FINAL TRANSCRIPT

Primo Water Corporation

Second Quarter 2020 Earnings Conference Call

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Welcome to Primo Water Corporation Second Quarter 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 second quarter earnings announcement released earlier this morning, or on the Investor Relations section of the Company's website at primowatercorp.com.

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 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're taking in response. Then Jay will discuss second quarter and first half financial performance, liquidity, ongoing cost containment and synergy work, as well as the third quarter outlook, before handing the call back to Tom to provide a long-term view on the Company ahead of Q&A.

Within the prepared remarks, Tom and Jay will be discussing our continuing operations, which will incorporate the Legacy Primo business and exclude the S&D business, which was sold in February.

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

Tom Harrington — Chief Executive Officer, Primo Water Corporation

Thank you, Ryan, and good morning. I hope everyone has been safe and healthy since our last update.

Our crisis management teams continue to work 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. We continue to emphasize the health and well-being of our Primo team and our customers, and are abiding by social distancing guidelines, staggering employee shifts, providing our associates with personal protective equipment, and allowing members of our team to work from home where possible.

As it relates to our customers, our no-contact delivery method and the recent rollout of our mobile app has enhanced the experience and supported continued growth in our residential Water Direct and our Water Exchange at-home consumer businesses.

As the effects of the pandemic continue, we’re focused on doing everything we can to ensure that customers continue to have access to high-quality drinking water. Whether it is delivered direct to their door through our 5-gallon Exchange program, or at one of our self-service refill stations, we’re working to bring healthy hydration to people whenever, wherever, and however they want it.

Before I review our current plan and Jay reviews the financial performance in greater detail, I wanted to share my perspective on our performance for the quarter. While the pandemic has certainly had an impact on our revenue and adjusted EBITDA for the quarter, the Company performed better than we expected in terms of revenue, which was approximately 2 percent better, and adjusted EBITDA, which was approximately 14 percent better.

Our leadership teams reacted swiftly to the top-line pressures largely created from our commercial customer base and the coffee service businesses and flexed our cost structure to deliver a 170-basis-point improvement in adjusted EBITDA margin. We benefitted from the highly variable nature of our cost structure and our ability to act swiftly and decisively.

Our teams have, despite COVID-19, made excellent progress on synergy capture, as we recorded approximately $4 million year to date. We generated approximately $51 million of adjusted free cash flow in Q2, a result of better than expected adjusted EBITDA, well-managed working capital, and the timing of cash interest payments.

Unfortunately, principally driven by the impact of the coronavirus, we did take an impairment charge of approximately $115 million, largely on our European operations. Jay will discuss this in more detail later in our prepared comments.

Our liquidity is in good shape and has improved in Q2, and we remain confident in our ability to fund the needs of the business, including our stale dividend and highly synergistic tuck-in acquisitions.

While the pandemic has presented an obvious set of unique and meaningful challenges, I remain confident that we will return to our historical growth algorithm on adjusted EBITDA later this year, despite a slower recovery in terms of revenue growth. Our commitment to our customers and to executing against our pure-play water strategy is yielding resilient financial results, despite a difficult operating environment.

Shifting to a recap of our current actions. While we've not seen a big bounce-back, we are encouraged, as we are seeing businesses in many states and numerous countries cautiously reopen. We're encouraged that the worst of the crisis may be behind us. We continue to focus on the long-term drivers of our future growth, ensuring that the fundamentals of our business remain strong.

We're also reviewing how the pandemic is changing the way we serve our customers and are adapting accordingly. We believe that changing consumer behaviour may create new and lasting opportunities for our business. Many of them are long-term positives.

For example, consumers sheltering in place is accelerating water consumption at home. And assuming elevated levels of work from home and cocooning through and after the pandemic, we would anticipate further growth from our residential customer base and at-home consumers who use our Water Exchange or Water Refill solution.

Another example is the increased use of online ordering and no-contact delivery. These are two areas where we are well positioned to benefit from changing consumer trends. Our mobile app was rolled out across the US during the second quarter, and while the feedback from customers has been very positive, we will continue to enhance this customer-friendly solution.

We continue to make improvements to our website, including water.com, to simplify the ordering process. With all of our investments in the customer experience, we're confident that we can retain these new customers through and beyond the pandemic.

These investments coincide with the increase in our Net Promoter Score. Our initiatives are working, as our Net Promoter Score is trending well above 2019 levels, and our core churn rate is continuing to decline, as we just recorded another record low in our US operations during Q2 of 18.6 percent. This is a decline of 350 basis points compared to last year and lower than the 21 percent we reported in Q1.

While we are quite pleased with our current and consistent reduction of the churn rate, we do realize it will be several quarters before we understand the impact of the pandemic on the commercial customer base.

In parallel to our initiatives around existing customers, we're working to generate new customer adds in this new environment. A good representation of where we see a lot of these changing dynamics coming together is in our partnership with a large e-commerce retailer. We remain the only third-party business service on this retailer's platform that was up and running through the second quarter.

As you may recall, the program originally began in test markets in Florida and Georgia, expanded into Texas and Connecticut and, in the second quarter, was expanded to southern California. We expect to extend the program across our US footprint before the end of Q4, as the customer feedback has been quite positive.

