FINAL TRANSCRIPT

Primo Water Corporation

Third Quarter 2022 Earnings Conference Call

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PRESENTATION

Operator

At this time, I would like to welcome everyone to the Primo Water Corporation's Third Quarter 2022 Earnings Conference Call.

Thank you. I'd now like to turn the conference call over to Mr. Jon Kathol, Vice President of Investor Relations. Please go ahead.

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

Welcome to Primo Water Corporation's third quarter 2022 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 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 capable of being estimated, is included in the Company's third quarter earnings announcement released earlier this morning, or on the Investor Relations section of the Company's website at www.primowatercorp.com.

I am 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 by providing a high level review of the third quarter and our progress on Primo's strategic initiatives. Then Jay will review our segment level performance and will discuss our third quarter performance in greater detail, and offer our outlook on the fourth quarter and full-year 2022, before handing the call back to Tom to provide a long-term view ahead of Q&A.

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

Tom Harrington — Chief Executive Officer, Primo Water Corporation

Thank you, Jon, and good morning, everyone.

I'm pleased with the results of the quarter, and I'm thankful to all Primo associates for their ongoing contributions to the Company's success.

In particular, I'd like to call out Jay Wells, our CFO, who announced his retirement, effective April 1st. I thank Jay for his dedication and valuable contributions during his tenure at Primo. Primo has a strong Finance team, and Jay has played a significant role in helping drive financial and operational improvements. I am deeply appreciative that Jay will remain with Primo until his retirement date to help facilitate a smooth Leadership transition, and wish him all the best in his retirement. Thank you, Jay.

We continue to execute our differentiated Water Your Way platform, and despite near-record inflation, we delivered strong organic revenue and Adjusted EBITDA growth in the third quarter. Our investment thesis remains intact, with a portfolio of leading water solutions across multiple channels and geographies, strong consumer tailwinds, and a recession-resistant revenue base. The continued investment in our digital platforms, increased connectivity of dispenser sales to our Water Solutions, and ongoing optimization of our route-based operations provide a strong foundation to achieve our long-term growth targets.

In the third quarter, we delivered strong revenue and Adjusted EBITDA growth. As a result, we are increasing our full-year 2022 guidance on revenue to be between $2.22 billion and $2.24 billion, with normalized revenue growth of 13 percent to 14 percent, organic revenue growth of 14 percent to 15 percent, and Adjusted EBITDA to be between $415 million and $425 million.

Third quarter consolidated revenue increased 6 percent to $585 million. Organic revenue growth was 15 percent. Excluding the impact of foreign exchange, and the exit of the North America single-use bottled water business, revenue grew 18 percent, driven by continued consumer demand, increased dispenser sell-through, ongoing M&A tuck-in acquisitions, improved service metrics, increased revenue per route, and increased OTIF, or on-time and in-full delivery execution, continued volume growth in

Water Direct and Exchange, and a stabilized customer base in Refill, as well as improved customer experience, including benefits from our updated mobile app.

Adjusted EBITDA in the third quarter increased 10 percent to $117 million supported by higher volume, increased pricing, and effective expense management that offset the impact of inflation. Adjusted EBITDA margin for the quarter was 20 percent, 80 basis points higher than the prior year.

In the Global Water Direct business, our customer base increased to approximately 2.3 million for the third quarter. This was a 3.6 percent increase compared to the prior year, through a combination of organic customer additions, customer base acquisitions to our tuck-in strategy, while customer retention remained consistent with prior quarters.

Our Water Direct and Exchange business continues to experience strong top line momentum, with 17 percent organic revenue growth through improved customer satisfaction, enabled by increased delivery frequencies and higher in-stock levels. We benefited from increased points of distribution in Water Exchange late in Q3, and improved Water Exchange connectivity with dispenser sales.

Our Water Refill and Filtration business continues to show improved performance. Organic revenue increased by 11 percent in the quarter as a result of price increases in outdoor machines, improved machine uptime, and improved service levels in Water Filtration. Relative to price elasticity, customer trends remain positive. Customer feedback related to the higher pricing has been minimal as we track this through a combination of metrics, including call centre activity, customer retention, and customer growth.

Our Water Dispenser business continued to improve through the third quarter as well, with revenue up 47 percent, with retailer sell-through volume of more than 270,000 dispensers. We continue to see volume growth from increased promotional activity, increased product distribution and penetration across our existing customer base. We include coupons from Primo Water with the sale of our water dispensers to drive connectivity of dispenser sales to Water Services, which is a key driver of future organic growth.

On the topic of dispensers, United States Customs and Border Protection recently reclassified hot and cold water dispensers, and water filtration dispensers. Effective November 6, 2022, dispensers and filtration units are no longer subject to a 25 percent tariff; instead, a 2.7 percent tax. This reduction applies to the vast majority of Primo's imports and will allow us to adjust the average selling price of dispensers that we sell to our retail and e-commerce customers. As a result of the reduction in the cost of goods and subsequent price reduction, we expect to accelerate dispenser sell-through, which enables growth in water connectivity. The cost of goods reduction will be realized in 2023 as new inventory flows through its supply chain. We will benefit from a reduction in CAPEX associated with the water dispensers that we rent to customers in the Water Direct and Water Filtration business.

From a digital perspective, we are pleased with our progress from our investments in our mobile app, My Water+, which is currently rated at 4.9 on both the iOS and Android platforms, a direct result of our most recent updates. Our Google online reputation score has increased 63 percent since the end of 2021, and our Google My Business score has increased 46 percent. These ratings are a significant improvement from prior quarters and build our confidence on our digital and CX programs. We will continue to invest to provide a best-in-class digital solution for our customers, and since we have replatformed most of our digital e-commerce websites, we will now turn our attention to the redesign of our website, water.com, through a combination of internal and external resources to further enhance the effectiveness of this site. Please review Slide 9 and Slide 10 in the supplemental deck for more specifics.

