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FINAL TRANSCRIPT

Primo Water Corporation

First 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 First Quarter 2022 Earnings Conference Call.

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 First 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 Harbour 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 first 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 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 first quarter and our progress on Primo’s strategic initiatives. Then Jay will review our segment level performance and will discuss our first quarter performance in greater detail and offer our outlook for the second 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.

Thomas J. Harrington — Chief Executive Officer, Primo Water Corporation

Thank you, Jon, and good morning, everyone.

I am quite pleased with the start to 2022 and our Q1 results. As the impact of the pandemic begins to wane and we adapt to the current inflationary environment, we remain confident in our ability to deliver on both our short-term and long-term outlook. I'm especially proud of the efforts of the team and pleased with everyone's continued commitment to safety, customer satisfaction, and growth as our teams have once again responded to the challenges presented by the unprecedented cost inflation and the war in Ukraine.

In the first quarter, we achieved double-digit revenue growth driven by strong customer demand, particularly in our Water Direct and Exchange businesses, and continue to deliver robust growth on Mountain Valley, America's premium spring and sparkling water brand. Our global Water Direct and Exchange customer base increased 4.5 percent to $2.3 million for the quarter. This was an increase of 100,000 customers versus Q1 of 2021 through organic customer addition, customer base acquisitions through our tuck-in strategy, and improved customer retention rates, which increased to 86.5 percent.

As I mentioned last quarter, the three and five-gallon bottle water category growth opportunity is estimated to be as large as an incremental $29 million U.S. households and continues to increase based on tailwinds, including growing consumer demand for environmentally-responsible products, the shift away from sugary sweetened beverages, and well-documented concerns with tap water quality. The residential opportunity for increased sales of three and five-gallon return on bottled water remains a top priority, as the category has significant growth potential from our perspective.

We remain focused on increasing household penetration through our execution of our razor/razorblade model. While the Water Dispenser segment declined during Q1 because of higher retail price points and less promotional activity driven by tariffs and the elevated cost of ocean freight, sell-through volume of more than 190,000 dispensers to consumers resulted in a 2.4 percent sequential increase in the first quarter versus Q4 of 2021. As ocean freight costs moderate, we expect to see a return to growth in our Dispenser business through increased promotional activity and the benefit of new customer distribution wins and the increased penetration from our existing customer base. As an example, we recently gained new dispenser business at Costco with shipments beginning in Q2.

We continue to experience elevated costs driven by inflation across several operating expense categories, including labour, fuel and freight. To address the higher costs of approximately 10 percent during the quarter, we implemented two pricing actions; the first in January and the second in March, each in response to higher-than-forecast inflationary costs at that point in time. Currently, we believe that the pricing actions we have executed will cover the higher costs. The full benefits of these pricing actions are expected to be realized in Q2.

Despite the cost headwinds, we continue to invest in the customer experience, evidenced by organic customer growth and improved customer retention rates. Improved pricing, continued demand for our products, and the improvement in customer retention gives us confidence in our 2022 guidance, in our long-term 2024 outlook of high single-digit organic revenue growth, and Adjusted EBITDA approaching $525 million.

In Q1, consolidated revenue increased 10 percent to $526 million and Adjusted EBITDA increased 15 percent to $88 million, again, driven by higher demand for our products and improved pricing and volume led by our Water Direct and Exchange business. Consolidated revenue, excluding the retail single-use plastic business in North America, grew 13 percent to $500 million, and on an FX neutral basis, overall revenue was up 14 percent. Consolidated organic revenue was up by double-digits, as we experienced a gain of 12 percent for the quarter.

As referenced earlier, the Water Dispenser segment declined because of higher retail price points and less promotional activity driven by tariffs and the spike in ocean freight costs experienced during the quarter. As ocean freight container rates moderate, we expect to return to growth in our Dispenser business. As I mentioned in the past, water dispenser sales provide a key point for consumers to enter the bottled water category where we can capitalize on our recurring razor/razorblade revenue model. The recurring purchase behaviour generates organic water sales as part of our water go-to-market strategies.

