Cott Corporation

Second Quarter Earnings Release Conference Call

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PRESENTATION

Operator

Welcome to Cott Corporation's Second Quarter 2019 Earnings Conference Call. All participants are currently in a listen-only mode. This call ends no later than 11:00 am Eastern Time. The call is being webcast live on Cott's website at www.cott.com, and will be available for playback there until August 22, 2019.

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

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

A reconciliation of any non-GAAP financial measures discussed during the call with the most comparable measures in accordance with GAAP is available on the Company's second quarter 2019 earnings announcement, released earlier this morning, or on the Investor Relations section of the Company's website at www.cott.com.

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

Jarrod Langhans — Vice President, Investor Relations, Cott Corporation

Good morning, and thank you for joining our call. Today I'm accompanied by Tom Harrington, our Chief Executive Officer, and Jay Wells, our Chief Financial Officer. Tom will kick things off by providing his thoughts on a number of activities within our business segment, including a discussion on some of our ongoing initiatives and our operational performance during the second quarter relative to our expectation.

He will then turn the call over to Jay for a discussion of our second quarter consolidated financial performance, as well as the results of our key operating segments and thoughts on the full year. Tom will conclude with a few thoughts before we move to Q&A.

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

Thomas Harrington — Chief Executive Officer, Cott Corporation

Thank you, Jarrod, and good morning everyone. I am pleased with the performance of the Company over the first half of the year; in particular, the Adjusted EBITDA performance relative to prior year, and compared to consensus in the second quarter. Overall, the business performed well, and would have been even stronger if the FX headwinds had not increased.

On the operational front, we continue to execute against the initiatives that we've outlined in the past, and fully expect them to contribute to our growth over the coming quarters and year. Within our route-based services businesses, we've seen improved results from our European operations. Our customer growth program has been the most successful since we acquired Eden Springs in the middle of 2016.

Execution of our high-density area sales and marketing efforts, as well as other country-specific activities, are delivering net customer growth in most key markets. We have enhanced our footprint through organic growth and tuck-in acquisitions in countries such as Poland, where HOD water is enjoying good growth, and where we are building meaningful route density as a result of our actions.

We are also pleased with the extension of our booth program into the United Kingdom. Sales productivity is meeting expectation, and over three quarters of the new customers are residential. This is an important development as we look to implement actions in the coming years to develop the underpenetrated residential market across our European operations.

Turning to our U.S. route-based services business, we continue to see good top line and EBITDA growth, even with the general inflation in the U.S. over the last 18 months. As you are aware, the freight costs we faced were a headwind in 2018. However, we're pleased they are now largely resolved.

While more recently we've seen some wage inflation, given the low unemployment rate, these costs have been offset by our pricing initiatives. Importantly, as the U.S. route-based business is our largest business, it's nice to see that we delivered 5 percent HOD water top line growth in the quarter, when excluding the Mountain Valley acquisition.

Consistent with historical seasonality, the team drove this growth through the delivery of good net customer growth, continued improvements in our customer satisfaction and service levels, as well as improved pricing. We remain confident that the investments in the customer experience that we are making will contribute to our future growth. Although these route-based service activities all come with investments, we believe that they are positioning our Company for success and continued growth as we look out over the next three to five years.

As an update, we have implemented enhanced communications with our customers in the U.S. in advance of the implementation of the new mobile app, which is on target for a Q4 rollout. We've introduced more relevant consumer offerings, through products such as our Mountain Valley brand, Sparkling Ice, and branded sparkling water and seltzers.

We are increasing penetration of case pack water that we sell into our returnable customer base. It's best to think of this effort as cross-selling a new package to our customer.

We continue to develop new and expanded channels of customer acquisitions, such as the new e-commerce platform, which enables consumers to order and reorder returnable five gallon water through this significant online retailer. As you know, we began test marketing during the second quarter in a few cities in Georgia, and are expanding across the state of Florida during Q3. We are working with our customer on the timing of a further expanded rollout, and we're excited to add another channel of customer acquisition to our current portfolio of customer acquisition tactics.

We continue to make improvements and investments in our digital customer acquisition capabilities, through search engine optimization and search engine marketing initiatives, as well as executing on new tuck-in targets across the Mountain Valley distribution network.

We continue to work on developing state-of-the-art equipment offerings for our customer. For instance, we will introduce a new and improved water/coffee dispenser called the Aqua Barista, which is a combo unit that dispenses water and K-Cups, as well as an IOT, Internet of things, enabled filtration water cooler later in the year.

In terms of the new patented filtration technology, we will be introducing a solution to the market that we believe will provide us with a competitive advantage in terms of retaining and attracting new customers. This new patented filtration technology meaningfully extends the life of the water filter, will require far fewer service interactions, and in turn, we expect will increase customer satisfaction.

We plan to shift the dialogue with the customer, from "When did you last change your filter?" to a solution that provides high quality safe drinking water, transparently through the introduction of an app that enables customers to confirm their water quality in real-time, which we believe will alleviate any fears they may have about water quality, which, as you know, has been a long-standing issue relative to municipal water supply in some markets across our footprint.

