FINAL TRANSCRIPT

Cott Corporation

Second Quarter 2018 Earnings Conference Call

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PRESENTATION

Operator

Welcome to Cott Corporation's second quarter 2018 earnings conference call. All participants are currently in a listen-only mode.

This call will end no later than 11:00 a.m. Eastern Time.

The call is being webcast live on Cott's website at www.cott.com, and will be available for a playback there until August 16, 2018.

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 statement 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 the 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 second quarter 2018 earnings announcement released earlier this morning, or on the Investor Relations sector (sic) [section] of the Company's website at www.cott.com.

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

Jarrod Langhans — Vice President of Investor Relations, Cott Corporation

Good morning. Thank you for joining our call today as we present to you from Barcelona, where Eden Springs is headquartered, so we apologize in advance for any background noise.

Today I'm accompanied by Jerry Fowden, our Chief Executive Officer; Jay Wells, our Chief Financial Officer; and Tom Harrington, Head of our Route Based Services segment.

Jerry will kick things off by providing his thoughts on our operational performance during the second quarter relative to our expectations, as well as our full year 2018 outlook. He will then discuss our recently announced senior leadership changes before turning the call over to Jay for a discussion of our second quarter consolidated financial performance, as well as the results and expectations of our Coffee, Tea and Extract Solutions segment. Tom will then discuss the results of our Route Based Services segment, as well as provide his vision of our company over the next few years. Tom will then hand the call back to Jerry for some closing comments before moving to Q&A.

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

Jerry Fowden — Chief Executive Officer, Cott Corporation

Thank you, Jarrod, and good morning, everyone. Before I comment on our planned leadership changes—congratulations to Tom, by the way—I wanted to provide my perspective on our strategy, performance, competitive advantages, and the wider trading environment we've seen so far this year, in addition to some of the key plans we have designed and will implement as we look to the

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balance of 2018 and 2019 in order to continue our good top-line momentum and successfully accommodate various macro factors, such as inflation associated with higher transport and SG&A costs, the strengthening of the US dollar, recently enacted tariffs, and the green coffee commodity environment.

First, let me just remind everyone of the key attributes and competitive advantages of New Cott, and the strategic objectives we seek to deliver on in order to drive sustained value creation for our shareholders.

New Cott's attributes are a service company focused on the growth-oriented better-for-you segments of water, coffee, tea, and filtration solutions with a largely subscription-based or reoccurring revenue business model that has strong infrastructure-based barriers to entry; very low customer concentration; an attractive cash flow conversion rate; and an attractive free cash flow outlook of $115 million-plus in 2018 and $150 million-plus in 2019, alongside a strong balance sheet with long-term fixed coupon debt which alleviates any exposure to rising interest rates; plus the opportunity to execute overlapping value creating tuck-ins, as well as larger more strategic transactions to fuel further growth and value creation; and an attractive capital deployment strategy which includes a stable dividend, continued investment in innovation and organic growth, a plan to accelerate our rate of value-creating tuck-ins, and an opportunistic share repurchase program which bought back around $16 million of stock during the first quarter.

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This set of attributes and Cott's combination of organic growth and accelerated tuck-ins should drive a 3 to 4 percent revenue growth in 2018, and set us up well for attractive revenue growth in 2019.

So now let me turn my attention to our Q2 performance. I'm pleased to report our business is performing well, and we've continued to demonstrate attractive top-line momentum during Q2 with revenues of $604 million, up 4 percent versus the prior year.

In addition to good top-line revenue growth, Q2 also saw gross profit increase 5 percent to $301 million and adjusted EBITDA increased 2 percent to $83 million.

Now within Route Based Services, where we saw 7 percent top-line growth, we're starting to see the benefits of our high-density area, or HDA strategy, and the investment in over 100 additional salespeople within DS Services start to come through in both organic new customer additions and the channel mix of those new customers.

Our Route Based Services segment added 16,000 net new organic customers during the quarter, with both DS Services and Eden Springs showing net new organic customer growth, of which a good proportion were those all-important independent commercial customers.

In addition, I'm pleased to report our lowest customer quit rate that we've ever recorded. I believe this record improvement in quit rate is a clear reflection of the work undertaken by our route drivers to improve customer service, as well as the benefits from our US national customer care

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centre, which is performing excellently and has delivered best-in-class service metrics on things like speed-to-answer and first-call resolution.

Moving to our Coffee, Tea and Extracts segment, Q2 saw revenues lower by $8 million, with half of this due to the pass-through of lower green coffee commodity costs per pound, and the other half reflecting lower coffee volumes versus Q2 last year which, if you recall, was a very tough comp to lap with 13 percent coffee volume growth in Q2 last year. You can see this in the fact that S&D's two-year coffee volume growth is up 8 percent. That's Q2 '18 over Q2 '16.

I believe we're set up well for success, as S&D continues to win market share; bring on board new customers; grow it's cold coffee, liquid, and extract business; and execute additional plans to continue to improve its cost structure and operating efficiencies.

