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Primo Water Corporation

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PRESENTATION

Operator

Good morning. My name is Cree (phon), and I will be your conference Operator today. At this time, I would like to welcome everyone to the Primo Water Corporation's Q4 Fiscal Year 2020 Results Conference Call. All lines have been placed on mute to prevent any background noise.

After the speakers' remarks, there will a question-and-answer session. If you'd like to ask a question during this time, simply press *, then the number 1 on you telephone keypad. If you'd like to withdraw your question, press the # key. Thank you.

I'll now turn the call over to Jon Kathol, Vice President, Investor Relations. Please go ahead

Jon Kathol — Vice President, Investor Relations, Primo Water Corporation

Welcome to Primo Water Corporation's fourth quarter and full year 2020 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 Primo's website at www.primowatercorp.com and will be available for a playback there for two weeks.

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 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, when the data is estimable, is included in the Company's fourth quarter and full year earnings announcement released earlier this morning, or on the Investor Relations section of the Company's website at www.primowatercorp.com.

I am virtually accompanied by Tom Harrington, Primo's Chief Executive Officer; and Jay Wells, Primo's Chief Financial Officer.

As part of this conference call, we have included a deck online at www.primowatercorp.com that was designed to assist you throughout our discussion.

Tom will start today's call by providing an update on the business impact of the ongoing pandemic and our progress on strategic initiatives we are currently focused on. Then Jay will discuss our fourth quarter and full year financial performance, provide an update on ongoing synergy work, and offer our outlook for the first quarter and the full year 2021 before handing the call back to Tom to provide a long-term view ahead of Q&A.

Within the prepared remarks, Tom and Jay will be discussing our continuing operation, which incorporates the Legacy Primo business and excludes the S&D business, which was sold in February of 2020.

Lastly, please be aware that the fourth quarter included a 14th week of activity, making 2020 a 53-week year compared to 52 weeks in 2019. All year-over-year comparisons will include this 53rd operating week, except where otherwise stated.

With that, I'll now turn the call over to Tom.

Tom Harrington — Chief Executive Officer, Primo Water Corporation

Thank you, Jon, and welcome to your first earnings release with the Company.

Good morning, everyone. Earlier this morning, we published our fourth quarter and full year 2020 financial results that continue to validate our transformation to a pure-play water company. We delivered a solid quarter and a strong 2020.

I'm incredibly proud of how our team has responded to a year unlike any other in our company's history, the continued importance that new and existing customers place on our products and services, and the ongoing efforts of our Primo team to fulfill our commitments to our customers.

I have repeatedly stated that our mission is to provide our customers with high-quality drinking water whenever, wherever, and however they want it. And we've demonstrated our commitment throughout the pandemic. Despite all the challenges presented to us, 2020 was a very important year for Primo and included several strategic successes and highlights that set us up for a bright future.

From an operational standpoint, we are entering 2021 as a different company compared to just one year ago. In 2020, we demonstrated a firm grasp on our highly variable cost structure and leveraged it to respond accordingly to the economic impact of the pandemic.

We began the year by divesting our noncore S&D Coffee & Tea business and acquiring Primo Water as part of our transformation to a higher-growth and structurally higher-margin pure-play water business. We have transitioned more than 500 Legacy Primo associates to the team and consolidated over 120 facilities related to the Legacy Primo acquisition. The execution has been a clear success.

We made improvements to our route infrastructure where we increased the daily productivity per route, as well as increased our route density.

Another important piece of improving our route density is our tuck-in M&A strategy. We executed 10 tuck-in acquisitions, which will combine to add more than $30 million of revenue annually. As part of a reaction to the challenges we experienced because of COVID-19, we halted tuck-in M&A during Q2 and Q3 to preserve liquidity. While we believe this was a prudent decision for 2020, we maintain a robust pipeline of tuck-in opportunities that we plan to execute against in 2021 and beyond.

All these efforts have yielded a structurally more profitable and efficient Primo. And last quarter, we raised our long-term adjusted EBITDA margin target from 16 percent to no less than 18 percent. As we enter 2021, we remain diligent in how we plan to put costs back into the business, and we'll balance our investments in organic growth initiatives while making sure to protect these efficiency improvements.

Our financial results were very strong despite the difficult macroeconomic environment. We grew adjusted EBITDA, generated higher adjusted free cash flow, and reduced our SG&A as a percentage of revenue. We also exceeded our initial plan for synergy realization by a large margin, which Jay will elaborate on in a moment. And we were added to the Russell 2000 Index in July.

We made important and tangible improvements to the customer experience as we executed against our Customer for Life philosophy. Consumers are doing more from their home, and staying home is taking on new meaning. Elevated levels of dining in and working from home are driving growth from our residential customer base and at-home consumers who use our Water Direct and Exchange or Water Refill and Filtration services. Fortunately, we have the capabilities to execute from an online perspective in retail stores and direct to the customer doorstep.

