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Cott Corporation

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PRESENTATION

Operator

Welcome to Cott Corporation's third quarter 2018 earnings conference call. All participants are currently in listen-only mode.

This call will end no later than 11:00 a.m. Eastern Time.

The call is being webcast live on Cott's website at www.cott.com, and will be available for playback there until November 23, 2018.

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 harbor 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 US 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 in the Company's third quarter 2018 earnings announcement released earlier this morning, or on the Investor Relations sector of the Company's website at www.cott.com.

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

Jarrod Langhans — Vice President of Investor Relations, Cott Corporation

Good morning, and thank you for joining our call. Today, I'm accompanied by Jerry Fowden, our Chief Executive Officer; Jay Wells, our Chief Financial Officer; and Tom Harrington, who currently heads up our Route Based Services segment, and will be transitioning into the CEO role effective at the beginning of fiscal 2019.

Jerry will start this morning's call by providing a few thoughts on the quarter, as well as some commentary on our new board members. Tom will then offer some thoughts on our company overall, and he'll then provide an update on some of the initiatives that we have put in place over the last few years as we look to deliver on our full year 2018 and 2019 free cash flow expectations with steady growth thereafter, before turning the call over to Jay for a discussion of our third quarter consolidated financial performance, full year expectations, as well as the results of both our Route Based Services segment and our Coffee, Tea and Extract Solutions segment before moving to Q&A.

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

Jerry Fowden — Chief Executive Officer, Cott Corporation

Thank you, Jarrod, and good morning, everyone. In looking at our third quarter, I'm pleased to report that our results continue to come in as expected, our strategy is working, and we have wind in our sails as we look to the future.

All in all, with these good results and a positive outlook, it seems like the perfect time to turn the reins over to Tom Harrington to lead Cott into the future. As you know, Tom will take over as Cott's new CEO from the start of 2019, and I will transition into the Chairman's role.

It's been an exciting time over the last few years, and I was proud to be part of Cott's transformation as we executed our strategy designed to reshape our business from a mature soft drink company with low margins and a high big-box retail customer concentration to a higher-margin, growth-oriented company with low customer concentration and more of a reoccurring revenue business model.

During this process, we not only created a new business model, but we significantly improved our growth profile, shifted our emphasis and business towards Route Based Services, and meaningfully reduced our exposure to both commodity fluctuations and the big-box retail channel.

This transformation and its benefits can clearly be seen in the business' current momentum and our third quarter's consolidated results, where revenue grew 5, 6 percent on an FX and coffee price neutral basis, and adjusted EBITDA grew 11 percent, as we saw good leverage going down the P&L.

In addition, the quarter produced $56 million of adjusted free cash flow, bringing the year-to-date adjusted free cash flow to $85 million, which puts us well on track to deliver at the top end of our 2018 adjusted free cash flow target, as well as delivering over $150 million of free cash flow in 2019.

In looking at our business operations we saw gains in almost all areas, with water consumption per customer increasing, growth in organic new customers and net customer numbers, as well as pricing gains as we implemented our specific HOD pricing initiatives, all this alongside a significant increase in coffee extract sales.

So with a strong quarter behind us, good top- and bottom-line momentum, and a number of significant initiatives in place that Tom will cover, I believe we are very well set up for quarter four, the full year, and for 2019 as a whole.

All in all, Tom and I feel confident as we look ahead that we'll continue to see growth in customer numbers, as well as growth in consumption and price or average revenue per customer. And that with the momentum we have, we'll deliver good consolidated revenue, EBITDA, and free cash flow growth going forward.

On that note, I'd now like to spend a couple of minutes welcoming our two new directors. As we move through our transition, we believe that it was important to add new board members to the team in order to provide a diversity of experience, as well as an attractive blend of expertise. Britta Bomhard and Steven Stanbrook are both highly respected executives who joined our Board of Directors on Monday and have tremendous international business experience.

As we noted in our press release yesterday, Britta is the Executive Vice President and Chief Marketing Officer of Church & Dwight and has held that position since 2016, prior to which she held the role of general manager of Europe at Church & Dwight from 2013 to 2016. And previously, Britta served in a variety of general management and marketing roles across Europe with both Energizer and Wella.

Steven currently serves on the board of directors of Imperial Brands PLC, as well as Vee Pak, prior to which he was chief operating officer, international for S.C. Johnson & Son where he oversaw operations spanning more than 100 countries.

Both Britta and Steven, as I mentioned, will bring a wealth of knowledge and experience to Cott's board, and will broaden our board's sales, marketing, and international perspective.

On that note, I'll pass the call over to Tom to cover some thoughts on our company overall and update us on some of the initiatives that we've put in place over the last few years.

Tom Harrington — Chief Executive Officer, DSS, Cott Corporation

Thank you, Jerry, and good morning, everyone. When I think about our company and all of the work we've undertaken over the last few years, I see three common themes.

First, delivering on our 2018 and 2019 revenue, EBITDA, and adjusted free cash flow goals should act as a catalyst to a higher stock valuation and improved multiple, as we believe we've not yet realized full credit for transforming into a business that has more predictable and consistent growth in revenue and free cash flow generation.