During 2022, like many others, we have faced significant cost inflation across labour, fuel, freight, and other input costs, which have been fully offset by our pricing actions through Q3. The Primo team has done an outstanding job offsetting these increases while continuing to improve the customer experience.

As discussed last quarter, the automated route optimization tool, ARO, in North America, sequences routes in the most efficient path possible, which maximizes the time Route Sales Representatives will spend with customers, enhances commission earning time en route, unlocks route capacity to handle future organic growth, and minimizes the time spent behind the wheel. ARO remains a key operating initiative. In September, for example, we operated 23 more routes per day compared to August with no increase in total miles driven, a direct result of the team's efforts implementing the tool.

In addition, our year-to-date revenue per stop in North America has increased nearly 22 percent compared to last year. These efforts have been part and parcel to offset cost increases while improving operational efficiency and the customer experience, and enabled us to increase delivery frequency in support of our efforts to grow our Water Exchange business. As we look to the future, we are in the process of selecting third party consultants to support our growth algorithm and strengthen operating efficiencies across our route-based platforms.

For the full-year 2022, revenue is projected to increase to between $2.22 billion and $2.24 billion, with normalized revenue growth of 13 percent to 14 percent, adjusted for the exit of the single-use bottled water retail business in North America. We expect full-year 2022 Adjusted EBITDA to be between $415 million and $425 million.

We were awarded a five-year contract to be Costco's exclusive service provider for bottled water delivery services direct-to-consumer and business members. This increased activity, and our growth in Water Exchange locations supports our 2024 organic growth outlook.

We have a strong balance sheet, a compelling margin profile, and a path we are confident in for long-term top and bottom line growth. We are maintaining our revenue outlook for 2024 of high single-digit annual organic revenue growth, and we are increasing our 2024 Adjusted EBITDA outlook to approximately $530 million, with Adjusted EBITDA margins of approximately 21 percent.

Based on our performance in delivering operating, digital, and customer improvements, we are reducing our incremental capital investments from $150 million from 2022 through 2024, to $110 million. Specifically, this is a reduction from $50 million in 2023 and 2024, to approximately $30 million in 2023 and 2024. This decision is based upon our confidence in run rate performance that enables us to reduce the investment dollars and still deliver the 2024 outlook.

Finally, I will reiterate that our strategy is working. We're confident in our ability to deliver our 2022 guidance and achieve our long-term 2024 outlook.

I'll now turn the call over to our CFO, Jay Wells, to review our third quarter financial results in greater detail.

Jay Wells — Chief Financial Officer, Primo Water Corporation

Thank you, Tom, and good morning, everyone.

Starting with our third quarter results, consolidated revenue increased 6 percent to $585 million compared to $551 million. Consolidated organic revenue, which excludes the impact of foreign exchange, and adjusted for the exit of the single-use bottled water retail business in North America, increased 15 percent in the quarter.

Adjusted EBITDA grew 10 percent to $117 million. Excluding the impact of foreign exchange, Adjusted EBITDA grew 14 percent, which represents 80 basis points of margin expansion. As Tom discussed, the effect of price increases, volume growth, and strong demand drove profitability.

During the quarter, we maintained targeted staffing levels and have more than 98 percent of route delivery position sales. We are confident that the incremental investments in our people and the use of our predictive staffing models will enable us to deliver our full-year 2022 targets and beyond.

Turning to our segment level performance for the quarter, North America revenue increased 8 percent to $407 million compared to $413 million. Organic revenue increased 18 percent. The organic increase was driven by 17 percent organic growth in Water Direct and Water Exchange, which included 11 percent price mix and 6 percent volume growth. Adjusted EBITDA in North America increased 16 percent to $102 million.

In our Europe segment, revenue increased by 6 percent to $71 million. Organic revenue increased 15 percent, excluding the impact of foreign exchange, driven by our Water Direct business with growth in our residential customer base and B2B volume as Europeans return to the office. Adjusted EBITDA in the Europe segment increased 8 percent to $16 million. Excluding the impact of foreign exchange, Adjusted EBITDA increased by 29 percent.

Turning to our Q4 and full-year outlook; based on the information we have available to us as of today, we expect consolidated revenue from continuing operations for the fourth quarter to be between $540 million and $560 million, and that our fourth quarter Adjusted EBITDA will be in the range of $102 million to $112 million.

For the full-year 2022, revenue is projected to be a little higher than previously forecast, to between $2.22 billion and $2.24 billion, with normalized revenue growth of 13 percent to 14 percent adjusted for the exit of the single-use bottled water retail business in North America. We still expect full-year 2022 Adjusted EBITDA to be between $415 million and $425 million. We expect around $10 million of cash taxes, $60 million of interest expense, as well as capital expenditures of approximately $200 million.

Our 2022 performance reinforces our confidence in our ability to deliver sustained organic revenue growth. Supporting the organic growth outlook, our recent gains in new points of distribution in our Exchange business; geographic expansion of our Costco in-store events, resulting in a substantial increase in the number of events in North America and our Water Direct business; as well as the improved performance of our Refill business. These gains are a result of our commitment to improve the customer experience through increased service levels, as well as investment in the digital experience.

