Primo Water Corporation

First Quarter 2020 Earnings Conference Call

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Peter Grom
JPMorgan — Analyst

Daniel Moore
CJS Securities — Analyst

Derek Dley
Canaccord — Analyst

Mark Petrie
CIBC — Analyst

PRESENTATION

Operator

Welcome to Primo Water Corporation's first quarter 2020 earnings conference call. All participants are currently in listen-only mode.

This call will end no later than 11 a.m. Eastern Time. The call is being webcast live on Primo's website at www.primowatercorp.com and will be available for playback there for two weeks.

This conference call contains forward-looking statements, including statements concerning the Company's future financial and operations performance. These statements should be considered in connection with cautionary statements and disclaimers contained in the safe harbor statement 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 regulations (sic) [regulators].

The Company's actual performance could differ materially from these statements, and the Company undertakes no duty to update these forwarding (sic) [forward-looking] statements, except 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 included in the Company's first quarter earnings announcement released earlier this morning on the Investor Relations section of the Company's website at www.primowatercorp.com.

I will now turn the call over to Ryan Coleman of Alpha IR, Primo's investor relations service provider.

Ryan Coleman — Investor Relations, Primo Water Corporation

Good morning, and thank you for joining our call. Today, I'm virtually accompanied by Tom Harrington, Primo's Chief Executive Officer; and Jay Wells, Primo's Chief Financial Officer.

As a 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 with an update on the business impact of the ongoing pandemic and the actions we are taking in response. Then Jay will discuss our first quarter consolidated financial performance, our liquidity and cost-containment efforts, and our first half 2020 expectations before handing the call back to Tom to provide a long-term view on the Company ahead of Q&A.

As a reminder, we sold our S&D Coffee & Tea business at the end of February and, as a result, this business has been classified within discontinued operations.

At the beginning of March, we acquired Primo Water Corporation, which included assuming the Primo name, as well as the Primo ticker. Within our prepared remarks, we will be discussing our continued operations, which will incorporate the Legacy Primo business for the month of March, as well as exclude the S&D business.

With that, let me turn the call over to Tom.

Tom Harrington — Chief Executive Officer, Primo Water Corporation

Thank you, Ryan, and good morning, everyone. I would like to begin by extending my well wishes to all of you. I sincerely hope everyone is safe and healthy.

As it relates to the safety of our associates and customers, we've undertaken enhanced social distancing guidelines; implemented deep [audio gap]; staggered employee shifts; provided gloves, masks, and sanitizers; and offered work-from-home options where possible, including in a number of our Customer Care Centres.

In addition, we've created international crisis management teams who are working together to ensure that our team members are operating in safe and secure environments and that we are implementing and updating our operations for the latest safety recommendations from the CDC and the WHO.

As a result, our teams continue to work to service our customers safely across our entire operation. I cannot thank our teammates enough for their efforts as we work to provide an essential product to customers across our 21-country footprint.

Many things in the world have changed, but one thing has remained constant and that is the desire for our customers to continue to receive safe, high-quality drinking water from our team. We've continued to deliver millions of gallons of water, and we're proud of the commitment that we've seen from our associates.

Moving to our first quarter. I'm pleased that our results were ahead of our expectations, including a one-month contribution from the Legacy Primo business that we acquired at the beginning of March. Our consolidated revenue from continuing operations was 11 percent higher than last year and adjusted EBITDA was up 31 percent.

Excluding our divested businesses, our adjusted EBITDA margin was 14.8 percent, a 200 basis point improvement versus prior year and representative of our pure-play water business ability to leverage growth into margin expansion.

Underlying the strong consolidated performance, our North American water solutions business revenue was up 9 percent and adjusted EBITDA was up 37 percent compared to the first quarter of 2019, which excludes any contribution from the Legacy Primo business we acquired at the beginning of March.

In March, the Legacy Primo business drove a 37 percent increase in revenue and a 96 percent increase in adjusted EBITDA on a pro forma basis led by the significant increase in retail sales experienced across the US market in our Water Exchange business.

As you might expect, our European Water Direct business was negatively impacted by the pandemic, where we experienced closures of commercial customer locations earlier and more broadly than in North America. Our Eden division, whose European operations represent approximately 20 percent of overall company revenue, increased revenue by 1 percent with the benefit of tuck-ins, while adjusted EBITDA was down $4 million in Q1.