Second, while we're in the early stages—two quarters to be precise—of our new business model, and many potential investors are not yet aware of the transformation that has been made over the last several years, we remain committed to communicating the results of our transformation through a variety of investor conferences, non-deal road shows, plant or office visits, and working to obtain additional coverage amongst new analysts.

As part of this outreach, in 2019 we're planning multiple opportunities for investors to visit additional sites in the US and are planning an Investor Day in New York City in March of 2019. This will not only provide me with an opportunity to spend more time with our analysts, current investors, and potential new investors, but it will also allow us to go a layer deeper within the organization to provide access to members of our Route Based Services and Coffee, Tea and Extract Solutions businesses.

And third, continuing to provide clear and transparent messaging to the market by providing quarterly updates on several financial metrics of our business, as well as KPIs that drive our business to better show the consistency and recurring nature of our revenues and free cash flow.

In regards to the KPIs, we'll continue to provide consistent information around revenues and margins by operating segment each quarter, and we will start allocating any adjustments made on a consolidated basis to each segment so that everyone is better able to understand the results of our segments.

Although not included within this quarter's exhibits, we will provide the breakdown of adjustments by segment in future quarters.

In addition, we will share several KPIs to assist everyone with understanding our results, including performance metrics such as customer growth, bottled water consumption, pricing, and tuck-in activity within our Route Based Services business and volume, mix and coffee pricing within our Coffee, Tea and Extract Solutions segment.

I believe that providing these KPIs will improve the understanding of our business, and provide greater visibility on the predictability and dependability of our growth prospects.

With that said, I wanted to spend a few minutes walking through a number of our recent initiatives that will drive our business over the next few years, as well as our environment, social and governance, or ESG programs.

Our ESG programs are part of the culture of all of our businesses. And in addition to creating goodwill with our customers, should expand the pool of investors that look at our business as not only a business with good top line and free cash flow growth, but also one that is committed to the environment through sustainable business practices.

So let’s start with the customer initiatives within our Route Based Services segment. Over the last few years, we’ve implemented a number of initiatives to grow our customer base and to shift the mix of our water delivery customer base within North America.

As many of you know, with outsized growth in our residential customer base a couple of years ago, the mix between residential and commercial customers within our North American division shifted a few degrees towards the residential customer.

As a result, home and office water delivery customer programs have been executed to meet two goals: to drive total organic customer growth and to shift our mix of customers, with a greater emphasis on growth of our commercial customer base.

I'm pleased to report that our mix has begun a shift back towards the commercial base over the last 18-plus months and is approximately 60 percent commercial. Our initiatives are working.

As a reminder, our European division customer base is primarily commercial.

Looking at our customer performance in the third quarter, overall we increased our total customer base by one-half of 1 percent, with our HOD cooler customers up almost 1 percent. For the full year, with customers coming in Q2 and Q3 and then some seasonal reduction in Q4, we expect our total customer base in Route Based Services to exceed 2.5 million compared to 2.4 million in the prior year, including tuck-in acquisitions.

As we look to the remainder of the year and 2019, our goal is to continue with focused marketing initiatives designed to drive customer growth and improve our mix.

To move a layer deeper, our customer initiatives over the last couple years have been driven by a controlled and focused plan which includes, first, an investment in sales headcount designed to improve our overall North America mix and to drive organic growth in the commercial channel.

I'm pleased to say that our sales associates are continuing to meet our internal targets. Or said another way, they are driving the appropriate per day placements to meet the objectives we set with this initiative. This program also benefits our long-term growth, as commercial customers are not only our most profitable accounts, but they are also our longest-lived accounts.

And second in Europe, we've implemented our high-density area, or HDA, program to improve the return and effectiveness of our cost of marketing dollars, by focusing on a number of major urban markets where data indicates we can achieve a higher return from our sales and marketing investments. This HDA strategy has resulted in new customers being added in specifically selected geographic areas, thus providing increased route density and thereby enabling improved customer satisfaction.

Moving to our customer experience. We have spent a significant amount of energy and resources in this area over the last few years, and it will continue to be a key area of focus and investment going forward. These activities assist in driving a lower quit rate, longer customer life cycle, and supports our ability to drive organic customer growth and revenue per customer location.

As we noted on our call last quarter, we continue to see historically low churn rate in North America, and our European division continues to maintain their consistently low churn rate as well.

Customer experience will be a key topic when we hold our Investor Day, where our Route Based Services management team will provide a more in-depth discussion on these initiatives. But in advance of this, I'd like to touch on just a few topics.

One, we've made significant improvement in our customer service levels since we opened our Lakeland call centre, which incorporated state-of-the-art technology which allows us to be proactive and contact customers in order to make sure that all issues have been resolved, assist other backlog functions during peak periods, and perform outreach efforts in order to learn what else we could do for our customers.

