Cott Corp. Dumps its Legacy for a Healthier Future

Description

Cott Corp. (TSX:BCB)(NYSE:COT) announced July 25 that it was selling its traditional beverage business to Dutch bottler **Refresco** for US$1.3 billion.

Although Cott has been around in one form or another since the 1920s, it took off in 1990 under Gerry Pencer, who convinced Dave Nichol, the mastermind behind the President's Choice brand, that Cott should bottle the private label's cola product.

Within four years, sales grew from $43 million to $500 million; Cott was off to the races, eventually becoming North America's largest contract beverage manufacturer.

However, its growth came at the expense of profits, creating a volatile business. In recent years, CEO Jerry Fowden's taken the company in a new direction, finding new, healthier product categories to grow its business while also generating more reliable profits.

"The sale of Cott's traditional business substantially accelerates our ability to deleverage the business and positions us well to grow our water, coffee, tea and filtration businesses both organically and through value accretive tuck-in acquisitions while also giving us the optionality to expand our platforms through larger scale acquisitions if and when the right value enhancing opportunities present themselves," Fowden said in Cott's press release.

Still, a work in progress, Cott's announcement signals the end of its legacy business. Using the proceeds of the sale to pay down debt, the company will be left with its water and coffee business as the primary revenue generator along with Royal Crown Cola and Aimia Foods.

A bird in the hand…

It's never easy to sell a business, but it's especially hard when it's been an integral part of the company's history. While investors have endorsed the deal — its stock is up almost 7% on the news — Cott's name will probably always be synonymous with soda pop.

Make no mistake; this deal is meant to narrow the company's focus while strengthening its balance sheet. As of the end of March, Cott had net debt of US$2.4 billion, or 7.8 times EBITDA. By the time the deal closes at the end of 2017, its net debt will have dropped to 3.5 times adjusted EBITDA — a far healthier use of leverage.

Moving forward, Cott's 2017 estimated pro forma revenue is US$2.2 billion with adjusted EBITDA of US$285 million, a 13% adjusted EBITDA margin and 130 basis points higher than its adjusted EBITDA margin in fiscal 2016.

Bottom line

Cott's move allows it to generate stronger free cash flow without betting the farm to do so.

It's looking for 2-3% annual organic revenue growth along with higher gross margins, lower interest costs, greater synergies, and future revenue growth from tuck-in acquisitions that don't require a lot of debt but strengthen its position within the coffee- and water-delivery service business.

Last July, I suggested that Cott's stock was worth owning because it was moving from a value play to a growth play. A year later, it's trading around $18 and has made very little headway.

Divesting its legacy beverage business just might be the tonic its stock requires. I like the move. It's a good example of addition by subtraction.

Three to five years from now, investors will look back on this move as transformative.

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