As we look to the second half of the year, I'm pleased to report that the second phase of our synergy capture is on track and will come on stream, and that S&D has signed an agreement with a well-recognized national chain to replace their existing coffee supplier in around 1,200 outlets that will provide over 2 million incremental pounds of coffee per year, starting in December 2018.

Overall, we're pleased with the performance of S&D, and believe we're on track to deliver against our acquisition model and growth expectations.

So with our underlying business performing well, let me just spend a little time on the plans we're putting in place so that we continue to deliver against our growth objectives.

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As we've stated in the past, one of the many positive attributes of New Cott's business model is our low customer concentration and our low exposure to the retail channel. This business model and customer mix provides us with significant flexibility to adjust pricing across our customer base when factors, such as the macro items mentioned, warrants such action. Thus, we have started to communicate carefully planned and specific price increases and price adjustments to our US Route Based Services customers.

These various pricing actions and price adjustments are being phased in between August and December 2018, and are designed to fully offset the increased cost discussed today. These Route Based Services pricing actions, coupled with the next phase of S&D synergies being implemented, alongside our organic growth, new customer wins, and tuck-in activity, as well as the many other innovation and efficiency programs we've discussed in the past, means we're confident that we can continue with our positive top-line and EBITDA momentum.

So with a solid quarter behind us and a clear path and set of actions to continue to grow in the second half of 2018 and in 2019, let me now turn to our planned leadership changes announced this morning.

First, I'd like to congratulate Tom and again say how pleased I am to see him being given the opportunity to take over the reins of our company beginning in fiscal 2019, as we continue to execute against our strategy. Tom's selection as Cott's future CEO has been the result of a thorough and

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thoughtful succession process undertaken by Cott's board over the last couple of years, which concluded that Tom was the best choice to lead Cott into the future.

As an accomplished, results-oriented leader with significant industry knowledge and operational experience, we're confident that with the support of our leadership team, including Jay sitting next to me today, Tom as CEO will continue to execute our strategy and operate our business with the same drive, passion, discipline, and dedication that we've seen from our leadership team over the last 10 years.

As you have read in our press release this morning, I will remain with Cott as Executive Chairman. In this new role and capacity, I look forward to working with Tom and the tremendous leadership team at Cott in order to provide a smooth and seamless transition. My, the board's, and Tom's objective is to undertake this transition so that Cott continues to execute against its goal of being the preeminent international route-based, direct-to-consumer water, coffee, tea, and filtration service provider with strong organic growth, superior shareholder returns, and strong free cash flow.

With that, let me now also thank Dave Gibbons on behalf of the board for his leadership and tremendous service to Cott, and for being such an excellent Chairman over the past 11 years and for steering our company, and its strategy so wisely.

So on that note, let me hand the call over to Jay to walk through our consolidated results.

Jay Wells — Chief Financial Officer, Cott Corporation

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Thank you, Jerry, and good morning, everyone. Consolidated revenues from continuing operations increased by 4 percent to $604 million.

Revenue growth was driven by general growth within our Route Based Services segment, as well as the acquisition of Crystal Rock and some favourable foreign exchange. This growth was partially offset by the items Jerry just noted within our Coffee, Tea and Extract Solutions business.

With a number of moving parts this quarter, let me break out the various components of our revenue growth for the second quarter of 2018, and provide some modelling expectations as we look out to the remainder of the year.

First, we had Route Based Services revenue growth of $27 million, which includes $5 million of favourable foreign exchange, approximately $13 million of benefit from the addition of Crystal Rock net of the PCS sale, as well as growth within HOD water and retail sales.

As we look out to the back half of the year, we would continue to expect our Route Based Services segment to generate around 3 percent top-line growth alongside around $10 million of additional quarterly revenue from the Crystal Rock transaction net of the PCS sale. This would then be offset in part by a foreign exchange headwind of around $3 million per quarter using the exchange rates that existed at the end of July.

Our Coffee, Tea and Extract Solutions segment provided a $8 million offset to our Route Based Services revenue growth, with half coming from reduced cost of coffee, as the benefit of which is passed through to our customers.

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As we've stated in the past, the business model for our Coffee, Tea and Extract Solutions business is one in which we basically add a fixed fee on top of the cost of coffee. So with green coffee commodity market prices in decline, we have seen some reduction to our top line, but an offsetting reduction in cost of goods sold. We'd expect to see a similar trend in both the third and fourth quarters of this year and into the first quarter of 2019, when we would then begin to lapse the lower cost of green coffee.

The other half of the $8 million came from reduced coffee volume that was the result of lapping a 13 percent growth quarter in the prior year, which included a pipeline fill for new customers. We expect to return to coffee volume growth in the second half of 2018 and into 2019.

When you add up all the pieces, you get an increase of 4 percent, or in excess of $20 million of net top-line revenue growth for the second quarter of 2018, and we remain confident in being able to continue to drive 3 to 4 percent top-line growth in the back half of the year.