Our performance in the first two months of Q1 was solid and tracking in line with our expectation and in several cases better. Our ongoing investments in the customer experience are beginning to pay off, with retention rates increasing in North America resulting in a historically low dispenser churn rate where we achieved a 260 basis point improvement compared to prior year. Our focus on delivering the hydration solutions our customers want, along with a great customer experience, is working and is reflected in our reduced churn rate.

We achieved our 5 percent top-line growth expectation, adjusted EBITDA was above expectations, and our EBITDA margin grew as a result of volume leverage as well as efficiency initiatives the Company executed. We were in excellent position to meet or exceed both internal and external expectations for 2020. Importantly, the underlying performance of the business is a strong indicator that our strategic decision to transition to a pure-play water company is the correct path forward.

We then moved into a period of uncertainty as many European countries made the difficult decision to lock down all but those businesses identified as essential services; closed in several countries in compliance with local government mandates. These actions negatively impacted the adjusted EBITDA of our European business in Q1.

The effects of the pandemic have been nothing like a recession from the speed-of-change perspective. We felt the impact over the course of 10 to 12 days rather than a more gradual slowdown typical of a downturn of two to three quarters.

Management has taken the necessary cost actions, although it certainly takes more than 10 to 12 days to fully implement, particularly considering the various employee legislation and work councils across our footprint. Jay will provide more colour on the actions that we implemented during his prepared comments.

While managing through the revenue pressure within our commercial customer base, we do see many opportunities with the at-home consumer across our Water Direct, Water Refill, Water Dispenser, and Water Exchange solutions. As people adopt social distancing guidelines, no-contact home delivery of all products has become more important and will likely increase in importance to consumers.

One of the best examples we see developing is in our program with a large E-commerce retailer. The customer decided to suspend all home service offerings except for our bottled water service, a decision we understand was based on customer demand and their request of water delivery. We're currently offering water delivery through this retailer in parts of Georgia, Florida, Texas, and Connecticut, and expect to extend the program across our US footprint.

As consumer behaviour continues to change as a result of the coronavirus, we expect that no-contact home delivery and E-commerce capabilities will be vitally important. We are well positioned and prepared to meet these changing consumer demands and to participate fully in the growth these channels will likely provide.

We're pleased with the efforts we've executed within our customer experience initiatives, including updates to our website, the initial release of our mobile app, the extension of the mobile app across the US this week, and our ongoing efforts to reach consumers with our product offerings whenever, wherever, and however they want it.

In addition to expanding our E-commerce programs, we will accelerate two core growth initiatives. The first is to increase our penetration of the European residential base. And the second is to expand our Water Refill, Water Exchange, and Water Dispenser for our model, recurring razor/razorblade revenue model, through Europe.

As the leader in pure-play water solutions, we believe that we are uniquely positioned to successfully implement these initiatives as a result of our technical know-how, our dispensing equipment expertise, and our footprint.

These actions will provide us with future profitable growth and better balance within our customer mix across our European business. We, like many of you, are following the governmental mandates closely; are beginning to see encouraging signs as local governments in both Europe and North America are implementing the early stages of return-to-work plans.

As we move past this crisis, we expect to deliver margin expansion and drive increased organic growth as the leader in pure-play water solutions. Our transformation and the strong business momentum we carried into 2020 have simply been delayed by this unexpected and unprecedented event.

The fundamentals of our business are strong, and there are long-term industry tailwinds and consumer behaviour trends that we expect will benefit our pure-play water business model.

We remain equally confident in the opportunity to provide sustainable hydration solutions to a growing customer base and positioning the Company for continued growth while ensuring we deliver long-term shareholder value.

Before my closing remarks and opening the call for your questions, I'd like to turn the call over to Jay who will elaborate more on our performance, our cost-reduction initiatives, our capital expenditure expectations, as well as our strong liquidity position. Jay?

Jay Wells — Chief Financial Officer, Primo Water Corporation

Thank you, Tom, and good morning, everyone.

Starting with the first quarter, we began the year with another quarter of strong top-line performance, as consolidated revenue from Container operations was up 11 percent, including a one-month contribution from the Primo acquisition.

If you exclude the revenue contribution from the Primo acquisition, revenue was up 6 percent compared to Q1 2019. The revenue growth was driven by customer and volume growth, as well as improved pricing dynamics within our Water Direct business.