We are maintaining our revenue outlook for 2024, up high single-digit annual organic revenue growth, and we are increasing our 2024 Adjusted EBITDA outlook to approximately $530 million. During 2022, like many others, we faced significant cost inflation in labour, fuel, freight, and other input costs, and have successfully offset this impact through our pricing and efficiency initiatives. While we have successfully offset these costs with price increases to eliminate the detrimental effect of inflation, Adjusted EBITDA margin is impacted as the increased revenue from this pricing is offset by increased costs.

Our 2024 Adjusted EBITDA margin is now expected to be approximately 21 percent, when accounting for the effect of our incremental pricing that has been dollar-for-dollar offset by inflation. We previously shared our intent to invest an incremental $150 million in CAPEX to support organic revenue growth and the expansion of our Adjusted EBITDA margin. We decided that during 2023 and 2024, we will reduce these incremental investments from $50 million per year to approximately $30 million per year.

Returning to our normalized total CAPEX spend of approximately 7 percent of revenue in 2025. As Tom mentioned, this decision is based upon our confidence in run rate performance that enables us to reduce the investment dollars and still deliver the 2024 outlook. As we mentioned last quarter, we are exploring an opportunity to sell a few parcels of real estate in California that have seen significant appreciation in value. Interest levels remain high, and we are working with interested parties to further the process.

In addition, we remain focused on reducing our leverage ratio to below 3x in 2023, and to less than 2.5x by the end of 2024. As a reminder, our current debt maturities are in 2027 and 2028, and we therefore have no pressure to refinance any of our debt at this time, and are pleased with the current debt structure.

Our 2024 outlook supports our planned multiyear dividend step-up that will return an incremental $36 million to shareholders through 2024, as well as the $100 million opportunistic share repurchase program announced last quarter. This is on top of our previously announced plans for incremental investments to fuel top line and bottom line growth.

On August 9, 2022, our Board of Directors approved a $100 million opportunistic share repurchase program, which commenced on August 15. During the quarter, we repurchased approximately 800,000 shares for approximately $11 million. The repurchase program reflects the Board's confidence in our future performance and our continued long-term cash flow generation, and demonstrates our ongoing commitment to providing fundamental value for our shareholders.

Yesterday, our Board of Directors authorized a quarterly dividend of $0.07 per common share. Our growth outlook can fund our growth, as well as an increase in our annual dividend. As a reminder, our path to a multiyear dividend step-up includes an increase in our quarterly dividend per share by $0.01 in 2022, another in 2023, and another in 2024. The increase in the dividend will return over $6 million incremental dollars to shareholders in 2022 and $36 million by the end of 2024.

Remaining area of capital deployment includes our tuck-in M&A. For 2022, we expect to be towards the lower end of our target of $40 million to $60 million.

I will now turn the call back to Tom.

Tom Harrington — Chief Executive Officer, Primo Water Corporation

Thanks, Jay.

We are pleased with our year-to-date results and are excited about our future. We think the Primo Water investment thesis is compelling. We are the only public pure play consumer water platform, a national and local brand in both North America and Europe, a predictable recession-resistant revenue base where we meet consumers that work at home and in stores, and attractive high single-digit long-term annual organic growth targets, where dispenser sales connect to one of our Water Services, which is a key driver of future organic growth.

With the continued emphasis on achieving our 2030 water conservation goals as part of our broader ESG program, supported by multiple favourable tailwinds such as increased consumer attention to health and wellness, and aging water infrastructure.

I want to reiterate, we are a fundamentally stronger and more streamlined business than ever before. We have made significant strides over the past couple of years to focus on our core competency as a pure play water company. It is important to understand that we are a different Company today, a direct result of our strategic decision to exit the soft drink and coffee business, and to acquire the legacy Primo business. As a result, we have a healthy balance sheet, a compelling long-term growth outlook, and an attractive margin profile that has risen to 20 percent in the latest quarter. Although there is seasonality to Adjusted EBITDA margins on a quarterly basis, we recognize this achievement as a significant milestone on our path to our 2024 Adjusted EBITDA margin target.

Our long-term organic revenue growth outlook is compelling, and we remain confident in our outlook for 2024 as we forecast high single-digit annual organic revenue growth, an updated 2024 outlook to reflect an increase in Adjusted EBITDA to approximately $530 million based on our strong performance in 2022, Adjusted EBITDA margins of approximately 21 percent, adjusted EPS of $1.10 to $1.20 per share, net leverage of less than 2.5x, and ROIC greater than 12 percent.

Looking ahead, as we continue executing our differentiated Water Your Way platform and focusing on a few key priorities, we will leverage our pure play water model to drive normalized revenue of $540 million to $560 million in the fourth quarter. We will deliver organic revenue growth in the range of 14 percent to 15 percent. We will continue to execute our razor/razorblade model, with growth in the number of dispensers sold driving top line and earnings growth through water connectivity. The Primo team continues to deliver results.

Once again, I'd like to thank the Primo Water associates across the business for their tireless efforts to serve our customers.

With that, I'll turn the call back over to Jon for Q&A.

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

Thanks, Tom.

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

Operator, please open the line for questions.

Q & A

Operator

Thank you.

Your first question comes from Nik Modi with RBC Capital Markets. Please go ahead.

Nik Modi — Analyst, RBC Capital Markets

Thank you, good morning everyone, and Jay, congrats on the retirement.

Jay Wells — Chief Financial Officer, Primo Water Corporation

Thank you, sir.

Tom Harrington — Chief Executive Officer, Primo Water Corporation

Morning, Nik.

Nik Modi — Analyst, RBC Capital Markets

Morning, Tom. Tom, maybe you should just provide a little bit more context on the announcement regarding Costco. Obviously a pretty significant opportunity, I would suppose, so maybe any additional colour you would provide would be helpful.