And second, we've made very good improvements in our IT capabilities over the last few years as well. In North America, we've connected our distribution centres, route sales representatives or drivers, and call centre through the iPhone handhelds that the drivers utilize, enabling real-time discussions to resolve customer opportunities as they occur.

Today, with a few clicks of my phone, I can see where our drivers are, what they have on their truck, how many customers they service, and how many customers they are projected to serve over the remaining portion of their day. We will look to utilize this infrastructure as we build out a customer app that our customers can use to order products, pay their bill, and find their driver.

We're also looking to implement similar programs and initiatives in Europe.

As you may have gathered, this is an area that I'm very excited about, an area which will provide us with significant upside opportunity as we look over the next three to five years.

Turning to pricing. As many of you know, we rolled out a carefully planned and executed price increase initiative to our US Route Based Services customers. These various pricing action have been phased in beginning in August and were designed to fully offset the inflation that has been pervasive throughout 2018. I'm pleased to say the pricing actions have come through as expected.

Moving to coffee extract and new menu initiative, as well as our channel expansion projects. Our Coffee, Tea and Extract Solutions segment will focus on continuing to grow its core coffee and tea volumes while seeing higher growth in product categories, such as coffee extracts.

We continue to build out our customers' menus in areas such as cold brew coffee and other extract-related products that have seen significant growth over the last few years, which we expect to continue going forward.

We've done well with this category, with extracts increasing from around 5 percent of our revenue mix to 8 percent over the last few years. Extract volume has seen strong growth, increasing by more than 50 percent this quarter relative to the third quarter of 2017. And on a year-to-date basis, we've seen volume growth of 38 percent and expect to continue the growth over the next one, three, and five years.

Additional growth will come from our continued expansion into new channels that we've historically under-penetrated. We have seen good growth in areas such as health care and other noncommercial businesses and would look for outside growth in this area going forward.

With key initiatives and high growth in the area of extracts and new channels, we would look for our core roast and ground coffee and tea business to deliver more modest performance, whereby collectively we're able to deliver on our total volume and revenue growth goals across the business as a whole.

These initiatives, as well as a number of others that I did not mention, would be expected to take our consolidated revenue growth from 2 percent to 3 percent up to 4 percent to 5 percent over the next two to three years, including tuck-in acquisitions.

As a final topic, I'd like to note that our transformation into a primarily water and coffee route based services business, we now have a culture and operational expertise focused on social responsibility and sustainability. This mind-set and the programs associated with these practices assist in driving efficiency, inspiring further innovation and building platforms for long-term growth, an assured supply at a time when many individuals and businesses have become very short-term focused.

To provide you with a few examples of how we're doing our part: First, our 3- and 5-gallon packaging is one of the most environmentally friendly packages in the consumer goods space. A single 5-gallon bottle will be used around 50 times, and therefore it represents almost 2,000 single-use 0.5-litre water bottles. We then grind the 5-gallon bottle up, utilize a portion of it in the manufacturing of our next 5-gallon bottle, and the remaining material is typically reused as components in products, such as vehicle centre consoles and cup holders.

Second, our European Route Based Services division is 100 percent powered by green energy sources. And third, our Coffee, Tea and Extract Solutions segment is focused on working with farmers across the world in order to assist in crop yields, sustainability, and environmentally friendly farming initiatives. We will continue to provide more information on these topics over the course of our communications in 2019 and beyond.

Before I pass the call over to Jay, I want to thank the associates of our business units for their collective efforts in the quarter satisfying our customers and delivering solid results. Thank you.

Jay?

Jay Wells — Chief Financial Officer, Cott Corporation

Thank you, Tom, and good morning, everyone. With good top-line performance across our Route Based Services segment, we saw consolidated revenue increase by 5 percent to $609 million and adjusted EBITDA increase 11 percent to $93 million.

I'll go into greater detail on the growth drivers when I cover the operating performance of our Route Based Services segment, but the good momentum we saw in the third quarter gives us confidence in delivering full year revenues of around $2.37 billion and full year EBITDA in the range of 312 million to $315 million in 2018.

As we exit 2018 with our growth initiatives and increased tuck-in programs in place, we are set up well to deliver 4 to 5 percent top-line growth over the next few years. And we will provide an update to our 2019 guidance, including the incorporation of Mountain Valley during our Q4 earnings release conference call.

Turning to cash. Adjusted free cash flow from continuing operations was $85 million year to date. Please note that the $85 million of year-to-date adjusted free cash flow includes a revision of prior quarters as a result of reclassifying cash payments from continuing operations to discontinued operations. As we look at adjusted free cash flow for full year 2018, we're expecting to deliver at the high end of our stated goal of 115 million to $120 million, with CapEx of around $125 million.

With respect to capital deployment, we returned approximately $32 million to shareholders in the third quarter through $8 million of dividends, as well as $24 million in share buybacks. Since launching our share repurchase program in May, we have bought back $40 million of shares at an average price of $15.65.