Adjusted EBITDA from continuing operations was $70.4 million, a 31 percent increase from the first quarter of 2019, and adjusted EBITDA margin was 14.8 percent, an improvement of 200 basis points compared to last year.

One month of operations of the Legacy Primo business contributed $7.3 million of adjusted EBITDA in the quarter. Excluding that contribution, adjusted EBITDA was $63.1 million, an 18 percent increase compared to Q1 2019. The increase in adjusted EBITDA was driven by strong customer growth, volume growth, better pricing, as well as tuck-in acquisitions and the benefit of operational leverage.

The first two months of the first quarter saw solid performance that met or exceeded our expectations. Our new pure-play water business and operations were off to as strong of a start as we could have hoped. Over the next three weeks, or in March, we saw good performance in our North American operation. We ended the month with our Direct customer base reaching 1.8 million for the first time ever fuelled by residential customer growth.

On the other end of the spectrum, our European operations came under pressure as a result of COVID-19 closures. But please remember, approximately 80 percent of our total revenue is generated outside of Europe.

In the first three weeks of April, revenue from our commercial customers came under pressure as North America began to issue stay-at-home orders, but over the last couple of weeks we have seen trends start to improve as businesses have started to reopen both in the US and Europe.

As a reminder, roughly 60 percent of our total $2.1 billion of revenue is generated from our residential customer base or the at-home consumer. Our North American residential customer base has increased by high single digits, with residential returnable volume up over 20 percent during this period. In addition, we continued to see solid growth within our Legacy Primo Exchange business, which was also up over 20 percent.

To offset the revenue pressures caused by the crisis, cost-containment efforts became a key focus. And I think it is important to reiterate that we benefit from a highly variable cost structure that enables us to react to changing business conditions. Most of our operating costs fall within route delivery, sales, marketing, and back office. In other words, it is largely labour costs, and we have reduced headcount by over 20 percent over the last couple of weeks.

As far as production costs are concerned, in Europe we source roughly two-thirds of our finished goods water product from third-party co-packers. As a result, our production costs in Europe are also largely variable.

We scaled back on all discretionary spending, such as marketing and sales expenditures. We paused our capital spending plans in markets where we have seen the sharpest drop in demand, particularly with commercial customers in Western Europe. Capital expenditure plans for our residential or at-home consumer, which includes residential Water Direct customers, as well as our Legacy Primo business, remain unchanged as demand remains healthy and growing in these areas.

Turning to our liquidity position and the health of our balance sheet. We ended the first quarter with a cash balance of over $100 million and available net borrowing capacity on our cash flow revolver of just over $200 million for a combined total liquidity position of around $300 million. During the second quarter, in an abundance of caution, we borrowed approximately $170 million on our cash flow revolver in order to move the liquidity from our revolver to our balance sheet. We do not currently expect to utilize these funds, but wanted to ensure we secured the liquidity given the uncertainty associated with the crisis.

We ended the first quarter with a pro forma last 12 months net leverage ratio of around 3.4 times and continue to target a post-synergy net leverage ratio of 3.0 times.

On that note, we still expect to capture $7.5 million of cost synergies in 2020, $17.5 million in 2021, and $10 million in 2022 for a total of $35 million. Most of our synergy capture will come from G&A and back-office functions, such as finance, credit and collections, as well as such areas as Customer Care Centres and public company costs. That means we have a clear line of sight into these cost reductions and they are firmly within our control. These efforts have already been put into action and are progressing well.

From a capital allocation perspective, we will continue to take a balanced approach and closely monitor our priorities in 2020. As part of our efforts to preserve cash, we have placed a temporary hold on our share repurchase activity, although in Q1 we did repurchase approximately $25 million of stock under our share repurchase program and $7 million of stock related to satisfying employees’ tax obligations on share-based awards.

We remain committed to paying our quarterly dividend, and we believe we are in a unique position to capitalize on the current environment in our search for quality M&A opportunities that fit within our existing model. We do not, however, have plans to execute on any tuck-in acquisitions in the next couple of months, given the current travel restrictions.

In looking at our debt, other than our cash flow revolver, our debt is long term in nature with our outstanding debt balances not due until 2024 or thereafter, as our senior notes’ first maturity date is July 1, 2024. In looking at our covenants, we are comfortable with how our business is operating in this environment and our ability to continue to have ample coverage.