Gross profit increased 5 percent to $301 million during the quarter, driven primarily by overall revenue growth, offset in part by increased costs within our Route Based Services segment.

Interest expense from continuing operations was $19 million in the quarter. As a reminder, our 450 million 5.5 percent euro debt will fluctuate based on the latest euro to US dollar exchange rates, as will the US dollar interest expense associated with this debt.

With that said, we continue to expect around $19 million of interest expense per quarter based on current foreign exchange rates.

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Adjusted EBITDA from continuing operations increased to $83 million, with general top-line growth from our Route Based Services segment and the acquisition of Crystal Rock being partly offset by lower coffee volume and increased costs within our Route Based Services segment, including around $2 million of freight cost, as well as some increased costs from the additional headcount associated with the investment in our commercial sales force expansion.

As we look out to the back half of the year, we expect to continue to see some level of increased costs, which Tom will cover, as well as the levers that we will utilize to offset these items.

Turning to income tax. Income tax expense was $2 million compared to a $2 million tax benefit. With regards to cash taxes, we still expect our cash taxes to be in the 7 million to $10 million range in 2018 and for a number of years to come. On a full year basis, I would suggest that you model income tax expense to be in the 5 million to $10 million range.

Adjusted free cash flow from continuing operations was $12 million for the quarter compared to $37 million, as we had interest payments on both of our senior notes in the second quarter of 2018, which accounted for over $19 million of additional cash usage relative to the prior year, as well as some timing around working capital.

With two interest payments in the second quarter, we will not have an interest payment in the third quarter, which will benefit our free cash flow.

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As it relates to our full year 2018 and 2019 expectations, we remain committed to achieving our target. That means 115 million to $120 million and $150-plus million of adjusted free cash flow for 2018 and 2019, respectively, which includes CapEx of 115 million to $120 million.

Let me now cover the operating performance of our Coffee, Tea and Extract Solutions segment. On a year-to-date comparable period basis, we saw positive coffee volume growth, and we continued to see the key drivers of our growth during the year coming from a variety of areas, including ongoing growth from our customer base within the on-the-go coffee and tea market; capturing additional market share within the on-the-go foodservice channels; growth in new channels, such as hospitality, government offices, and hospitals; and increased penetration into the menus of our current customers in the areas of cold-brewed coffee, extracts, ingredients, and additional specialty product offerings.

We have a robust pipeline of potential new business and have recently seen a number of wins, including picking up a large national chain that Jerry discussed, increasing production for one of our larger customers, and national liquid cold coffee and extract production wins, to name a few.

In addition, over the last year we've started to see requests from our customers to participate in discussions and proposals for the broader international market whereby we could provide either our expertise, or various extracts and concentrates, which are easily transported overseas.

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It is our strong liquid extract coffee growth and the robust pipeline, plus the recent wins just noted, alongside other opportunities such as these that allow us to remain confident in our EBITDA and free cash flow growth goals for this year and into the future.

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

Tom Harrington — Chief Executive Officer, DSS, Cott Corporation

Thank you, Jay, and good morning, everyone. Before I spend a few minutes on the recent leadership changes, I'd like to walk through the operations of our Route Based Services businesses, which saw a revenue increase of 7 percent.

For the quarter, key drivers of revenue growth, in addition to Crystal Rock, included 5-gallon water growth, HOD PET growth, and growth within our retail divisions. Gross profit increased 7 percent to $258 million, driven primarily by revenue growth, offset in part by increased costs, including freight, which we discussed on last quarter's results call.

On that note, let me give you an update on some of our other 2018 initiatives and investments. During the quarter, we placed over 40,000 Storm coolers in the US and Canada, and we're making good progress with our combined water and Keurig-authorized single-cup dispenser in the US, in addition to working on a new and improved design. And we are in the process of completing a European model, which will include a single-serve component that is popular within the European community. These new products should launch sometime around the middle of 2019.

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As Jerry noted, we saw a good net increase in our customer base in the quarter driven by a number of efforts, including in an investment in sales headcount dedicated to growing our commercial customer base in the US. We've increased this headcount threefold since 2017 to over 150 associates.

And although this increase in headcount comes with a cost, we believe that it is the correct action to take for a couple of reasons. First, it begins to better balance our mix of customers between commercial and residential accounts, and second, it will benefit us in the long term as commercial customers are not only our most profitable accounts, but they are also our longest-lived accounts.

As we noted earlier in the year, in conjunction with the expansion of our commercial sales force, we have also redesigned our approach to residential marketing, including our retail booth program. In essence, we are taking the high-density area, or HDA approach, that our European operation is implementing and we are applying this to our US-based residential marketing effort, where we are focusing on the regions that we're able to provide the best customer service and return on investment, which are tied to the distribution centres where we have the greatest routes and customer density.

As a result, we are concentrating our residential marketing activity within HDAs, and in turn, reducing our costs in certain regions that we do not find as attractive.