We expect that no-contact home delivery and e-commerce capabilities will continue to be vitally important. And the expansion of our online retailer program is a great way to ensure we are positioned to capture these changing consumer demands and participate in their growth. Fortunately, we have the capabilities to execute both from an online perspective, as well as from an execution perspective, at the customer doorstep.

In addition to expanding our online retailer partnership, we're focusing on increasing our penetration of the European residential base by expanding our Water Refill, Water Exchange, and Water Dispenser 4R model, or recurring razor/razorblade revenue model, as well as our online marketing effort. We are one of the leaders in water solutions in Europe and have the footprint and expertise for a low-cost rollout of these products.

While still in early stage development, our team is currently developing the plans to begin implementation in 2021, on a country-by-country basis. We've also introduced a new transactional website in six countries in Europe for residential customers to sign up for the 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. These actions will provide us with future profitable growth and better balance within our customer mix across our European business.

One way we typically generate new customers is through our retail booth program with Costco. When the pandemic hit, Costco temporarily shut down the booth program as they managed through COVID-19, and the program remained shut down for most of the second quarter.

As a final comment on customer add, I'm pleased to report that our booth program with Costco is now back up and running, a good sign as we return to more normal operating conditions. As a reminder, we capture roughly 27 percent of our new customer additions from this activity, and it's an important customer acquisition channel for us. We think the restart of our booth program, after a temporary shutdown due to COVID-19, bodes well for continued strong customer growth in future quarters.

Finally, as we focus on the future, we continue to develop our efforts on improving our sustainability leadership. The growing attention on reducing plastic waste and being more environmentally responsible works in our favour. One of our 5-gallon bottles can be sanitized and reused up to 50 times before being recycled, which saves about 1,500 plastic half-litre water bottles.

In Europe, we've been carbon-neutral for eight consecutive years. Our offices are entirely powered by renewable energy sources. We have introduced biodegradable water cups.

In North America, we've shifted new route truck purchasing to propane-powered trucks to reduce carbon emission. We've greatly improved energy efficiency at our plant to ensure lower energy usage per finished product. And we will achieve the Alliance for Water Stewardship certification in the first two of our springs as previously communicated.

Overall, it remains clear to us that the long-term growth drivers of our business remain intact and are improving. Our pure-play water model is presenting multiple areas for profitable growth, and we have the management team, cost structure, brand strength, and quality asset base to successfully navigate this crisis.

Before my closing remarks and taking your questions, I'd like to turn the call over to Jay to review our second quarter and first half financial performance.

Jay Wells — Chief Financial Officer, Primo Water Corporation

Thank you, Tom, and good morning, everyone. Starting with consolidated results.

Second quarter revenue was $457 million compared to $456 million last year, up 1 percent, excluding the impact of foreign exchange. Revenue for the first half of the year increased 5 percent to $931 million.

The revenue increases were primarily driven by the benefit of the Legacy Primo acquisition and growth in our residential Water Direct, Water Exchange, and Water Refill businesses, partially offset by lower revenues in our Water Direct commercial business, particularly within our European commercial customer base. This is a result of the high concentration of commercial customers in Europe, and these customers are more traditional corporate offices where workforces continue to work from home. But each week, it is a bit better than the week before.

On a pro forma basis, second quarter adjusted revenue was down 12 percent, while first half revenue was down 3 percent.

Second quarter adjusted EBITDA from continuing operations was $82.5 million, a 10 percent increase from the same period in 2019. And adjusted EBITDA margin was 18.1 percent, an improvement of 170 basis points compared to last year. The Legacy Primo business contributed $15 million of adjusted EBITDA in the quarter. On a pro forma basis, second quarter adjusted EBITDA was down 6 percent versus prior year.

For the first half of the year, adjusted EBITDA was $153 million, a 19 percent increase from the first half of 2019. First half adjusted EBITDA margin was 16.4 percent, a 170 basis point improvement compared to 2019, excluding our divested business. The increases were primarily driven by the benefit of the Legacy Primo acquisition, growth in revenues from increased Water Direct services and products to residential customers within the US, and improved operating leverage resulting from the cost reduction actions taken in the second quarter.

The Legacy Primo business contributed $22 million of adjusted EBITDA during the first half of the year, which includes a full second quarter plus one month of March. On a pro forma basis, the first half adjusted EBITDA increased by 5 percent, driven by better operating leverage and growth in revenues in our residential Water Direct, Water Exchange, and Water Refill businesses.

Second quarter SG&A was essentially flat at $247 million, but a portion of our SG&A expense in the quarter related to COVID-19. These costs included severance and other payroll reduction costs, as well as costs related to securing PPE and other safety equipment. These COVID-19-related SG&A expenses totalled $15.4 million during the quarter. On a pro forma basis, adjusted for COVID-19-related cost, SG&A was down 14 percent in the quarter.

While we are on the topic of cost, I would like to provide an update to our cost reduction initiatives.

In early April, we responded quickly to a lower revenue environment. I think it is important to reiterate that we benefit from a highly variable cost structure that grants us the ability to react to changing conditions. Most of our operating costs fall within route delivery, sales, marketing, and back office. In other words, it's largely labour cost and we have reduced headcount in these areas by over 20 percent.

We executed all these cost reduction efforts in about four weeks' time, and given the uncertainty around the second wave, we're going to be very judicious in how quickly we put costs back into the business over the next 12 to 18 months.

