Company: **Cott Corporation**

Conference Title: **Third Quarter 2016 Earnings Conference Call**

Moderator: **Jarrod Langhans**

Date: **Thursday, 10 November 2016**

Operator: Please stand by, we are about to begin. Good day everyone and welcome to Cott Corporations Third Quarter 2016 Earnings Conference Call. All participants are currently in a listen-only mode. This call will end no later than 11:00 a.m. This call is being webcast live on the Cotts website at www.cott.com and will be available for playback there for two weeks.

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 others fillings 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 Third Quarter 2016 Earnings announcement, released earlier this morning, as well as on the investor relations section of the company's website at www.cott.com. I now would like to turn the conference over to Jarrod Langhans, Cott's Head of Investor Relations. Please go ahead sir.

Jarrod Langhans: Good morning and thank you for joining our call. Today you will hear from Jerry Fowden, our Chief Executive Officer, Jay Wells, our Chief Financial Officer, and Tom Harrington, CEO of DS Services, who will cover water and coffee solutions. In addition, we have Ron Hinson CEO of S&D Coffee & Tea with us this morning.

Jerry will start this morning's call with an update on our strategy and his observations on the quarter. He will then turn the call over to Jay, who will discuss our third quarter 2016 consolidated financial performance and an overview of our reporting segments within our traditional business. Tom will then cover water and coffee solutions segments before turning the call back to Jerry, who will complete the call with our expectations for the remainder of the year and our outlook for 2017.

During the quarter with the completion of the acquisitions of both Eden and S&D, we created the reporting segment water and coffee solutions which now include the DS services as well as Eden and S&D. Following our prepared remarks, we'll open the call up for questions. With that, let me now turn the call over to Jerry.

Jerry Fowden: Thank you Jarrod, and good morning everyone. Before we cover our third quarter results, I wish to make some overall comments, covering our diversification strategy and the progress to date, as well as our performance during the quarter.

So, first, on our diversification strategy. As you are aware, while not forgetting our focus on the four "C's" of customers, cost, capital expenditures and free cash flow, we have continued to diversify our business, by organic means such as growing our contract manufacturing, and value added in sparkling waters, as well as through acquisitions. Specifically within the water coffee and tea sectors.

In order to become a higher margin business with greater emphasis on growing categories, versus our historic dependence on declining categories such as carbonated soft drinks and shelf stable juices. As I look back, I'm pleased with the progress made over the past 2-3 years in the execution of this strategy, that's seen our gross margins move from 10-15% to over 30%.

It has reduced our combined dependence on carbonated soft drinks and shelf stable juices from 55% of revenue and EBITDA to the mid 20% range of revenue and EBITDA. Not only have we meaningfully shifted our business mix, but we have increased our scale, improved our cash generation and increased our valuation, providing benefits to all stakeholders.

That said, the execution of this strategy is not complete and over the next 2-3 years, we intend to stay focused on the full "C's", organic growth and continued complimentary and overlapping diversification in HOD water, coffee, tea and filtration. Such that we further strengthen our scale, our identity and leadership position in the sectors.

Now, on to our Third quarters performance, which overall saw a revenue of 17% to $885 million, gross margins up over 350 basis points to 34.5%. Adjusted EBITDA up 17% to $111 million and adjusted for a cash flow broadly in line for the quarter coming in at $67 million dollars compared to $70 million, as the benefit on Eden and S&D, largely offset incremental capital expenditures and $5 million of adverse foreign exchange. Leaving year to date, adjusted free cash flow up 13 million dollars or 21%. These results however, contain a mixture of puts and takes which I would like to expand on.

So, let's look at this Q3 performance in greater detail. The five key factors I would like to highlight and ensure everyone understands, are the following. Number one, the closing of the acquisition of Eden Springs on 2 August, with revenue and EBITDA performance in

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its first two months in line with our acquisition model. Our expectations for the performance integration and synergy capture as we look forward to Q4 as well as 2017, are unchanged, and in line with our acquisition model.

Number two, the closing of the acquisition of S&D coffee and tea, on 11 August. With strong organic volume and EBITDA performance in its first seven weeks versus our acquisition model and with some very recent customer wins, we have a positive outlook for Q4 and 2017.

Number three, a continuation of stable volumes in fact up to 2% in actual cases, in our North American traditional business unit with the ongoing growth in contract manufacturing and value added in sparkling waters offsetting the decline in carbonated soft drinks and shelf stable juices.

Number four, despite ongoing significant gross and net organic customer wins at DNS services, a softer revenue performance than we would had wished, with a 2% decline if you exclude Aquaterra and continued higher than expected operational costs, which we currently anticipate continuing into Q4. Although we expect the situation will improve as we prove progress through the first half of 2017.

And, finally, number five. With the strengthened of the US dollar, and the further post-Brexit devaluation of the British pound, we have a more adverse foreign exchange landscape for both Q4 and in 2017 as a whole. These five factors and understanding them and their implications, is important. Not just to understand our Q3 results, but also Q4 and the 2017 expectations.

That said, our business is a better, stronger scale business with higher margins and attractive platforms, increasingly positioned to participate in growth markets. We have

experienced significant net organic customer growth in DS services of over 60,000 customers' year to date, versus less than 10,000 last year to date, which demonstrates the strength of the business and the potential we have as we go forward. This is especially true, when coupled with the ongoing growth we see in contract manufacturing and valued added in sparkled waters in our traditional business, as well as the recent new customer wins in custom coffee roasting for 2017.

On that note, let me pass over to Jay, to cover our consolidated Q3 financial performance as well as some more details behind our Q3 operating performance in our traditional business reporting segments, prior to Tom covering our operating performance in our water and coffee solutions segment. I'll then return to cover our Q4 and 2017 outlook for the business as a whole.