Turning to our recently announced Mountain Valley acquisition. Mountain Valley is a business that we are familiar with, having worked with them as a distribution partner for many years. We are projecting for Mountain Valley to generate pro forma 2018 revenues of over $50 million, of which we will see a revenue benefit in the fourth quarter of around 8 million to $9 million.

As a reminder, we acquired Mountain Valley in mid-October and are excited to add to our portfolio a fast-growing, highly recognized American brand of spring and sparkling water. Mountain Valley has been bottled in glass continuously since 1871, with one production facility in Hot Springs, Arkansas, and four protected and owned springs with excess capacity to supply long-term demand.

Channels of business include HOD, the natural food channel, on-premise, E-commerce, and strategic contract packaging with a focus on spring water bottled in a variety of glass bottle sizes ranging from 5-gallon bottles to 333 mL.

With the oversized growth provided by Mountain Valley's premium water brand, we would expect this business to drive a cash-on-cash IRR above our typical acquisition targets. As we look to integrate this business with our Route Based Services segment over the next two years, we would expect to generate approximately $1.5 million of cost-related synergies in addition to organic growth associated with the business.

With Mountain Valley already being a part of our distribution system, we'd expect a smooth integration.

With the acquisition of Mountain Valley and Crystal Rock this year, in addition to other smaller tuck-in acquisitions, we have well exceeded our goal of 40 million to $60 million of tuck-in acquisitions for the year. And looking to 2019, we have the ability to deliver another 40 million to $60 million of tuck-ins, as we continue to have a robust pipeline of targets, and we will continue to review other opportunities that would include companies of similar size as Mountain Valley, or scale opportunities within the market.

Let me now cover the operating performance of our Route Based Services segment. Route Based Services saw revenue increase 7 percent in the quarter, driven by 5-gallon average sales price being up roughly 3 percent, total customer growth of over one-half of 1 percent, 5-gallon volume per customer up 1.3 percent in North America, and the addition of Crystal Rock.

Gross profit increased 7 percent to $267 million, driven primarily by revenue growth drivers I just mentioned, including pricing initiatives that offset the inflationary cost that we have discussed throughout the year.

Operating income increased by 27 percent, as we saw the benefits of our revenue growth leveraged throughout our system. And we continued to see good progress from our commercially focused direct sales force, as well as activities within our other customer acquisition programs, as noted earlier by Tom.

We also saw positive activity in most of our European markets as it relates to our customer growth plan focused in high-density areas, and we continued to see a reduction in our overall customer churn rate, which will be instrumental in driving sustainable profit growth over the coming years.

Now let me cover the operating performance of our Coffee, Tea and Extract Solutions segment. For the quarter, we continued to see volume pressure, as we were lapping 9 percent growth in the prior year. Although our roast and ground coffee and tea volumes were down 3 percent as we were lapping this tough comp, our extract volume was up over 50 percent, driving 1 percent growth in revenue after adjusting for the change in average cost of coffee.

As we look to Q4, we expect to move back towards volume growth as we begin onboarding a new national convenience retail chain in December, which has around 1,200 outlets and over 2 million incremental pounds of coffee per year. This new customer, in addition to our growth in extracts and new channel volume, sets us up well for good growth in 2019.

Gross profit was $35 million compared to 37 million. And operating income was $5 million compared to 4 million, as lower coffee volume was fully offset by a combination of increased volumes within extracts, as well as cost reductions within the quarter.

So as a quick summary, we had a good Q3 quarter where we delivered on revenue, EBITDA, and cash, and we have built momentum going into Q4, where we're on track to deliver on our 2008 (sic) [2018] expectations. With this good momentum, a number of growth initiatives working effectively, and a good tuck-in pipeline, we are set up well going into 2019 in order to deliver on our 2019 goals, which would incorporate top-line growth of 4 to 5 percent, as well as over $150 million of adjusted free cash flow.

I will now turn the call back to Jarrod to move us to Q&A.

Jarrod Langhans

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 up for questions.

Q&A

Operator

At this time, if you would like to ask a question, please press *, then the number 1 on your telephone keypad.

Our first question comes from Derek Dley with Canaccord Genuity. Your line is now open.

Derek Dley — Canaccord Genuity

Yeah. Hi, guys. Jerry, as I gather, I think this'll be one of, if not, your last conference calls with us. I just wanted to congratulate you on the transformation of the business and the value you've helped create over the last 10 years.

Jerry Fowden

Oh, that's very nice of you, Derek. With comments like that, I'm sure I'll miss talking to you on a quarterly basis going forward. I mean, that said, it certainly is a nice quarter for my last call with financial performance, revenue, EBITDA, and free cash flow doing well, but probably even more importantly, the underlying key drivers of customer growth, consumption per customer growing, and average price per customer growing.

So when you couple that with the momentum we've got, it's that that gave us the confidence, Tom and I, to lift our going-forward guidance not just for Q4 or 2019, but for the next few years to come to 4 percent to 5 percent top-line growth. So all in all, I've enjoyed the time. I feel it's the perfect time to hand the reins over to Tom as he takes over as CEO in January 2019.