As part of the ongoing oversight of our business, we have performed multiple worst-case stress test analyses on our operations, including the impact to our business if the crises extended through the end of 2020. And even under these circumstances, we would be cash flow positive and continue to be in compliance with our covenants.

As I noted during our Investor Day, the main debt covenant that we watch is a minimum interest coverage of 3:1 adjusted EBITDA to interest. At the end of the first quarter on a last 12-month pro forma basis, we had coverage in excess of 4.5 times, and we have become even more confident on our ability to manage through this crisis as we have seen a number of markets begin to reopen across our footprint.

As a quick summary and looking out to the rest of 2020, overall we are pleased with our first quarter performance and the strong underlining trends of our core businesses. As we move into the second quarter, macroeconomic conditions continue to be impacted by the pandemic. Nonetheless, we are very confident that we possess the balance sheet strength, variable cost structure, access to liquidity, and skilled management teams necessary to successfully navigate this business environment.

Looking ahead, we currently expect second quarter consolidated revenue from continued operations to be flat to slightly down. We would expect revenues in the second quarter to be between 430 million and $450 million. On a consolidated basis, we have taken a conservative position and modelled our water business down 8 to 10 percent, as the increase in residential customer demands are mitigating some of the pressure within the commercial channel.

Water filtration down 3 to 5 percent and coffee services down 60-plus percent as it is a commercially driven channel, resulting in an overall decline for the quarter on a pro forma basis of around 15 percent.

We now believe our first half adjusted EBITDA will be roughly $140 million, an improvement for what we provided during our investor webcast in March thanks to a strong first quarter and contribution from the Legacy Primo business as well as our operating expense reductions.

From a Q2 perspective, that would result in adjusted EBITDA of approximately $70 million. Our estimates were developed using the assumption that most business closures would continue throughout Q2. However, we are starting to see trends that are better than what we forecasted. And that is why we believe we will be at roughly $140 million of adjusted EBITDA for the first half of 2020.

As we think about the full year, we will wait until our second quarter results call before providing specific guidance beyond the first half of the year. Once we move past this crisis, we remain confident in our long-term expectations of 5 percent revenue growth, 20 to 30 basis points of EBITDA margin expansion per year, $35 million of cost synergies to be realized through 2022, 12 million to $15 million of annual organic adjusted EBITDA growth, as well as 5 million to $10 million of additional EBITDA annually from accretive tuck-in acquisitions.

Although we would not expect to see our business deliver on the 5 percent top line growth in the back half of the year, we should benefit as we come out of the crisis as it relates to adjusted EBITDA and EBITDA margin expansion due to the cost initiatives and operational changes that we have made that will benefit us as consumers get back to work.

As a result, we should be able to move back to our long-term EBITDA growth algorithm at some point this year.

I will now turn the call back to Tom.

Tom Harrington

Thanks, Jay. As you just heard Jay cover, we performed well in Q1 and are in a strong liquidity position and are confident that our highly variable cost structure allows us to generate free cash flow and the flexibility to respond quickly to changing demand dynamics across the markets we serve.

As we enter the second quarter, we're especially focused on a handful of key priorities. Above all, we will prioritize the health and safety of all of our associates and customers. We will continue to invest in our residential Water Direct markets as we are seeing considerable growth in these channels as consumers adapt to the current environment.

We plan to accelerate our extension of our Water Refill, Water Exchange, and Water Dispenser businesses in Europe. We will continue to evaluate our cost structure, seeking to identify additional noncore cost reductions in response to changing market dynamics to enhance margins. And we'll continue to manage our free cash flow, expecting to generate sufficient free cashflow to fund our staple dividend and highly synergistic tuck-in acquisitions, while maintaining compliance with our credit agreement and covenants.

As Jay noted, we expect our consolidated Q2 revenue from continuing operations to be flat to slightly down year over year and expect to finish the first half of the year with adjusted EBITDA of approximately $140 million. Market conditions are changing by the day and we view these forecasts as floating targets, but we will continue to offer as much transparency as conditions allow.

The crisis is unprecedented, and, at the same time, it has placed our business in a centre of an essential need for the consumers and customers that we serve and that is providing quality, safe, healthy hydration to customers whenever, wherever, and however they want it. Our team is committed to not only serving our customer base, but we've developed plans to expand our solutions across our footprint over the coming years.