Jay Wells: Thank you Jerry and good morning everyone. As Jerry mentioned, we saw some segments in our business continue to grow such as delivery of three and five gallon water bottles to home and offices, as well as growth in single serve coffee at DS services. Growth in contract manufacturing and value added in sparkling waters at Cott North America, as well as growth in roasted custom coffee volumes at a recently acquired S&D coffee and tea.

As you might expect, other parts of our business remain challenging, such as carbonated soft drinks and shelf stable juices in our traditional business and brew basket coffee sales at the DS services. In addition, we saw some recent pressure within DS services and the demand for insourcing of small bottles of case-packed water that we deliver to our HOD water customers. In sales of one gallon of HDPE bottles to retailers across the US.

Again this backdrop, overall revenue of $885 million, was higher by 17%, 20% higher excluding foreign exchange. Excluding Eden and S&D on a constant currency basis,

revenue was broadly flat. The key revenue drivers for the business excluding Eden and S&D on a constant currency basis were: one, the outgoing [inaudible] shift in our North America traditional business unit with 9% actual case volume growth in contract manufacturing, with a revenue per cases lower, the brand owner normally supplies the majority of the ingredients and packaging materials.

Two, soft sales and brew basket office coffee services and case packed water at DS services, have broadly offset the 3% volume growth in three and five gallon HOD water and growth in single serve coffee at DS services.

And three, the revenue contribution from Aquaterra, gross profit increased to $306 million. With gross margins up 350 plus basis points, to 34.5%, compared to 30.8%. Driven primarily by the mix impact from the additions of Eden and S&D 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 higher than anticipated operational costs at DS services.

Adjusted EBITDA, adjusted primarily for acquisition, integration and transaction costs, increased 17% to $111 million to primarily to the additions of Eden and S&D offset by $5 million of import adverse foreign exchange, over $3 million of incremental investments in organic new customer growth at DS services, $4 million associated with lower sales with an office coffee services, retail and case packed water at DS services, and $5 million of higher operational cost at the DS services.

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 Q3 EBITDA was approximately $5 million, predominantly from our UK operations. This has driven a $12 million year to date impact from foreign exchange and we would expect to

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end the year with foreign exchange impacting EBITDA by approximately $6 million in the 4th quarter and some $18 - $19 million on a full year basis.

Based on today's exchange rates and 2017 forecasted rates for the British pound, Euro and US dollar, we anticipate an average foreign exchange impact on 2017 EBITDA of roughly $12 - 18 million, with two thirds of the impact occurring in the first half of the year. Given the reason foreign exchange volatility, we will update these figures each quarter going forward, as we gain more insight into 2017 rates.

Turning to income tax, as noted during our modeling call on 17 August, as a result of how structured the Eden acquisition we placed a valuation allowance against our existing Canadian net operating and loss carryovers which increase our reported income tax expense by $9 million in Q3, resulting in income tax expense for the quarter of $5 million, compared to a tax benefit of $6 million in the prior year.

Looking to Q4, and full year income tax expense, we also discussed during our modelling call that we may be required to place a valuation allowance against a portion of our existing US analogue carryovers. But this determination will not be made, until the S&D purchase accounting process has been completed later this year. Please note that these valuation allowances, do not impact cash taxes which are less than $1 million for the quarter and we continue to expect our full year cash taxes to be minimal in 2016 at approximately $6 million.

Adjusted net income, adjusted primarily for acquisition, integration and transaction cost, as well as the tax valuation allowance just discussed, was $13 million during the quarter. Adjusted net income per diluted share was flat at $0.09. Free cash flows remain a key focus within our business and strategy. During the quarter, adjusted free cash flow was $67 million as the addition of Eden and S&D was offset by increased capital expenditures

and $5 million of adverse FX. On a year to date basis, our focus on the four "Cs" had delivered adjusted free cash flows, which were up to 21% or $13 million.

On that note, I will now cover the operating performance of our traditional businesses. First, Cott North America. Our Third Quarter 2016 volumes were up 2% in actual cases driven by strong growth in value added water, which increased 19% in actual cases, as well as contract manufacturing which grew 9% in actual cases.

Cott North America's revenues were down 4% at $326 million with a revenue growth from improved volume being offset by a product mixture in the contract manufacturing with a revenue per case as lower as the brand owner normally provides the ingredients and packaging materials. Gross margin increased by 90 basis points to 13.7%, due to the operational leverage of increased actual case volumes and improved operational cost. Offset in part by a competitive landscape.

Now turning to the UK. As we've been forecasting for the last year, the UK beverage and retail markets remain challenging as hard discounters pressure the more traditional large format multiple grocers. But in the face of these headwinds and the loss of volume previously communicated, we have again, been pleased with the operation results for our UK business during the quarter, as they continue to make good progress against cost and business efficiency programs.

Looking at the operating results for the quarter, UK volume decreased 6% in actual cases and 1% in servings, while revenue decreased only 2% on a foreign exchange neutral basis. In local currency, gross profit as a percentage of revenue was flat, at 14%, as strong growth at EMEA foods, high cost controls and lower inventory levels were able to offset the lower volumes in the quarter.

Looking forward to Q4, we continue to expect the UK market to be a challenging environment and even though we have performed better than expected over the past four quarters, we continue to expect full year 2016 UK EBITDA to be down approximately 10% as a result of an increasingly adverse post Brexit foreign exchange environment, the UK retail and beverage market competitive pressures, lower UK volumes and the lapping of cost and efficiency programs that we began implementing in the back half of 2015.

In effect, our successful cost and efficiency measures and stronger operating performance has been able to postpone the EBITDA headwinds we forecasted for 2016 from the customer loss communicated. The impact of this customer loss started in Q2 2016, thus we would not fully lap the effects of this until the third quarter of 2017.