I would also like to point out that we recorded an impairment charge during the quarter. We typically perform our annual assessment of goodwill and intangibles during the fourth quarter, unless there is a potential indicator of impairment. As a result of the impact COVID-19 had on our operations, notably in Europe and Canada, we performed the assessment of our goodwill and intangible values during the second quarter.

With the assistance of third-party valuation experts, factoring in the impact of COVID-19, as well as higher overall discount rates, we recorded a pretax non-cash charge of $115 million. Most of that charge, roughly $104 million, was related to goodwill, with the remainder allocated to impairment on trademarks and other intangibles.

Turning to our segment-level performance, starting with our North America segment, where we generate approximately 75 percent of our total company revenues. Second quarter revenue increased 13 percent to $364 million, driven by the benefit of the Legacy Primo acquisition and growth within our residential Water Direct, Water Exchange, and Water Refill businesses, partially offset by decreased revenue in our commercial customer base.

For the first half of the year, revenue increased by $93 million or 15 percent. On a pro forma basis, second quarter adjusted revenue was lower by 7 percent, but first half adjusted revenue was up 1 percent.

In the second quarter, SG&A expense increased 2 percent to $176 million. The increase was driven by the acquisition of the Legacy Primo business, largely offset by cost reduction initiatives implemented during the quarter. On a pro forma basis, adjusted for COVID-19-related cost, second quarter SG&A fell by 14 percent.

Second quarter adjusted EBITDA in this segment increased 38 percent to $78 million, including a $15 million contribution from Legacy Primo. For the first half of the year, adjusted EBITDA increased 45 percent to $140 million, which includes a $22 million contribution from Legacy Primo. The increases are primarily the result of the Legacy Primo acquisition, growth within our residential Water Direct, Water Exchange, and Water Refill businesses, as well as improved operating leverage. On a pro forma basis, second quarter adjusted EBITDA rose 12 percent, while first half adjusted EBITDA increased 23 percent.

In our Rest of World segment, second quarter revenue decreased 30 percent to $93 million, and revenue in the first half of the year fell 15 percent to $216 million. The declines were driven by decreased revenue in our Water Direct business, as well as in our coffee services business.

Second quarter SG&A expense decreased by 7 percent to $60 million, primarily driven by cost reduction initiatives enacted in our European business. First half SG&A expense rose 2 percent to $127 million, primarily the result of COVID-19 and severance costs related to rightsizing our route structure. Adjusted for costs related to COVID-19 and severance costs, SG&A expense decreased by 19 percent in the second quarter.

Adjusted EBITDA in the quarter decreased by 53 percent to $12 million. For the first half of the year, adjusted EBITDA declined by 38 percent to $29 million. The decreases were driven by lower operating earnings in our European business.

Turning to our liquidity position and balance sheet. We entered the second quarter with a cash balance of $211 million and available net borrowing capacity on our cash flow revolver of $99 million, for a combined total liquidity position in excess of $300 million. We are not having any significant issues collecting payments from our customers, and we are comfortable with our working capital position.

We ended the second quarter with a net leverage ratio of 3.5 times and continue to target a post-synergized net leverage ratio of 3.0 times.

I would also like to provide an update on the synergy work we've been doing. We are still confident that we will attain $35 million in cost synergies over three years. 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 the call centre 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. We are running ahead of our anticipated synergy capture for this year, as we originally forecasted $7.5 million in cost synergies achieved in 2020 and have already realized almost $4 million in synergies year to date. This acceleration in synergy realization has been spurred by the aggressive cost actions we are taking in response to the pandemic, so we are pulling forward some actions we originally expected to do in 2021.

Overall, we are pleased with the financial performance of our business in the second quarter and first half of the year. Obviously, demand from our commercial customers remained challenged by the pandemic, but we have taken appropriate action to protect our business and minimize disruption. There remains additional work to be done, and we are carefully monitoring changing conditions. But our pure-play water strategy, ample liquidity, and variable cost structure offers us a secure buffer against unprecedented macroeconomic conditions.

As we look to the third quarter, based on the information we have available to us today, we currently expect consolidated revenue from continuing operations to be between $480 million and $500 million, which would represent a pro forma decline of between 8 to 12 percent.

We also believe our third quarter adjusted EBITDA will be in the range of $100 million to $105 million, roughly flat on a pro forma basis, thanks to the growth in our residential Water Direct, Water Exchange, and Water Refill businesses; a gradual recovery of our commercial Water Direct business; as well as our operating expense reductions.

Once we have moved past this crisis, we are still reiterating our long-term expectations of 4 to 5 percent top-line 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.

While we believe we will not return to top-line growth until next year, we can return to EBITDA growth and continue to generate EBITDA margin expansion before then, thanks to the cost initiatives and operational changes that we have made. 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, our consolidated results are holding up well, and we're very comfortable with our rightsized operating footprint and cost structure, as well as where we are from a liquidity position.

As we enter the back half of the year, we're staying focused on a handful of key priorities. Above all, we will prioritize the health and safety of all our associates and customers. We continuously strive to improve the customer experience, and we'll continue to invest, from order placement to final delivery.

In North America, we will continue to invest in our Water Direct, Water Refill, and Water Dispenser markets, as we are seeing considerable growth in these channels as consumers adapt to the current environment.

In Europe, we plan to accelerate our Water Refill, Water Exchange, Water Dispensers businesses, and online marketing capabilities to diversify our customer base and capture growing demand.