And with that said in mind, I think I'll allow Tom and Jay to pick up the Q&A on this call with everyone knowing that I'm here in the background because Cott's part of my heart and my life. And I look forward to being Chair of this business going forward.

But thanks, Derek, and for the rest of this, I'm looking at Jay Tom knowing they've got everything in control and all the numbers to hand.

Derek Dley

Okay. Terrific. Jay, maybe I'll start with you. Just on the 2019, I guess it's updated guidance of free cash flow 150 million plus. Just to be clear based on some of your commentary, that does not include Mountain Valley until we get an update in Q4, is that correct?

Jay Wells

No. I mean, right now we're just finishing up our AOP for next year. We're going to incorporate Mountain Valley into that number. And once we get through all the work that we're working on right now, we look to update our 2019 guidance really on the next earnings call once we get through all that.

But yes, you are correct, it does not include Mountain Valley.

Derek Dley

Okay. Terrific. And then just on the liquid extract business, obviously it's growing very fast here. Can you give us some colour just on the capacity that you currently have to support that growth going forward? Is there going to need to be any additional investment in that business? And is it incorporated in your CapEx guidance?

Jay Wells

No. I mean, one thing we're very excited about as we're seeing the Millennial and the Gen Zers moving much more to cold coffee beverages and away from the hotter drinks, we're seeing overall volume in roast and ground-type coffee probably trending down to about 1 to 3 percent. But at the same time, we are one of the leaders of providing high-quality coffee extracts that is the key ingredient to these types of drinks. So with us being the leader, now I think we're well set, but that doesn't mean that technology isn't continuing to involve to become even higher quality.

So within our strategy, within our plans we will continue to invest within this type of technology to continue to be the leader. So currently our CapEx goals do include that. But to the extent some additional new innovation comes along that we need to invest additional CapEx in to continue this type of growth, we're more than willing to invest some of our CapEx behind innovation and growth.

Derek Dley

Okay. Okay. Thank you very much. I'll leave it there. Cheers.

Jay Wells

Thanks, Derek.

Jarrod Langhans

Thanks, Derek.

Operator

Our next question comes from Peter Grom with JPMorgan. Your line is now open.

Peter Grom — JP Morgan

Hey. Good morning, everyone. And, Jerry, congratulations again. Wish you the best of luck going forward.

Jerry Fowden

Thanks, Peter.

Peter Grom

So I have a bigger-picture question for Tom. As you're transitioning to your new role as CEO, I guess how does your experience over the past several years in the Route Based business frame your outlook for the business going forward? Are there things you would have done differently over the past several years? And how do you see the business evolving from a competitive perspective and for Cott specifically in the coming years? Thanks.

Tom Harrington

Yeah. Thanks, Peter, and good morning. I really see the RBS, Route Based system as the highest percentage of our business. I expect the business to grow in total 4 to 5 percent. That would mean, of course, based on what we said about coffee, tea, and extracts that RBS will grow faster. That would include the historical tuck-ins that we do.

One of the key learnings is mix is very important to us as a component of the organic growth and the right balance of residential and commercial, that's probably the single biggest learning from the big shift of residential. And then I think, importantly, obviously that revenue will put us in position to continue to have free cash flow growth and generation over the coming years, and a bit more focus on sustainable business practices which are core to what we do with both the RBS business and the Coffee business.

Peter Grom

Great. I'll leave it there. Thanks, guys.

Tom Harrington

Thanks, Peter.

Operator

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

Amit Sharma — BMO Capital Markets

Hi. Good morning, guys.

Jay Wells

Good morning.

Tom Harrington

Good morning.

Jerry Fowden

Good morning.

Amit Sharma

Jerry, congratulations, but I think you may have to remain busy finding new better deals for Cott. So there's no rest for you at this time. Very quickly, Jay, one question for you and Tom as well. When we talk about higher revenue per customer, can you just help us understand like where is it coming from? Is it just inclusion of Mountain Valley-type products? Are they buying differently? Is it residential? Commercial? And when do we start to see that flow through on the margin line a little bit more?

Tom Harrington

Yeah. There's a couple of components. So it's clear that we've successfully implemented the pricing that will lead to higher revenue. It's clear that healthy hydration and the shift away from other beverages to categories like bottled water is a benefit to us.

There's always opportunities for us to sell our existing customer base more. So that could be things like PET penetration. We haven't baked in Mountain Valley yet, just to be clear in terms of the numbers. So the additional penetration in efforts there is not yet in any of our guidance. We'll do that after we finish our work with the annual operating plans, which we're frankly in the early stages, middle stages of finalizing next year. So that's really—the last piece is obviously mix.

So we get higher volume, higher revenue from commercial, so one of the outputs we get is longer life, higher revenue per customer, and that mix is an important component of our growth algorithm.

Amit Sharma

Tom, does that show up on the margin line at some point when it becomes larger driver or large enough of a driver of the business?