With regards to EMEA foods in the UK, we were again pleased with the performance of the EMEA foods which had another good quarter with 18% local pricing revenue growth and good EBITDA growth. I will now hand the call over to Tom to cover our water and coffee solutions segments.

Tom Harrington: Thank you Jay, and good morning everyone. Let's start with the DS services. Overall revenue was up at 4%, $279 million, due primarily to the addition of Aquaterra. Revenues were down 2% when we exclude Aquaterra as the decline in the sales of brew basket coffee, case pack water sold to HOD customers and one gallon water sold to our retail customers, offset the 3% volume growth that we saw in returnable bottles and growth in single cup coffee.

The decline in brew basket coffee has been an ongoing trend for DS services. We believe that our OCS business will benefit from the acquisition of S&D in two key areas. First, by converting our coffee supplies from a third party roasted to S&D, we believe we will be able to upgrade our portfolio by offering higher quality coffee in the right package

sizes relying on S&D's proven track record in the area of product offerings. Secondly, we will take advantage of the decades of coffee knowledge and expertise of the S&D management team in improving our daily operations.

In relation to the lowest sales of case pack water, our route sales representatives have spent less time and energy cross-selling, as a result of their focus on new customers' installations. In addition, we did experience product shortages as part of our transition, from one external co-packer to another in 2016. This impacted both our home and office delivery sales as well as our sales to our retail customers. While our inventory position is improving during this quarter and we do not expect these issues to continue into 2017, the effects will continue to be felt in Q4.

Adjusted EBITDA decreased $5 million to $49 million. The decline in EBITDA came from a number of areas, including our investment of $3 million behind new customer programs, which drove new organic customer growth in a quarter. This is principally related to incremental commissions paid to our sales associates, as well as to our retail partner driving the bulk of the growth.

$4 million associated with reduced sales in brew basket coffee retail and case pack water, and $5 million plus in higher operating cost generated from a number of tea areas including health and welfare cost. All partially offset the $5 million reduction in incentive accruals in the addition of Aquaterra. At this point I would like to spend a little more time covering a higher operating cost in our DS services businesses.

These costs are partly a result of the significant customer growth that we have seen throughout the year as we have incurred direct cost increases from this growth in terms of route operations, particularly in the area of overtime. With this significant growth it is

taking more man-power, and more time to properly set up the new customers for this service.

We have also adjusted our routing on an ongoing basis and have needed to take short term actions such as adding ad hoc routes to adjust the growth in certain markets in the US. In addition to these costs, we have seen operating challenges in terms of production efficiencies and some increased costs to properly maintain our fleet of route trucks. While we see these cost pressures remaining in the fourth quarter, as we continue to set up the 20,000 plus net new customers, signed during the quarter, we anticipate the level of these incremental costs reducing as we move through 2017. In terms of the non-growth cost impacts, our teams are working diligently on these issues and are implementing a number of other cost reduction initiatives for 2017.

In other parts of our water and coffee solutions segment, primarily Eden springs and S&D's coffee and tea, we have acquired two good businesses that we will look to grow in the overcoming years. We will grow these businesses through a combination of organic growth, new customers and a broader product portfolio. An example of this would be S&D's recent success in business development of their cold brew coffee and coffee extract segments.

In addition to this growth, we will benefit from synergy capture and vertical integration which will further support growth in EBITDA and free cash flow. During the quarter Eden and S&D provided $157 million of revenue and $20 million plus of adjustment EBITDA to our consolidated results. Our S&D team recently landed a number of new contracts, which positions them to drive incremental volume in EBITDA for 2017. We feel positive about our outlook for S&D and their ability to meet or exceed our acquisition model in 2017.

Eden has also seen modest growth this year on an FX neutral basis, and we are confident in the business delivering +1% of top line FX neutral growth next year. Eden's EBITDA remains on track, to meet the target that we noted in our modeling call. As a reminder, we have provided modeling information on the Eden and S&D on our website and did a modeling call on 17 August. With this modeling deck, we also included estimates for revenues and EBITDA for the period from closing on the acquisitions in August 2016 to year end, which we believe remain reasonable. I will now hand the call back to Jerry to cover our outlook for the balance of the year in 2017.

Jerry Fowden: Thank you Tom. Now, I'll review our outlook for Q4 and 2017 as a whole, by providing a view on each business segment, as well as certain macro and companywide factors. First, after additional business, we expect the North American beverage landscape, especially CSD's to remain challenging. But overall we believe our North American business unit can continue to maintain the broadly stable actual case volumes by a growth in contract manufacturing and value added of sparkling waters offsetting the ongoing market and private label decline in CSD's and shelf stable juices. This volume stability should allow us continue to generate the good level of healthy stable free cash flows we've become used to from this business.

With regard to top line revenue, we expect the same trend in 2017 that we've seen in 2016 as we continue to shift the mix within our business to those products that have lower revenues per case, but broadly similar cash margins per case, such as contract manufacturing where the brand owner typically provide the ingredients and packaging materials.

In the UK, we will remain focused on running a low cost and efficient business as we progress through 2017. We will start to lap the adverse impact of the lost customer volumes as we get into the third quarter of 2017. We also have a plan to introduce and

drive a similar range of value added in sparkling waters in the UK that have been so successful for us here in North America. These products will again leverage the same production lines that we use for CSD's today.

We do, as Jay mentioned, anticipate lower UK EBITDA in Q4 2017, primarily as a result of the adverse British pound versus US dollar exchange rates discussed. As well as to a less of degree, lapping the Q4 2015 cost and efficiency savings as well as the lost [inaudible] volume that will impact us until the end of the third quarter of 2017. As our UK traditional business starts to work more closely with Eden, we believe we have the opportunity to expand our presence within various specialty water segments, that will both leverage our existing facilities and extraction rights and allows us to greater penetration into new channels such as hospitality.