We grew our global customer base in 2020 and served roughly 2.5 million unique residential and commercial accounts. We did this while simultaneously reducing our global cooler quit rate for the fourth quarter by 120 basis points from 21.5 percent to 20.3 percent.

We do realize that it will be some time before we understand the impact of the pandemic on the commercial customer base and whether customers who have not purchased since the pandemic began are permanently lost. However, we’re making important strides aimed at retaining existing customers and are working hard to generate new customer adds in the current environment.

We have seen consumer purchasing behaviour change significantly during the pandemic. Consumers are buying more of their products online and having more of those goods and services brought directly to their doorstep in a safe, no-contact way. We are well positioned to benefit from these trends as our overall digital and E-commerce efforts continue to progress.

We launched our My Water+ mobile app and rolled it out across the US in May. The app has been well received, and we’ve been encouraged by the rate of customer adoption. As of the end of 2020, the app has been downloaded more than 190,000 times.

We improved many of our E-commerce websites, including water.com, with the intent of simplifying the ordering process for customers and to raise their awareness of the breadth of water solutions and products we offer. In 2020, our unique web visitors in North America were higher than 2019 by 51 percent, and our web conversion rate was 12 percent higher than 2019.

We launched a new transactional website in 17 countries in Europe for residential customers to sign up for our service. This is the first time that European consumers could sign up online with us, and we’re pleased with the early performance in terms of the number of new customers and the low cost to acquire these new customers.

And we’re investing in our teams with the sole focus of developing online and E-commerce efforts across multiple retailers, as well as a more robust social media effort. All these initiatives are greatly

improving the customer experience, and as a result, our cumulative Net Promoter Score in North America for 2020 was 47.1, which is well above the 30.8 we saw for 2019.

We also continued to advance our innovation efforts. In January 2020, we launched PureFlo, an IoT-enabled water filtration unit that monitors water quality and filter life and provides real-time analytics on water usage and quality. We launched a cooler sanitization program in the US to complement the existing programs we have in Canada and in Europe, as customers are increasingly conscious of the cleanliness of the products they use and consume both at home and in the office.

And lastly, we made important progress advancing our ESG initiatives. Our services greatly reduce the use and disposal of plastic waste. One of our 5-gallon bottles can be sanitized and reused up to 50 times before being recycled, which saves about 1,500 plastic 0.5-litre water bottles. During the third quarter, we achieved carbon neutrality in our US operation, and our European water business has been carbon-neutral for nine consecutive years.

In North America, we shifted some of our transportation fleets from diesel to propane, which reduces carbon emissions and is 75 percent cleaner than the current EPA standard for nitrogen oxide emissions. And we have improved energy efficiency at our plants to ensure lower energy usage per finished product.

In Europe, we source 100 percent renewable energy to cover the electricity consumption of all of our European operations, which have achieved carbon-neutral electricity consumption.

In December, our Diamond Spring site in Pennsylvania was certified by the Alliance for Water Stewardship, AWS. And we became the first company to have a spring water source certified under AWS standards. The certification is confirmation of having met the global benchmark for responsible water

stewardship and water quality. We subsequently obtained the same certification for the second of our springs, our Wekiva Spring site in Florida, which was announced last month.

All these achievements are important steps towards becoming an industry leader for natural resource stewardship and advancing our ESG message across the broader investment community. In short, 2020 was a year marked with challenges and successes.

Overall, I'm quite pleased with the progress we made against our pure-play water strategy. We continue to execute in our key focus areas to ensure that we are well positioned to capitalize on opportunities. And we remain confident that long-term growth drivers of our business are intact.

I'll discuss our priorities and outlook for 2021. But first, I would like to turn the call over to Jay to review our fourth quarter and full year results in greater detail.

Jay Wells — Chief Financial Officer, Primo Water Corporation

Thank you, Tom, and good morning, everyone. Starting with our fourth quarter consolidated results, revenue increased 15 percent to $505 million compared to $440 million. The 53rd week contributed $19 million of revenue. Excluding the impact of foreign exchange and the 53rd week, revenue increased by 9 percent.

The increase is due to the Legacy Primo acquisition, as well as increased demand for our products and services from residential customers and at-home consumers. This was partially offset by lower revenue from our coffee services and the Water Direct commercial customer base in both our North America and Rest of World segments.

On a pro forma basis, excluding the benefit of the 53rd week, revenue decreased by 4 percent. Fourth quarter adjusted EBITDA increased 36 percent to $98 million compared to $72 million in 2019. The

53rd week contributed $4 million of adjusted EBITDA. Excluding that contribution, adjusted EBITDA grew by 31 percent.