We will then utilize this technology to proactively contact the customer if we see any changes with their water quality, and communicate when it is time to replace the filter. With this new technology, and an investment in an expanded sales team, we anticipate good growth from this channel over the coming years.

As we've noted in the past, the filtration channel for us is a separate and distinct channel from our HOD water channel, as filtration is generally not the most economical solution for our core HOD water customers in the small commercial channel. When looking at the water filtration segment of our business compared to HOD water, historically, we have only seen around 3 percent of our total flip converted to water filtration. Naturally, if filtration is what a customer wants to move to, we would expect that these customers would convert to a Cott solution.

Our typical commercial HOD water customer is a small business with 10 to 15 employees that generally utilizes a water cooler in a customer-facing area such as the waiting area at a doctor's office, a dentist office, or an auto repair shop. But the cost to install a filtration unit and extend the water line in these types of locations is not cost-effective. We believe that HOD bottled water provides the lowest cost solution for this customer base.

In terms of water filtration, we target larger businesses as the economics for the customer can be better, and therefore, the installation of the unit, and a three to five-year contract, or a rental agreement, typically makes the most sense.

Elaborating more on our customer service initiatives; the overall goal of our business and service proposition is to position the customer at the center of everything we do, and to strive for flawless execution on all customer interactions. The idea of the ultimate customer experience is not a new one to our business, but a mindset that we've been reinforcing for a number of years.

The evolution started back in 2015 when we invested in our state-of-the-art Customer Contact Center in Lakeland, Florida, where we have around 500 associates who service approximately over three million calls per year. This Customer Contact Center has evolved into a world class center, and these investments are paying off in improved service satisfaction as we've consistently seen reductions in calls per customer, alongside lower customer churn.

After rolling out our new state-of-the-art Contact Center, we invested in a platform designed to improve and assist us with the route-based delivery system, utilizing a handheld iPhone for our route sales representatives, or RSRs, where we create a seamless solution for our RSRs to get their route's delivery schedule, to learn what the customer's special instructions are, and to plan out their day utilizing best in class technology.

These tools are real-time in nature, so we're able to see where our RSRs are located at any point in time during the day, what inventory they still have on their truck, and how far along they are on their route. This transactional data has been married up with Omnitracs, our investment and routing software that enables us to do more efficient route planning. We continue to see good progress with route logistics, and we'll continue to develop our skills on this platform as we look to invest in our operations in order to continue to leverage our business and create margin expansion.

Looking at our overall customer initiatives; think of our initial efforts as building the foundation, and most importantly, building customer satisfaction through improved service capabilities. Now, we are focusing our investments to drive further customer loyalty and revenue per customer, by interacting with the customer directly, and providing them with the communication tools that they desire. Once we are satisfied with the effectiveness of the platforms we have built in the U.S., we will then export them to Europe.

Moving to our coffee, tea, and extract solutions business; we believe the competitive environment will be less of a challenge for us as we move into the back half of the year. That said, even in this competitive environment, we delivered good coffee volume growth during the quarter, up 3 percent, and delivered extract volume growth of 24 percent. With this consistent growth in our core coffee business and the full-year expectation for extracts to grow 30 percent, we're confident that our coffee, tea, and extract solutions segment is on the right track, growing market share, and is poised to move past the short-term challenges and return to a consistent revenue and EBITDA growth story as we move into 2020.

Switching over to a new initiative that we rolled out this year, environmental, social, and governance; we've made good progress in the development of our ESG program, but we're still early in the process, so we are trending in the right direction. As part of our planning and growth, we are building our strategy and internal capabilities to meet our environmental goals of achieving alliance for water stewardship and carbon neutral certification. We are also working with ESG rating agencies to ensure our current efforts are reflected in their assessment, and have seen our sustained analytics (phon) scores improve from our efforts, moving up to the top third of our industry.

We expect our scores to improve along the way as we continue building our ESG program and engaging with rating agencies.

I'd like to now move to a quick update on our annual strategic review process. We officially began our annual strategic review process late in Q2, and although this is a fluid process that is ongoing throughout the year, this is the time that we look back over the past years and forward over the next three to five years, and perform a thorough review of our businesses. The process provides an opportunity for our entire Leadership team to review past successes and identify areas for opportunity while reviewing historical, internal performance data, reviewing external, third-party data, as well as other analytics, including feedback from investors, and to align and develop the actions we need to take in order to ensure our continued success as a business.

This process enables us to reinforce our commitment and focus on efforts that accomplish a number of important objectives, such as ongoing succession planning and employee development, as well as customer, operational, and other strategic investments, all of which lead to and support predictable organic revenue growth in both segments with a minimum expectation of 2 percent to 3 percent of revenue growth, maintenance of a robust pipeline of M&A targets in the RBS reporting segment that drives a minimum 1 percent to 2 percent of revenue growth, and a continued focus on free cash flow management.

With that, I'll turn the call over to Jay where he will review our second quarter results and provide an update on full-year expectations, before I wrap things up and we move to Q&A.

Jason Wells — Chief Financial Officer, Cott Corporation

Thank you, Tom, and good morning, everyone. We continue to see good top line performance, with revenue up 6 percent when you exclude the impact of foreign exchange, the sale of Cott Beverages LLC, and the change in average cost of coffee, driven by growth and pricing benefits within HOD water, and good price/mix and extract growth within our coffee, tea, and extract solutions segment.