Now, let’s turn to water and coffee solutions, in particular, DS services. As we enter the fourth quarter, we expect to continue to generate new customer sign ups across the first six weeks of the quarter. Followed by a slow down in customer sign ups, as we reduce [inaudible] marketing campaigns for the holiday season.

This is due to a combination of factors: a) not getting the same return on the marketing dollars during this time period as customers are focused elsewhere, and b) the suspension of our in-store retail boot program from Thanksgiving to New Year. That's when you add in the normal level of seasonal customer churn, and the reduced seasonal new customer marketing program, we believe we can start to revert to a more normal level of new customer activity. And as a result, catch up on our Q3 new customer installations and start to plan the reorganization and optimization of our routes for 2017, in order to more efficiently absorb and service, the significant level of 2016 new customer additions.

While this will not immediately remove the increased operational expense that we've seen this year, as that will continue during Q4, it should allow us to position ourselves to progressively reduce these incremental operating cost across 2017. That in general, we see the shape of DS services and it's Q4 performance as being very similar to Q3. However, we would not expect any incremental reversal of incentive accruals in Q4 which assisted Q3 performance. And, as noted in our press release, DS services Q4 will be a 13 week quarter, versus a 14 week quarter last year.

Now, as we look at Eden Springs and S&D coffee and tea, our outlook is in line with our modeling call of 17 August, although it’s fair to say we’re off to a strong start in S&D, as mentioned earlier. We also included S&D in the financial calendar section of our press release, as they will have a 12-week Q4 this year, as opposed to our typical 13-week quarter.

Turning to commodities for 2016, we continue to see a year in which on a net-basis, commodities inclusive of our advanced coverage and hedges are fairly benign. As we look to 2017, there appears to be on an FX neutral basis, some modest inflationary pressure across a broad range of commodities. However, the impact of the strengthening US dollar will drive a much greater degree of commodity inflation on certain specific commodities, such as aluminum, corn, apple concentrate, et cetera, which are traded in US dollars. Thus driving significant commodity inflation, when those commodities are used as part of our manufacturing process, outside the US in places such as the UK, Europe and Mexico.

On capital expenditure for 2017, our views are unchanged from that we’ve covered in the past or on the recent Eden and S&D modeling core. That is $50 - $55 million of our traditional business, approximately $75 million for DS services inclusive of Aquaterra, and around $43 - $48 million for Eden and S&D combined.

On foreign exchange, Jay covered this earlier in his remarks and with the recent appreciation of the US dollar and depreciation of the British pound, we see the adverse Q4 foreign exchange impact being some $6 million and the 2017 adverse impact being in the $12 - $18 million range. However, given the significant foreign exchange volatility we have seen recently, we will update you on this each quarter, as the year progresses.

Now, while talking about foreign exchange, we updated you last quarter that the immediate impact of the initial post-Brexit UK exchange rate meant that our full year 2016 free cash flow would come in at around $135 million and be at the bottom of our $135 - $145 million range. Since then, we have had further devaluation in the UK exchange rate and we have also closed our Eden and S&D transactions. So, bringing all of this together, we see our 2016 adjusted free cash flow as now being back in the $135 - $148 million range with the Eden and S&D part year contributions more than offsetting the further weakness in Sterling.

Thus, as I stand back and look to the future, I believe we have a more attractive shape to our business, I believe that our organic focus and actions, plus the potential for small, overlapping tuck-in acquisitions, as well as the Eden Springs and S&D transactions, along with synergies and the ability to reduce the cost of servicing our debt, will generate strong free cash flow over the next 3 - 4 years, and rapid de-leveraging.

Our strategy has focused on the diversification of our business to all-cash-generative, higher-growth or higher-margin businesses, while continuing to follow our four Cs and generate strong free cash flow from our traditional business. Such that cuts overall business progressively becomes a lower-risk company that should trade more in-line with other CPG and service industry peers.

The quarter, as discussed, contains a number of positive vectors, such as a strong start for S&D, but also a softer performance and higher operating costs than we would have wished from DS Services. Although we need to remember the significant demand for their services and their 68,000 net new costumers signed up this year versus just 7,000 last year. Even though that has placed an unprecedented strain on our business and cost structure that we now need to address.

The net effect of all of this is we are today a much stronger, more diversified cash-generative business with a meaningfully more attractive outlook from two-three years ago. So, on that note, I'd like to turn the call back to Jared to open up our question and answer session.

Jarrod Langhans: Thank you, gentlemen. During the Q&A, so that we can hear from as many of you as possible, we will 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.

Operator: Thank you. If you would like to ask a question, please signal by pressing "*1" on your phone. Please make sure your mute function is turned off to allow your signal to reach our equipment. Again, that's *1 for questions. We'll go first to Mark Petrie, the CIBC.

Mark Petrie: Good morning guys.

Jerry Fowden: Good morning, Mark.

Speaker : Good morning.

Mark Petrie: I guess my question is around the DS business and obviously the growth has been pretty remarkable over the last nine plus months and it seems like it's impacting service levels

to some extent and obviously bringing some excess cost into the business. So, sort of stepping back when you think about the progression into 2017, and obviously the customer growth you'll end up achieving is a big caveat to this. But how should we think about the structural profitability for that business once you address some of the one-time costs that you've had to incur? I mean, do you need more people on the ground and so the margin structure reduces or is there positive leverage for you guys as that business grows?

Jerry Fowden: Thanks, Mark. I think that is probably the core area of questions and understanding for this call today. As you've rightly pointed out, I think it's 68-odd thousand net new customers we've added this year versus… organically, that is, versus 7,000 last year. And probably to help everyone understand that - and then I'll pass over to Tom to elaborate on a couple of areas - when we talk about adding 68,000 net new customers, you have to remember the average customer life is somewhere just over four years. Therefore there is customer churn each year.