Over the longer term, we remain optimistic about the new and improved operating model that our pure-play water strategy enables. Under normal circumstances, we would expect our business to grow its top line by around 5 percent, and excluding synergies, our pure-play water business is expected to drive 20 to 30 basis points of EBITDA margin expansion per year. I'm optimistic that this growth algorithm will be enhanced with the expansion of our products and services over the coming years.

As we look to the back half of the year, it will be difficult to get back to our 5 percent top-line growth overnight or in a single quarter. But with the significant operational changes we have made throughout our business, I don't see why we would not work back to our long-term algorithm as it relates to adjusted EBITDA growth in the back half of the year in terms of both organic EBITDA growth and tuck-in EBITDA growth. I believe that we will remain cash flow positive this year, providing the cash to support our dividend and execute highly synergistic tuck-in acquisitions when the time is right.

Clearly, we continue to believe in our improved financial profile, the improvements in our customer experience, our Customer for Life philosophy, and our continuing drive to improve average customer lives and retention rates across the business.

When you look beyond the uncertain near-term environment, it should be clear to see why we are optimistic about the opportunities that lie ahead for our business and, in turn, the value creation that we will generate for all stakeholders. Under our pure-play model, we are the North American market leader in direct-to-consumer water service, water refill, water exchange, water dispenser sales, and a top-five player in the water filtration category.

In addition, we will remain the market leader in direct-delivery water in Europe as well as a top-five player in the European water filtration category, and we look forward to bringing our 4R razor/razorblade model to Europe.

Before moving to Q&A, I wanted to take a moment to thank all of our associates. Each day I continue to grow more impressed by our team and the selflessness they show our valued customers in an unprecedented environment. We're incredibly lucky here at Primo to have such a dedicated workforce.

We will now turn the call back to Ryan to move us to Q&A.

Ryan Coleman

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 for your cooperation.

Operator, please open up the line for questions.

Q&A

Operator

At this time, if you would like to ask a question, press *, and the number 1 on your telephone keypad. Press *, followed by the number 1 on your telephone keypad. We'll pause for just a moment to compile the Q&A roster.

Your first question comes from the line of Derek Lessard.

Tom Harrington

Hello, Derek.

Jay Wells

Good morning, Derek. Tom and Jay here.

Derek Lessard — TD Securities

Lessard or the other guy? Is it me? Can you hear me?

Tom Harrington

Yeah. Yes. You're okay. You're first, Derek. And you're talking to Primo.

Derek Lessard

Yeah. Exactly. I was wondering if you could maybe just talk about the top line for a second. Obviously, very strong performance. So I know you did point to increased pricing. I was just wondering if you could talk about how you're able to get pricing through given the economic backdrop. And secondly, how much of a strength would you attribute to pantry stocking?

Tom Harrington

Yeah. It's a good question. Two questions, actually. So if you think about our business, normal course in the Water Direct business in the first couple months with some of those numbers pre-COVID, if you will, so that continued in place normal course, that would include pricing. We have not stopped pricing through particularly in our residential customers. Obviously, there's some commercial customers closed down.

And there was likely for sure some stockpiling, particularly as each of the shutdown, stay-at-home orders occurred. Didn't all happen at the same time. Depends on where you were. But as those stay-at-home orders were extended, any of the stockpile that went in either through our Legacy Primo business, through Exchange, or direct from the Water Direct business, the at-home consumer finished the product because in April, as I think we said in our prepared remarks, we continued to experience 20-plus percent growth in both residential and the Primo business, which says that there's a normal flow-through of orders and that stockpiling is behind us.

Derek Lessard

Okay. Thanks for that. Helpful. And maybe one last one for me before I re-queue. Q2 from a seasonality point of view is typically stronger for you guys. So maybe if you could just help me frame that with the slightly lower expected revenue sequentially.

Tom Harrington

Yeah. Go ahead, Jay.

Jay Wells

Yeah. I mean really yes, Q2 as we get into the summer season is normally a stronger month. And I set forth some of our forecast expectations that we based our forecast model on. Please keep in mind that we are being conservative in our projections. Let's not get over-optimistic on the top line and make sure we're taking enough costs out to maintain our profitability and our liquidity.

But looking at April, for example, I just got a flash from our North America business, which is our largest business. Their revenue came in 5 percent better than forecast and so did their EBITDA. And that's why we're now saying that we're comfortable with 140 million of EBITDA in the first half of the year.