Tom Harrington — Chief Executive Officer, Primo Water Corporation

Yes, obviously, kudos to our Sales team who successfully worked with Costco to extend what's been a long-standing relationship, and to our teammates in the front line that are providing the level of service to give Costco the confidence in awarding us this relationship that'll run through the end of 2027.

There's two parts here that are super important. It supports our long-term growth outlook, so the incremental new customers that we'll gain from this relationship helps support the high single-digit growth story. At the same time, it also will support us leverage our route and customer density, which enhances our ability to get to that 21 percent EBITDA margin, as those customers come over, and on top of our existing customer base. It's a double, well, this is actually a home run, but think of it as a double because it provides us the benefit both organic customer growth, which will drive volume over the long haul and gives us leverage through the income statement because of route density on our route infrastructure.

The other piece here that's beneficial is, and we hadn't shared this previously, but we are also the exclusive in-store dispenser provider for Costco. If you think about what we refer to as connected dispensers, I now have the water service through our in-store events; I also sell the dispensers so that we really can connect that Costco member to one of our services by doing both. Sell the dispenser, offer the service, so it's a pretty significant gain for 2023, and hopefully beyond.

Nik Modi — Analyst, RBC Capital Markets

Excellent, and just (multiple speakers).

Tom Harrington — Chief Executive Officer, Primo Water Corporation

What we did reference, which is—I'll do a Taiwan, because it wasn't a Costco question, but I referenced in our script, we did gain a nice chunk of new Exchange business with incremental locations in an existing customer, and that's important because it too does two things. It supports the organic growth. We'll see accelerated growth in Exchange as we move through the next couple years. But it also will benefit our route density, which helps us achieve the 2024 target of about 21 percent Adjusted EBITDA margin.

Nik Modi — Analyst, RBC Capital Markets

Very helpful colour. Tom, I'm sure someone is thinking this right now, but obviously, historically, in downturns, or at least the last downturn, these particular businesses came under some duress. Can you just talk about how this time is different? What's changed in the operating model today versus what you were dealing in the last economic downturn across this business?

Tom Harrington — Chief Executive Officer, Primo Water Corporation

Yes, I think there's a couple of market conditions that are different, Nik, and certainly, the benefit of a Management team that operated in 2008, '09 and '10, both here and in Europe is helpful. I think our experience and execution during the pandemic, when we eliminated 18 percent to 20 percent of the

SG&A cost, speaks to the variable nature of our business, so that in the event of a downturn, we have the muscle memory to flex the structure appropriately to match whatever may happen to the top line.

But the other key difference for us is around the connected dispenser and the benefit of being pure play water, which we were not in the first go-around. I sell dispensers; consumers can pick a water service, and our water services span the socioeconomic scale. If you think about a typical Water Direct customer, they're higher income, likely to weather a storm better, and then we have the Refill business, which we did not have in 2007 and 2008, which is a lower cost, higher value solution for consumers who, in my mind, are going to absolutely devoted to high-quality drinking water.

Those are real tailwinds in a recession or not, but we give people optionality in the event they feel pressured. You could get an Exchange, which is a little bit lower price or better value than Water Direct. You forego the benefit of my guys and gals going to your door. Or you can fill it up yourself at real value at Refill. We think it really positions us to be resistant, for sure, through this. I think frankly, Q3 performance is an indication of how resistant we are today.

Nik Modi — Analyst, RBC Capital Markets

Excellent, thank you so much, I'll pass it on.

Tom Harrington — Chief Executive Officer, Primo Water Corporation

Thanks, Nik, appreciate it.

Operator

Your next question comes from Derek Lessard with TD Securities. Please go ahead.

Derek Lessard — Analyst, TD Securities

Yes, good morning, everybody. I echo the congratulations to Jay on your well-deserved retirement.

Jay Wells — Chief Financial Officer, Primo Water Corporation

Good morning.

Tom Harrington — Chief Executive Officer, Primo Water Corporation

Good morning, Derek.

Derek Lessard — Analyst, TD Securities

Good morning, Tom. Just maybe if I could hit on—I'll start on the margin performance, the strong margin performance, considering the inflationary Forex pressure. Just a couple questions there. I was wondering if you had a sense of the impact of both of those items on the margin, and I guess going forward, should we assume 20 percent as your new base level?

Tom Harrington — Chief Executive Officer, Primo Water Corporation

I'll take the second question first, and then I'll give the first part of your question to Jay. I think the way to look at the 20 percent is that, along our journey to approximately 21 percent, this is a good indication that we have a clear line of sight and execution to get there. What you do have to understand is there is some seasonality to the EBITDA margin by quarter, so I'd say the first important milestone is, at least as I recall, the highest we've been at, in that it's indicative of where we'll get to. It doesn't mean that Q1 will be there; I'm not suggesting—that's not a guidance on that, but there will be variations on quarter on our way to that consistent 21 percent.

Jay Wells — Chief Financial Officer, Primo Water Corporation

Yes, and on the margin, look at first three quarters of the year. We said that we've covered over $65 million inflation with pricing. If you annualize that, you get above $80 million. If you look at the math purely increasing the denominator by 80 but not increasing the numerator, EBITDA; that's what got us from 21 percent to 22 percent, so basically the midpoint, 21.5 percent to approximately 20 percent. That $80 million of pricing that was dollar-for-dollar offset inflation, was probably right around 50 bps of EBITDA margin.

Derek Lessard — Analyst, TD Securities

Okay, that's super helpful and the colour. One last one for me is, the SEC had a bit of an ominous tone last week with how you reported the revenue from exiting the single-use retail bids, curious if you're still able to maybe give details or some colour around what your true core growth was, excluding the exit?

