Value Investors Should Check Out Cott Corporation for Hidden Cash Flows

Description

Even if a company is posting impressive accounting earnings, what matters at the end of the day is cash. Cash is the only thing companies can actually use to reinvest back into their business or pay out to shareholders. Sometimes accounting earnings can actually distract from a company's true cash flow generation. **Cott Corporation** (TSX:BCB) is a prime example.

In the past five years, Cott has generated over $500 million in free cash flow. If you were just paying attention to profits, however, you only would have seen the company earn less than $200 in net income over that time period. Cott's big depreciation charges every year (about $100 million annually) cause earnings to look depressed, even though the business is throwing off some serious cash. This can lead to some serious mispricing.

For example, Cott trades at 20 times 2016 earnings. That hardly looks cheap. When you drill into the financial statements, however, the company should generate over $1 in free cash flow per share, meaning shares trade at only 14 times free cash flow. By 2018 management expects to improve free cash flow to $1.50-1.65 a share. If that's to be believed, shares have a free cash flow yield of over 11%, nearing value territory.

How is management going to grow cash flow even more?

Cott manufactures and sells beverages through 62 manufacturing, production, distribution and fruit-processing facilities. It's well diversified, offering carbonated soft drinks, shelf-stable juice and juice-based products, clear and flavoured waters, energy drinks and shots, sports products, ready-to-drink teas and alcoholic beverages. Much of it is contract manufacturing and distribution is for global brand companies.

By controlling a large portion of the market, Cott can offer customers a wider range of services, while bargaining for better terms. To strengthen its position, Cott has made four to nine acquisitions per year, shelling out an average $30 million in cash annually.

The most attractive part of this strategy is that is can easily extract more value out of acquired businesses than if the companies were independent. For example, the company has paid an average of only 2.5 times EBITDA for acquisitions since 2007. With Cott trading at a significant premium to that, every acquisition adds a significant amount of value.

It’s not too late

With only a $1.6 billion market cap and accounting earnings that obfuscate its true cash flow generation, it’s no wonder Cott shares look fairly cheap. Shares trade at only nine times expected free cash flow in 2018. By then, management expects the balance sheet to be delevered below historical norms, meaning the company should have plenty of firepower to boost the next leg of growth.

If you’re a value investor searching for hidden gems, Cott may be just that.

CATEGORY

1. Investing

TICKERS GLOBAL

1. TSX:PRMW (Primo Water)

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