So to add 68,000 net new customers… we have added some - I won't get the number right, 250,000 to 300,000 customers this year had to be installed and of course, we have taken equipment back from less than 200 customers to end up with a net 68,000 growth. So, that's a tremendous amount of activity. Meaningfully higher than we've had in prior years and what we've not really got the balance right on yet and that's what we have to get right in 2017, is on the right level of net new customer additions and how we more efficiently and effectively install these new customers. So, I'll ask Tom to expand on some of that and some of the cost-action plans that we do have in place for 2017. Tom?

Tom Harrington: Yeah, Mark. Good morning. A couple of forces at play. Jerry's correct. So, net 68,000. We generally bring in approximately 300,000 gross but this year, it's 100,000 plus higher. So, it's meaningfully different than anything we've experienced in the past. So that we

have been creating serious inefficiencies and that's driving the operating cost, as we burden our RSRs with this significant increase, route by route. And, as you would expect, in a perfect world, they'd come in 200 a day and they'd be spread [inaudible] across all routes in the US, but it doesn't work out that way. So that we have concentration where these customers end, which are burdening pieces of the business differently than others.

As we referenced in the call, we are now just about caught up in 2016, and expect a return to more normal. But it really is about putting in place a right operating structure to take advantage of the leverage that you referenced, which is, in fact, greater route density. So, while the - I'll call it "the front line GM of route sales reps and operating management" are focused on this tsunami of growth, a separate team is working on our route plan for 2017.

Which is a detailed approach that says we will need to add routes in this town at this rate in anticipation of the growth, while at the same time developing approach that, while we still certainly expect to enjoy the growth, is that we manage that growth a little bit differently in 2017 so that we can properly service the customers, reduce the inefficiency in the system, and then leverage the benefit of the customer route density.

Jerry Fowden: Thanks, Tom. And, Mark, I guess the only thing I'll say with 200+ depos of over 2,000 routes, this is something along the day-to-day execution has a lot more wrinkles to it than this kind of higher level conversation. And, while 7,000 net new organic customers last year was not the right level and we want more than that, it's pretty clear than 68,000 this year have placed too much strain on the organization, and we haven't quite honed on whether it's 30,000 or 40,000 or what the right number is for next year, and where we could get a better balance between installing them efficiently and not putting an excessive burden in the organization. So, while not a perfect answer, I think it kind of lays out pretty clearly some of the different dynamics going on there, Mark. And I hope that helps you.

Mark Petrie: Yeah, no, that's very helpful. I guess my follow-up would be: do you have a sense of how far into 2017 you'll end up being - assuming the growth-rates normalize at a rate that you're comfortable with and feel like you can manage - do you have a sense of when the profitability kicks in and some of these excess cost really fall away?

Jerry Fowden: I would kind of hope that by the time we get to the second half of next year, we would be in a better shape. Tom briefly mentioned we are putting some other cost in efficiency and straight-forward, good old-fashioned type cost control that Cotts used to in place that will help us next year, so we do know there are some specific and firm cost-reduction things that we've already decided on for the next year. But as it comes to the route side of things and optimizing those routes and rebalancing them, I think that will be progressively beneficial through the year and we should expect a reducing level of that kind of friction cost.

They'll be there on the first half of the year, and hopefully they'll either not be there or be much lower on the second half of the year. And we'll also kind of kind of firm up on a number. I don't know if it's 30,000 or 35,000, 28,000 or 40,000, but some level of new-customer-additions as we look at next year, but a nice rate of growth, but one that we believe we can handle in a much more balanced fashion, with somewhere between 15 and kind of a higher level of growth for this year 16.

Mark Petrie: Okay. That's great. Thanks a lot.

Jerry Fowden: Thanks, Mark.

Operator: And we'll take our next question from Derek Delay, with Cannacord Genuity.

Derek Delay: Yeah, thanks –

Jerry Fowden: Good morning, Derek.

Derek Delay: Good morning, guys. Can you just touch on some of the integration plans? It sounds like S&D is going slightly better than expected in the early months here and Eden Springs as well. Can you talk about some of that potential cross-selling or synergy capture that you expect to get next year and where you could be potentially higher on that?

Jerry Fowden: Ah, yeah, I'll have Ron in a minute with a couple of comments, which might catch him by surprise, which is why I'm saying it. Because Ron is on the call from a remote location and Ron is the CEO of S&D Coffee and Tea. To say a few comments, Derek, as you remember we had that modeling call on 17 August. We laid out within that our go-forward plans for both Eden and S&D. From memory, I think it was 1% organic top-line growth for Eden next year growing to 1.5 in the outer years, and for S&D it was about 3%. Then for the two businesses together over a four-year period, it was about 22 million dollars of synergy.

Tom was just discussing that DS would be able to take advantage of S&D's expertise and our intent would be for DS' office coffee business to procure its coffee supplies through S&D, whereas today they're both from alternative outside third party. So, that would be one classic example of a synergy.

We also held a big multiple supplier gathering in Europe just about four weeks ago, bringing DS Services and Eden Springs together, and all the suppliers of coolers and the different equipment they install for their customers to work on the consolidated range of coolers that we would want to a leverage of procurement scale. The quality and types of machines that we could both use that helps simplify the supply chain and reduce the

service cost, for the combined Eden and DS businesses we look forward. So, that's another area on water cooler procurement where there would be synergies.

We've also now agreed our approach towards implementing the appropriate SGNA structure between DS Services and Eden Springs and we would imagine that that would go live during the first quarter of next year and therefore there'll be some SGNA savings on that regard. So, there's a number of areas where we see synergies: $22 million in total over four years and I would say at the moment we feel pretty comfortable about the synergies we originally had in the plan for 2017, that if you recall from the modeling call, was $2 million for S&D and $2 million for Eden. We feel comfortable about that.