So being very conservative on the top line in our forecast in order that we're taking the right amount of cost. And if we over-deliver on the top line, as we did in April with North America, we'll over-deliver on the bottom line.

Tom Harrington

Yeah. Derek, I think hopefully you see a track record that says we're consistently meeting and beating by a little over the last few quarters. So also being conservative because this thing changes every day. So it's a combination of our confidence that we'll do what we say at a minimum.

Derek Lessard

Thanks for that, gentlemen, and congrats on a great quarter.

Tom Harrington

Thanks, Derek.

Jay Wells

Thanks, Derek.

Operator

Your next question comes from the line of Peter.

Tom Harrington

Hello, Peter.

Peter Grom — JPMorgan

Hey. Hey. Good morning, guys, and congrats on a great quarter this morning. I hope you and your families are safe and healthy.

Tom Harrington

Thank you. They are.

Peter Grom

Good. So just quickly just more of a housekeeping. Does the Q2 revenue guide of 430 million to 450 million include the impact of FX or exclude it?

Jay Wells

Yeah. Overall we're not seeing a lot of ramifications on FX. So there is no FX built in. At maximum, could we see another half a percent of FX headwind, but right now you look at the quarter that we just closed, FX had very little effect and our forecast has the same.

Peter Grom

Okay. That's helpful. And then, Tom, I just was hoping you could elaborate on your second half comments. And I just want to make sure I kind of heard this right, but you don't expect revenue to get back mid-single-digit growth, but some of the cost actions you've taken you do anticipate a return to mid-single-digit EBITDA growth in the back half of the year? Did I hear that right?

Tom Harrington

You did. So—

Peter Grom

Okay.

Tom Harrington

—we didn't get them done, as I said, in 10 or 12 days, but we've essentially in less than four weeks executed operating expense cuts that enable us to get back to the EBITDA algorithm and expect to expand on margins. And then, frankly, as it recovers, which we see some signs of hope coming back as people reopen country by country, segment by segment, that we'll be judicious on managing the costs and the revenue on a go-forward basis to make sure that we, frankly, get the spreads and return to in short order, sometime before the year is out, to our normal EBITDA algorithm.

Peter Grom

Okay. That's helpful. And just quickly, I mean I think there's kind of been some confusion just in terms of what the right pro forma bases are for Q1, for Q2, but maybe just high level what is the kind of right base to be working off of for the second half of this year?

Tom Harrington

For the second half of this year?

Jay Wells

Ah. Oh, Peter, throwing a little bit of a curve ball. Pro forma for the second half of the year.

Tom Harrington

Yeah. Actually, I don't have that handy. We haven't provided any guidance on the second half yet. And frankly, it's because it's such a fluid situation that as we get through the second quarter, we'll affirm what we do in terms of beating the half one, and then have a much cleaner line of sight about what our expectations are country by country because it still changes. Largely positive, but there's a negative here or there too, frankly, in terms of delays of openings, right?

Jay Wells

And we also have a couple of events, virtual events, set up throughout the quarter, and we'll provide updates on how we're seeing the recovery and a little bit more light on how we're seeing the back half of the year as we get through this quarter.

Operator

Your next question comes from the line of Daniel Moore.

Daniel Moore — CJS Securities

Good morning, gentlemen. Thank you for the colour and taking the questions.

Tom Harrington

Morning, Dan. How are you?

Daniel Moore

Very well. Thank you. Maybe just in Europe, you've obviously talked about things starting to open back up there. Maybe just talk about the volume cadence we've seen thus far in Q2. I know you provided a lot of colour and a lot of numbers, so I'll have to go back to the transcript. And if you're repeating, I apologize, but kind of where were volumes in April? And what have you seen more recently in terms of those volume trends the last couple of weeks? Thanks.

Tom Harrington

So if we go back, it shut off pretty quickly in middle of March, but it varied by country, right? So the numbers I'll give you are an average of an average of an average over 18 countries because they're not all the same. And it's roughly 40 percent is how we're looking at it in our worst-case forecast for Q2.

And as an example, Sweden is normal course because they never really closed. Switzerland was the first country to creep back in to business and we see the trend bottom out. I don't want to say trough, but I believe in the case of Switzerland we probably hit the trough, and it looks like it wants to come back, not meaningfully, but look, we watched Alliance every day, so we're pretty close to how they trend out.