We will continue to evaluate our cost structure to identify opportunities for additional spending reductions and ensure that we are judicious when determining when to begin to put costs back into the business.

And lastly, we will continue to manage our free cash flow and expect to generate sufficient free cash flow to fund our staple dividend and highly synergistic tuck-in acquisitions, while maintaining compliance with our credit agreements and covenants.

As Jay noted, we expect our consolidated Q3 revenues to be down between 8 to 12 percent on a pro forma basis, and for adjusted EBITDA to be roughly flat on a pro forma basis. This crisis is making forecasting a more dynamic and fluid process than usual, but we're focusing on the things we can control and positioning our business to both withstand the crisis, as well as find new ways to capitalize on changing consumer trends and demand. Therefore, our long-term growth algorithm remains unchanged.

In addition, we continue to expect to return to EBITDA growth before the end of the year and believe we will remain cash flow-positive this year, after providing cash to support our dividend and execute highly synergistic tuck-in acquisitions when the time is right.

Before moving to Q&A, I want to take a moment to thank all of our associates for their commitment to Primo and to our customers. I'm very grateful to lead an organization with such a dedicated workforce.

I'll now turn the call back to Ryan to move us to Q&A.

Ryan Coleman

Thanks, Tom. During the Q&A, to ensure that we can hear from as many of you as possible, we would ask for a limit of one question and one follow-up per person. Thank you for your cooperation.

Operator, please open up the line for questions.

Q&A

Operator

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

Your first question comes from the line of Nik Modi.

Nik Modi — RBC Capital Markets

Good morning, everyone. Hope everyone's doing well.

Tom Harrington

I'm good.

Nik Modi

A couple questions, Tom, if you just or, Jay, if you could just help us understand kind of what your underlying operating assumption is for the guidance that you gave for the third quarte? It's down, I think, 8 to 12 percent. Are you assuming reopenings happen at the current pace? Are you assuming rollback of reopenings? Just wanted to get kind of your understanding of how you're thinking about it, given the fluidity of the situation. And then maybe even touch on international?

And then the second question, which hopefully will be a quick one, is can you help us understand what your customer acquisition costs look like today, given this current environment, versus what they historically have been? Thanks.

Tom Harrington

Hi. Good morning, Nik. I'll take part of the first one, and Jay will handle the second part. In terms of our forecasting, we expect the residential at-home to continue at its current run rate. So we enjoyed Water Direct residential growth. We enjoyed Exchange growth. We've had Dispenser growth. So we've included similar rates of growth in our Q3 assumptions.

In terms of the single-biggest challenge that we face is the commercial side of Water Direct. We have the decline slowing, but as we've said in the past, it is a slow recovery, country by country, across Europe. So we haven't seen that big breakout. So it continues to get better, a little bit every week, every week. So we've really reduced the decline, as we think about Q3, in terms of those two components of the top line.

Jay Wells

Yeah. I mean, to give you a couple more numbers on that, Nik, I mean, you look at the quarter, our residential Water Direct business was up about 29 percent, Exchange was up about 25 percent, and we're continuing to see those trends. And you know what? You look, as we entered the quarter, commercial was down about 30 percent and trending in the right direction. So you look at that, that's where we get the average of the revenue.

You asked about the overall customer acquisition. Right now, overall, our e-commerce, our website is the primary method that we are using to acquire customers, and it's honestly one of our lower cost methods to acquire customers. So that continues to be a very good source of customer adds of residential customers, our focusing much more on e-commerce and no-contact delivery, which is our sweet spot. And we continue to upgrade our websites, so that continues very well.

Our RSRs are still providing great service and getting referrals, and we're still getting very good customer adds through that. And that's also a very low-cost customer add.

Tom Harrington

You go to the part of your question about Europe. So we have reduced the rate of decline, as Jay referenced. But we also have introduced the ability for customers to sign up online. And they're small numbers. I actually just got an email that we reached 1,000. Right? So if you just think about, in the years gone by, we didn't have that level of residential sign-up.

So we think that bodes well for our future in terms of our ability to address the mix issue in Europe. And we now learn that we can actually drive residential customers in for the service where, heretofore, we really haven't had that confidence. So—

Nik Modi

Okay.

Tom Harrington

—we're optimistic about that. It's just it'll be small and slow but also at a lower cost per new, in terms of cost to acquire.

Jay Wells

Yep. With everything reopening, as Tom mentioned, we are restarting the Costco booth programs, which that's gone back to that cost structure. And the one part of our sales and marketing that is still slower, that we're holding back on, is more the commercial door knockers that we've talked about in the past because as businesses and offices have not fully reopened so, yeah. I would say that's the area we're going to be slower to put costs back in on the customer acquisition side.

Nik Modi

Excellent. Thanks for that perspective. I'll pass it on.

Tom Harrington

Thanks, Nik.

Operator

Your next question comes from the line of Peter Grom.

Jay Wells

Good morning, Peter.

Tom Harrington

Hello, Peter.

Peter Grom — JPMorgan

Hey. Hey. Good morning. Hope you guys are doing well. So two questions from me. So maybe first, more of a housekeeping item, but I was hoping you could actually break out the COVID costs a bit? Most companies seem to be including PPE and bonuses and excluding severance from adjusted earnings. So if you could kind of break out what was severance versus PPE in the quarter, that would be helpful.