Gross profit, excluding Cott Beverages LLC which was sold in February 2019, increased 5 percent. Our gross margin as a percentage of revenue was up 50 basis points to 51.8 percent, driven by fixed cost leverage as a result of good top line growth.

SG&A expenses increased to $284 million compared to $275 million, due to the addition of selling and operating costs associated with the Mountain Valley acquisition, general inflation, which was mitigated through pricing actions, and increased sales and operating expense within our coffee, tea, and extract solutions segment, associated with increased coffee volumes, offset in part by the sale of Cott Beverages LLC.

Adjusted EBITDA was $84 million compared to $81 million, as the growth from revenue and corresponding fixed cost leverage was offset in part by a $5 million increase in sales and operating costs within our coffee, tea, and extract solutions segment, as well as increased foreign exchange headwinds with our route-based services segment.

Adjusted free cash flow from continuing operations was $12 million of usage, primarily driven by the timing of working capital in the quarter. In terms of free cash flow cadence, we typically see free cash flow usage in the first half of the year as we build inventory and prepare for the busy summer season, and then we see good cash inflows in the back half of the year.

Turning to returns to shareholders; during the second quarter, we returned approximately $28 million to shareholders through $8 million in quarterly dividends, and $20 million of share repurchases.

Moving to our full-year outlook; we continue to expect revenue to be over $2.4 billion, inclusive of increased FX headwinds of around $25 million, or over 1 percent for the year, and green coffee commodity cost, which has continued to be low, resulting in a full-year revenue impact of around $15 million, albeit, this is simply a pass-through. But as I said, even with these factors, we see over $2.4 billion of revenue in 2019.

Moving to Adjusted EBITDA; the current Bloomberg Consensus figure of $328 million is reasonable relative to our full-year outlook when looking at the current macro environment. As we reaffirmed in our press release this morning, our full-year free cash flow guidance remains at $150 million plus.

Let me now cover the operating performance of our route-based services segment. The route-based services segment saw revenue increase 6 percent on an FX neutral basis. We continue to have good growth in our HOD water channel, where FX neutral revenue grew around 6 percent overall, and 4 percent excluding Mountain Valley, despite rain above historic norms in many of our geographies. This growth was driven by increased volumes, in part from a stronger customer base, which was up approximately 3 percent year-over-year excluding Mountain Valley, as well as increased revenue per customer.

Gross profit increased 4 percent to $272 million, driven primarily by revenue growth. Gross profit as a percentage of revenue was roughly flat, at 59.6 percent, as growth within the segment was offset by negative foreign exchange.

SG&A expenses increased to $238 million compared to $229 million, due primarily to the addition of selling and operating costs associated with the Mountain Valley acquisition, and general inflation, which has been mitigated through pricing actions. SG&A expenses as a percentage of revenue were roughly flat, at 52.2 percent.

Operating income was up 5 percent, while Adjusted EBITDA was up 3 percent, at $80 million, as revenue growth and the ensuing operational leverage was partially offset by a negative foreign exchange impact.

Overall, we've been pleased with the performance of our route-based services segment during the quarter, as we have been able to demonstrate the strength of the business, the elasticity of pricing, and have continued to invest in our customer experience, including new technologies, customer service, and new SKUs, and also invest in our people who are the most important component of our shareholder value creation model.

Let me now cover the operating performance of our coffee, tea, and extract solutions segment. As Tom mentioned, we continued to take market share in the second quarter, with a 6 percent increase in adjusted revenue, to 24 percent growth in extracts, and continued growth in coffee and tea pounds sold.

Gross profit improved to $42 million compared to $37 million, driven by increased volumes and operational leverage, improving gross margin as a percentage of revenue to 27.7 percent compared to 25.7 percent.

SG&A was $39 million compared to $34 million, driven primarily by increased selling and operating costs, which in turn resulted in Adjusted EBITDA of $9 million.

All in all, we were pleased with the results of our coffee, tea, and extract solutions segment, as the business was able to generate good volume growth in both pounds of coffee sold and liquid volumes sold to offset the pricing pressure that was experienced as a result of the competitive environment. This pricing pressure is expected to begin to subside in Q3, and although Q3 is typically the least active quarter for this business, we would expect to see continued volume growth in Q3, and we would expect to leave Q4 with both top line and bottom line growth as we exit the year, putting us in a strong position as we enter 2020.

I will now turn the call back to Tom.

Thomas Harrington — Chief Executive Officer, Cott Corporation

Thank you, Jay. Before we close, I just wanted to reiterate what our long-term expectations are for this business. Albeit, there will be a few puts and takes along the way.

First, we look to generate between 2 percent and 3 percent organic revenue growth each year, driven primarily by our U.S. route-based services division, which saw 5 percent HOD water growth this quarter when excluding the Mountain Valley acquisition. We would then look to add to that growth with another 1 percent or 2 percent of growth through tuck-ins.