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In addition, our high-density effort area focus in Europe continues to progress well. In most of our key markets, we enjoyed customer growth and continue to see a reduction in our overall customer churn, which is instrumental in driving sustained growth over the coming years.

As an update to Crystal Rock, in May we successfully transitioned the Crystal Rock business over to our IT platform, and we're well on our way to fully integrating the business. I want to thank the associates that have worked so hard to complete this integration in short order.

The Crystal Rock acquisition remains on track to hit the original acquisition model projections provided on our last call, and we've begun to review opportunities within the region as it relates to small tuck-in acquisitions, as well as in working with some of our partners, as we now have a broader reach in the northeastern part of the United States.

Looking at some of the key macroeconomic factors that we've seen this year, as well as what we see for the back half of 2018 and into 2019, I would say that two key items would be inflation and tariffs.

Let's start with inflation, which has been affecting Route Based Services businesses to varying degrees during the first half of this year, primarily in a form of increased costs associated with utilizing long-haul third-party carriers. This is something that in the wider market will moderate over time, but will remain with us in the short term.

As a reminder, 90 to 95 percent of our US transportation costs are linked to our routes and our route sales representatives who drive the local delivery vehicles. Here, we have an energy

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surcharge on customers' invoices that increases or decreases each period based on the Department of Energy on-highway diesel price, and in effect, acts as a pass-through mechanism, both up and down, for changes in the cost of energy.

Our route sales representatives are paid primarily in the form of a commission, which allows for their annual compensation to increase as we grow our revenues and add customers to their routes. And they are well aware of this, as these associates generate around 25 percent of our new customer additions annually. As a result, we've not seen incremental inflation-related increases amongst this category of associates.

The other 5-plus percent—a much smaller element of our transportation cost—is the longer-haul or freight lanes between regional production centres and distribution centres. Here, unlike other businesses, we use many more in-house long-haul drivers and use fewer third-party carriers, thus the impact on us from the current spike in third-party carrier costs has been much smaller than the impact of many other companies.

We began the year by increasing wages to these associates in order to better compete within the market and avoid the increased costs associated with the third-party carrier costs. Although we filled some of these positions, we have begun the contract with third-party carriers for a number of lanes to avoid the significantly increased costs associated with spot rates. We are thus likely to continue to incur higher costs in the back half of 2018 and into 2019 as a result of contracting out these lanes.

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In looking at our second quarter results, as well as our expectations for the back half of the year and into 2019, we are beginning to see some market inflation within our P&L from areas such as wages, health and wellness cost increases, and incremental costs associated with our headcount expansion in commercially focused sales positions.

As many of our peers have already noted, and as we have discussed on our recent marketing and conference calls, with unemployment around 4 percent nationally, inflationary pressures are not surprising. As a result, we have developed and put into action a plan to increase prices across our customer base.

The phasing and implementation, which started in the third quarter, of the different elements of the plant were designed to fully offset these transport and other inflationary costs discussed. In an effort to maintain a competitive advantage, we’re going to refrain from providing specific details around which customers will be impacted and at what level, but the implementation has started and has been put through a thorough vetting process.

In addition to pricing, we’ll also continue to move forward on several cost-efficiency programs, such as the implementation of new logistics and customer service-related tools that have been designed to increase the density of our routes and allow us to provide a higher level of customer service, which in turn should drive increased efficiency and longer customer lives.

Turning to the recently announced tariffs on Chinese-related imports. We currently procure a variety of our coolers from China, thus as things stand today we may have a modest increase of 2

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million to $3 million in CapEx exposure in 2018, although we're still working through the terms and definitions of the newly enacted tariffs and have filed for product exemptions.

In an effort to get ahead of the situation, we are working towards increases in our cooler rents as an offset to these potential costs. As a reminder, our coolers have around a seven-year life, thus it would be a relatively modest rental increase per month required to offset the tariffs.

We're also looking at a number of initiatives that we've been working towards as well, which includes looking at alternative suppliers and updating our refurbishment policy to increase the useful life of the coolers.

While we'd prefer not to see these types of costs impact our business, we understand that these external factors come and go with time and with our recurring revenue model, customer service focus, lack of customer concentration, and pricing power, we are well positioned to manage these types of issues, especially when comparing us to the broader market in general, and as a result, we remain confident in delivering on the expectations we have set for ourselves.

As it relates to the leadership changes that we announced this morning, I wanted to start by thanking Jerry and the Board of Directors for the confidence they have in me. As DS services was the first key transaction in the transformation of Cott over the last five years, I've been privileged to be a part of this transformation.

Jerry and I are very much aligned, and I welcome the opportunity and appreciate the trust that Jerry and the board have placed in me to continue to build upon the successes already achieved

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at Cott. I'm excited about continuing to work with Jerry and Cott's senior leadership team, including those members sitting with me today, to further build our leadership position with the goal of being the preeminent international route-based, direct-to-consumer water and coffee solutions service provider.