And then I was kind of hoping you could dive into the residential versus commercial dynamic a bit more? And maybe provide some context as to what you saw in those markets in July? And then just thinking about the places where we have seen a resurgence in cases, is there anything to call out about trends in those markets? Are you seeing a similar uptick to what you saw in March and April? Or have consumers kind of more gotten—perhaps gotten used to this new normal? Thanks.

Tom Harrington

I'll let Jay answer your first question—

Jay Wells

Yep. So—

Tom Harrington

—on investments.

Jay Wells

So you look at the $15 million and change. About half was related to North America; half was related to the rest of the world. I'd say, in each segment, it was probably $1 million of spend in each segment, for a total of $2 million on PPE, which we did adjust out.

You look in the US. We probably spent about $4 million to $5 million on front-line incentives for Q2, that are not continuing into Q3, for our customer-facing associates. And then there was about $9 million of severance that was part of that adjustment.

And if you do the math, that was predominantly related to Europe where—here in the US, the idea of people going on unemployment, not having large severance, is more than do-able. Over in Europe, it's much more significant costs when you reduce your workforce by about 20 percent, as we did. So that's where the predominant amount of costs were and kind of follows what we said in our 8-K, when we talked about the restructuring costs we were going to incur.

Tom Harrington

In terms of growth, let me start in Europe. So we track performance, as you can imagine, by day. And where countries have reopened, we see a return of volume. And in some cases, that looks like prior year. In some countries, they're still effectively on full shutdown and haven't reopened in a meaningful way. And in those countries, we see the 35 or 40 percent decline.

Overall, it is improving and, instead of 40 percent, we believe it'll be—and we think 30 percent in Q3. Obviously, we'd be hopeful it gets better but right now, that's what our internal numbers indicate to us.

In the US, it has slowed a tad in a couple markets where there was, let's call it the reset. if you think about California—but California never really reopened. So if you think about the performance in California—this is commercial—it's about the same. And in Texas and in Florida, you see a little bit of more of a settling number, as opposed to a continually improving number. And those are the three biggest markets for us in terms of real change, in terms of shutdown and impact on our business. But overall, the commercial is getting better slowly, day by day, in North America.

In terms of residential, we had something on the order of 30 percent growth in dispenser sales in the quarter which, to us, is obviously like, more razors is the leading indicator of future growth in either Water Direct or Water Exchange and, frankly, Refill. So that bodes well in terms of future water consumption.

We think people have become accustomed to no-contact delivery. They order online, and when they're home, they drink more. So we also benefit from that—continue to benefit from that through the quarter and expect that will stay in place through Q3. So we don't see any reason why, at this point, that would change.

And then as larger companies have begun to announce longer duration of work from home, we also think that benefits us because people are home. They're going to consume more. Our job is to effectively market to them, and we are. So we have no-contact delivery messaging. We have work-from-home messaging. And we're obviously looking to expand our piece of that puzzle.

Jay Wells

Yeah. And, Peter, one thing, keep in mind, we don't talk about it a lot because it is in our Other category, but our coffee services business, which is much more office-type specific, we're—continue to seeing that down 50 percent, 60 percent. So even though it's another, much smaller part of our business, we are seeing that part of our business be much slower to come back because it really is much more the true, traditional office that we do that type of services at.

Tom Harrington

So we expect that trend, frankly, to continue—

Jay Wells

Yep.

Tom Harrington

—over the next quarter at least—

Jay Wells

Yep.

Tom Harrington

—probably longer, frankly.

Peter Grom

Thank you. Pass it on.

Jay Wells

Thanks, Peter.

Operator

Your next question comes from the line of Kevin Grundy.

Kevin Grundy — Jefferies

Hey.

Jay Wells

Morning, Kevin.

Kevin Grundy

Good morning, guys. Hey. Good morning.

Tom Harrington

Hello, Kevin.

Kevin Grundy

And—yeah. Good morning, Tom. Morning, Jay. And congrats on the strong result, particularly given all the volatility. I did want to come back to the revenue guidance, though, the down 10 percent, maybe just sort of zoom out a little bit. So on a US and international basis, so you guys reported up 12.5 percent and down 28 percent, respectively. What were the June and July exit rates? I'm just trying to—I'm just trying to understand the rate of the decel in total in the US and then, presumably, the rate of improvement. I'm just trying to make the math work here in terms of why it's going to be down 10 percent in third quarter.

Tom Harrington

We're digging out that number—

Jay Wells

Yeah.

Tom Harrington

—right now.

Jay Wells

No. I mean, you look at the quarter—or let's even go to July. I know that was the number that you asked. I mean, Water Direct in North America was 8 percent to closer to 9 percent type decline, as we go out. So we have that. That excludes the coffee that I just mentioned. That's more at the mid-50 percent-type declines. So as we talked, North America's definitely coming back well.

You look at Europe, I mean, it's pretty much just getting below the 30 percent number as we're ending July. So that's why, when we really look at the quarter, it is much more looking at residential in the mid 20 percent of growth, and commercial more right around 30 percent decline.

Kevin Grundy

Okay. All right. I'll pick that one up with you guys offline later, just particularly around the international piece because it doesn't sound like things are getting materially better than, Jay, based on your comment. But I'll pick it up later because I do—

Jay Wells

No. No. I think—

Kevin Grundy

Go ahead.

