How a Shake-Up Could Help Cott Corporation Explode

Description

Cott Corporation (TSX:BCB)(NYSE:COT) is a relatively unheard of Canadian name in the soda industry. As with other large soda companies, such as **The Coca-Cola Co.** (NYSE:KO), share prices have been quite stagnant and room for growth in an industry often labeled as unhealthy has posed a problem in recent years.

Cott's brands are relatively unknown and are circulated primarily in the Canadian market. The company does, however, have good market penetration and decent sales growth with a high overall percentage of its shares owned by institutional investors.

The company has been burdened by a relatively large debt load — one which is hampering earnings further. The company is currently losing money and, at current levels, appears to be distressed; razor-thin margins in an industry dominated by larger players with bigger brands are plaguing the private-label soda manufacturer.

A shake-up might be what the company needs

In recent years, Cott has begun experimenting with their product offerings. Last year, the company acquired S&D Coffee for $355 million, providing the company with access to an increasingly diversified product line as well as access to S&D's customer base.

Around the same time, Cott announced it was acquiring Eden Springs, a European direct-to-consumer services provider specializing in home and office delivery of water and coffee products. The vast majority of this acquisition was financed using debt (the €450 million private placement of 5.5% notes covered almost all of the €470 million purchase price for Eden).

These acquisitions have also brought additional management talent to the Cott team, and Cott expects some synergies for its core operations with the flow of new blood through the company's veins.

That said, these acquisitions were not cheap, and the debt load on the company's books will need to be kept in check. The operating cash flow generated from these two transactions is calculated to exceed the expected capital expenditures over the coming years, generating annual free cash flow between $225 million and $275 million from 2019 onwards.

Bottom line

Shaking up the company's product lines, management teams, and capital structure does not come without a price. I expect significant volatility with respect to Cott's share price in 2017 as the company fully integrates these new lines into its sales and distribution model. As a long-term play, the fact that Cott is making good strategic acquisitions and thinking about ways to increase margins is something that appeals to investors.

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