As the head of our services business, I've been a little deeper in the operations of our business over the last few years and, therefore, I've incorporated some of the key concepts and focuses from our operating segments into what I see as our equation for creating shareholder value, that being through reliable, recurring, and predictable growth in revenue and free cash flow generation by: one, becoming our customers' favourite direct-to-consumer beverage service provider and premier water, coffee, and filtration company through an enhanced customer experience, which includes ongoing analytics of changing consumer behaviour, implementation of new and relevant customer touchpoints through our web and mobile platform, continued cost efficiency initiatives, and instilling a service-oriented culture across our businesses; two, innovating with products and services across our leading platforms through the utilization of current technologies that deliver the appropriate customer experience, as well as effective sustainability practices and stewardship; and third, investing in our associates, the lifeblood of our organization, with effective development, career progression, competitive compensation, and the appropriate work–life balance which empowers our associates to drive sustainable customer satisfaction and growth.

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With this as our guide, I believe we are set up to grow well into the future as we continue on our path of shareholder value creation.

As I work towards taking on my new responsibilities in 2019, I want to assure you that the DS Services business that is close to my heart will be in good hands. Dave Muscato joined our team as President of DS Services business beginning in of April of year. Dave is an excellent executive that has extensive experience in the HOD segment. He previously worked as president of a home and office oil delivery business, as well as president of Schwan's home delivery business segment. Prior to that, he spent 20 years with Nestlé's home and office water business here in the US, where he lead the US home and office water business. So I can safely say Dave is one of the few key executives in the US with as much experience, industry knowledge, and passion for home and office water as I have.

So on that note, I'll now turn the call back to Jerry.

Jerry Fowden

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

Cott has undergone a significant transition from a mature, low-margin, private label carbonated soft drink business with high big-box retail customer concentration to a growth-oriented, higher-margin business with much lower customer, product, and channel concentration.

In essence, although we operate within the consumer sector, we are now a service-based business that no longer mirrors the exposures of the CPG market. This diversification strategy was

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focused on building leadership positions and platforms in growing categories, including water, coffee, tea, and filtration services, with the benefits of our new business, including predominantly reoccurring revenues, strong infrastructure-based barriers to entry, low customer concentration, and strong cash conversions. These business attributes, along with a very full and attractive pipeline of small to medium tuck-in acquisitions that we are currently working on, plus the balance of our capital deployment strategy which supports investment in innovation and growth, alongside a stable dividend and an opportunistic share repurchase program, positions us well for the future.

In addition, we have the balance sheet to be able to execute on large-scale complementary transactions as well. We continue to look at and review multiple opportunities particularly in the water space, where we see the greatest number of opportunities for transactions and the highest potential for overlapping synergies.

That said, we have been and will continue to be disciplined in our approach and all such opportunities. We will not execute anything unless it meets our stated financial and strategic objectives.

In looking out to the balance of 2018 and the full year with the plans and actions outlined today, including the pricing that we're implementing this quarter, we remain confident in reaching our $2.35 billion-plus revenue goal, as well as our 2018 and 2019 adjusted free cash flow goals.

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We're excited about the growth prospects of both our Route Based Services and Coffee, Tea and Extract Solutions segments, and believe in the prospect New Cott offers its shareholders for value creation as we execute against our plans.

So on that note, I will now turn the call back to Jarrod.

Jarrod Langhans

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

Operator, please open up the line for questions.

Q&A

Operator

Certainly. As a reminder, if you would like to ask question, please press *, followed by the number 1 on your telephone keypad.

Our first question is from Peter Grom with JPMorgan. Your line is open.

Peter Grom — JPMorgan

Thanks, and good morning or I guess good afternoon for you guys. So first, Jerry and Tom, congratulations. I wish you guys both the best of luck.

Jerry Fowden

Thank you very much indeed.

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Tom Harrington

Thank you.

Jerry Fowden

And sorry if the background noise came across too bad. It's pretty busy here in the centre of Barcelona.

Peter Grom

No worries at all. So you guys discussed pricing actions designed to mitigate freight and general inflation in the Route Based business, so how should we think about the consumer response? And would you expect any impact on consumption or new customer growth?

And then second, are you seeing or hearing anything from your competitors on their pricing strategy? Thanks.

Jerry Fowden

Yeah. I'll make a few comments, and then I'll pass over to Tom. I think the first thing to highlight is, as I mentioned on the call, we've just had our lowest-ever rate of customer quits across our Route Based business. That's both in North America, as well as in Europe. So we think we're in a pretty good place when it comes to the satisfaction of our customers with the service that we offer.

When you couple that with the new customer wins we've been getting as we increase our sales force in that area from around 50 to over 150, with a strong bias there towards these independent commercial customers rather than residential customers—they're the long-lived,

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higher-margin customers—we feel that our customer pipeline is looking pretty attractive. And we are seeing not just within the water space, which I think one analyst mentioned in his note today that prices are going up, we are seeing price increases in other service-related companies. So we think the consumer expects it. Our customers are in a good place with our lowest quit rate ever, and we're making customer gains.