Jay Wells

—and keep in mind—I mentioned it in my prepared remarks—our European business is much more the traditional office. So even though the countries are starting to reopen, and we are seeing improvements, in countries that are reopening, offices continue to work from home, as here.

So even though the countries do reopen, it's really when the offices get back reopened, is when we're going to see the good bounce back in that business. So again, like I said, we're seeing positive trends, being that it's ended July at below 30 percent down, but it's going to be a little slower as companies continue to push out when they return to work.

Kevin Grundy

Okay. Okay. And then my second question is on Nestlé and, really, two areas: first, capital allocation; second, competitive environment. So of course, you've commented a number of times; there's no shortage of dialogue in the market about the strategic fit of that business. I don't think you need to comment on it.

But I guess, what I would like to know is, is the intention to keep your powder dry with respect to tuck-in M&A—is that something we should anticipate, sort of, less of here in the balance of the year, given the opportunity for a transformative and very accretive deal?

And then, relatedly, are you seeing any change in competitive behaviour from Nestlé, given that it's a possibility they may just, sort of, be running this for cash here ahead of a potential sale? Are you seeing anything different in the way they're running their business? Then I'll pass it on. Thanks, guys.

Tom Harrington

Okay. Thanks, Kevin. In terms of, let's call it the pricing environment, with the competitive set, we really don't see any meaningful changes in pricing, in terms of new customer offers that are better or worse. They're roughly the same, so there's been no change there in terms of activity to drive customers, from a pricing perspective.

As it relates to tuck-ins, we've said we expect to do the low end of our full year range of $40 million, and we've done something on the order of $18 million and $19 million through the first half of the year. So we would continue to do those highly synergistic tuck-ins that get to the historical synergized EBITDA numbers that are something like a 3. So we actually would obviously continue to do those in spite of what may happen, what could happen if any potential larger transactions.

Kevin Grundy

Okay.

Jay Wells

Yeah. I mean, at that type of—you got to remember, at that type of post-synergy EBITDA multiple, we're doing something at around a 3 times—anything is providing us additional firepower if we lever up to the 4 or 4 and change. So it actually gives us more leverage.

Kevin Grundy

Got it. Understood. Thanks for the time, guys. Good luck.

Tom Harrington

Thanks, Kevin.

Operator

Your next question comes from the line of Derek Dley.

Derek Dley — Canaccord Genuity

Yeah. Hi, guys.

Jay Wells

Hey, Derek.

Tom Harrington

Hey, Derek.

Derek Dley

Hey. Good morning. I just wanted to switch gears a little bit, just on the cost side. Clearly, you guys did a really good job of being flexible and adjusting your cost base. Can you talk about some of the areas where you were able to reduce these costs? And, if any, were there any learnings that you guys had, maybe from past, slower consumer spending environments, that allowed you to adjust these costs rapidly?

Tom Harrington

Yeah. I think a couple things, Derek. Most of the senior management team around the Company, who are here operating businesses in 2008, ’09, and ’10, so we have prior experience in meaningful downturns. So I think we used our past experience to benefit from how we execute in COVID.

Key areas, look. We reduced routes on both sides of the continent. We reduced them very aggressively. We will be slow to put them back in. Right? So as the customer base and the revenue come back, then we’ll adjust routes. But we’re going to be—and we used the word judicious. We’re going to be super-mindful about how fast we might put that cost structure back in.

But we certainly cut sales and marketing, and that’s a big wild card for us. So we continued to invest in marketing for the online activities, principally driven towards residential. It has paid off in terms of growth there. We don’t have the old-fashioned door knockers we call area sales representatives because we need to understand how the small, commercial office environment reopen. And it would be folly for us to put people on the street, knocking on doors when some high percentage of them are still closed. So we’ll have to think about how we bring them back in the future, but very cautious, market by market, based on how much of that small office environment reopens.

Clearly, the Costco piece is back in place. That would’ve been costs that we took out early in Q2. But we’ve now begun to slowly ramp up there to meet the demand of the in-store events. So that’s a bit of a change. We’re optimistic that’ll help us drive, obviously, more residential customers and more residential Water Direct volume into the business.

We think there’s some opportunities on Water Refill that—we’re still early in our understanding of Legacy Primo, but we might make some investment in sales there because the places where we place them are open. So we view that opportunistically.

And then there's a whole set of cost structure in the background. Right? So if you separate what we're doing with the Legacy Primo business because that's really duplicate, back office costs and all that. That's all part of our synergy discussion.

But we have eliminated lots of non-customer-facing costs, and we will be quite judicious about how many we would need to add back in over time. And we're, frankly, not at the point, largely other than route people and those Costco salespeople, about adding much headcount in till we—we've got to get through another piece of time here to really understand where we think this thing turns out over the next 9 or 12 months.

Jay Wells

Yeah. And my only add to that is I would say the history that Tom and the team have had in seeing issues and revenue challenges come up, the speed of execution was great. I mean, we got all these cost cuts done pretty much in the four weeks of April.

So we don't have a full quarter of the savings we're talking about but being able to—when you take the cost of those reductions out, reducing our SG&A by 14 percent in the quarter, that's really how we over-delivered on where we thought we were going to be on EBITDA, just with the speed of execution and the amount of costs we were able to take out. And now, we're set up to get a full quarter of benefit in Q3.

