what we're lapping and where the 20 million that Jerry's talking about should be spread.

**Amit Sharma**

All right. I understand. And the only reason I'm trying to like get a little bit better clarity on this, the organic sales growth in the DS business, at least in the HOD business, was down and you talked about the case water business—

**Jerry Fowden**

Yeah.

**Amit Sharma**

So that goes away hopefully in the first half, right, but then you have—

**Jerry Fowden**

Yeah. Let's help on the organic sales growth because we've said we're looking in DS in particular—

**Amit Sharma**

Mm-hmm.

**Jerry Fowden**

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—for 3 percent overall total revenue growth in 2017 versus 2016. Might that be more like 2 to 3 percent in Q1 and Q2 and 3 to 4 percent in Q3 versus Q4? That would allow you to look at that 3 percent average on the year, overall growth, including the challenges in office coffee, but strong performance in HOD 3- and 5-gallon water, 3 percent for the year, 2 to 3 percent first half, 3 to 4 percent second half.

**Amit Sharma**

Got it. And then as we look at your free cash flow outlook for '17, Jay, can you tell us how much of that is organic versus fully a contribution from S&D and Eden?

**Jay Wells**

Oh, yeah—

**Jerry Fowden**

We've got $25 million of EBITDA rollover benefit of 2017 versus 2016; you got to take off the interest charge; you got to take off the CapEx. I think we originally said we were expecting around $10 million of free cash flow net over the cost of financing from one of those transactions and maybe 10 to 15 from the other on a full year basis. And all you've really got is seven-twelfths of that next year versus this year.

So you've got 20 to 25 and you've got half of that, so 10 to 12.5, something like that. We've not got the number in front of us, Amit, but that's a rough and ready.

**Amit Sharma**


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That's great. That's good enough. And the last one for me, Jay, you'd talked about strong working capital controls, and that's probably the difference between where you ended up for the fourth quarter free cash flow wherever you were. Can you talk about a little bit about what those measures are and could those continue in '17 as well?

**Jay Wells**

Yeah. I think you said it right. I think we always have and will continue to work our working capital very hard. And that was some of the benefit we saw in 2016, and I think we still have more opportunities in '17. So I think you will continue to see that benefit coming into '17.

**Amit Sharma**

Great. Thanks so much.

**Jerry Fowden**

Thank you, Amit.

**Operator**

There's no further questions at this time. I will now turn the call over to Mr. Langhans.

**Jarrod Langhans**

Thank you very much for joining our call today. This will conclude Cott Corporation's fourth quarter and fiscal year 2016 call.

Thank you for attending.

**Operator**

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This concludes today’s conference call. You may now disconnect.

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