Jay Wells — Chief Financial Officer, Primo Water Corporation

Yes, I'll cover that one. Yes, and we did get a comment from the SEC and we did have to change how we reported. If you look at the footnote underneath the table in the press release, we do provide the detail, that you can do the math based on that, but then also, in our prepared remarks, we did talk about the numbers excluding the North America single-use bottled water business. Hopefully between the tables, or if you want to listen to the recording again or look at the transcripts, we talk about it excluding, and you can do the math looking at the table in the press release. But that was purely in response to the comment we received.

Tom Harrington — Chief Executive Officer, Primo Water Corporation

Jay can correct me, but I referenced in the script, 18 percent revenue growth excluding FX and excluding the impact of single-use retail.

Derek Lessard — Analyst, TD Securities

Okay. That's helpful. Thank you.

Jay Wells — Chief Financial Officer, Primo Water Corporation

We did what we can, basically, based on the comment we received.

Derek Lessard — Analyst, TD Securities

Yes, absolutely. Thanks, gentlemen.

Tom Harrington — Chief Executive Officer, Primo Water Corporation

Thanks, Derek.

Jay Wells — Chief Financial Officer, Primo Water Corporation

Thanks, Derek.

Operator

Your next question comes from Andrea Teixeira with JPMorgan. Please go ahead.

Andrea Teixeira — Analyst, JPMorgan

Thank you, good morning everyone, and extending my congrats as well to Jay. Thank you for all the help these years.

I have a question and a more strategic one, and then kind of a follow-up on the guide for ’24. First on the Exchange and Refill, perhaps in talking about demand trends in these businesses through the quarter, at the exit as well, just wondering if you’re seeing finally these more price-conscious consumers trade to these solutions which obviously have a better value for them, if they’re buying case pack of water? In that sense, can you actually use more marketing dollars to communicate to them this value proposition?

I think you had mentioned before that you’re beginning to see some trends improvement with better uptime of, I think, the dispensers. There’s also additional locations coming online on the part of the retailer, so if you can talk to us a little bit of how you’re expecting that to be embedded in your guidance for the fourth quarter and perhaps into next year? Then the clarification, I will come back.

Tom Harrington — Chief Executive Officer, Primo Water Corporation

Thanks, Andrea, and good morning.

We're pleased with the performance of, I'll call the various hydration solutions we are. Our Water Direct business, Water Direct less Exchange continues. We are attracting new customers, they're starting the service, they impact us both—we have the ability to put full price, and we have very good volume growth. I think the volume growth for Q3 was something like 6 percent.

That's pretty indicative that business is in pretty good shape. It will remain that way go-forward for a couple reasons. One, the incremental benefit of the new Costco relationship, which will bring Water Direct customers; the tailwinds that naturally support our business in Exchange; the growth of locations in Exchange, which just started to on-board at the end of Q3, so that'll give us a positive tailwind; the fact that dispensers were up 47 percent, most importantly 270,000 sold at retail in the quarter. Those customers who bought a dispenser will come to one of our services, could be Water Direct, could be Water Exchange, could be Water Refill.

Then in the quarter, we've had the best quarter we've had since we've owned legacy Primo, with 11 percent volume growth in Water Refill and Exchange, which is a function of a little bit of price, a lot more service, don't know how many consumers they're shifting there. From a marketing perspective, we've got some work to do about refining the offers we put inside the dispenser; that work is in-process. It is a very effective marketing tool to give new dispenser customers incentives to start one of our services. We're happy that they start each, as we think about moving into, if there is a recession, that we'll hopefully have the visibility to see where the customers start, and then make sure that we're very clear about the optionality, based on the value equation, for each solution.

Andrea Teixeira — Analyst, JPMorgan

On that, I think your business has proven to be more recession-proof. I guess it would be helpful if you can share some of the data, back in the days of the GSC (phon), if that was the case and how it behaved.

Then my follow-up question more on the data, your guidance, the $5 million that you got in your guidance, that related to the tax rebate you're going to have?

Tom Harrington — Chief Executive Officer, Primo Water Corporation

Yes, so two questions, I'll take the first. I'll give Jay the second. If I go back to 2007, 2008, things were a little bit different. You had the mortgage crisis, right?

Andrea Teixeira — Analyst, JPMorgan

Mm-hmm.

Tom Harrington — Chief Executive Officer, Primo Water Corporation

Which did impact us, on residential. We don't believe that same event is going to occur, right? That impacted us in places like California, Arizona, Nevada, Florida, where there was a bigger impact on a mortgage crisis. We as a Company also took actions to better manage how much credit a customer could have. We've continued that forward. That learning from '07, '08 is embedded in our business model, so we won't have to face that again.

Then I think, importantly, on Page 20 in the supplemental deck, gives you a look at the growth of bottled water category over a multitude of events. The takeaway from that page is, are resilient with the capital, or frankly, so that this business manages to continue to grow and recover. What's different today is, there's a real tailwind for us about the shift to healthy hydration. Even in a recession, people are going to care about what they drink and what their family drinks, and people care more today about water quality infrastructure than they did before.

I think that further supports our ability to be recession-proof, based on these types of changes from 15 years ago. Then, I'll give the tariff question to Jay.

Jay Wells — Chief Financial Officer, Primo Water Corporation

Yes, I mean, if you look at the tariffs, very good work, going from the 25 percent down to 2.7 percent. It's going to take a bit for us to move the inventory through into next year. Keep in mind, when you look at the tariff and how we buy dispensers, I'd say half is CAPEX because we rent them to our Water Direct customers, and about half are in cost of goods sold, because that's what we're selling at retail.

