Cott Corporation’s Comeback Hits a Roadblock

Description

Ever since **Cott Corporation** (TSX:BCB)(NYSE:COT) announced its second-quarter earnings August 4, the news wires have gotten awfully quiet, and so has Cott’s stock, which is down 7% over the past two months.

In July, I highlighted the reasons why I thought it was time to cue the Cott comeback. Unfortunately, despite all the good news at the company over the summer, the comeback seems to have hit a roadblock.

But not to worry; I don’t believe it’s a permanent condition. Every stock that’s been on a prolonged run takes a break from time to time. Since October 31, 2014, Cott stock is up 182%—an annualized total return of 68%. Congrats to those who took a flyer on it when it was trading in single digits; you’ve done well.

One of the things I didn’t mention in my previous article about Cott is CEO Jerry Fowden being named the Ernst & Young Entrepreneur of the Year 2016 Award in the Corporate Innovator category for the state of Florida. That happened in June, and, while it’s only a regional award, it highlights how far the company’s come since Fowden was named CEO back in February 2009.

If you took a chance on the turnaround expert back then and bet $10,000 on his ability to right the ship, today you’d have almost $200,000. And while you can’t expect the same kind of returns over the next eight years, I don’t believe you should pass on its stock because the super-sized returns are gone.

Could it reach $40 by 2020? Why not? That’s still a 20% annual return.

Here are a couple of reasons I think that’s possible.

Cott has made two significant acquisitions in 2016

The first acquisition, Eden Springs, which it closed on August 2 at a cost of US$525 million, gives it 20% of the European home and office water-delivery market and a top-five position in European office coffee and filtration services. It fits in nicely with DS Services, its home and office delivery of water and coffee in North America.

In the second acquisition, Cott paid US$355 million to buy North Carolina–based S&D Coffee, a coffee roaster providing coffee and tea solutions across the U.S. With this purchase, it moves further into the coffee market and away from its past reliance on carbonated soft drinks.

Together, the two acquisitions add approximately $1 billion in revenue and $110 million in adjusted EBITDA.

Smart use of capital

While I still feel that its level of long-term debt is too high—US$2 billion on July 2 and US$2.7 billion after completing the second acquisition on August 11—its adjusted free cash flow is estimated to be upwards of US$275 million by fiscal 2019, well above its projected 2016 adjusted free cash flow of US$145 million.

That's almost double the free cash flow for an additional US$700 million in debt. It could have the extra debt paid off by the time we get to 2019. It's aggressive debt repayment, but it's doable.

In addition to the extra debt, it did a bought deal in late June that sold 15 million shares to the public at US$15.25 each. Using a strong stock price, it was able to give itself a little cash cushion until the two acquisitions could be fully integrated.

Bottom line

Cott's transition from a private-label soda pop manufacturer to its "Better For You" beverage platform gives it a much stronger and diversified stream of revenues than before its recent M&A binge.

Carbonated soft drinks used to account for 33% of its revenue. Now that's less than half at 16%, while its Better For You products have ballooned to 55% of revenue from 21% prior to its recent acquisitions.

Has its stock price stalled? You bet it has. But if the company continue to make smart decisions, I don't see this as a roadblock, but rather as a temporary pause.

Two or three quarters from now, I think you'll see by the numbers that it was only a matter of time before Cott stock got unstuck.

CATEGORY

1. Investing

TICKERS GLOBAL

1. TSX:PRMW (Primo Water)

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