Tom Harrington

Well—

Jay Wells

Yeah. Let me take that. I mean, you really look at our mix of a commercial into more commercial customers, and Tom mentioned it on the call, commercial customers have a longer life. And as we go through that life, we take price on each anniversary date. So as our mix shifts, as we have longer life—these small commercial customers that we're taking regular pricing every year, that will make that alone higher-margin customers.

Amit Sharma

Got it. And then just one more for Tom. Tom, can you just remind us what's your kind of relationship with Keurig at this point from a distribution point of view? And since they have had a new management team there for the last maybe couple of years, how that relationship has evolved in terms of integration or product you carry or strategically?

Tom Harrington

Yeah. So we have long been a Keurig Authorized Distributor in the US. And frankly, with the transition, I think our relationship is stronger today than it has been historically. We do use a Keurig authorized brew mechanism in the AquaCafé, and continue to work with them on developing the next evolution of appliances.

So we're actually in a good spot with that relationship and working closely together today than we have in the past.

Amit Sharma

Great. Thank you so much.

Jerry Fowden

Thanks, Amit.

Tom Harrington

You're welcome. Thanks, Amit.

Operator

Our next question comes from Derek Lessard with TD Securities. Your line is now open.

Derek Lessard — TD Securities

Yeah. Good morning, everybody. Just a question in terms of the Mountain Valley acquisition; nice little tuck-in there. I was just wondering how much of an opportunity you see in the spring and sparkling category? And is it a category where things like branding and packaging matter, and therefore, there's going to be more of a premium multiple that you pay on these acquisitions?

Tom Harrington

Yeah. So the way I think about the Mountain Valley acquisition is it gets us in a category we have historically not been, which is sparkling water. So we're excited about adding that to our portfolio over a period of time.

It is … the category enjoys double-digit growth. Most of the growth in the premium category is driven by brands outside of North America. So we think there's a unique positioning for us in multiple channels to expand that business over time.

Derek Lessard

Okay. And given—is it more of a retail category? And therefore, how much synergies do you expect to extract from these type of assets?

Tom Harrington

It's multiple channels, so there is an HOD business, frankly, with the existing DS business as distributors. There's other distributors in the US, so that's one part of it. And then it's multichannel distribution that they have. Currently, a big percentage of that would be in the natural channel.

But there's lots of opportunities for us to expand this business across multiple channels, including channels like foodservice, where they have a small footprint today than we would hope they'd have in the future.

Derek Lessard

Okay. Thanks for that.

Jerry Fowden

You're welcome.

Operator

Our next question comes from Judy Hong with Goldman Sachs. Your line is now open.

Judy Hong — Goldman Sachs

Thank you. Good morning. And I also echo my congratulations to Jerry, and it's been great working with you for me as well. So I guess in terms of the pricing, it sounds like it went pretty well. So maybe a little bit colour just in terms of clarification that it's fully in the marketplace and there's no further to go, and then just as you've had this pricing in place, sort of what kind of conversations or impact that you think you've had? And as relating to that, just thinking about gross margins going forward and some of the freight headwinds potentially abating at least on a year-over-year basis, how we should think about the margin impact as you have the pricing through? Thank you.

Tom Harrington

Yeah. So, the pricing actions were phased in beginning in August. And they were intended to fully offset the inflation we experienced this year, as well as some potential inflation as we think about next year, as well as we articulated, in Q4 we'd expect it to offset the full year impact of freight. So the pricing has been implemented in that manner quite successfully.

The best arbiter of that is certainly the flow through in revenue, but we've managed to maintain the lowest quit rate or best retention rate historically in the US, which is a good indication that it's been accepted in the marketplace. We'll also see that pricing in 4, but also enjoy the benefit of that pricing in as it rolls over into Q1 and Q2 of 2019.

The freight headwind remains. It will obviously be less next year as we roll over it. And you'll recall, we said 2 million a quarter in Q1, 2, 3. It'll obviously be there next year. We've made some progress filling the openings, but I wouldn't tell you we've conquered that just yet.

Judy Hong

Got it. Okay. And then, Tom, just obviously you've spent a lot of time highlighting the technology investments that you've been making, and we have talked about that at the analyst meeting in March. Just wondering maybe taking a step back sort of the upside opportunity you see, maybe the rollout of the timeline? And then as we think about sort of the impact both top line and bottom line, how we should think about the opportunity over the next few years?

Tom Harrington

Yeah. I think we continue to work on the development of the technology. The current focus is really around the customer-friendly app. We don't have it yet today. We think that it will help us build revenue per customer. We would expect to see that as we finish our planning process, particularly around DS because they would be first. So it's still in development. That's the biggest opportunity.

It should manifest itself in a stickier customer because we become real—much easier to do business with. And really, that's the view. The longer term is we'll then extend that to Europe. So it's early stage DS and then we'll extend it in Europe and later in '19, frankly in 2020 and beyond as we get there.

Judy Hong

Got it. Got it. Okay. Thank you very much, and looking forward to all the KPI metrics as well. So thank you for that.

Jay Wells

Thanks, Judy.

Operator

Our next question comes from Dan Moore with CJS Securities. Your line is now open.