But you also mentioned that S&D got off to a good start, which they did, and they had signs of new customers, so, Ron, you want to chat a little bit about what's going on in the custom coffee area with regards to your customer approach?

Ron: Well, I think pretty much what I say would be redundant, Jerry, you summed it up very well. There are other synergies that S&D and DS are certainly working on as it relates to our category management model. We're talking of some of our larger food service customers, for instance, about their private label water program where DS can come in and talk to them and present a category management program, similar to what S&D does on our custom coffee and tea programs. So, that's very exciting and we've already got that underway.

Our business comes in chunks and we present a category management program where we talk to them about - our customers - about what we can do to help them grow their business. That has come along extremely well, I think we're ahead of schedule and 2017 looks extremely bright for us, as we've got a lot of potential new customers in the queue.

Derek Delay: Okay, thanks a lot. And Ron, just to follow up on that, can you remind me the average length of a customer contracted S&D? Is it closer to seven years?

Jerry Fowden: Well, Derek, it's less "contracts in S&D" because it's less like the DS Office Coffee Business. You've got to remember S&D supplies convenient stores, quick service restaurants, hotel chains. But I think from all of the due diligence we did for something like the top five or ten customers in that business, it was an average life of around ten years.

Derek Delay: Okay, great. Thank you very much.

Jerry Fowden: Thanks, Derek.

Operator: And we'll take our next question from Amit Sharma from BMO Capital.

Amit Sharma Hi. Good morning, everyone.

Jerry Fowden: Good morning, Amit.

Amit: Jerry and Tom as well, can you just help us provide context around the new customer additions. So, 68,000 through the first three quarters. What is it as a base, number-wise? Is it an additional 1%, 2%? How should we think about that? Or is that even the right way of thinking about it?

Tom Harrington: The net customer up roughly 3% on a year-over-year basis.

Amit: Okay. So –

Jerry Fowden: The only thing I would add to that, Amit - and we did mention it earlier in the year, and it's still a bit early to kind of go too definitive, but we did say that a lot of these incremental new customers had a very strong residential bias to them. If you remember, particularly flooding in strongly around the time of most newspapers carrying stories about the poor quality of municipal water, lead in North-East schools school water, Flint, this, that and the other. Therefore at the time, we said we should assume that they have a slightly lower consumption level, and that we would need to track their retention rates over time.

Now, as we do track these new customers, they are residential biased. Their consumption is maybe 15-ish% lower than where we would've historically been. They're still attractive customers that we would that we would want. And while we have not seen any difference or certainly no adverse difference, maybe there's a smidge of favorability, but we don't really know yet. So their churn rates, they appear to have in these early few months which might only be three, or six, or eight months, they appear to have the same churn rates as the balance of our other residential customers, so we'll continue to update this as time passes.

But obviously I meant – I think you can understand although we're tracking these new customers as a separate group, on churn, it could end up being three, or four, or whatever years before we can provide a definitive answer.

Amit: I think that's really helpful, just one more clarification on that. How many of that 68,000 have come online, or how many – so Tom talked about he was trying to catch up with those. Does that mean as we are modelling for contribution from these new customers going forward, is it a three month lag or longer?

Jerry Fowden: Yeah, Tom have you got a...

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Tom Harrington: Yeah, I mean the –

Jerry Fowden: Tom?

Tom Harrington: Our online percentages are pretty similar to the historical map. The bulk of these customers come from our in-store booth that we execute, and we reference that we typically suspend that in November/December because of the holiday season for the retailer, so that the vast majority will come in from the direct contact inside that retail outlet with our sales people and that customer.

Jerry Fowden: And just to add to that a bit because I think you were kind of asking something else in addition. I'm guessing we will have by the end of the quarter, we would have installed probably over 8,000 or 10,000 of those incremental 20,000 that came in, in Q3.

Amit: Okay, that's what I was asking.

Jerry Fowden: Yeah, did we have 58 of the 68 on board or something like that? I won't get it right, but that gives you a flavour. Actually –

Amit: Absolutely, and –

Tom Harrington: I mean just the – it's less than 5,000 as of this morning, so we – you know the point is that as the growth has slowed because of that suspension that we have now closed the gap, and almost caught up. So another week or so we'll pretty much be caught up and they will all be installed.

Amit: Okay, and then the last one on this topic is that how do we then reconcile the decline of net 2% in the organic business? Does that mean the rest of the businesses may be down 4% or 5%, and is that temporary? Do we expect it to come back?

Jerry Fowden: Yeah, I think the best way to expand on this and Jay might want to comment, and we did provide a revenue breakdown schedule within the press release. There was something like seven-ish million dollars of decline. That wasn't three and five gallon water to HOD water customers. It was things like office coffee services, where we believe the combination of DSS OCS business with S&D will give us a proposition where we can win in coffee.

Because it's not just about offices, we want a win in coffee whether it's a deli, a convenience store, or a gas station, a quick service restaurant, a hotel etcetera. So we do believe that both synergies and business proposition with DSS, OCS and SND working together, but as we look out over the next year or two, we're going to be in a winning position in coffee.

The other areas was weaker case pack water sales which was from a couple of factors. Frankly, we had some supply issues over the summer in changing a supplier because one of them was letting us down on service a bit in terms of meeting the quantities we were ordering. And our RSR's that sell the three and five gallon water as well as do the cross selling of small pack products, were frankly so busy rushed off their feet with all these installations and new customers. But the focus and the success of cross selling these additional ad-on sales took a bit of a hit as Tom mentioned.