When you look at the reduction, what we're selling at retail, our goal is to lower our average selling price, because our goal there is basically to sell the coolers at no profit, and then have connectivity to our much higher margin Water Services, therefore accelerating dispenser sales and water connectivity.

If you look at pre-tariffs, the opening pricing point for an introductory cooler was just below a $100. That's really the sweet point for coolers. It's now $125, $130. Our goal is, as ocean freight has gone down and it has gone down closer to pre-pandemic levels, now when we work our inventory, we'll get to the lower tariff rate. We'll be able to get back to that price point, add promotions, sell even more dispensers, bring more consumers into our product, and then have increased connectivity to our three highly profitable water services.

Andrea Teixeira — Analyst, JPMorgan

Mm-hmm, so in other words…

Tom Harrington — Chief Executive Officer, Primo Water Corporation

(Multiple speakers).

Jay Wells — Chief Financial Officer, Primo Water Corporation

Yes, somebody had asked, are we taking an extra $5 million going from the 525 to the 530 in 2024, is that the tariff benefit? The answer is no, because any P&L benefit is going to be given back to the consumer.

Andrea Teixeira — Analyst, JPMorgan

Reinvested.

Jay Wells — Chief Financial Officer, Primo Water Corporation

Yes, yes.

Tom Harrington — Chief Executive Officer, Primo Water Corporation

Invested in growth.

Jay Wells — Chief Financial Officer, Primo Water Corporation

Yes. The costs for CAPEX, yes, that will help us with CAPEX next year as we work through the inventory. But for the P&L benefit, that's much more, we're performing ahead of our plan for this year, and it's flowing it through to the guidance in 2024.

Andrea Teixeira — Analyst, JPMorgan

Okay, that's fair. I'll pass it on. Thank you.

Tom Harrington — Chief Executive Officer, Primo Water Corporation

Thanks, Andrea.

Operator

Your next question comes from Dan Moore with CJS Securities. Please go ahead.

Lee Jagoda — Analyst, CJG Securities

Hi, good morning, it's actually…

Jay Wells — Chief Financial Officer, Primo Water Corporation

Good morning, Dan.

Lee Jagoda — Analyst, CJG Securities

…Lee Jagoda for Dan.

Tom Harrington — Chief Executive Officer, Primo Water Corporation

Hey, Dan. Okay, got you.

Lee Jagoda — Analyst, CJG Securities

It's Lee Jagoda, how are you? Starting with, I think you mentioned about $85 million of annualized price increases, if you kind of look at the annualized number. I think you also said it was dollar-for-dollar, just recouping the costs. How much of that is actual price versus surcharges that you ultimately could give back, and do you have any commentary on the more recent pullback, or what you're seeing in terms of a more recent pullback in your some of your input costs?

Tom Harrington — Chief Executive Officer, Primo Water Corporation

The incremental, let me just go back. The $85 million you reference was the cost inflation, not the pricing, and we did offset that $85 million. Our current fee structure has only one very small component that's tied directly to on-highway diesel, that's our energy surcharge. That one will go up and down with the price of diesel. It's on a 30-day lag, and then we pass it up or down. It will go down, but it’s a very small component of the construct, if you will. Importantly, diesel actually has been the most challenging of fuel prices in terms of pullback from its height. That has not moved in, the last I read it was at a record spread between unleaded in diesel.

Our delivery fees are related to a multitude of input costs, and the amount and the timing and how we affect that is 100 percent at our discretion, right? There’s no direct corollary for that. Hopefully, I think I’ve answered that piece.

Then, I think the other part is, of how much was volume and how much were price and/or fees, I want to say it was 11 percent related to pricing activities, which would exclude these, and 6 percent volume growth that drives the overall growth in North America, just to give you some colour about the construct there. There's lots of volume, which is important, because it's not just price and offset inflation, we're also seeing organic volume growth, which is one of the key drivers of our future.

Lee Jagoda — Analyst, CJG Securities

Great. Then one quick one just on the European business; are you still seeing sequential gains, and should we expect continued sequential gains just on the return to office, which would hopefully offset whatever macro concerns or headwinds are going on there in the business?

Tom Harrington — Chief Executive Officer, Primo Water Corporation

Yes. I would say that our return to work—or excuse me, return to office, because they have been working, continues in that we've seen good growth in Europe last quarter.

Jay Wells — Chief Financial Officer, Primo Water Corporation

Organic revenue is 15 percent.

Tom Harrington — Chief Executive Officer, Primo Water Corporation

Yes.

Jay Wells — Chief Financial Officer, Primo Water Corporation

That's on an FX-neutral basis, so the euro is driving down. If you look purely at a local currency basis, organic is up 15 percent, so we're definitely seeing that benefit of it. For me, more importantly, if you go on an FX-neutral basis, Adjusted EBITDA was up 28 percent. We're seeing the flow-through to the bottom line also, and see getting the leverage back that we lost at the start of the pandemic. Yes, we’re seeing return to office, improved volumes, and more importantly, if you exclude the FX, we're seeing it come down our P&L and getting the leverage we should be getting with that returning volume.

Lee Jagoda — Analyst, CJG Securities

Perfect. Thanks very much.

Tom Harrington — Chief Executive Officer, Primo Water Corporation

Thank you.

Operator

Your next question comes from John Zamparo with CIBC. Please go ahead.

Tom Harrington — Chief Executive Officer, Primo Water Corporation

Good morning, John.

John Zamparo — Analyst, CIBC Capital Markets

Good morning, Tom, good morning, Jay.