Tom Harrington

And I said in my prepared comments that the team acted swiftly and decisively—not the most fun thing to do, but they'll also act decisively as we go back in. So we'll be very thoughtful before we add any costs back in, and it really comes down to, what do we need to effectively service our customers? And that'll be the drive. That'll dictate how we approach it.

Derek Dley

Okay. Great. Thank you very much.

Tom Harrington

Thanks, Derek.

Operator

Your next question comes from the line of Derek Lessard.

Jay Wells

Morning, Derek.

Derek Lessard — TD Securities

Good morning, gentlemen.

Tom Harrington

Hello, Derek.

Derek Lessard

Yeah. I echo congratulations on managing through this environment. Maybe … I do want to follow up maybe on Derek's question. I mean, and it relates more to, I guess, the sustainability of your margin. Obviously, you're at around 18 percent now and believe the guidance that you've given for Q3 puts you at around 21 percent. Is that level sustainable in the context of the cost-cutting or the costs that you've taken out of the system?

Tom Harrington

No. Look, we believe that there'll be some gains in terms of increased EBITDA margin, post-COVID. But we have to be very thoughtful about what costs need to go back in, as part of that decision, in terms of where we think that EBITDA margin will be. And we're not ready to do that yet. I want to get through another quarter or so before we really understand that the new cost structure will be X higher.

Q3 is really still managing very similarly to Q2. Right? So we got costs out in Q2, but we didn't get them all out, right, because we executed in April. So we're seeing, really, the forward benefit of a full quarter of actions taken in Q2, which is providing some of that spread. And then we need to see what the recovery rates are, frankly, on both sides of the Atlantic, in terms of the commercial revenue return.

And can we accelerate, and does the acceleration on residential continue? We believe it will continue, so we really have to see how that commercial comes back before we can land on the Xs and Os of EBITDA margin expansion on a permanent basis.

Jay Wells

Yeah. I mean, Derek, keep in mind, part of the benefit is the synergy benefit that is incremental to margin. That's definitely going to stick, and that was—that is additive and part of the Primo transaction that we did. And, yeah, we have taken a lot of costs out, but we want to make sure we continue to invest behind the business, grow the top line, as we've given guidance to, and just be very judicious to put it in. So, yeah. Q3 is solid, but I didn't want you to forget the benefits of the synergies is also going to help our margin as we capture those synergies.

Tom Harrington

Yeah. And. Derek, think of it like this. So if we had—and my number will be wrong—100 area sales reps calling on commercial customers pre-COVID and the commercial market takes longer to recover, well, we won't put 100 in. So maybe our new run rate is 50. But I'm not eyeing the team, frankly. We're not at the point yet to land on it 67 people. So that gives you X of future benefit, and that's what we're—

want to get through this next quarter or so to really fine-tune that, based on what would then be seven months of experience.

Derek Lessard

Okay. That's fair enough. And maybe just switching gears, can you talk about the upside that you see with your online partnership? And you're in several markets now. Just curious how long do you think that runway is?

Tom Harrington

I think it's a pretty long runway. Southern Cal rolled out. We get very good scores in terms of customer feedback, which is critical in terms of how people rate us. We have lots of training to do with all of our route people, right, because it's a very tight SLA, service-level agreement, in terms of when we execute. So it's not a meaningful impact today, but we think over time that we'll hone this process and that it could be a very nice contributor in the future.

And it is largely residential, so we know, clearly, there's a spike here as it relates to that. We think that's sustainable. So we really like the future of that. It's just not big numbers in any particular month at this point in time. But just think about the slow roll. Now we go from 2 states to 30 states to 45 states, right, that we've got to be intelligent about executing that pretty darn near flawlessly. Right?

And you'll remember our in-store booth program rollouts of past years; like, we've learned from those too, right, so being thoughtful about making sure we get it right from our perspective, from the retailers' perspective, and most importantly from that members' perspective. Different member in this case.

Derek Lessard

Right. Thanks for that, guys.

Jay Wells

Yeah. Thanks, Derek.

Operator

Your next question comes from the line of Daniel Moore.

Jay Wells

Morning, Dan.

Daniel Moore — CJS Securities

Good morning, Jay. Good morning, Tom.

Tom Harrington

Hello, Dan.

Daniel Moore

Maybe just reflecting the obvious significant cost reduction initiatives, can you update us on how we think about incremental margins as volumes return? And what, ultimately, margins could look like in two to three years maybe relative to the levels implied by your kind of pre-COVID algo?

Tom Harrington

Yeah. I'll answer part of that and then I'll let Jay, obviously, chime in. But look, we think our long-term growth algorithm remains the same as we sit here today, which would be 4 to 5 percent top-line growth, $10 million to $15 million of organic EBITDA growth, $5 million to $10 million from tuck-ins, 20 to 30 basis points of EBITDA margin expansion. So we believe that we would expect that to be back in place sometime next year, subject to the difficulties of COVID and all that, so I have to put the disclaimer in there.

The one thing that we are still sorting through is what is the one-time benefit or change in our cost structure as we come out of COVID? And that was the conversation we just had that said we're not prepared to make that decision. We need another 30—another quarter or two to really understand what we think the forward structure will look like after all this work that we've done.

Jay Wells

Mm-hmm. And again, I said it, I believe just on Peter's question, if I remember it right—I could be remembering wrong—we are delivering accelerated synergies on end of this year. Now we guided $7.5 million with where we're at, almost $4 million year to date. We're probably end of the year $11 million and change. And that is … on $2 billion of revenue, that is a good incremental change.