So there's about there's about three percent of revenue missed versus where we would have wanted to have been in those kind of nothing to with three and five gallon water cooler sales. I don't know if we'll close all of that gap next year, certainly we feel we'll make substantial progress in coffee when we leverage OCS, and DS and SND together. We think we'll be in a better position on case pack water because unless [inaudible] third party supplier lets us down, we should have that issue in the summer months.

Retail is always a bit volatile, you know we had a good quarter one on retail this year Amit, I think in DS, if we go back and look, and we didn't have such a good quarter three, and as we know, supermarkets promotional programs, everything else, it does move up and down.

Jay Wells: Yeah and retail Amit, our goal as we looked at that as more of a fixed cost coverage amount, we just want to keep that flat. If you look over the past year, it is lumpy and bumpy, but if you look back the last 12 months I'd say it's flattish, this was just a down quarter.

Amit: Got it, thank you so much.

Jerry Fowden: Thank you Amit.

Operator: And we'll take our next question from Judy Hong with Goldman Sachs.

Jerry Fowden: Hi Judy.

Rita: Hi, this is actually Rita filling in for Judy.

Jerry Fowden: HI Rita.

Rita: So I guess I had a question, a follow-up on DS and I guess we have talked a lot about some of the issue in terms of the weakness and the underlying top line bit. As we think about 2017 and the 3% to 4% underlying sales growth algorithm, based on Easy Comms potential benefit from energy costs rising, and maybe some of the flows through of the

customer edition, trying to hit the PNL next year. How are we thinking about that 3% to 4% percent algorithm next year? Could you potentially overshoot that?

Jerry Fowden: Well, at the moment we're undershooting it, so I might not be so positive as to talk about overshooting it. We have said that we believe the operating costs will slowly improve as we go through 2017 but still be present in the first half of the year. We do have this kind of 3% growth which you know three to four is what we would look for in the three and five gallon water cooler business.

On the energy side of things, we don't benefit from energy and we don't really get hit by energy either in the services because we have this energy surcharge that goes up or down on a monthly basis based on the prior federal reported cost of diesel. So in effect that's a pass through. It can take our revenue up or down depending on whether that surcharge increases or decreases, but we should be neutral on the EBITDA line.

Rita: Okay, got it. Then just going into the growth that we saw in the quarter on sparkling water, what are the plans to expand a little bit further as you look to 4Q and 2017 in terms of either shifting capacity, targeting new channels and then how big do you think it can get for next year?

Jerry Fowden: Well certainly some of that is the fact that this as a category is a very attractive growth category and I think the category albeit different people design it slightly differently. I think the value added water category in total was up about 10 or just over 10%, and obviously 19% that's an area where we are performing at least in line with - frankly at the moment but I'm sure individual quarters will vary - better than the category. I

t is a priority focus for us, and it contains quite a variety of different products in that there are still products in sparkling products, there are unsweetened products, and there are

sweetened products, there are organic products as well as some that use enhanced sweetness. Therefore it's across that range of products including some ice type beverages that we have seen this 19% growth.

We believe that's an area that we will see further worthwhile growth as we look forward, not just for the fall but also 2017. It is an area that we have seen as key, and we have targeted something like double digit, a 10% growth in that area as part of our three year strategic plan you know on a year in and year out basis. The fact that it runs on the same identical line that we would otherwise be producing carbonated soft drinks on. It's a very attractive offset to that ongoing decline in CSD that it ensures we maintain good high levels of asset utilisation.

So it's a growth category in general, we are exceeding the category growth at the moment, we're targeting 10% compound annual growth in volume per annum there, and it provides this offset, what would otherwise be de-leveraging of the lines that we use for CSD's. I don't know if that covers it well enough.

Rita: No, that's great, thank you.

Jerry Fowden: Really glad, thank you. I think we have got time... for one more question.

Operator: Okay, thank you, and we'll take our final question today from Bill Schmitz will Deutsche Bank.

Bill Schmitz: Hey guys, thanks for squeezing me in, have been going back and forth from different calls.

Jerry Fowden: Thank you Bill, and always nice to hear from you.

Bill Schmitz: Thanks so much, you say that to all the girls. Can I – maybe I missed it, but can just tell me what the EBITDA impact was in aggregate, like year to date from like the over time, the shortage of like the co-packed water, maybe like lower customer service from existing customers because of all the new ads. And then like –

Jerry Fowden: Okay then, there's different bits there, but I think the easiest thing to break the down into some segments is you know the incremental cost, the positive costs of marketing to get 68,000 customers instead of 7,000 customers is 3 to 5 million per quarter. So here we are after three first quarters, that's going to be in the $10 to $15 million range for a full year to date basis, and that's the positive side of the equation where we will get the customers in the future benefit.

We have also had the more adverse side of that equation which is the friction cost associated with all the pressure that that has placed on our business. That was $5 million this quarter, and I haven't got in front of me a year to date number. But its three to four in the earlier quarter, so if you take five and you add on two lots of three and a half at seven, you have got you know twelve-ish million dollars there Bill, and the OCS and case pack water which was more on retail which was more over this quarter phenomenon than anything else. I think it was about $3 or $4 million.

Bill Schmitz: But OCS has been a bit a of headwind every quarter. It was really more the retail and the case pack water most likely this quarter. Okay, I mean so I mean is this being like way too aggressive, but is there like I don't know like $30 million of EBITDA that's latent, that comes back?

Jerry Fowden: Well, the higher than we would have wanted friction and operating costs should progressively come back as we go through 2017, and the rate of incremental marketing

expenditure on new customers is what I referred to earlier and you might have been on one of those other calls. We need to work out Bill what's the right level of new customer acquisitions as we look forward for 2017 and 2018.