The organic revenue growth should then generate $10 million plus of organic EBITDA growth, another $5 million to $10 million of tuck-in EBITDA growth. As I look back over the last few years, I believe we have performed fairly consistently at generating both organic and tuck-in growth through our route-based services operation, even with the increased foreign exchange headwinds we've seen. Although, we've seen competitive pricing in our coffee, tea, and extract solutions segment, and some dissynergies associated with our copper cost, which resulted from the sale of our legacy business. We are well set up for the future.

Let me also revisit our expectations for 2019. As Jay mentioned, we expect revenue to be over $2.4 billion, including the additional FX headwind and continued low coffee commodity cost of green coffee. In moving to Adjusted EBITDA, we believe the current Consensus figure is reasonable and in line with our full-year outlook. We do believe that Q3 and Q4 are slightly imbalanced, but in aggregate, we expect to deliver the full-year of current Consensus. We remain committed to our full-year free cash flow guidance of $150 million-plus.

Before I pass the call over to Jarrod, I want to thank all of the teams across the business units for delivering a good quarter and for remaining focused on delivering on our full-year commitment. Thank you.

Jarrod Langhans — Vice President, Investor Relations, Cott Corporation

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

Operator, please open the line for questions.

Q & A

Operator

Certainly. At this time, in order to ask a question, please press star, and then one on your telephone keypad. I'll pause for just a moment to compile the Q&A roster.

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

Judy Hong — Analyst, Goldman Sachs

Thank you. Good morning.

Jason Wells — Chief Financial Officer, Cott Corporation

Good morning, Judy.

Thomas Harrington — Chief Executive Officer, Cott Corporation

Good morning, Judy.

Judy Hong — Analyst, Goldman Sachs

I guess, Tom, you commented on the EBITDA projection for the full year. If I look to Consensus, it's around $330 million, which does imply a pretty big acceleration in the back half. Number one, can you just walk us through what is sort of the delta from first half into second half, in the context of what gets better?

Then, I guess if you kind of take a step back and look at your EBITDA projection beginning of the year, how do you think it's evolved, certainly given that FX has become more negative, and obviously in the first half you had some pressure on some of the operating cost increases?

Thomas Harrington — Chief Executive Officer, Cott Corporation

Thanks, Judy. Looking at EBITDA performance for Q3 last year, we saw good EBITDA performance with 11 percent growth versus the prior year. In Q4, we incurred higher cost in the quarter resulting in 3 percent growth versus the prior year. With the lower hurdle we're lapping in Q4, we estimate that EBITDA growth for the back half of the year would be weighted more heavily, naturally, to Q4, based on those cycles.

If you look at the growth, we for sure have FX headwinds; we would expect them to taper off towards the end of the year. We did have, as you recall, the Management incentive hurdle from Q4, which we clearly won't have this year. That's how we think about the change, quarter-over-quarter. Of course, we have the growing—improving, not growing—improving performance of S&B (phon) as we've cycled through all the competitive pricing issues we've had in the past.

Jason Wells — Chief Financial Officer, Cott Corporation

I think you asked about FX versus where we started the year. I mean, everybody sees the U.S. dollar continues to strengthen, and as the year has gone on, has probably provided a $5 million to $7 million headwind.

Judy Hong — Analyst, Goldman Sachs

Got it, okay. Then, the second question is, as you're going through the annual strategic review, I'm just wondering how you're thinking about the coffee business strategically going forward. It sounds like you do expect the competitive environment to get better in 2020, potentially setting up for a better year from a performance standpoint, but when you kind of think about how that business fits in strategically, can you just comment on how you're approaching that as you're going through the strategic review? Thank you.

Thomas Harrington — Chief Executive Officer, Cott Corporation

Yes. It's really early in the process, Judy, so we've had our initial discussions, but I wouldn't articulate them yet as strategic. We have meetings over the next six to eight weeks, and I think we would have clarity as we move through the year.

In terms, specifically, of the coffee business, the headwinds are about behind us, as we've noted. We're happy with the performance, we've gotten through that pricing competitive issue, and we begin to return to growth, frankly, in Q4. We think that business is set up quite nicely for 2020.

Judy Hong — Analyst, Goldman Sachs

Got it. Okay, thank you.

Jason Wells — Chief Financial Officer, Cott Corporation

Thank you, Judy.

Thomas Harrington — Chief Executive Officer, Cott Corporation

Thanks, Judy. Appreciate it.

Operator

Your next question is from Kevin Grundy with Jefferies. Your line is open.

Kevin Grundy — Analyst, Jefferies & Company

Hey, good morning, guys.

Thomas Harrington — Chief Executive Officer, Cott Corporation

Good morning, Kevin.

Kevin Grundy — Analyst, Jefferies & Company

A question on capital deployment; can you talk a little bit about what the pipeline looks like for tuck-in M&A, how you're thinking about deleveraging versus buyback? It looks like you've exhausted the existing share buyback authorization, but of course, with the stock down here, it would seem like that would be a sensible consideration relative to what you're seeing from a tuck-in M&A perspective. Maybe you can comment on that, and then I have a follow-up.

Thomas Harrington — Chief Executive Officer, Cott Corporation

Yes, in terms of the tuck-ins, we articulated that we'd be at the high end of the range on those tuck-ins, that it remains our expectation. We have a good pipeline that—some we would execute this year, but a developing pipeline as we move into 2020. No material change to our confidence in the ability to deliver the M&A pipeline on a go-forward basis.