As a reminder, our internal research indicates that approximately 60 percent of respondents surveyed are new to the Water category, 45 percent prefer Water Direct, 30 percent prefer Water Exchange, and 25 percent prefer Water Refill. We should continue to gain our fair share of this growth, as our razor/razorblade model remains one of our strategic advantages.

You will likely remember that our B2B channel experienced some softness in December and January resulting from reduced foot traffic. A clear demonstration of what some call the January swoon is illustrated in the chart of mobility data included in our supplemental presentation on Page 8, titled Visits to Retail and Recreational Locations. It shows a decline in foot traffic of roughly 20 percent in the December/January timeframe. As we suspected, the timing corresponds with increased rates of the Omicron variant here in the U.S. Fortunately, we have seen these visits to retail start to rebound as the effects of the Omicron variant have eased, and we continue to work diligently to meet the current levels of demand.

We've added an analysis of our North American B2B customer base on Page 9 of the supplemental presentation deck that provides a view of the diverse mix of our B2B customer base. Importantly, it shows that we have no appreciable customer concentration in our Water Direct business.

A recap of our growth drivers on Slide 10 demonstrates growth in several key areas: customer count increases on Water Direct and Exchange; consistent gains in the average selling price of our three and five-gallon bottles; our premium Mountain Valley revenue and e-commerce revenue.

We continue to invest in route operations to improve our service metrics, enhancing the customer experience. We are near our targeted staffing levels and are currently staffed more than 98 percent in route delivery in the U.S. We believe the long-term benefits of improving the customer experience and increasing customer retention outweigh any short-term investments.

As it relates to our efforts in ESG, we remained focused on elevating our position on environmental responsibility and finding new ways to honour our commitment to protect the environment, provide quality drinking water, and manage sustainability. Later this quarter, we plan to publish our first environmental, social, and governance report. The report represents the next step on our ESG journey. We've been working on formalizing our priorities in governance structure, establishing initial targets, and enhancing the collection of our data from across our Company. As part of our ESG strategy, last November, we announced the planned exit of the single-use bottled water retail business in North America. We remain on pace to completely exit this category by the end of the second quarter, eliminating approximately 400 million bottles from the ecosystem. This is a major step in enhancing our ability to focus on a more environmentally friendly, returnable bottled water business. Our three and five-gallon returnable bottles provide an attractive alternative to combat the challenge of plastic waste based on their reusability and recyclability.

Over the last few months, we've been asked about our business exposure to the war in Ukraine, as well as our business in Russia. In 2021, our business in Russia recorded approximately $14 million of revenue and approximately $3 million of Adjusted EBITDA. We have decided to exit Russia and expect to complete this exit over the course of the next 60 to 90 days. As we work to exit our business in Russia, we will continue to supply water to the humanitarian and NGO efforts in Eastern Poland as they manage the influx of Ukrainian citizens displaced from their homeland. I would like to extend my appreciation to those associates of ours in Poland and in other European countries, as several of our associates are hosting refugees from Ukraine in their own homes, and we're profoundly proud of the help they are providing in these very difficult times. Our thoughts are with the people of Ukraine, and we hope for a speedy end to the conflict.

I'd like to now turn the call over to Jay to review our first quarter results in greater detail.

Jay Wells — Chief Financial Officer, Primo Water Corporation

Thank you, Tom, and good morning, everyone.

Starting with our first quarter consolidated results.

Consolidated revenue increased 10 percent to $526 million compared to $478 million. Excluding the impact of foreign exchange and the exit of our North American single-use plastic bottled water refill business, revenue increased by 14 percent. These gains were largely driven by growth in our Water Direct and Exchange businesses, as we saw a rebound from the effects of reduced foot traffic and the Omicron variant, which caused B2B volume to suffer in December and early January. Rebound has continued into our second quarter.