What we know is we don't want it to be the 7,000 year to date for 2015, and we don't want it to be the 68,000 has overstrained our system year to date for this year. And we are thinking you know it's probably more likely to be into that 30,000 to 40,000 net new customer additions per annum, that provides an attractive ongoing incremental lift to the revenue performance without being so great that it overwhelms our ability to efficiently run the route to absorb these new customers.

Tom gave a more detailed answer to someone earlier on Bill, you know whereby he said , "Look, you might like that it was just 200 customers every week that turned up, spread across the whole country and you can stick one customer on every 10th route." Well it's not like that. You get 8,000 out of one marketing push in one geography and it overwhelms that location, and then a week or two later, a similar thing happens somewhere else. So we have got to find a different balance to bringing these new customers on.

Bill Schmitz: Got you. And do you have a sense for what you know ROI on the 10 to 15 million is?

Jerry Fowden: Well the average customer life is 4.2 years, these are residential customers, by and large which some 15-ish percent lower consumption. We are only – we are only six to eight months in to the churn of these customers, and we are trying to track whether they have any different characteristics with regards to customer churn that would make the economic difference.

We can say so far after six to eight months, we are not seeing any different or adverse customer churn. So assuming they have the same four and a bit year average life, we would be in the position that we're looking at something like a 15-ish month, could it be 16 month payback on these customers. Therefore we still see them as financially attractive.

Bill Schmitz: Okay, and can you just breakout the package for me, like the 10 to 15 that's sort of like strategic marketing span and the 12 million year to date friction. Like what do you sort of define as marketing and what do you define as friction?

Jerry Fowden: Yeah, and the marketing costs really are the costs of the complete costs end-to-end from attracting, speaking to signing up and installing a new customer, to the point that the cooler is in his home and it is up and running, and we say that to around $150 to $200 per customer. And it would contain things like the following, but it obviously depends if we got them through the web, we got them through a door knocking salesman; we got them through our retail booth program etcetera.

But if it was for example a retail booth program, there's the cost of putting the booth into that retailer for the Wednesday group to Sunday. There's the cost, the base cost of the two members of staff that would service that booth, there's the commission to those members of staff each time they sign up a new customer. There's the commission to the retailer for each new customer signed up where there is the requirement to return that if they don't stay a customer for a period of time.

There is the cost of the at risk odd going round to install the cooler, you know train the new customer as to how the cooler works and how the program works. If it wasn't a retail booth customer, and it was one you got through print on paper, then flying the ad in the coupon stuff that's in newspaper. There's probably a $50 off offer within that add for new

customers, and then there will still be the cost of the RSR going round and installing that cooler and training the customer.

So $150 to $200 per new customer is what's in their sales and marketing cost. The friction cost is really if you got 68,000 net new customers, what it means is we have installed something like you know 250 over 300,000 customers this year as new customers. And then you have had your normal customer churn off that four year life Bill, so you have uninstalled 150 that's 200,000 or something, so it's a tremendous amount of work. What we have learnt is going from 7,000 or 68,000 has overstrained the organisation, and we need to pick because I was mentioning earlier that right balance is it 30,000 is it 35,000, is it 40 – what's that right balance for 2017 where we can manage it more efficiently.

Bill Schmitz: Okay, that's helpful, and then I talked to Jude about this a little bit, but like December quarter usually is a pretty good digestion quarter right, so it's like you're not really adding customers like the boosts are down because they're selling Christmas trees, customers aren't really getting it, and so like...

Jerry Fowden: Yeah we should start to catch up on – Tom was mentioning you know as of this morning, we still had 5,000 of last quarter customers to install; we should catch up within the next week or two. We'll stop our retail booth program thanksgiving to New Year, and we'll reduce our market expense, so for the first six weeks of this quarter, we'll still have new customers coming in from marketing on the normal level of churn.

In the back, six or seven weeks to the quarter, we should have stopped having new customers in as we halt that booth program and stockpile marketing spend. We'll still have some regular churn, so we should start to get back on an even keel as we get to the end of Q4. And that means we can really work on optimising our routes and getting back

to a more efficient cost structure as we go through the first half of 2017 Bill, as long as we don't overload ourselves again.

Bill Schmitz: Okay, great, and then one last one, I know this call is going on forever, but are you going to re-price in the UK? I mean I asked the question on another call. I mean it seems like given the currency devaluation like normal macroeconomics, like that happens. Most guys push pretty aggressively to get some pricing through, I see people have had mixed success, but ultimately they get it. So I mean is it still too early or do you – is there a scenario where they – look where they you know pricing starts to inflate?

Jerry Fowden: That's a good question for the UK, and I'm sure the actual outcome will be a bit like you described Bill. We'll take two steps forward in asking for all that we need, and we'll take one step backwards and end up somewhere in the middle with a lag of is it three months or is four months. I don't know how many people are on this call because disproportionately not from the UK like me have read about and understood Marmite-gate in the UK [inaudible].

Bill Schmitz: Yeah, I saw that a 50% price increase.

Jerry Fowden: Well after getting relisted and thrown out of the stores for a while and that's a major leading brand and not a private label, Bill, where we all know the dynamics are a little bit different. So of course, yes, we are going for pricing. We are already in certain discussions with the trade, talking about it being effective in the early part of next year, and I'm sure you know the outcomes will vary slightly.

But it is something we need, but we'll still have that adverse lag because devaluation hits you pretty quickly, and then it takes the time to claw it back. We have always said our traditional business has a lead and a lag when there's commodity inflation or deflation.

Bill Schmitz: Okay, great. That's helpful, thanks guys.

Jerry Fowden: Thanks Bill.

Operator: And at this time I would like to return the call back over to our speakers for any additional or closing remarks.

Jarrod Langhans: Thank you very much for joining our call today. This will conclude Cott Corporation's Third Quarter 2016 call. Thanks for attending.