Dan Moore — CJS Securities

Yes. Good morning. Thanks for taking the questions.

Tom Harrington

Morning, Dan.

Dan Moore

Wanted to maybe just touch on the competitive landscape as it relates to tuck-ins, any changes there as far as purchase multiples are concerned? And just kind of looking back historically, if we have a little bit more volatility, be it equity markets or just general business confidence, how does that impact multiples and/or prices that sellers are willing to accept? Wondering if it might actually could be a slight net benefit for you?

Tom Harrington

I'll take the first part, and I'll let Jay handle the second part. We continue to have a robust pipeline, both in North America and Europe on the RBS side. And while the multiples are different on one side of the Atlantic to the other, we're not seeing meaningful upside pressure. And that's for what I'd, Dan, describe as the historical tuck-in.

Mountain Valley would be I think Jay would call it a chunky tuck-in. It's a little bit different, obviously, but historical tuck-ins it's normal course, frankly, for us as we see it.

Jay Wells

Yeah. I mean, you got to keep in mind here in North America, we're basically primarily the only buyer out there, so we maintain discipline. And as we've talked before, you look much more as a 1.1, 1.2 times revenue because the EBITDA varies greatly between these targets, but it's pretty standardized; synergizes to around a 3 times post-synergy EBITDA multiple. And we just stay very disciplined with the pipeline.

At first they don't like that offer, we let them go away for a year, carry 42-pound jugs for another year, and a year later our price sounds a little bit better. So we maintain our discipline, and really the market doesn't affect that.

And for the larger-scale tuck-ins, it really depends what we're looking at buying. When you look at Crystal Rock, we synergize down to around a 5 times post-synergy EBITDA multiple; that's higher than our average tuck-in, but we were picking up plants, routes, distribution centres. So getting a much more—hole in our infrastructure filled and that's why we pay a little bit higher, but really provides additional benefits than just a customer list acquisition.

And you look at Mountain Valley, we're adding one of the premium HOD water brands out there, sparkling water, that's really demonstrated significant growth going forward. And yes, we paid a little bit higher multiple for that. But as I mentioned in my prepared remarks, you run the IRR on it and the cash-on-cash IRR is one of the higher ones we've done in a deal because of the growth that company demonstrates and will continue to show going forward.

Dan Moore

Very helpful. Just one more quickly following up on the last question. It sounds like price increases went through very smoothly. Quit rates are still at historic lows. Historically, how long does it take for that to show up? Is it a function of weeks or months, if it were going to have an impact?

Tom Harrington

Yeah. So we enjoyed think of it as a half-life in Q3 and we expect getting the full benefit in Q4, and then that'll flop as well into Q1 and Q2. So think of it as a couple of months, depending on when you do it by the time you realize a full benefit.

Jay Wells

We've had two billing cycles now.

Tom Harrington

Right.

Jay Wells

Any calls that—that normally is the time it takes for customers to call in and discuss it, and we saw minimal incremental call-in and issues with regards to the customers with the price increase.

Tom Harrington

Yeah. We think of it as fully behind us at this point in time.

Dan Moore

That's perfect. Thanks for the colour. And, Tom, look forward to seeing you in Atlanta in a couple of weeks.

Tom Harrington

Yeah. Thanks, Dan.

Operator

Our next question comes from Mark Petrie with CIBC. Your line is now open.

Mark Petrie — CIBC

Hey. Good morning. And I'll echo my congrats to you, Jerry. Just wanted to follow up on the—

Jerry Fowden

Thanks, Mark.

Mark Petrie

Yeah. So I just wanted to follow up on the pricing and just be totally clear on it. So the price increase was 3 percent or the impact in the Q3 results was 3 percent? And then related to that, I'm wondering if you can just sort of help us break down the big buckets in terms of the 4 to 5 percent growth, revenue growth target that you've got there. Just help us understand the variety of drivers underneath that, please.

Tom Harrington

So the impact was 3 percent in the quarter, right? So that's the way that would have flown through. The future comes from a number of components of revenue growth. Five-gallon customer growth, which is the historical HOD water customer, will be a key component. We have the benefit of increased consumption on that package with more customers and then the execution of price increases. So those are the key drivers of revenue growth in Route Based and then add tuck-ins.

And we exceeded our tuck-in guidance this year. And we have a robust pipeline of tuck-ins for next year, so that'll be the fourth big lever, if you will, of revenue growth in RBS that'll drive the 4 to 5 percent. And then on Coffee business, we said that we would expect to hit our historical 3 percent growth … the 3 percent growth next year.

Jay Wells

And just a clarification, when I said 3 percent pricing, it was purely 3 percent pricing on our 5-gallon bottles that we had to price in on, not across the entire business and all of our products.

Mark Petrie

Okay. So in terms of that 4 to 5 percent, though, then is price kind of the main driver of that? Or how would you rank order those four drivers?

Tom Harrington

Yeah. It's not the main driver. It is a component. And as we think about 4 to 5 percent, it'll be parts of each of those. So we get—we said we had 1 percent HOD customer growth this year, we had the 3 percent on the 5-gallon bottle, and then you get the 1.3 consumption that in RBS actually added up to more than 5 percent and delivered 7 percent in the quarter, right?