Total organic revenue growth was 12 percent for the quarter. Adjusted EBITDA grew 15 percent to $88 million. As Tom discussed, the effects of pricing actions, volume growth, and strong demand drove profitability.

During the quarter, we made substantial progress in achieving full stacking levels and now have more than 98 percent of our route delivery positions filled. We are confident that the incremental investments we are making in our people will enable us to deliver on our target of 9 percent to 10 percent revenue growth for the year. The increased staffing costs were accompanied by continued inflationary cost pressures in other areas of our business. The major buckets of higher costs included materials associated with our soon to be exited North American single-use bottled water business, ocean freight, transportation, and labour. The additional pricing actions taken in the first quarter have offset these increased costs, and we have captured enough price to offset the cost increases that we have seen to date.

Turning to our segment level performance for the quarter.

North America revenue increased 9 percent to $397 million compared to $366 million. Excluding the impact of foreign exchange and the exit of the single-use plastic bottled water refill business, revenue increased by 13 percent driven by growth in our Water Direct and Exchange businesses. Organic revenue growth was 11 percent, driven by a 3 percent increase from volume and an 11 percent increase from price mix within our Water Direct and Exchange businesses. Adjusted EBITDA in North America increased 15 percent to $79 million.

Turning to our Rest of World segment.

Revenue increased by 14 percent to $129 million. Excluding the impact of foreign exchange, revenue increased by 18 percent. All channels in the Rest of World segment showed increases, demonstrating the benefit of our multi-country, multi-channel model. The increase was driven by growth in both residential and B2B customers. We are pleased with the performance of our Rest of World business, which is beginning to recover from the pandemic and commercial businesses are beginning to return to work. Adjusted EBITDA in the Rest of World segment increased 8 percent to $16 million, as the benefit of higher revenues from Europeans returning to work was partially offset by investments in sales and marketing for residential customers in Europe to further diversify our customer base and better balance the customer mix.

Turning to our Q2 and full year outlook.

Revenue was strong in Q1 and is off to a good start in Q2, with strong customer demand and price increases to offset increased costs.

With respect to Adjusted EBITDA, inflation has resulted in cost increases in labour, fuel, freight, and materials. We are confident we can take price to offset these cost increases, but it may result in short-term windows of cost headwinds.

In addition, we are focusing on long-term growth and laying the foundation for future growth. This requires us to invest in that foundation this year.

Finally, the exit of the business in Russia creates a one-time headwind as we lack $14 million of revenue and $3 million of Adjusted EBITDA from this business.

With that said and based on the information we have available to us as of today, we expect consolidated revenue from continuing operations to be between $540 million and $560 million, and that our second quarter Adjusted EBITDA will be in the range of $100 million to $110 million.

For the Full Year 2022, organic revenue growth is projected to be 7 percent to 8 percent and overall revenue growth is expected to be 9 percent to 10 percent. Adjusted for the exit of the North American single-use retail water business, we expect 2022 Adjusted EBITDA to be between $410 million and $420 million.

As Tom mentioned, the exit of the North American single-use retail water business continues to move quickly. In 2021, these products accounted for revenue of approximately $142 million. We now expect the 2022 revenue of this product line to be about $40 million, with minimal effect on Adjusted EBITDA. We still expect to exit this category by the end of the second quarter.

For the year, we also expect around $10 million of cash taxes, $50 million of interest expense, as well as capital expenditures of approximately $200 million. The capital expenditure figures include incremental spending, as we discussed during our Investor Day last November, which is being used to support our growth outlook and EBITDA margin expansion.

Key initiatives being funded by our multi-year incremental CAPEX include: driving digital growth and leading dispenser innovations such as the rollout of an update to our mobile app, My Water+, and plans to execute a global e-commerce web shop, both of which will grow our customer base, leading to dispenser and refill innovation, creating differentiation in our products and offerings; investment in delivery vehicles to reduce emissions and to support sustainable fleet management; investment in new spring sources, including Mountain Valley, support increased customer demand and future growth; installation of water production equipment that supports our ESG strategy, reduces water usage, and increases efficiencies in places like Los Angeles and Calgary; investment (audio interference) solutions to support supply chain and logistics operational excellence. These initiatives and investments will support our 2024 outlook, which includes revenue and Adjusted EBITDA growth, as well as EBITDA margin expansion.