The increase was driven primarily by increased demand for products and services from residential customers and at-home consumers, improved operating leverage, the Legacy Primo acquisition, and synergy realization. On a pro forma basis, excluding the benefit of the 53rd week, adjusted EBITDA increased 11 percent versus prior year. Our adjusted EBITDA margin increased by 300 basis points to 19.4 percent.

Fourth quarter SG&A expenses increased 5 percent to $248 million compared to $237 million. The increase was driven by the addition of the Legacy Primo business and $8 million of expenses from the 53rd week, partially offset by lower SG&A resulting from cost reduction initiatives implemented earlier in the year.

We benefit from a highly variable cost structure that offers us flexibility, and we remain very diligent in terms of putting costs back into the business. It will be important to balance our organic investment plans while protecting the efficiencies we have generated, and we will be judicious with that process as conditions evolve.

Turning to our segment-level performance for the quarter. In North America, revenue increased 24 percent to $385 million compared to $311 million. Excluding the impact of foreign exchange and the $19 million benefit of the 53rd week, revenue increased by 18 percent.

The increase was driven by the Legacy Primo acquisition and increased demand for our products and services from residential customers and at-home consumers, which was partially offset by lower revenue from our Water Direct commercial customer base and coffee services. On a pro forma basis, excluding the impact of the 53rd week, revenue in the North America segment decreased by 3 percent.

Adjusted EBITDA increased 43 percent to $82 million, which includes the $4 million benefit of the 53rd week. Excluding that benefit, adjusted EBITDA increased by 36 percent due to the Legacy Primo acquisition, improved operating leverage, and synergy realization. On a pro forma basis, excluding the 53rd week, adjusted EBITDA grew by 11 percent.

In our Rest of World segment, fourth quarter revenue decreased by 8 percent to $120 million driven by lower revenue from our Water Direct customer base and coffee services. Adjusted EBITDA decreased 1 percent to $24 million, as decreased volume in our Water Direct customer base and coffee services business was largely offset by improved operating leverage resulting from our highly variable cost structure.

Now turning to our full year consolidated results. Revenue increased 9 percent to $1.95 billion compared to $1.79 billion. The increase was driven by the Legacy Primo acquisition, increased demand for products and services from residential customers and at-home consumers, and the 53rd week, partially offset by lower revenue from our Water Direct commercial customer base and coffee services. On a pro forma basis, excluding the 53rd week, full year revenue was $1.97 billion, down 4 percent compared to 2019.

Full year adjusted EBITDA increased 26 percent to $362 million compared to $287 million. The increase was driven by increased demand for products and services from residential customers and at-home consumers, our highly variable cost structure, the Legacy Primo acquisition, synergy realization, and the $4 million benefit of the 53rd week. Adjusted EBITDA margin increased by 250 basis points to 18.5 percent. On a pro forma basis, excluding the 53rd week, full year adjusted EBITDA was $365 million, up 8 percent compared to 2019.

Full year SG&A expenses increased 5 percent to $1 billion compared to $962 million. The increase was driven by the addition of the Legacy Primo business, costs related to COVID-19, and $8 million from the 53rd week. The increases were partially offset by cost reduction initiatives implemented earlier in the year.

Turning to our liquidity position and balance sheet. We ended the year with a cash balance of $115 million and available net borrowing capacity on our cash flow revolver of $195 million for a combined total liquidity position of $310 million. We ended the year with a net leverage ratio of 3.4 times and continue to target a post-synergized net leverage ratio of 3.0 times.

Regarding our synergy work related to the Legacy Primo acquisition, we remain confident that we will obtain the full $35 million in synergies over the next three years. The cost actions and efficiency improvements that we enacted throughout 2020 have allowed us to realize a greater portion of those synergies sooner than we had anticipated.

As of year-end, we have realized roughly $18 million of cost synergies, well ahead of our previously planned $7.5 million. Since we executed some actions earlier than we originally expected, we are currently targeting roughly $7 million of incremental synergies in 2021 with the final $10 million in 2022.

Overall, we are pleased with how the business performed in both the fourth quarter, as well as throughout 2020, despite the global pandemic and its economic impact. Our commercial customers remain challenged, but we did not see a significant deterioration during the fourth quarter when lockdowns returned, which is encouraging.

Meanwhile, demand from our residential and at-home customers has remained consistently strong. We understand conditions can change quickly, but the resiliency of our pure-play water model and

our highly variable cost structure makes us confident that we can react accordingly while also executing our strategic priorities.

As we look at our first quarter 2021, based on the information we have available to us as of today, we currently expect consolidated revenue from continuing operations to be between $455 million and $485 million. We also forecast that our first quarter adjusted EBITDA will be in the range of $70 million to $75 million.