Jay Wells — Chief Financial Officer, Primo Water Corporation

Morning.

John Zamparo — Analyst, CIBC Capital Markets

Morning. I wanted to start with the Costco contract. You had a program in the past with Costco that didn't yield the profitability that you wanted. I wonder, what's different this time around, and do you expect these customers to be at a comparable margin to your existing customer base?

Tom Harrington — Chief Executive Officer, Primo Water Corporation

Yes, I remember that. Look, we learn from our mistakes, and in this case, a couple of things have happened. The pricing architecture is different than it was in 2016. Our ability and execution and focus on the customer experience, and I referenced in the script what we call OTIF, on-time, in-full, is higher today than it's ever been, which gets to our ability to properly service our customers, and we have a high degree of confidence that we can do that.

Costco has seen our ability to improve service over the last one, three, five years. We're confident that, between the current pricing architecture, the improvements we've made in the customer experience, that we'll be able to handle the new customers and handle the new customers the right way, which is really good service at the appropriate revenue and profit levels for the Company. High degree of confidence we can do that.

John Zamparo — Analyst, CIBC Capital Markets

Understood, thank you.

Then my follow-up is on the deferred incremental CAPEX projects over ’23 and ‘24. Should we think about that as deferring to future years, or is it that you took a closer look at those and you didn't think you'd get the return…

Tom Harrington — Chief Executive Officer, Primo Water Corporation

No, it’s…

John Zamparo — Analyst, CIBC Capital Markets

…(multiple speakers)? Any other colour there would be helpful.

Tom Harrington — Chief Executive Officer, Primo Water Corporation

Yes, it’s a good question. I’ll flip that one over to Jay.

Jay Wells — Chief Financial Officer, Primo Water Corporation

Yes, I mean, we said $50 million for this year, and then our initial plan was another $50 million in 2023 and another $50 million in 2024. Getting through this year, seeing the returns we're getting on the growth, returns on the efficiencies, and really seeing where our trajectory is, we feel that we only need to now spend $30 million in 2023 and $30 million in 2024. That should give us the investment we need.

Then, as I said in my prepared remarks, that incremental investment would basically go away starting in 2025, and we'd get back to what our historic levels of 7 percent of revenue, being of CAPEX. But it really is the momentum we're seeing in our business, the performance we're having. We don't think we need that incremental $40 million of investment over the next two years.

Tom Harrington — Chief Executive Officer, Primo Water Corporation

While we haven't provided specificity around 2025, we wanted to be clear about what CAPEX we weren't going to spend, $25 million go forward. We will be in a conference in early January where we'll provide much more colour around our views around ‘24 and ‘25.

John Zamparo — Analyst, CIBC Capital Markets

Great, that's all. Thanks very much.

Jay Wells — Chief Financial Officer, Primo Water Corporation

Thank you.

Tom Harrington — Chief Executive Officer, Primo Water Corporation

Thanks, John.

Operator

Your next question comes from Kevin Grundy with Jefferies. Please go ahead.

Kevin Grundy — Analyst, Jefferies

Hey, great, good morning, guys.

Tom Harrington — Chief Executive Officer, Primo Water Corporation

Good morning, Kevin. (Inaudible).

Kevin Grundy — Analyst, Jefferies

Jay, just to echo the others' sentiment on your well-deserved retirement as well.

Jay Wells — Chief Financial Officer, Primo Water Corporation

Thank you, sir. I will miss your certain conference where you sent me lobster on the beach, so that will be missed, Kevin.

Kevin Grundy — Analyst, Jefferies

You're always welcome. Don't let your retirement (inaudible). Two for me guys, first on pricing and then a follow-up on just the monetization of real estate parcels.

The first on pricing; just succinctly, is there an ability to lean in a bit more here than you have, including some of the pressures that you're seeing from an SG&A perspective? I guess I ask that in the context, your gross margin performance, and I know it's not all input costs offset by pricing, but it's been quite good, right? The gross margin’s up 230 basis points through the third quarter, year-over-year. EBITDA margin is up 50 basis points, and you guys called out the pressures that you're seeing from an SG&A perspective.

We also know, too, that the consumer is dealing with this inflation naturally across categories that they shop, so the cross-elasticities in play here are also noteworthy. A bit of a verbose question, but is there an opportunity for more here? Are you potentially leaving money on the table by not taking more price in the current environment?

Tom Harrington — Chief Executive Officer, Primo Water Corporation

Yes, I think the—a couple of answers to your question. I just want to give you the highlights, and then I'll flip it to Jay. I think one of the areas that may not be clear to many in the investment community is that, unlike others, maybe not all, then let’s call it route-based services, our route distribution costs are in SG&A. So, the route operations, the route salesmen, the fleet, the fuel that goes with that is recorded in SG&A. Others might record it in cost of goods, reflected in gross profit. I wanted to call that out because it's not been as clear as it needs to be, and we're going to work on that from a messaging perspective.

Then naturally in that SG&A, you would see all the input costs in labour, fuel, and freight actually manifest itself there. Part of our actions, in aggregate, is to cover it from the top all the way through SG&A, down to Adjusted EBITDA margin.

Jay Wells — Chief Financial Officer, Primo Water Corporation

Yes, I mean, when you look at our OPEX, I mean, Tom said it. Almost 50 percent of our OPEX is our route operations, and that's where you're seeing the wage inflation, and that's really where you're seeing the fuel inflation. That's the bulk of where the inflation is at. Unlike during the pandemic, we're actually now investing behind this part of the business. We're not cutting. Being at 98 percent staffed on our routes and using our predictive hiring model is how we're at the record OTIF levels that Tom referenced. This is our routes, this is how we're servicing our customers, this is how we're dealing with the increased volumes. It might seem inflated, but it's actually a very good spend.