As we announced yesterday, our Board of Directors authorized a quarterly dividend of $0.07 per common share. As discussed during our November Investor Day, our growth outlook and increased free cash flow generation can fund our growth, as well as an increase in our annual dividends. Our path to a multi-year 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.

Other aspects of capital deployment include continuing our tuck-in M&A. For 2022, we continue to target $40 million to $60 million of tuck-ins and remained focused on executing the robust pipeline of tuck-in opportunities in front of us.

Our long-term organic growth outlook has not changed. We remain confident in our outlook for 2024. We are forecasting high single-digit percentage organic revenue growth, targeted annualized Adjusted EBITDA approaching $525 million, Adjusted EBITDA margins of 21 percent to 22 percent, adjusted EPS of $1.10 to $1.20 per share, net leverage of less than 2.5 times, and ROIC greater than 12 percent.

I will now turn the call back to Tom.

Thomas J. Harrington — Chief Executive Officer, Primo Water Corporation

Thanks, Jay.

Looking ahead, we remain focused on executing on differentiated Water Your Way platform. We will leverage our pure-play water model to drive revenue growth of 9 percent to 10 percent in 2022, adjusting for the exit of the North American single-use plastic retail water business and including the revenue from the tuck-in acquisitions made during 2021. Organic revenue growth is expected to be in the range of 7 percent to 8 percent.

We continue to prioritize the customer experience on all things digital, and we remained focused in understanding the new customer journey by leveraging data to segment our audiences to provide the right content and products to them. Our current and future customers will be empowered to fully embrace our Water Your Way strategy in the new format with the ability to manage their accounts on the go, easily obtaining Primo products whenever, wherever, and however they want them.

We're also on pace to launch our new direct-to-consumer e-commerce destination later this year with new features that enhance the purchasing experience and will accelerate our dispenser sales. Our initiatives set the tone for our commitment to digital acceleration to provide the best solutions to our customers.

We will continue to execute our razor/razorblade model, with growth in the number of dispensers sold driving top line growth through the sale of water products.

Interest levels for the launch of our new Alkaline Water brand, Primo Plus, have been very encouraging. Primo Plus alkaline water complements our existing portfolio and is a growing trend globally. Primo Plus alkaline water has a pH level of 9.5 at the time of bottling, is sold in three-gallon bottles, and is currently available for Water Direct customers in certain U.S. geographies. We have a pipeline that could lead to incremental distribution of more than 1,000 Primo Plus exchange rack places.

Our efforts are paying off in other areas such as refill. We've partnered with a major retailer to install up to 1,000 additional refill machines at net new locations in 2022 and 2023. Supporting our initiatives are more structural and thematic tailwinds that are driving consumers toward healthy hydration solutions. The growth in the health and wellness category continues to support our prospects of gaining share of the broader beverage category.

In addition, the perception of the declining quality of municipal tap water is well-documented, which supports the growth of our products and services. Tap water as a primary drinking source is expected to continue to decline in all parts of the world for the foreseeable future.

As Jay noted, we expect our consolidated second quarter revenue to be between $540 million and $560 million, and for our Adjusted EBITDA to be between $100 million and $110 million. For Full Year 2022, we continue to forecast revenue growth of 9 percent to 10 percent, adjusting for the exit of the North America single-use retail bottled water business and including the revenue from the tuck-in acquisitions made during 2021, as we continue to see the improving demand in both the residential and B2B sectors as consumers and workers are increasing their mobility.

We are forecasting our Adjusted EBITDA to be between $410 million and $420 million.

We're also maintaining a strong pipeline of M&A targets which we expect to execute during the remainder of the year.