But the other side of the country, like Spain, just extended for another 30 days their stay-at-home. So it's a balance of all of those. The news, it sounds like the UK will make an announcement either Sunday or Monday. I don't know what that announcement will be, but that will certainly have an impact on a go-forward.

So hopefully that provides some colour, average of an average of an average, but it looks like it wants to improve versus that 40 percent, which we shared in our remarks.

Jay Wells

Yeah. I think average, average, Q2 we're forecasting revenue. US volume, that's a revenue number—

Tom Harrington

Yeah.

Jay Wells

—of about 40 percent down. But Tom and I get together with these guys on a regular basis, weekly or more often, and everybody is at least meeting or trending a little bit above that through April.

Daniel Moore

Okay. So just to clarify that that 40 percent is a revenue forecast for Europe for Q2. And April was around that level, a little worse than that?

Jay Wells

Overall, each month is a little different, but let's say the month of April, they're trending a little bit better—

Tom Harrington

Yeah. Yeah.

Jay Wells

—than the average of the average—

Tom Harrington

Yeah.

Jay Wells

—Tom talked about.

Tom Harrington

And I don't want to call it a green shoot, but we're seeing some signs of life that are better than what we had originally expected.

Operator

Your next question comes from the line of Derek Dley.

Jay Wells

Morning, Derek.

Tom Harrington

Hello, Derek.

Derek Dley — Canaccord

Hey, guys. Good morning. Okay. Just a question just in terms of commercial and residential. And sorry, I may have missed this just in a lot of the numbers that you guys have been speaking about, but did you guys mention the difference in growth rates that we've seen there? And maybe let's focus on North America for a second.

Tom Harrington

No. We gave you a couple of numbers, right? So what we've seen in our residential business in April was about a plus 20. And our Legacy Primo Exchange business at about plus 20, which is what we've shared. And then you said North America, but in Europe it would be a little bit better than 40 percent. On all those numbers the latter is on revenue, the others are on volume. The first two, so.

Derek Dley

And sorry, that was for April, right?

Tom Harrington

Yeah. That's the first few weeks of April, bulk of April.

Derek Dley

Okay. And then again when we think about just residential versus commercial split in North America where residential is, I believe, 60 percent of your business, 40 percent commercial, are you seeing that residential growth offset the declines I would assume that you're seeing in commercial?

Tom Harrington

Well, it's actually the opposite. It's 55 percent commercial, 45 percent residential.

Jay Wells

And we have the at-home.

Tom Harrington

Yeah. And then we have the at-home for Primo, right? And the residential growth is mitigating the impact on commercial. So I would say mitigate, not offset. But it continues to grow. And then we do get the benefit from the at-home consumer, which could be buying water refill, filling it themselves, or using the exchange model, which a way is for us to all counterbalancing the pressures from the commercial segment.

Jay Wells

Did that give you the answer you're looking for, Derek? Overall, yes. Commercial in the North America is down. Unit commercial against just the residential direct it is a negative number. Not as significant. In my prepared remarks I said overall our Water Direct business is down about 8 to 10 percent. That's a combination of the 40 percent in Europe that we've talked about, the growth in residential in North America we've about, and some offsetting decline in the commercial in North America.

Operator

Your next question comes from the line of Mark Petrie.

Mark Petrie — CIBC

Hey. Good morning, guys.

Tom Harrington

Good morning, Mark.

Mark Petrie

Hey. Good morning, guys. Hello. So I just wanted to ask about the cost base. You mentioned the 20 percent I think roughly headcount reduction. Wondering if you can just give a bit more granularity in terms of the aspects of your business where that was mostly weighted. If it was mostly routes or mostly in admin.

And at the same time, I guess just more broadly, like you've been investing in people over the course of the last couple of years. Could you just talk about how you balance that going forward as you expect revenues to rebuild and stabilize over the course of the next few quarters?

Tom Harrington

Yeah. So 20 percent or so headcount reduction, it will vary by market. So where there's bigger revenue declines, we adjust more aggressively. And it is a reduction in routes or consolidation of routes across the footprint because everything has been impacted.

It would then have a domino effect into things like the warehouse. It would have an impact in production, and production could be headcount, could be overtime management, could be shift changes. So if you think of the whole forward, route, side production, all of that has been affected.

We have reduced administrative support and some of the G&A for sure as we rightsize to the current realities of revenue. And we have reduced sales headcount because if you think about if small commercial isn't open, it's not a terribly productive use of our finite resources to have salespeople knocking on doors that aren't open.