But, Tom, more specifically on the pricing and the phasing-in of this?

Tom Harrington

Yeah. We've discussed in the past that component of pricing is one of the three levers in our revenue growth. So we have a long history of regular price increases to our customers, so our confidence level is high, driven especially by to Jerry's point, lower quit rate, higher retention in 2018 thus far.

Jerry Fowden

So hopefully—

Peter Grom

Great. Thank you.

Jerry Fowden

—that fits the bill, but any follow-on there?

Peter Grom

No, that's it. That's very helpful. Thanks.

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Jerry Fowden

Thank you.

Operator

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

Amit Sharma — BMO Capital Markets

Hi. Good morning, everyone.

Jerry Fowden

Good morning, Amit. I think it might have been you that put in your note that perhaps there was pricing in other bulk water companies, but I may have got it wrong. Anyway, what's your question?

Amit Sharma

No, we've definitely seen that, or at least heard it from investor sources that one of your biggest competitors is taking pricing there. Just on that, Jerry and Tom, both, so clearly the impact of inflation is coming through in this quarter as you look into your gross margin and SG&A. How should we think about the cadence of as you get pricing through how will it flow through to your P&L in back half and in 2019? Can you just help us frame that?

Jerry Fowden

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Yeah. I mean, Tom can maybe comment in a bit more detail, but we did start to communicate to our customers one of the elements of this increased pricing during July, and that element will go into effect in August. There are other elements to this pricing and they're very specific in their nature, and they've been well planned and vetted by our team, including for example, Tom mentioned the plan to make some small pricing adjustments with regards to coolers, given that relatively modest potential tariff impact. And there we're still working on whether there are ways around some of that as well, and we have filed for exemptions.

So there's a number of areas for this pricing. Each one will be communicated to our customers with an advanced lead time, and they will phase in such that they will all be implemented by December of this year. So the actual effect of the price going up is phased in between August and December, and the communication that they will be going up is from July through to November.

So everyone gets advance notice, and so far from the communications we've made in July—and I think, Amit, you've seen our call centre where we track calls every which way but loose—we have not seen a significant increase in customer calls related to the first piece, the first phase of that pricing.

Tom, I probably said too much already, but over to you.

Tom Harrington

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I think Jerry did a good job covering that. The first leg of the stool is the 5-gallon returnable customer base. Those customers have in fact been communicated to, and we would expect to see that flow through over the course of the middle of the third quarter by the time it's complete.

And to Jerry's point, we certainly get a few more calls, but it's not anything that's of meaningful impact in the centre. So we're pleased with the early start of that.

And then I will tell you that we need to do more work on understanding the impact of the tariff, as we've suggested. When we understand the full potential and impact of that, then we'll execute pricing increases on core customers before the year is over.

Jerry Fowden

And we'll give you, Amit, and everyone more guidance. At the moment this tariff space is moving around a bit. Tom and his team's doing a great job at looking at whether we can buy certain of them from other countries, and that is viable on a number of the models. So as we kind of are able to dot the i and cross the t there, given it's a very small item—we think maybe 2 million to 3 million for 2018—we'd like to see that amount be even lower. And we're working on various things to achieve that. The other thing in—

Amit Sharma

All right.

Jerry Fowden

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—regards to the pricing is I think what's clear here is while we have a business where we can take price, we are taking this price in order to offset those transport and other inflationary costs we've discussed. And if unemployment's staying around this 3.8 to 4 percent level, as you mentioned, Amit, it's not just going to be us; this is going to be across industry in general.

Amit Sharma

Got it. And then, Jay, just a quick one for you. The new coffee customer win starting in next year, and then as you look at next year also start to lapse some of the volume headwinds that you're facing from a comp perspective, can you just walk us through the rest of the year how does coffee look like? And then is 4 percent still the growth for next year, given that you're getting a pretty significant win in terms of new customer?

Jay Wells

No. I mean, first of all, thanks for the question, Amit. Keep in mind when you look at the back half of last year's, not as much as we saw in Q2 of last year, but back half of last year we did have 8, 9 percent volume growth in the back half of last year. So we still are lapping very good comps from pipeline fills and bringing on new customer wins over the year.

But with green coffee pricing, keep that in mind I did talk about that, we're still expecting a 1 percent drag on consolidated top-line revenue. But again, as we say, we back-to-back it to our customers; really shouldn't have any type of significant drag on our profitability, but it will be roughly a $6 million per quarter just top-line headwind and then lowering of our COGS.

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As I mentioned, we have the 9 percent growth that we're lapping in the back half of the year, but we're still looking for 3 percent coffee volume growth, and it really is we've got good growth in liquids, good growth in extracts, and really continuing to grow.