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 will turn the call back over to Jon to move us to 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 Kevin Grundy with Jefferies. Please go ahead.

Kevin Grundy — Analyst, Jefferies

Great. Thanks. Good morning, everyone, and congrats on the strong results.

Thomas J. Harrington — Chief Executive Officer, Primo Water Corporation

Thanks, Kevin. Good morning.

Kevin Grundy — Analyst, Jefferies

Hey. Hey. Good morning, Tom. Good morning, Jay.

I wanted to pick up on your outlook for the year and then shift to pricing, if I could. So first, just with respect to the outlook, maybe just comment on your decision to maintain your revenue and EBITDA guidance for the year despite the strong first quarter and what appears to be a solid start to the second.

Thomas J. Harrington — Chief Executive Officer, Primo Water Corporation

Yes. Clearly, we're pleased with the first quarter; revenue growth, EBITDA growth, margin expansion, so it's a rock-solid beginning, and we see that carrying into Q2, but it's early, so we'd like to get the next little bit under our wings well before we make any decisions about where the guidance would go, and I also think it's important to note that while we announced the exit of Russia, we're not changing our guidance to effect for the short-term headwind of $14 million and $3 million, so we'll continue to deliver our guidance in spite of despite that decision, so that's where we sit, but the business, to your point, is off to a terrific start. We're quite pleased with it, and it has continued into April, and I guess we (inaudible) be the first couple of days in May.

Kevin Grundy — Analyst, Jefferies

Okay. Very good. I think that makes sense.

Then just pivoting to pricing. I think the comment was, you took pricing in January and in March, so just a couple of questions or a couple of areas maybe you could touch on: the magnitude of the price increase relative to CPI, which is currently in the 8.5 percent area year-over-year; observations on elasticity so far, seemingly so far, so good, although early, at least with the first round, given the results; and then just broadly, the view on the ability to take additional pricing should the inflationary environment worsen from here, so thanks for that, guys. I'll pass it on.

Thomas J. Harrington — Chief Executive Officer, Primo Water Corporation

Yes. Thanks, Kevin. I'll take a piece of that and then I'll flip it over to Jay.

The best measure for us is our retention rate, and we're seeing good stickiness on our customers in both—across our Water Direct and Exchange business at 86.5 percent, if I have the number correct, so it's good growth versus prior year, and that says that our investments in service, our ability to be 98.5 percent staffed on route delivery, which is the best place we've been in, good golly, since before any variant, which frankly, is very important to us that we're properly staffed so that we can deliver on our commitments to the customer, and they're sticking with us. Then in terms of, if you look at our growth, I guess the best indication is double-digit revenue growth on both residential and B2B pretty much everywhere we do business, which we think is a pretty solid sign that our pricing is sticking, customers are sticking, which gives us confidence that we're in a good spot as we move forward.

Jay, any colour you want to add?

Jay Wells — Chief Financial Officer, Primo Water Corporation

I talked a little bit on my prepared remarks. If you look at North America Water Direct Exchange up 17 percent in the quarter, of that 11 percent is related to pricing, so that will give you the magnitude. When you talk about the two price increases, we have different levers to pull in our price increase. Earlier in the quarter, we took pricing on certain products. Later, we more increased our delivery fee, our ESC as we saw diesel prices continue to rise during the quarter, so even though we took two tranches, they were on different line items (inaudible) different products.

Kevin Grundy — Analyst, Jefferies

Okay. Very good, guys. Thank you. Good luck.

Thomas J. Harrington — Chief Executive Officer, Primo Water Corporation

Yes. Thanks, Kevin. Appreciate it.

Operator

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

Andrea Teixeira — Analyst, JPMorgan

Hi. Good morning, everyone, and echoing the success, and congrats on the quarter.

My question is more related to how you're seeing price elasticity. It looks as if it's probably early to tell, but wondering if you can parse out commercial against residential, and on that vein, if you're seeing anything, as you point out, like in the quarter-to-date, you've had very good improvement. If you can kind of give us a little bit of a difference between coming back in some of the commercial clients or even B2B against residential, and what are you seeing there quarter-to-date? Thank you.