It is important to understand the ongoing impact of the pandemic on our quarterly performance in 2021. The first quarter of 2020 included the positive impact of pantry loading resulting from the then unknown impact of the pandemic, coupled with solid core business performance during the first 10 weeks of 2020. Once we have lapped the pantry loading we saw in Q1 2020, we expect a return to more consistent growth versus prior year across all key metrics.

Please note that our current outlook does not include the impact of recent weather disruptions across a significant portion of the US, but our associates have once again stepped up to aid in the recovery of those areas that were the hardest hit. Our thoughts go out to those who were adversely affected.

For the full year 2021, revenue is projected to grow by approximately 5 percent and we expect $370 million to $380 million of adjusted EBITDA, including $7 million of synergy capture, around $15 million of cash taxes, $73 million of interest, as well as capital expenditures of around $135 million. The opportunity remains for an additional $40 million to $60 million of tuck-in acquisitions.

In terms of our growth algorithm after 2021, we expect to grow organic revenue by roughly 5 percent per year, organic adjusted EBITDA by $12 million to $15 million per year, and an additional $5 million to $10 million of inorganic adjusted EBITDA from accretive tuck-in acquisitions.

We remain confident that our starting point for annualized adjusted EBITDA margin will be no less than 18 percent and will increase by 20 to 30 bips per year over the course of the next few years.

I will now turn the call back to Tom.

Tom Harrington

Thanks, Jay. As you just heard Jay cover, we're pleased with where we stand today and how the business performed in 2020. As we look ahead to 2021, we are focused on a handful of key areas to drive organic growth and better leverage our pure-play water model.

Our first priority has always been and will continue to be the health and safety of all of our associates, customers, and suppliers. The resilience and dedication of our associates as they service the needs of our customers has been remarkable, and I want them to know how much we appreciate their efforts.

We will leverage our pure-play water model to drive organic revenue growth by approximately 5 percent. This includes continuing to enhance the customer experience from order placement to delivery and to improve the customer-facing tools to facilitate that experience. This will include building out a more robust and diverse E-commerce solution, improving the functionality of our mobile app and E-commerce sites, developing meaningful relationships with new online retailers, engaging customers with new and exciting promotions, instituting loyalty and rewards programs, and expanding our voice-of-customer initiative to gather critical feedback and refine our approach.

Entering 2021, we already possess a large customer footprint of over 2.5 million commercial and residential accounts with a distribution network that offers us scale and route coverage. We are simultaneously developing new and innovative customer acquisition strategies to further reduce our quit rate and improve customer retention.

In Europe, we plan to accelerate our Water Refill, Water Exchange, and Water Dispenser businesses to diversify our customer base and capture growing demand in the residential market. We are one of the leaders in water solutions in Europe and have the footprint and expertise for low-cost rollout of our Legacy Primo solutions. We believe we will begin to see the benefits in the back half of this year, and they will provide us with profitable growth and a more balanced customer mix in Europe over the longer term.

We will emphasize efficiency and leverage our highly variable cost structure to protect those improvements. Our team is focused on capturing the identified synergies, and we will continue to take appropriate action on that front.

We will identify and execute highly accretive tuck-in acquisitions across North America and Europe. And we'll seek new ways to further expand our standing as an ESG and sustainability leader.

Entering 2021, the growth drivers of our business remain intact. For one, the increased cocooning and work-from-home levels are trends that will not go away quickly, and we expect that they will continue to drive demand for our at-home solutions for the foreseeable future.

Consumers are drinking less sugar and sweetened beverages and opting for healthy hydration solutions where we're well positioned to benefit from growth in the health and wellness category. Customers are also purchasing more of their goods and services online where we stand to benefit from our E-commerce efforts.

And lastly, environmental awareness as well as concerns over municipal water quality highlight Primo's position as a provider of sustainable and healthy hydration solutions. All these underlying trends continue to support the demand for our products and services.

As Jay noted, we expect our consolidated first quarter 2021 revenue to be between $455 million and $485 million and for our adjusted EBITDA to be between $70 million and $75 million. For the full year ’21, we’re forecasting revenue growth of approximately 5 percent and for adjusted EBITDA to be in a range of $370 million to $380 million.

We expect to see sustained strength from our Water Direct residential customer base and in other at-home channels, and we continue to closely monitor the condition of our Water Direct commercial customer base.

I’d like to take a moment to address last week’s announcement that Nestlé has entered into an agreement to sell its Nestlé Waters North America business to One Rock Capital Partners in partnership with Metropoulos & Co. We continue to believe that the combination of the ReadyRefresh HOD business with our own makes strategic sense, and we remain an interested buyer if and when the opportunity arises. Nestlé did not provide an opportunity to carve the ReadyRefresh HOD assets out from the entire North American water business. Our interest was for the ReadyRefresh HOD business only and not the whole company.

As a matter of corporate policy, we won’t be commenting further about any particular strategic discussions we may or may not be having.