In terms of current capital deployment, it's really about investment in innovation and organic growth. A lot of that innovation is clearly in our investment against the customer experience, which we think enhances our business short and long-term, in terms of retention rates and, ultimately, at the end of the day, revenue per customer.

We would look to accelerate at the higher end of this range on our tuck-ins, so closer to 60 than 40. We continue with the quarterly shareholder; you're absolutely correct, we have exhausted the share buyback, and we'll continue to review larger acquisition opportunities should they come up. We continue to do our diligence. The markets remain frothy, from our view.

Jason Wells — Chief Financial Officer, Cott Corporation

Yes, and you look at the share buyback, Kevin. I mean, we have utilized all the available allocation for this year, but also we bought back almost $100 million of stock over the past year, so really, when you look at how I plan deployment of my capital and liquidity, we've really utilized an amount of cash I have available for that this year.

Kevin Grundy — Analyst, Jefferies & Company

Okay, thanks. One follow-up and then I'll pass it on. Just the gross margin progression broadly in route-based services in the back half of the year and your level of visibility on the margin improvement there that'll be required to deliver on the Consensus numbers which you guys indicated that you're comfortable with; can you comment on the level of visibility between the pricing that's in place, some of the operating cost pressure that you saw in the first half of the year, which seems like it should subside a bit, particularly around labour. Can you just comment on sort of the level of visibility here in the back half of the year?

Thomas Harrington — Chief Executive Officer, Cott Corporation

Yes, let's start with the production issue that was in the tail. While we did incur the incremental temp labour and unplanned overtime, largely as a result of the wage inflation, the team did a good job in cost down actions in the second quarter that at the end of the day has mitigated that cost. Frankly, the team did better than we thought. We don't see that as a particular challenge as we move into Q3 and Q4 as we sit here today.

Jason Wells — Chief Financial Officer, Cott Corporation

Yes, when you look at…

Kevin Grundy — Analyst, Jefferies & Company

Okay, that's great. Thanks.

Jason Wells — Chief Financial Officer, Cott Corporation

Yes. If you want to look at pure—the margin on EBITDA between now and the remainder of the year, keep in mind that we're still going to have some FX headwinds going through the end of the year. As we're still having pretty good headwinds in Q3, we should be holding relatively flat on an FX neutral basis, and then seeing more upside in Q4.

Kevin Grundy — Analyst, Jefferies & Company

Okay, thank you. Good luck.

Thomas Harrington — Chief Executive Officer, Cott Corporation

Thanks, Kevin.

Operator

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

Amit Sharma — Analyst, BMO Capital Markets

Hi, good morning, everyone.

Thomas Harrington — Chief Executive Officer, Cott Corporation

Good morning, Amit. How are you?

Amit Sharma — Analyst, BMO Capital Markets

Very good, thank you. Your tone on the RBS top line, it certainly looks better than it has been. Five percent growth in the quarter, you have a number of initiatives still coming online, customer service, app, filtration in the fourth quarter. As you look to 2020, what do you think, is 2 percent to 3 percent—do you want to stick with that, or could there be an upside as some of these initiatives start to help you from an organic top line perspective?

Thomas Harrington — Chief Executive Officer, Cott Corporation

Yes, we're focused on how we finish the year and ensure that we deliver on our 2 percent to 3 percent and 1 percent to 2 percent in terms of organic and tuck-ins. We have FX neutral, enjoy good revenue growth, but it does produce some challenges to us, has an impact particularly Q3 and Q4. Look, I think 2020, our first step about how we look to the future is around the strategic review process and what do we see over the next three years. Then after we align on what that is, we start the process of what's the annual operating plan, and we're frankly not there, as I sit here today.

Jason Wells — Chief Financial Officer, Cott Corporation

Yes, I mean, Amit, you look at the year and how we're guiding to get to the $2.4 billion, I mean, in Q1 we had about 6 percent growth on an FX neutral basis, 6 percent in Q2, but really, view in the back half of the year, we see that more normal—down to, we say between 4 percent to 5 percent, so let's say 4.5 percent, really to hit the $2.4 billion-plus. I think on the back half of the year, you see more a normal range, and that will continue into 2020.

Amit Sharma — Analyst, BMO Capital Markets

Got it. Then on the near-term, you did talk about the large e-commerce customer expanding the (inaudible). Can you talk about that a little bit, in terms of how quickly could it ramp up, if it has any margin implication for the RBS business?

Then, comment on pricing environment easing in the CTE category; is there potential for you to pick up some additional wins if pricing is normalized there?

Thomas Harrington — Chief Executive Officer, Cott Corporation

We'll take the e-commerce question first. Look, we're in—well, we're expanding to Florida in the quarter, it's a significant number of zip codes, and we're very focused on ensuring that we execute effectively with that new customer base and we install it. Amit, just think of this as learning from our past experience with customer acceleration back in the day, with the booth program, call it 2015. We've learned from that experience and on being judicious on the rollout.

In terms of margins, we're happy with the margin structure of that business, so we don't anticipate that it would have a negative impact on our existing U.S. RBS business. We're quite happy with where we are at the moment.