Amit Sharma

And just one last one—

Jerry Fowden

So the only thing I'd add to that, Amit—and Jay mentioned the good growth in liquid and extract—I wouldn't be surprised as we look out over the next kind of 12, 24, 36 months that the mix of our growth comes with a greater leaning towards this cold-brewed coffee, liquids, and extracts, where certainly we're seeing good double-digit growth in that area, as you know, for the last couple of years, and there are a couple of things bubbling up in that new customer win pipeline that are particularly biased towards that side of the business.

So overall, we are still looking forward to volume growth in S&D, albeit we've got some tough comps to lap this year, but nothing's changed with that kind of long-term vision of 3 percent sort of volume growth. It may just come with a bit more of a bias to cold-brewed coffee, liquids, and extracts.

Amit Sharma

And that is generally a better margin business for you, isn't it?

Jerry Fowden

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I mean, certainly on average it is, albeit that our margin across our roast and ground coffee varies wildly dependent on the segment or sector you're serving as to whether it's that 10, 11, 12 percent of our business that's route-based where the margins are high, or whether you're a big national customer where the volumes are much higher, and therefore the pricing is more competitive.

Amit Sharma

Just one more, if I may. So just on that, Jerry, I see you're not changing your 2019 fee actual (phon) guidance. But if we read through the comments, lots of positive things happening; pricing coming through, which the headwind is this year, pricing is coming next year; coffee, new customer win, perhaps shift to higher-margin business; customer adds looks pretty solid. I mean, why shouldn't we expect that 2019 may be some upside to what the outlook has been?

Jerry Fowden

Well, I think as Oliver Twist once said, "More, please." is always a good statement. But I think my fair response, Amit, would be we're not changing it up, and we're not changing it down. And we did have an odd question, I think, within the last few hours from someone about helping them bridge our 2018 free cash flow. Surprised we've not had it yet, but I know Jay has all the numbers ready in case that helps anyone.

Jay Wells

And I mean, Amit, with your question, as we always say, it's a little bit too early in the year to update our guidance for next year, but we will do it as we get into next quarter. But one question

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we did get a little bit is the first half of the year our free cash flow has been a little light, and it's a combination of interest payments falling more into the first half of the year than the second half, just with how they end right at the end of the quarter. And we've had some negative working capital that should reverse.

But to bridge people in case that question's out there, if you look at even looking at last year's adjusted EBITDA, we should have growth upon that. But if you take about 155 million of adjusted EBITDA on the back half, you minus 55 million to 60 million of CapEx, about 14 million of interest and about 3 million of cash taxes, then we should see about a 20 million, 25 million reversal in working capital. That will give us about 100 million of free cash flow generation in the back half of the year.

Amit Sharma

Got it. Thank you so much.

Jerry Fowden

Thank you, Amit.

Operator

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

Mark Petrie — CIBC

Yeah. Good morning, and all that. My congrats to Jerry and Tom. I just wanted to follow up with—

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Tom Harrington

Thank you.

Jerry Fowden

Thank you, Mark.

Mark Petrie

Yeah. I just wanted to follow up on the discussion around the water business, and clearly you're having success with the increased focus on higher-density markets. And so a couple of things on that, I guess, just mostly to clarify. Of the net customer adds of 16,000 in Q2, was that all commercial? And do you see that as a reasonable run rate for growth? And I guess was it all organic? Or was part of that from tuck-in acquisitions?

Jerry Fowden

All of that 16,000 was organic. We had, obviously, customer tuck-in acquisitions with Crystal Rock and some very small ones on top of that. That 16,000 was purely net new organic customer growth. And it was—I won't get this right, Mark—but it was 10,000-ish in North America and 6,000-ish in Europe, something like that.

And no, it was not all commercial because, as Tom mentioned, 25 percent of our new customers come through our route guys, and that's from across their whole customer base. But we clearly saw a good list in these independent commercial customers within that, and a good share of the mix. And we've also seen as the last three or four months have unfolded the productivity for each

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of these new commercially focused salespeople increase. And by productivity, I mean how many organic independent commercial customers do they each sign up on average each day, week, or month? And when they were brand new in February and March, their productivity rate was—and Tom will know the exact figure; I know he showed me something yesterday—but it was kind of less than half of where their productivity rate was last month as their experience and competence grows.

Tom Harrington

Yeah. And further clarity, the Eden growth is principally commercial because we don't have a developed business yet today on the continent. The DS growth I would think of it as 50-50, so half commercial, half residential.

So in aggregate, about two-thirds was commercial, which is where we said we would spend our energy, but we still like residential, so we need them to be a part of our mix.

Mark Petrie

Okay. That's helpful. Thanks. And I guess just to follow up on that, does the success of that effort from a sales perspective, does that affect your—and I guess maybe the focus in general on the higher-density areas—does that affect your pipeline for tuck-in deals at all? Or sort of how you think about tuck-in deals?