With that, I’ll turn the call back over to Jon to move us to Q&A.

Jon Kathol

Thanks, Tom. During the Q&A, to ensure 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. Operator, please open the line for questions.

Q&A

Operator

If you would like to ask a question, please press *, then the number one on your telephone keypad. Again, that's *, then the number 1 on your telephone keypad. Please hold as we compile the Q&A roster.

Your first question comes from the line of Derek Dley with Canaccord Genuity.

Derek Dley — Canaccord Genuity

Yeah. Hi, guys.

Jon Kathol

Good morning, Derek.

Derek Dley

Good morning. I just wanted to follow up on that last comment. I mean on the Nestlé and the One Rock. So when we look at that transaction and kind of run through our math, which there's a widely quoted number of $3.8 billion in revenue within that North American asset. And if we put a slightly lower margin on that than Primo generates, I get to a roughly 7.5 times EBITDA multiple for the transaction value, which is relatively in line with what we've seen in historical multiples in the space. I'm just wondering, is that how we should be thinking about that transaction?

Tom Harrington

Yeah. Derek, this is Tom. I'll pass that to Jay in just a minute, but I just want to reiterate some of my words from the script, which is we've maintained that we believe it to be a strategic value to our company to combine them and that we did best efforts in articulating our interest in ReadyRefresh HOD

business from day one. It became pretty clear that it was Nestlé's intent to sell it as a whole, and our interest remained narrowly in the piece of the business that fits strategically onto our footprint.

We remain interested. And I said in my comments, if and when this becomes available, we remain interested in the opportunity that the asset provides. But again, we always maintain our financial discipline, which is our historical track record here. Jay, can you take a shot at the—

Jay Wells

Yeah. I'm there with you, Derek. I've seen a wide range of multiples on this deal. When I've talked to individuals at the 12 times EBITDA or higher, so that's more the higher end of the range, they've said they're using a 10 percent EBITDA margin. And I looked at Nestlé's public filings since they just announced their earnings last week and yeah. I wasn't able to find any reference to EBITDA margin. But on the last page of their earnings release issued last week, they do state that their water business had underlying trading operating profit of 10 percent in 2020.

So I think that might be a disconnect because the operating profit includes depreciation and amortization expense. So on that, I went and looked to see if Nestlé broke out the D&A for the water business, and I couldn't find that. But if you simply take a very basic approach, and I took a percentage of the assets held for sale versus total assets times total depreciation, I got to a little under $180 million of depreciation. So through this really rough math, I'm not saying it's accurate, it's just what I could find from public records, I got to around a 15 percent EBITDA margin when factoring depreciation on the disclosed results.

So again, I'm not saying this is correct but yeah. I am getting to a number somewhat closer to what you used based on what I was able to find on public records with the assumptions I just mentioned.

Derek Dley

Yeah. Okay. And that's similar to how we got to that 7.5 times is that 15 percent margin using sort of the same sort of exercise you did with the public documents. I appreciate the clarity there. Thank you for that.

I just had a question in terms of customer additions from your E-commerce platform. How is that going? Did we see an acceleration at all from Q4 into Q3? Or what were the trends in that portion of the business this quarter?

Tom Harrington

Yeah. Yeah, Derek. It's Tom again. You'll recall that we will begin expand the footprint over the course of the end of the year. The program remains in place and it's now, however, you would find it under shop local. So the ability to transact with us for onetime purchases is intact. And we're quite pleased with the outcome, frankly, with that large E-commerce Amazon retailer. So we still remain confident in our ability to build that business over time in North America.

Derek Dley

Okay. Thank you very much.

Operator

Your next question is from the line of Derek Lessard with TD Securities.

Derek Lessard — TD Securities

Yeah. Hey, guys. Good morning.

Jay Wells

Good morning, Derek.

Derek Lessard

Congrats on a great quarter. Good morning. Happy to see guidance come back. Just one question here. The guidance that you're giving suggests that margins are going to be in the mid-18 percent level, which is where you've guided to. Just maybe help me square away that with this quarter's 19.4 percent performance.

Jay Wells

I mean, Derek, when you look at our full year guidance that we provided, one, you've got to keep in mind that we really need to jump-start some of our marketing spend to accelerate our recovery and to hit our targeted 5 percent organic revenue growth. So you need to factor that in. We will add it back. We will be disciplined as we add it back, but that's part of what we're factoring into our guidance.

I'm confident with our long-term outlook, but it's prudent to acknowledge the timing of returning to normal also, which is a little thing to keep in mind. We're not through the pandemic yet, and our belief is it's going to at least last through the front half of the year, if not longer.