In terms of coffee, pricing pressure has in fact eased, and we'll see our business turn around as we move through Q3 and Q4. We referenced some sales investments, so we expect that we would win our fair share of new customer opportunities as we move into 2020, and remember, the team—our S&B team did a good job extending contracts into the future, so we don't see a large risk of competitive pricing on our install base, if you will. We're happy with the 3 percent and the forecasted 30 percent growth, and that's pretty aligned with our expectations.

Amit Sharma — Analyst, BMO Capital Markets

Got it. Thank you so much.

Thomas Harrington — Chief Executive Officer, Cott Corporation

Thanks, Amit.

Operator

Your next question is from Peter Grom with JP Morgan. Your line is open.

Peter Grom — Analyst, JP Morgan

Hey, good morning, everyone.

Jason Wells — Chief Financial Officer, Cott Corporation

Good morning, Peter.

Thomas Harrington — Chief Executive Officer, Cott Corporation

Good morning, Peter.

Peter Grom — Analyst, JP Morgan

A quick one for me, and then I just had a broader question. But did weather have any impact on performance in the quarter, (inaudible)… We've seen a little weather over the last month or so, have you seen any uptick in consumption trends?

Thomas Harrington — Chief Executive Officer, Cott Corporation

Yes, I'll stick to Q2. We do see some weather impact, particularly in our European operations. It was certainly wet in the U.S., but it was nowhere near as warm in Europe as it was a year ago.

Peter Grom — Analyst, JP Morgan

Okay.

Thomas Harrington — Chief Executive Officer, Cott Corporation

It actually has an impact, but that's baked into the performance that we had in the quarter and the 6 percent obviously includes a tougher cycle, so we're quite pleased with the performance overall on net revenue growth, FX neutral, for the Q.

Peter Grom — Analyst, JP Morgan

Okay. Then my second question's just on free cash flow. I know a lot of this was timing-related. Can you help us bridge to the $150 million plus growth in the context of the first half performance? Then just broadly, I think previously you had stated working capital was expected to be about flat for the year. Is that still the right target? Thanks.

Thomas Harrington — Chief Executive Officer, Cott Corporation

Yes. Peter, our free cash flow is historically backend weighted, but I'll let Jay walk you through how we're thinking about it.

Jason Wells — Chief Financial Officer, Cott Corporation

Yes, and as you said, it really was driven by free cash flow. Similar to last year, we did have three of our four interest payments in the front half of the year, so easier working capital in the back half.

Then also, we talked about the FX headwind. That is providing us a headwind on EBITDA which does flow through to free cash flow. The good news is, that's more of a book headwind than not, because I'm not repatriating the cash at this point in time.

But we remain confident in the $150 million plus in a couple different ways. One, you look at our CAPEX, which also is spent in a foreign currency so we're getting some benefits on CAPEX. You really look at our investment for the first half of the year has been $50 million, so we're definitely trending at the lower end of our $115 million to $125 million historic CAPEX, so that will provide an offset. Similarly, we do see some additional pockets of working capital that we can take advantage of to offset the remaining FX that we're seeing.

Peter Grom — Analyst, JP Morgan

Great. Do you still think flat guidance for the working capital perspective is the right…?

Jason Wells — Chief Financial Officer, Cott Corporation

No, you look at the $5 million to $7 million FX that is hitting us. I'd say, on FX, we'll probably get a couple million back in CAPEX, and like I said, we'll probably be closer to the $115 million of our range, but then we will also see some working capital benefits to offset the other part of the FX headwind we're seeing.

Peter Grom — Analyst, JP Morgan

Okay, great, thank you.

Thomas Harrington — Chief Executive Officer, Cott Corporation

Thanks, Peter.

Operator

Your next question is from Daniel Moore with CJS Securities. Your line is open.

Daniel Moore — Analyst, CJS Securities

Yes, good morning, thanks for taking the questions. Just wanted to hone in on Europe a little bit in terms of the RBS business, it seems like you're seeing some pretty solid underlying organic volume trends despite macro being a little bit iffy, so kind of talk about those puts and takes and what's driving the success there on the ground.

Thomas Harrington — Chief Executive Officer, Cott Corporation

Yes, so you recall, we've talked about high density, and that really is an investment in customer growth in some of the markets in Europe, particularly those with a higher percentage of the population. We're seeing, if we're in year-two-plus of that, good execution and growth from those investments, so that gives us—despite all the other issues, that we are expanding penetration in the commercial piece.

Our booth program in the U.K. is rather exciting, it's meeting expectations on productivity, which is, if you think about it, completely new channels, customer acquisition tactics in that country. That's providing some good benefit as we, again, address the customer base there.

Then we referenced Poland in the script, so we've done some good tuck-ins and are strengthening some of our existing business, Poland happens to be one of those. Then of course, municipal water concerns on the Eastern part of our business would be a little bit higher than the Western part of our European business, but we can see good consumption there.

I think we're benefiting from a number of the tactics the team has successfully implemented over the last couple years that are coming to fruition here in the summer here of 2019, thankfully.

Daniel Moore — Analyst, CJS Securities

Helpful. Jay, just a little housekeeping item, but on the adjusted free cash flow, it was about between $8 million and $9 million in terms of acquisition integration. What do you expect that to come in for the full year? Thanks.