On the pricing question, I mean, we have been taking sufficient pricing to deliver it on our planned profitability to, one, grow, but also cover the inflationary costs. We're monitoring our call centre, and we have not really seen any type of significant uptick on customer calls. If you look at our retention, it's holding steady. We think we're taking the right amount of price to deliver on our profitability, offset the inflation we have. But one thing we've demonstrated, we have a very diverse customer base. We have the ability to take price as needed; we've taken what we think we can, but if we need to, we can take more.

Tom Harrington — Chief Executive Officer, Primo Water Corporation

I think one of the other points, and I'll pile on, is referenced in the script, a 22 percent increase in revenue per route. That's an important number. Unlike others in this space, the vast, overwhelming majority of our Route Sales reps, the drivers are commissioned. As part of that 22 percent, they get their share, but it also, frankly, is a tactic, that when we need to take more pricing, the RSR benefits from that. Good service that they provide; also, they get their piece of that price increase, just supports this. It's a flywheel, where the RSR it gets paid more, give good service, we can benefit from the price in the event we need to push it hard.

Kevin Grundy — Analyst, Jefferies

Yes, understood. That's helpful. One quick follow-up, guys. Any update on the potential for additional real estate proceeds on some of these parcels that you've been taking a look at? I think the commentary from the prior call was that there could be potential for further opportunity there and the efforts were underway. Any sort of timeline and governance you could put around that, I think, would be helpful for folks. I'll pass it on. Thank you.

Tom Harrington — Chief Executive Officer, Primo Water Corporation

Thanks, Kevin.

Jay Wells — Chief Financial Officer, Primo Water Corporation

Yes, I'll take that one. Yes, we're currently working on the real estate sales that we have targeted. We have started up our share repurchase a little earlier than we stated because we have not received any proceeds as of yet, but the process is moving on the one we've identified. We wanted to be opportunistic, that's why we leaned in and started buying stock before that happened.

Keep in mind, we have 72 properties in the U.S., so we are doing a full evaluation, a full study. Once we get through these current ones that have significantly appreciated in value, in California, we will continue to do so. The other thing I want to point out also is, it's not that we're exiting these areas, we're just monetizing these very valuable assets and finding a much more economic and more correctly-located place to set up these distribution centers.

Kevin Grundy — Analyst, Jefferies

Okay, very good, guys. Thank you, good luck.

Tom Harrington — Chief Executive Officer, Primo Water Corporation

Thanks, Kevin.

Operator

Your next question comes from Pavel Molchanov with Raymond James. Please go ahead.

Pavel Molchanov — Analyst, Raymond James

Thanks for taking the question.

Your strategy as a consolidator has a long history, and obviously there's always cycles of when M&A becomes more or less attractive economically. In this sort of quasi-recessionary environment, I'm curious, are you noticing any differences in prospective deal valuations versus recent history?

Tom Harrington — Chief Executive Officer, Primo Water Corporation

Yes. Right now, we indicated we'll be at the lower end of the range, and really, your question is, we're going to be very patient at this moment, because it's our belief that our pipeline, or list of targets, will feel the weight and pressure of inflation, frankly greater than we will, and that we're going to be very patient and diligent on that list to let those pressures apply. We think it's a good strategy with all the unknowns of how all of those input costs are going to affect those relevant businesses. We're being very judicious as we move through the next year or so, and hope to take advantage of that in the out years, if you will.

Jay Wells — Chief Financial Officer, Primo Water Corporation

Yes, the pipeline is still there, we just believe lower (inaudible) is better. As I think I saw in your notes, if the ability to acquire water rights come up, we are definitely looking at those as very valuable assets, and we should be able to pick up some very good rates in France, and we'll continue to do that also.

Pavel Molchanov — Analyst, Raymond James

Okay. Following up, you made an investment, one of your few kind of venture type investments, in Sipple Hydration Stations. This was about a year ago. Do you have an update on that and how the rollout in the U.K. is taking place?

Tom Harrington — Chief Executive Officer, Primo Water Corporation

Yes, we have, Pavel. We had talked about the ability to build the supply chain for those assets, and I'm happy to report that I now have assets in North America and I have assets in the continent in Europe. We are at the very early stages of identifying locations to place them, and think about this as kind of the A-B testing about where it's the right location to maximize the volume, and therefore, the return on that asset.

I was in London two or three weeks ago, we have a couple of placings throughout the tubes, and there’s some very high-volume units, so you get to see it firsthand. It's real; it is single-use replacement. I'm pleased that, in this quarter four, that we'll have most of those assets placed on-location and begin to get the true learnings about what's the appropriate current environment to place them. Then, it’ll be different in the U.S. than it is in Europe, which is fine by us, but that's exactly where we are. We remain optimistic about how this will play out over the course of the next couple of years.

Pavel Molchanov — Analyst, Raymond James

Understood, thank you, guys.

Tom Harrington — Chief Executive Officer, Primo Water Corporation

Thanks, Pavel.

Operator

There are no further questions at this time. I’d now like to turn the call back to Mr. Kathol for any closing comments.

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

Thanks, Pam.

As Tom mentioned, we will be attending the ICR Conference in Orlando, Florida on January 9, where we will review our 2024 and 2025 outlook and plans for continued growth.

This concludes Primo's Third Quarter Results Call. Thank you all for attending.

Operator

Ladies and gentlemen, this concludes your conference call for today. We thank you for participating and ask that you please disconnect your lines. Have a great day.