And at the end of the day, you've got to factor in the lapping of the pantry loading we saw in Q1 of last year. I mean you're talking high single-digit EBITDA-type contribution in dollars from that pantry loading. So I think Q1's going to provide us with a lot of noise, as I've mentioned previously, but feel we'll get back to what we guided as we did so.

And on your Q4-specific question, I mean we had a lot of cost levers that really benefitted us in the quarter. And I would say that, that inflated the margin. I wouldn't take that as run rate. But we did really watch costs tightly to close the year. We wanted to deliver on our numbers, and we did so.

Derek Lessard

Okay. That’s helpful, Jay. And maybe just one last one is maybe if you can highlight what you guys are seeing on the commercial side of the business, specifically if you’ve seen any green shoots that you can talk to.

Tom Harrington

Yeah. On our commercial business, if you went to October, was disappointing in Europe, but then recovered despite marginally. So we finished the year a little bit better than we anticipated in terms of commercial recovery. It obviously varies by country. But both North America and Eden have settled into the current rate.

So we have to cycle through that, obviously, in Q1, which creates some unknown about how ultimately that will finish. But then we’re confident that, as we cycle through the pandemic and as the year goes, returns to normal, that some amount of that commercial customer base should return.

Derek Lessard

Sure. Thanks, gentlemen.

Jay Wells

Thanks, Derek.

Tom Harrington

Thanks, Derek.

Operator

Your next question comes from John Zamparo with CIBC.

Tom Harrington

Morning, John.

Jay Wells

Hello, John.

John Zamparo — CIBC

Hey. Good morning, guys. I just want to follow up on the EBITDA guide as well. It seems like if you take out the 53rd week from this year, you add the synergies you're calling for, you add the two extra months of Primo that you'll have in '21 versus '20, even if you back out the pantry loading, that seems to get you to the lower end of the guide. And presumably, you'll have a reasonable amount of tuck-ins. So just hoping you could elaborate a bit on this. Is it that the additional spending kind of offsets entirely the revenue growth you're expecting? Is there anything else on the SG&A side that we should be aware of? Any other commentary there would be helpful.

Tom Harrington

Yeah, John. This is Tom. And good morning again. I'll take a piece of that, and then I'll turn it over to Jay.

But we have not considered any tuck-ins in our 2021 guide. So to your point is, as they come to fruition, they would drive incremental revenue and profitability over time. But we purposely let that out because we've changed our numbers to mid-single digit, 5 percent organic growth and have been clear about that. And then we will continue to execute, and Jay referenced $40 million to $60 million. We're going to continue to accelerate on tuck-ins as we move through the pandemic. And we got, frankly, a nice little pipeline. So it will be a return to historical practice, if you will.

John Zamparo

Okay.

Jay Wells

Yeah. And on the guidance on the EBITDA side, like I said, we do have some spend coming back in. We're not really spending any marketing dollars on the commercial side of our business right now. As things start coming back to normal, we do want to focus on returning that spend, which will be along with the return to norm, and we will be prudent as I mentioned.

For our guidance, you might be saying that we are at the lower end, but I have, like I said, it's rough estimates, but it's high single-digit EBITDA benefit in Q1 from the pantry loading we saw. And if you look at that quarter, our EBITDA was up significantly year over year, even when you exclude the one month of Legacy Primo we had.

So our desire is to be prudent to get through the year. As we lap Q1 and Q2, which were the biggest noisy quarters because of the pandemic, we will update our full year guidance. But at this point in time, we thought it was prudent to provide the guidance we did.

John Zamparo

Okay. That's helpful. Thanks. And then my follow-up's on the earlier question on commercial volumes. So maybe we could add residential as well. I think in Q3 on the call, you said in October that commercial was down about 30 percent and residential was up, I think, mid-20s. What would those equivalent numbers be for, let's say, December, January and what you're seeing for February so far?

Tom Harrington

Yeah. I'll give you a couple of numbers here, and Jay can elaborate if I miss anything. But residential, Water Direct, and Exchange in North America was up 26 percent excluding the 53rd week; so apples to apples. Commercial revenue was down 20 percent excluding the 53rd week. So residential maintained, maybe got a little bit better, and commercial settled in. And that's North America.

In the Rest of the World, residential was up 14 percent for the year and 21 percent for the quarter. But remember, it's a very small base. And the commercial business was down 20 percent for the quarter and, frankly, the same number for the full year. So we frankly saw it settled down into a run rate, and we're frankly pretty pleased about how the quarter ended.

Jay Wells

As Tom said in his prepared remarks, I mean and we were very happy with those results because we did see the second wave and increased lockdowns hit in Europe. And so we felt it performed well. As we got into January and into February, we're seeing improving trends over in Europe that have us excited. And North America has been pretty consistent with the residential numbers throughout the time last year, and we're seeing that continue. And commercial is improving a little every quarter.

John Zamparo

Okay. That's great. Thank you very much.