Thomas J. Harrington — Chief Executive Officer, Primo Water Corporation

Good morning, by the way. Thank you, Andrea.

Andrea Teixeira — Analyst, JPMorgan

Good morning.

Thomas J. Harrington — Chief Executive Officer, Primo Water Corporation

There's a couple of questions embedded there, and let me take a shot at that.

If you went to North America, our B2B business is growing at a faster rate in terms of revenue in residential, both double-digits, and then if you went to Europe, they're about the same in terms of growth; both in excess of, call it, mid-single-digit, mid-double-digits in terms of growth, so we're quite pleased. The pricing has gone through, and remember, our delivery and energy surcharges are generally pegged at a price of fuel, so it covers us from those—the volatility in that area; hence, the reason that we took another initiative in March once we saw the price of oil spike at the beginning of the Ukraine conflict.

Jay Wells — Chief Financial Officer, Primo Water Corporation

On different pricing, keep in mind, our average customer bill, $50, $55, whether you're a small business or whether you're a residential, so very similar billing structures, very similar volume consumption, and the same type of billing structure. So, if we're taking pricing, we're taking it across our entire customer base in North America here, not just focused on residential or B2B, and we've seen good volume in both, the revenue in both, and good retention growing in both, so not seeing any elasticity issues with the pricing we take.

Thomas J. Harrington — Chief Executive Officer, Primo Water Corporation

I think one important point is our current staffing levels and route operations at 98 percent, essentially fully staffed, is a significant difference from where we were a year ago before Delta, right? So, I think we're in the best possible position in the event anything comes forward, that I'm staffed, I'm ahead of it, we have much better pointing tools in place, we learned a ton from last year, so that gives us confidence that we can continue to deliver our customers, which, frankly, enables our pricing power.

Jay Wells — Chief Financial Officer, Primo Water Corporation

(Inaudible).

Andrea Teixeira — Analyst, JPMorgan

Hi. If I can just follow up a little bit on the quarter-to-date, and acknowledging that you have a tough comp on an organic basis, I think you were up 12 percent last year total company, is that something you're trying—when your commentary about like tracking well in the quarter, is that higher than what you were able to achieve with the 10 percent in the first quarter, or we should be cognizant of what's happened—I mean, the comparisons in organic?

Thomas J. Harrington — Chief Executive Officer, Primo Water Corporation

I think we're cycling if you looked at last year. Rock-solid Q1 last year, so very good performance on a year-over-year basis. We're cycling a good performance in Q2 of a year ago, so we like our current positioning, but I'm a-third of the way through the quarter, so I don't want to get too far ahead of myself here, and we're confident, we'll deliver against our commitments, and we'll see how it turns out, but right now, we're in a very good position.

Andrea Teixeira — Analyst, JPMorgan

Okay. Thank you so much. I'll pass it on. Best of luck.

Thomas J. Harrington — Chief Executive Officer, Primo Water Corporation

Thanks, Andrea. Appreciate it.

Operator

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

Derek Lessard — Analyst, TD Securities

Yes. Good morning, everyone. Echoing the…

Thomas J. Harrington — Chief Executive Officer, Primo Water Corporation

Hey, Derek. Good morning.

Derek Lessard — Analyst, TD Securities

Good morning, and congrats on the quarter.

I was just going back to some of the EBITDA adjustments that you made in the quarter. It looks like a big jump in integration expense. Just curious if that was just a bigger quarter in terms of tuck-ins for you guys.

Thomas J. Harrington — Chief Executive Officer, Primo Water Corporation

Yes, go ahead.