As we think about going forward, now alternatively, we are investing in online, in the Internet. So we see growth in online, no-contact delivery. We also see some benefits on E-commerce, and that's all part of our going forward plan both in North America and on the other side.

And then the other thing that's important is, in the US as an example for those sale people, it's a layoff and recall. Right? So as this comes back, and we'll be prudent, we would recall those folks, and hopefully, they'll come back on the payroll so that we can ramp up appropriately when the time is right. So that's really our approach and, of course, we're accelerating our investments in the Legacy Primo platform to see some opportunities in Europe.

Mark Petrie

Okay. That's helpful. And then just in terms of energy costs and the lower oil price, I know you guys have the energy surcharge formula in your customer contracts, but what sort of impact does the lower oil price have on your operating costs kind of going forward maybe Q2 specific and then balance of the year?

Tom Harrington

Yeah. So we haven't discussed the balance of the year, but in Q2, we'll have lower energy surcharge or a portion of it because fuel direct is a component of the energy surcharge. There are other inputs. And certainly part of our operating costs would be reduced by the benefit of lower fuel costs. Right? And that's all in our forecast if you will for Q2.

We'll also frankly drive a few less miles as we consolidate these routes on a net basis. So there's some cost savings baked into our numbers.

Mark Petrie

Okay. That's helpful, guys. Thanks. All the best.

Tom Harrington

Yeah.

Jay Wells

Thank you.

Tom Harrington

Thanks, Mark.

Operator

Your next question comes from the line of Peter.

Peter Grom

Hey. Thanks for taking the follow-up. So I just wanted to ask about Q2 a little bit more. I know you mentioned the guidance reflects some conservatism and trends are above plan through April, but I think it would be helpful to kind of understand what are you assuming from an operating environment standpoint in your plans for May and June just as we think about things to look ahead for as we progress through the quarter? Thanks.

Jay Wells

I mean, Peter, as Tom said, I think we've adjusted our cost structure that we're planning, even though we don't believe it, that this could be the new norm going forward. So we've taken the cost out to maintain our profitability to grow our profit under this current reduced revenue. We've done it in the right way, so more layoff recall.

So as we see the top line come back, we will start bringing the costs back. But within our model if the forecast is that we've taken a 15 percent decline in revenue top line, we've probably taken 20 percent of costs out in order to maintain our profitability.

And as we see the business come back, as we see businesses reopen, we will start adding back the costs that we have, but we are going to be very cautious as we do so to make sure we don't put costs back in when the crisis isn't fully over.

Peter Grom

Okay. That's helpful. Thanks.

Tom Harrington

Thanks, Peter.

Operator

Your next question comes from the line of Daniel Moore.

Tom Harrington

Hey, Dan.

Daniel Moore

Thanks for letting me sneak one more in. Just in terms of capital allocation, in the past your recession playbook has been to increase tuck-ins versus internal marketing. What would you need to see in terms of either revenue stabilization or leverage? Where would you need to get down to to be more comfortable in executing that playbook a little bit more aggressively?

Tom Harrington

Yeah. I'll answer the first part. Right now, we can't travel. So of course, we would be mindful of restrictions to do appropriate due diligence. While we believe that similar to prior economic opportunities, be they macroeconomic or downturn, that it'll take a couple of quarters, frankly, to flush out new opportunities that potentially, unfortunately, feel the pressures of this quarter and the next. And then we think there'll be a robust list of opportunities.

And we have an existing pipeline that we've held off on, frankly, right now because of those travel restrictions and the inability to appropriately diligence. And I think Jay in his prepared comments says we have the liquidity to execute against our original 40 million to 60 million on a full year basis. So we'd be hopeful that we'd ramp back up in Q3/Q4, dependent, right, on where we're at.

So we just want to be smart and judicious about how we add that in Q3 and Q4.

Okay. Thanks, Dan.

Daniel Moore

Oh, sorry, I didn't know we're still live. Thank you for the colour. That's very helpful.

Tom Harrington

Yeah. No worries. Apologize, but we're on, so.

Jay Wells

Thanks, Dan.

Operator

With no more questions, we will move back to Ryan for closing remarks.

Ryan Coleman

Thank you, everyone, for joining the call today. This will conclude Primo’s first quarter call. Thanks for attending.

Operator

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