Tom Harrington

Thanks.

Operator

Your next question is from Kevin Grundy with Jefferies.

Jay Wells

Good morning, Kevin.

Tom Harrington

Hello, Kevin.

Kevin Grundy — Jefferies

Hey. Morning, everyone. Jon, welcome to the call as well officially. Look forward to working with you. I have two, if I may. Strategic capital deployment and then a quick housekeeping question on free cash flow.

So I want to come back to the strategic capital deployment. So within the context of the larger transaction that you mentioned, of course, with Nestlé, which has gotten a lot of focus and appropriately so, and specifically, the range of timing now going forward with respect to outcomes, is that impacting near-term capital deployment decisions for the Company and for the board?

So I ask that you talked about the robust pipeline for tuck-ins. In the absence of larger considerations with respect to M&A, why not accelerate the pace of tuck-ins, which were on hold for understandable reasons this past year? I wouldn't put words in your mouth, but I know you guys have long felt the stock is undervalued, which I think many people on the call agree with. Would you consider share repurchases? So any comments there would be helpful.

And then I have a follow-up on free cash flow.

Tom Harrington

Yeah. I'll take a piece of that, and then I'll give some to Jay. Look. On the tuck-ins, we've maintained $40 million to $60 million. We won't see a lot of activity in Q1 frankly because we're still managing through the height of the pandemic from prior year, but we're building a list of actions. And of course, we want to make sure that we execute.

So if it's at the low end or the high end really comes down to where are those targets and our ability to properly execute so that we can maximize the return for our shareholders as it relates to tuck-ins.

And the other piece is, frankly, in CapEx, is that as we come out of 2020, we have to make some reinvestments in CapEx that we cut last year related to preserving liquidity.

Jay Wells

Mm-hmm. And to add on that, one, keep in mind, we're not through this pandemic yet. So we continue to really preserve our liquidity. We've done extremely well throughout, but we're not going to get over our skis and spending money too quick too fast.

Two, on your question, Q1 historically is not a free cash flow generating quarter for us, so really it's not a period that I would see excess cash that needs to be deployed. I have a little bit of borrowing on my revolver that I can deploy any excess cash if I end up with some. So on buyback and other capital deployment, another quarter of let's get through the pandemic. I don't have the cash flow this quarter really to deploy anyways, and we'll provide an update on our next quarterly call.

Kevin Grundy

Okay. But just to put a finer point, it does not sound like there's any sort of considerations where you guys feel like you should be keeping your powder dry. Is that fair?

Jay Wells

Don't have to make a decision on that for a quarter, as I said.

Kevin Grundy

Okay. Okay. All right. And then a quick one. Fair enough. Quick on the free cash flow. So you gave us most of the drivers here with respect to EBITDA, cash taxes, CapEx, et cetera. Is there anything noteworthy with respect to working capital this year we should be thinking about as we update our models for free cash flow?

Jay Wells

I would say when you look at our moving our guidance up to going forward really targeting 5 percent organic growth, that would normally use some working capital along the way. But we'll work hard to manage working capital to offset any type of use of working capital with that growth. And for me, the goal is to try and keep working capital flat on a go-forward basis.

Kevin Grundy

Okay. Very good. Thanks for the time, guys. Good luck.

Tom Harrington

Thanks, Kevin.

Operator

The next question is from Daniel Moore with CJS Securities.

Tom Harrington

Morning, Dan.

Jay Wells

Morning, Dan.

Daniel Moore — CJS Securities

Good morning. How are you?

Jay Wells

Morning. Very good. Thank you.

Daniel Moore

Wanted to expand quickly on exporting Primo's traditional Refill and Exchange businesses to Europe. I think you mentioned it would be H2 before you start to see impact, but any additional colour, insights, anecdotes, and how we think about the ramp there?

Tom Harrington

Yeah. We went through a very detailed analysis of opportunities by solution. So where is the Water Direct opportunity by country, where is the Refill, where is the Exchange in Europe as part of our AOP and multiyear strat plan.

We also referenced in our comments about building out our E-commerce capabilities. Some of us call it a wet shop, which would be the first place where we would begin to sell dispensers in a number of countries. And then we are working on our Exchange business in Russia and the Baltics.

So we have an early stage development in those countries. The team is working on developing that solution to see how that would expand in Eastern Europe. But before we go to other countries, let's say, Poland, as an example, we want to make sure that we have the right model that works in Russia and the Baltics that can then be expanded from an execution standpoint with little disruption.

So we're cautiously optimistic, and they are all in development of one stage or another on those two topics.

Daniel Moore

Got it. Helpful. And then my shot at everybody's favorite topic here, but do you see any change in the competitive environment with the change of ownership of ReadyRefresh, number one? And number two, apologize for a question I know the answer to, but any comments regarding when you might be able to begin a dialogue with One Rock?