Jay Wells

And keep in mind, when we talk price per customer, mix also benefits us on price per customer. As we add more of these small commercial customers, we'll get a price per customer benefit just due to mix. It's not driven by pricing alone.

Mark Petrie

Okay. Understood. I'll get back in the queue. Thank you.

Operator

Our next question comes from George Doumet with Scotiabank. Your line is now open.

George Doumet — Scotiabank

Yeah. Good morning, guys, and congrats, Jerry.

Jerry Fowden

Morning.

Tom Harrington

Good morning.

George Doumet

Just to follow up … yeah, just to follow up on our discussion around the 2019 free cash flow guidance of 150 million plus, so understanding that Mountain Valley is not in there, I believe you had a previous goalpost of 150 million or so. Is the difference there just a function of a tick-up in organic growth expectations? Or anything else going on there?

Jay Wells

I mean, you look at the drivers that we've talked about, and we've talked many times about it. It is organic growth is a key function. We're having some rollover, a pricing benefit into next year. We also have some synergy captures that we're finishing up on both the Eden and the S&D acquisition.

We have a little lower interest payment because we were carrying the DS notes at the beginning of this year. And we have some what I would call dis-synergies left over from the Refresco deal related to the TSA agreements, some corporate costs that were taken out. So those are the key drivers of getting to the 150-plus million of free cash flow for next year from the higher end of our range, around 124 million for this year.

George Doumet

No, that was—I think the 150 million goalpost was out there, but I guess incrementally speaking that plus, that's just a function of maybe your higher organic growth?

Jay Wells

Yeah. No. No, it is. And actually, we've been saying plus for a couple quarters, or at least a quarter now. But no, it really is, yes, you're looking at I would say the plus really a little bit more pricing, better growth, really moving to a 4 to 5 percent-type top-line growth is really the key driver, and the confidence behind it with how well we performed in the third quarter and coming into the fourth.

George Doumet

Okay. That's helpful. And just one last one, if I may. In the past, you've obviously spoken a lot about bolt-ons in the HOD space, but maybe looking at the coffee solutions area, is there opportunity to do small deals there? Any geographies through like from a geographic coverage standpoint? Or maybe specific solutions that we'd like to add to our suite? Anything you can comment there?

Jay Wells

No, no. I mean, you're … I think you're spot on within our strategic plan. We are in a growth business, so in a growthing business we've got two things that we're constantly looking to add: additional roasting and grinding capacity, and as I mentioned earlier when Derek asked the question, we're looking at our extract business. With the growth we're having, we have to look at continued ways to increase capacity and to keep up with the technology out there.

So looking at both of those areas, we are evaluating potential tuck-ins that will assist us in meeting both our growth in roasting and grinding capacity and extract needs.

George Doumet

Great. Thank you. That's it for me.

Operator

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

Amit Sharma

Thank you so much for taking the follow-up. Jay, very quickly, coffee green prices … green coffee prices have rebounded a little bit. So we should just, as we model 2019, just raise the top line? Is that how the impact should—

Jay Wells

No, no. Keep in mind when coffee prices hit their lows that they're currently at, a lot of our customers went very long on coffee. So the overall effect of increasing the cost of coffee, you will not see an immediate impact because we spoke before that, yeah, our customers used to hedge six to nine months, but we've seen even further hedging because of that. So it's going to be a very slow bleed-in.

But over the next six to nine months, really you shouldn't see the effect because where prices were, all of our customers had us hedge a much longer duration than they had historically.

Amit Sharma

And on your extract business, does it hurt you? Or were you able to pass through green prices in the extract business as well?

Jay Wells

No, it's no detriment. And overall, that business is a higher-margin business also, and not many companies compete with us and can provide the quality and the level of extracts that we do, so. So pushing through pricing on that type is not an issue in that part of our business.

Amit Sharma

Perfect. Thank you so much.

Operator

Our last question comes from Mark Petrie with CIBC. Your line is now open.

Mark Petrie

Yeah. Thanks. I just wanted to follow up with regards to the previous acquisition in filtration, Remington, I think. And just wanted to understand sort of how filtration has progressed within the portfolio?

Tom Harrington

Yeah. So as we mentioned before, we're developing the technology as a result of the IP that we acquired. So I think you'll hear us in 2019 talk about the execution of that technology and the benefit of a long-lived filter in our 2019 business plan.

We've begun to make some sales investment in a few markets to further develop the model that we think we can roll out across North America and ultimately, frankly, into Europe in the out-years.

Mark Petrie

Okay. Thanks. Look forward to it.

Tom Harrington

Thanks, Mark.

Operator

And there are no further questions in queue at this time. I'll turn the call back over to Jarrod Langhans for closing comments.

Jarrod Langhans

Thank you very much for joining our call today. This will conclude Cott Corporation's third quarter 2018 call.

Thanks for attending.

Operator

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

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