Thomas Harrington — Chief Executive Officer, Cott Corporation

Thanks, Dan.

Jason Wells — Chief Financial Officer, Cott Corporation

Good question. As we're still integrating, it would be a very rough guess. But I would say, if you look at Mountain Valley, we have been progressing—I would say it wouldn't be as high as that, but could it be around $5 million-plus, that sounds about right.

Daniel Moore — Analyst, CJS Securities

Understood, thank you.

Thomas Harrington — Chief Executive Officer, Cott Corporation

Thank you, Dan.

Operator

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

Mark Petrie — Analyst, CIBC World Markets

Hey, good morning. I just wanted to touch on the pricing dynamics in the water business. I know you had talked about that as a potential offset to some of the labour pressures that you've been seeing, but it sounds like maybe you addressed those, and even better than you had expected. Could you just sort of summarize where you're at in terms of the impact on pricing in the water business in Q2, and then also the outlook for that through the balance of the year?

Thomas Harrington — Chief Executive Officer, Cott Corporation

Yes, so our current pricing is in line with our expectations, and we see 1 percent to 2 percent, and we frankly see that not changing as we go through the balance of the year. The pricing environment, we're experiencing good price elasticity and the ability to continue to execute pricing with our customer base.

It’s certainly supported by our efforts on things like customer experience and customer satisfaction and service levels that our teams are executing, so when a customer is serviced flawlessly, it gives us greater power in terms of pricing elasticity.

Mark Petrie — Analyst, CIBC World Markets

Then if I could just ask about the filtration launch, just to confirm the timing of that, and then your expectations in terms of how that would roll out?

Thomas Harrington — Chief Executive Officer, Cott Corporation

We would expect the new device to land sometime in Q3. This will be a slow rollout, it’ll frankly start in the Western United States, because you have the pipeline of the asset hitting the U.S. Then we’ll refine our skills in terms of how we do the sales pitch and will implement the app so that customers can see water quality in real-time, and then roll it out over the coming years. This is not a roll it out across the entire RBS footprint or filtration footprint in one quarter, it’ll be over time over the course of a couple years.

Mark Petrie — Analyst, CIBC World Markets

That’ll go through your existing—at least in the test or the initial launch in the Western U.S., through your existing sales force?

Thomas Harrington — Chief Executive Officer, Cott Corporation

Yes, we have a dedicated team of people today, but we would look to expand that once we have that asset in place, which is really two parts to the execution, Mark. There is the installed base, which we want to convert for retention purposes and then upgrade. That's 160,000 or 170,000 filtration customer locations. Then, use the expanded sales force then to build on that base of 160,000 to some other larger number in the future.

Mark Petrie — Analyst, CIBC World Markets

Okay, thank you.

Thomas Harrington — Chief Executive Officer, Cott Corporation

Great, thanks, Mark.

Operator

Your next question is from Brian Hunt with Wells Fargo. Your line is open.

Thomas Harrington — Chief Executive Officer, Cott Corporation

Morning, Brian.

Brian Hunt — Analyst, Wells Fargo

Thank you. I'm just wondering if you could talk—how are you doing, Tom, Jay. I was wondering if you could discuss a little bit more on your efforts to cross-sell and add cases of sparkling. The basket opportunity seems like a great opportunity because there's no additional stop, but it definitely adds additional dollars and gross profit to each stop. When you look at what you reported for the quarter, I believe you said you were up 4 percent ex-acquisitions and pricing was up 1 percent to 2 percent. Do we assume the rest of that is basket, and could you just explore those comments?

Thomas Harrington — Chief Executive Officer, Cott Corporation

Yes, our current focus is first on case water, which is traditional cased water that you might by a 24-pack at some retail location. We really are using our direct sales force to get to the consumer to fill that consumption occasion. We're quite pleased because the historical penetration was roughly 8 percent to 10 percent in the U.S., and we're seeing a double-digit increase in that penetration, which is really increasing the size of the basket.

Now, in addition to that, we began a slow rollout this year of Sparkling Ice across the business, and we've also focused on sparkling water and seltzer, two different brands, one essentially in the West and one in the Northeast Corridor, and they're producing some good results. This is an ongoing execution contact with the customer, so our CX is actually, we believe, going to be the key enabler as we begin to not rely on the route salesperson to interact directly with the customer; they're doing a good job. But our investments in CX will enable us to enhance the communication via mobile, via text, via our app, and we think that that'll help us build that base of penetration over time.

It's largely a U.S. execution today, so over time, we have to find the appropriate solutions in Europe and extend it to Europe, and frankly, into Canada.

Brian Hunt — Analyst, Wells Fargo

Great, thank you. That sounds like an exciting opportunity. Next, looking at this online retailer that you're expanding across Georgia and Florida with, can you talk about what their pricing strategy is relative to your core pricing strategy? As well as, because you're expanding, potentially, so rapidly with them geographically, does that new customer kind of skew your acquisition targets geographically? Thank you.