Tom Harrington

Sure. I'll take the first part. Look, our success is really ultimately driven not by what ReadyRefresh does, but how we interact with our customers. And an example would be the global reduction in quit rate from 21.5 percent to 20.3 percent says that our investments in the customer experience, in our web, and

things like the app are producing a tighter relationship between us and our customers. Right? And if you will, that's the Holy Grail.

And in terms of any specifics, there's nothing going on that causes us alarm or concern. We're sticking to our key focus. And frankly, in the month of February, we're focused on the terrific efforts our teams have done in Texas, Oklahoma, and Arkansas. So interestingly, those folks also live there and have gone through those issues. But as an example, we operated Saturday and Sunday to get our business back in shape and properly hydrate people who, frankly, are in a great need of water. So we're going to stick to our knitting. And nothing that causes us great concern on a competitive front in North America.

Jay Wells

And since Tom didn't take the second, I guess I have to give the, no, we can't comment any further on that. I will take—

Tom Harrington

As the CFO.

Daniel Moore

You always do take the easy ones, Jay. All right. Thank you very much. Appreciate it.

Tom Harrington

Thanks, Dan.

Jay Wells

Thanks, Dan.

Operator

Your next question is from Graham Price with Raymond James.

Tom Harrington

Morning.

Graham Price — Raymond James

Hey. Good morning. Thanks for taking my question. This is Graham Price on for Pavel Molchanov. So just real quick, in your long-term growth algorithm you target the $5 million to $10 million in accretive tuck-ins, which seems to be quite a bit lower than what you did last year and what you expect this year. Just wondering if we can view that as a bit of a conservative target that potentially you could do a bit more than that?

Tom Harrington

Yeah. We have in a number of years in the past done more, so our track record would say higher. But again, we're still in this pandemic. So we'll do nothing early in the year, and I want to be very cautious about how we go after it. But we have a good pipeline. And those tuck-ins, that $5 million to $10 million, is on an EBITDA basis. And it comes to timing of, frankly, when you close those deals. Right? So in some cases, you might get half-life, right, in a particular calendar year, as an example, as opposed to the higher end. But we won't forego any opportunities that make sense for us in our footprint as they become available on both sides of the Atlantic.

Graham Price

Got you. Thanks. That's helpful. And then, yeah. I guess, sticking with the last part of what you just said, I just wanted to kind of pick your brain on that landscape in the US versus overseas and kind of how those compare.

Tom Harrington

Yeah. Right now we would have what I would call a balanced approach. Right? So that we have like-sized opportunities on both, but that's as I sit here today and this pipeline develops each quarter. So

we have a good pipeline in North America. Frankly, we announced Mountain Valley of Los Angeles, which is a terrific opportunity for us. That brand, that acquisition has been very beneficial to the Company, and it helps us get into the premiumization of the space with high-priced bottles. So we'll continue to go down that path.

And then there's obviously a few other opportunities. And then when you get to Europe there are—it's a—if we have a 20 share or so approximately, there's lots of small tuck-ins country-by-country. And the team has worked through the list in every country who is the top 5 and that, frankly, becomes our target list.

Jay Wells

And we'll continue to evaluate adjacent countries that we can still see benefit. For example, we added Hungary last year. So we will continue to do that too over in Europe.

Graham Price

Perfect. Thank you very much.

Tom Harrington

Thank you.

Jay Wells

Thanks.

Operator

Your next question is from Andrea Teixeira with JPMorgan.

Andrea Teixeira — JPMorgan

Hi. Good morning.

Tom Harrington

Morning.

Andrea Teixeira

And thank you for squeezing me in. I think I'm going to try again. So my question's a follow-up from the prior questions on M&A. Just to summarize, as we heard you comment and I appreciate the candor, how long you think you would wait for the if and when ReadyRefresh becomes available? Or will you move down the list as you have to, obviously, you don't want to miss the other opportunities?

Jay Wells

I mean, I think we've been at least since the end of December 2014 when we acquired DS, I think we have been consistent that we view it as a highly strategic opportunity, and we still view it as so. And we will always be available and interested in talking about this opportunity.

Andrea Teixeira

But do you think it's changed with a private equity that perhaps wants to maximize the value of the total with this business being a higher-margin business?

Jay Wells

Yeah. Yeah. I mean, I do apologize, but I mean this is just an area that we've really provided all the comments we can on that opportunity.

Andrea Teixeira

Of course. I understand. I'll pass it on. Thank you.

Jay Wells

Thank you.

Operator

As a reminder, if you would like to ask a question, please press *, then the number 1 on your telephone keypad. Again, that's *, then the number 1 on your telephone keypad.

And at this time, there are no questions.

Jon Kathol

This concludes Primo's fourth quarter and full year results call. Thank you, all, for attending.