Tom Harrington

It has not to date. So we're opportunistic. We focus tuck-ins certainly on our best ability to execute, but we've not had an interruption or a collision of tuck-ins versus organic, if you will. And

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remember that the tuck-ins generally—this will be overly general—are commercially focused, right? So we have more residential customers in our base than a typical tuck-in, so it's a lot easier for us to execute than in that footprint.

Jerry Fowden

No. And I think as I said on the prepared remarks, Mark, we are working on a relatively full tuck-in pipeline at the moment. There's a spread in there from ones that are absolutely tiny to ones that Jay would call the chunkier sort of tuck-ins.

Can never tell 'til everything's done, whether they all come through, but we do feel comfortable and confident about that kind of ongoing vision we have of more than doubling up on our rate of tuck-ins.

Mark Petrie

Okay. That's great. Thank you. And then I guess just one other question around your comment about opportunities in cold brew and extracts and international, understanding that you could fulfill part of that from your existing assets, but is that an area where you could prioritize M&A? And is there anything … any sort of insight you can offer or provide in terms of the market structure or consumer preferences in Europe versus what we see in North America?

Jerry Fowden

It is something that we could do by M&A, but I think it would be wrong to say that that's our current priority. It's always impossible to fully pick the path towards growth in these high-growth

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categories. Whether that was energy drinks five, six, seven years ago; craft beers two three, four years ago; or cannabis in Canada this year, what you often find in these areas is tonnes of new capacity gets laid down, transactions are done at inflated multiples, the market settles out, multiples come down.

We have a very attractive existing infrastructure in this area. We have also developed over the past 12 months good partnerships with operators where we provide the know-how and the coffee, and they have some capacity for the conversion. So we believe between our own operations between these partnerships where it allows us to kind of cost-share but have much more flexibility in ramping up our production capability, we're well set to carry on with this increased growth in that liquid and extract area.

Mark Petrie

Okay. That's excellent. Thank you very much.

Jay Wells

Thank you.

Jerry Fowden

Thank you.

Tom Harrington

Thank you.

Operator

Your next question comes from Derek Dley with Canaccord Genuity. Your line is open.

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Derek Dley — Canaccord Genuity

Hey, guys.

Jerry Fowden

Good morning, Derek.

Derek Dley

Good morning. Just wondering, can you guys break down the organic growth at RBS in terms of pricing, consumption, and new customers? Was it still roughly like a third, a third, a third across the board?

Jerry Fowden

Tom? I mean, from the data I've seen—and then you can chip in—I think our underlying North American growth was somewhere in the—if you adjust for PCS, this is—somewhere in the upper 2 percent sort of level; something like 2.8, 2.9 percent. Now within Aquaterra there was a smidge of foreign exchange. So if you wanted to take Aquaterra out of there, you might say DS Services in the US was, I don't know, 2.3, 2.4, 2.5, somewhere around there.

I would say in this quarter the new customers, despite us being very pleased at the 16,000 because they came in phased during the quarter—if you exclude Crystal Rock or tuck-ins—the new customers we're phasing in this quarter so you get more benefit next quarter and the quarter afterwards—because we only took those commercial salespeople on in February, March, and their

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productivity was improving—I would say you have a little bit more in volume and a little bit more in price than you have in new customer wins compared to that normal third, third, third.

But Jay's been trying to look at that number—

Jay Wells

Yeah. No. No. I mean, I called it out on my prepared remarks. Really where we saw the growth is in HOD 5-gallon volume and the retail area. So I would say it was probably heavier toward the volume side this quarter; a little bit of price, but heavier on the volume side—

Jerry Fowden

Yeah. And I think they had a better quarter on the PET that we sell to those HOD customers off our route trucks as well.

Jay Wells

Yes.

Jerry Fowden

So hope with us all chipping in there, Derek, we got to a reasonable answer in the end.

Derek Dley

No, that was perfect. That was perfect. And then just in terms of S&D, can you guys—like is it possible to disclose or a rough estimate of what your volume growth would've been if you could adjust it for that large customer fill last year?

Jerry Fowden

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I think the easiest way to look at that and I've tried to give people what I'd call an easier proxy, as you know our goal with S&D is 3-plus percent volume growth, and as we look out over the years we're comfortable with that. It may come a bit more in liquid and extracts versus roast and ground, but when you look at Q2 2018 over Q2 2016, i.e. you're taking out of the equation that issue of lapping a 13 percent growth quarter, the two-year growth is 8 percent.

So I think that's a very fair way of looking at it. Over two years on a normal quarter Q2 '16 versus a normal quarter Q2 '18, you've had 8 percent growth. Now whether you want to call that 4 each year or a 5 and a 3, kind of up to you, but I think it shows things are pretty much on track.

Derek Dley

Okay. That's great. Thank you very much.

Jerry Fowden

Thank you, Derek.

Tom Harrington

Thank you, Derek.

Operator

And we have no further questions at this time. I'll turn the call over to Jarrod Langhans for closing comments.

Jarrod Langhans

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

Thanks for attending.

Operator

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

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