Thomas Harrington — Chief Executive Officer, Cott Corporation

Yes, look. In terms of pricing, there's really no conflict between what they market online for, and what we market online for. We've been very cautious about the economics of that customer so that we don't self-inflict mix issues, or pricing pressures. We like our current price elasticity, and we're going to stay very focused on how that contributes to our revenue growth in the next couple quarters and well into the future. We've been rather judicious in our approach to that.

We look at it, in terms of customer acquisition tactics, if we have six tactics, this would be tactic number seven, and then we would always look to balance those customer acquisitions by channel. We love all of our customers, but we're particularly focused on small commercial because it has the highest profitability, largely driven by higher pricing and the length (phon) of the customer. We'll always look to balance, and our local teams are accountable for ensuring that the balance in any market, any region is appropriate to maximize the top line and the bottom line along the way. I think the teams are doing a pretty god job of that today.

Brian Hunt — Analyst, Wells Fargo

Then my last question if you can squeeze in one more, just talk about, maybe, balance sheet goals. Where's your target leverage? I know there's seasonality in the business today and you're kind of peaked for the year, but where do you see yourself longer-term? That's it for me. Thank you, and best of luck.

Thomas Harrington — Chief Executive Officer, Cott Corporation

Yes, thanks, Brian.

Jason Wells — Chief Financial Officer, Cott Corporation

Leverage; our leverage, if you disregard the new lease accounting rules where everybody is starting to put leases on their books, and I believe we will slowly catch up. Our leverage is around three and three-quarters right now. We really expect that number to continue to decline as we pay down our ABL and grow our EBITDA during the year. We're continuing to do so over the reminder of this year and for several years to come.

No specific targets, but that's where our focused cash flow deployment is after the dividend, after the tuck-ins, and investing in growth. But we'll continue to focus on reducing our leverage.

Brian Hunt — Analyst, Wells Fargo

Thank you.

Operator

Our last question is from Amit Sharma with BMO Capital Markets. Your line is open.

Amit Sharma — Analyst, BMO Capital Markets

Hi, thank you so much for taking the follow-up. Tom, just wanted to make sure that I heard this right. As you were talking about your filtration business, did you say 3 percent of your HOD customers tend to convert to filtration?

Thomas Harrington — Chief Executive Officer, Cott Corporation

No, no.

Amit Sharma — Analyst, BMO Capital Markets

A clarification—sorry, go ahead.

Thomas Harrington — Chief Executive Officer, Cott Corporation

No, that's a good question, so some clarity is helpful. Of our total quit, 3 percent of them…

Amit Sharma — Analyst, BMO Capital Markets

Right, okay. Okay, got it.

Thomas Harrington — Chief Executive Officer, Cott Corporation

…quit. It's a very small number, right.

Amit Sharma — Analyst, BMO Capital Markets

Right, okay. As Tom talked about…

Thomas Harrington — Chief Executive Officer, Cott Corporation

We don't see—what's important is we don't see a big exodus of my HOD water basis converting to filtration.

Amit Sharma — Analyst, BMO Capital Markets

Right.

Thomas Harrington — Chief Executive Officer, Cott Corporation

If they do, we expect them to stay with us, and frankly, we think that'll only be enhanced with the pending execution and rollout of our new patented technology. We think it really will—we'll get more of those 3 percent that come to us, and then obviously expand our market share over time.

Amit Sharma — Analyst, BMO Capital Markets

Got it. Just one more on that; when you think about the revenue structure of the filtration business, can you talk about that a little bit? You did say that you entered into a longer-term contract. How should we think about that? It's less revenue but better gross profit, is that the way to think about the filtration business?

Thomas Harrington — Chief Executive Officer, Cott Corporation

Yes, it's not necessarily less revenue; it frankly depends on the customer. You have some that are less, some that are more. Higher revenue comes with larger customers where we would typically enter into a longer-term agreement. When you think about the free cash flow from the customer—and look, this is an average of an average for our customer base. It's about the same as an HOD water after you factor out capital.

Amit Sharma — Analyst, BMO Capital Markets

Got it, okay. Even if people move to filtration, it's not diluted to your free cash flow profile of the business?

Thomas Harrington — Chief Executive Officer, Cott Corporation

Yes, I've used the word agnostic. We like customers; we're happy to have them in either solution. Look, our investments are about enhancing our footprint in the filtration side of our business, so at the end of the day we benefit from the best of both worlds in healthy hydration, growing category.

Jason Wells — Chief Financial Officer, Cott Corporation

Some of our larger customers, we do both.

Thomas Harrington — Chief Executive Officer, Cott Corporation

Correct.

Jason Wells — Chief Financial Officer, Cott Corporation

Where their offices are and they have an easy access to water, we do filtration units. In the plants where there's no easy access to water, we do water coolers. Our goal is to generate similar dollar profits, and be agnostic to which our customer want and just provide them the service that best fits their needs.

Amit Sharma — Analyst, BMO Capital Markets

Got it. Thank you so much.

Thomas Harrington — Chief Executive Officer, Cott Corporation

Great, thanks, Amit.

Operator

Ladies and gentlemen, this concludes the Q&A period, and I'll turn back to you, Jarrod, for any closing remarks.

Jarrod Langhans — Vice President, Investor Relations, Cott Corporation

This ends our Q2 2019 Earnings Results. Thank you, all, for joining. Goodbye.

Operator

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