And then we've talked how many handful of million of extra costs will never come back in the business? That will be right. But again, we are going to every year grow organically, invest behind growth, and we want to make sure we come out with a sustainable EBITDA margin going forward that also sustains our top-line growth.

Daniel Moore

Understood. And maybe one more, just in terms of Refill and Exchange. Sounds like 2021 is when we start to hit the ground a little bit more into Europe. Would you expect a meaningful contribution in '21? Or do we sort of roll out and then '22 is where it starts to hit the top line? And ultimately, how large an opportunity do you see that relative to where the North America business is maybe today?

Tom Harrington

Yeah. It's a great question. I would view it more towards '22. So we're in the market selection analysis stage, Dan. So we've said in the past that we don't think Exchange works in every country. We think it'll work really well in some countries. Frankly, the same with Refill. So the teams are working through a point of view about the first markets we should go to are A, B, C. And that would then become the focus of a rollout that we execute in ’21, and then you’ll get the forward benefit.

Another important part of this is what do we do with the razors? The part—it could be that we move on razors first, dispenser sales, so that we begin to seed the market. And we have learned in our early days of our online … new online water solution in Europe that you can actually get a cooler inside a home in Europe, which is an important learning for us, which then gives us the wherewithal to then present, how do we sell the dispenser or razor into the European market? So it’s a multistep process.

Based on what we learned coming out of COVID, we’re going faster than we would have anticipated. So we’re probably 18 months ahead of where we would be otherwise, and that’s ultimately where it goes. And if you just think about the Legacy Primo business, it took—it’s a multiyear process of consistent execution with the razor and the razorblade, and then the benefit of Refill is kind of the third leg of that stool.

Daniel Moore

All right. And I’ll save the ultimate TAM for another day. Thanks for the colour.

Jay Wells

Thanks, Dan.

Operator

Your next question comes from the line of Faiza Alwy.

Faiza Alwy — Deutsche Bank

Yes. Hi.

Jay Wells

Morning, Faiza.

Faiza Alwy

Good morning. Thanks.

Tom Harrington

Hi, Faiza.

Faiza Alwy

Hi. So first I just wanted to get a sense of how much of the COVID costs do you think are recurring versus one-time?

Jay Wells

Yeah. I mean, the severance costs that I've talked about, 9 million, that is one-time, quick adjustment of our workforce down to meet the volumes. So that will not be recurring.

You look at the $4 million to $5 million of front-line incentives for our associates, who are out there in the middle of this pandemic but continuing to service customers well, that was purely a Q2 item. We have not continued that into quarter three, so that is one-time.

And you look at roughly globally $2 million of PPE, that we did a lot of stockpiling. We had a lot of increased costs. Yes, we're continuing to have some, but nothing to that level, and that won't be adjusted going forward. That was more just the one-time cost of really getting us up and running on the PPE. That will not continue to be listed. So I view—I wouldn't adjust it if I don't view them all as one-time. So they are one-time in my view.

Faiza Alwy

Okay. Understood. And then just on 4Q, I'm curious if you can put some kind of parameters around how you're thinking about 4Q, just given where we are at this moment in the pandemic. Should we just—is it fair to assume sort of just a sequential improvement from what you're expecting for 3Q? Is there a scenario where things get maybe a lot better? And I guess I'm wondering if there's just more uncertainty on the top line and if maybe you have more control on the EBITDA line, just given how much progress you've made on the cost structure?

Tom Harrington

Yeah. We think about Q4 as sequential, right? And it's really how we are—we watch the revenues very closely and the customer count. So assuming that there's some incremental benefit as we move forward, it might be a little bit better. But it's really kind of trended off where we see it today with the hope it gets a little bit better.

We are in greater control of our EBITDA because of the variable nature of our cost structure and I think now, frankly, our track record of our ability to act swiftly and decisively and do this. And we've said we think we'd get back to EBITDA growth sometime before the end of the year. Well, it's going to happen sometime in Q4 and we fully expected that's what would happen. And our current view of Q3 is we basically get to flat EBITDA year over year, so one would think we'd get growth sometime in Q4.

Faiza Alwy

Okay. That makes sense. And then, Jay, anything you can say on the cash flow generation this year? Not adjusted, but actual where do you expect to be in terms of actual reported cash flow?

Jay Wells

No. I mean, we're not giving EBITDA guidance, so I don't think I can do cash flow. But all I can say is, year to date very happy with how our cash flow has been coming in. You look at our commercial customers, the bulk of our customers are honouring their commitments; only a few are asking for postponement of payment. Our residential customers, which are actually quicker payers than our commercial customers, so the overall mix of our business has gone to improved type of working capital customers, so very happy with that. We've watched our CapEx tightly.

So you look at our year to date, this is probably our best position of free cash flow year to date that we've had as a company, so very happy how we are managing through a difficult situation, both on operating the business and managing our cash and liquidity.

Faiza Alwy

Okay. Thank you so much.

Jay Wells

Thank you, Faiza.

Operator

I would now like to hand the call over to Mr. Coleman for any closing remarks.

Ryan Coleman

This will conclude Primo's second quarter earnings call. Thank you all for attending.

Operator

Thank you for your participation. This concludes today's call. You may now disconnect.