Jay Wells — Chief Financial Officer, Primo Water Corporation

I would say you're really seeing the final type of severance costs related to the overall acquisitions, the larger acquisitions we have done. You are seeing some related to SipWell over in Belgium where we did complete that right at the end of the year, but I would say as we've wrapped up our synergy capture, it's now that we're eliminating some dual staffing, and you're seeing the cost of that running through, I would say, so we have a little bit more of that through the year, but I would say you're seeing the final costs associated with the larger acquisitions we've done.

Derek Lessard — Analyst, TD Securities

Okay. Thanks for that, Jay, and I guess one more for me, and it sounds like—I was wondering how you guys are thinking about the balance between return to office and maybe more permanent working from home schedules, but it sounds to me like you're agnostic either way.

Thomas J. Harrington — Chief Executive Officer, Primo Water Corporation

That is correct, so we took it on the chin, as everybody knows, when we went through the pandemic, on our commercial business, and we've benefited from work from home in residential. Good news is our—as people have begun to work from home, our residential business continues to grow, retention continues to improve, and we have that mid-double-digit growth in commercial in Europe, which is a real sign of the work from home, and we're seeing similar, if not better, numbers in North America. So, we're quite pleased of the current balance between the channels as the world makes its last changes, (inaudible) open to what the balance of work from home and work in the office will be, so we think we're really well-positioned. Our business today is roughly, in terms of customer count, 50/50, so we're about halfway—half of our Water Direct business is resi—residential, excuse me, and the other half is commercial, so we have good balance, and we have good double-digit growth of both, so we really like where we're at.

Derek Lessard — Analyst, TD Securities

Okay, and maybe just a follow-up to that, where are you in terms of the initiatives in Europe to sort of improve that mix?

Thomas J. Harrington — Chief Executive Officer, Primo Water Corporation

Last year, we articulated good residential growth. We continue to have good residential—despite the war, good growth in our European business. We are seeing continued growth in that residential business. We continue to enhance our website. We've opened a number of e-commerce shops, which is important, because that's where we will sell dispensers which is the gateway to water services, so we're quite pleased with where we are.

We are making enhancements. We refreshed our mobile app in North America. We'll be extending that app into Europe sometime in 2022, and we are consolidating and investing in new sites in Europe, and a couple of those, we rolled out in the last month or so, so all those components of the plan are coming together, and we think we will, over time, continue to de-risk and get better mix in our customer base in Europe.

Derek Lessard — Analyst, TD Securities

Okay. Thanks for that, and good luck for the rest of the year, gentlemen.

Thomas J. Harrington — Chief Executive Officer, Primo Water Corporation

Thanks, Derek. Appreciate it.

Operator

Your next question comes from George Doumet with Scotiabank. Please go ahead.

Maromene — Analyst, Scotiabank

Good morning. This is Maromene (phon) calling on George's behalf. Congrats on the quarter.

Can you talk a little bit about expectation going forward in Europe given the war, and also, how does the volume compares to pre-pandemic level at the moment?

Thomas J. Harrington — Chief Executive Officer, Primo Water Corporation

I missed the first half of that question. Do you mind repeating it? You faded a little bit.

Maromene — Analyst, Scotiabank

Yes, the volumes in Europe given the uncertainties going forward.

Thomas J. Harrington — Chief Executive Officer, Primo Water Corporation

Yes, okay. We don't have any direct business in Ukraine. We do have good-sized businesses, as everyone is aware, in Poland and Hungary, and those businesses are performing quite nicely despite all of the disruption, so we're pleased with how those businesses perform. If you look on it over a two-year basis, come back to pre-pandemic, our revenue is growing. It's higher, if I have it right, versus two years ago.

Jay Wells — Chief Financial Officer, Primo Water Corporation

Our commercial business in Europe is still a little down.

Thomas J. Harrington — Chief Executive Officer, Primo Water Corporation

A little soft

Jay Wells — Chief Financial Officer, Primo Water Corporation

A little soft.

Thomas J. Harrington — Chief Executive Officer, Primo Water Corporation

But aggregate is the increased offset by our stated objective of growing the residential business, so that's coming to fruition the way we would have hoped. So, we're quite pleased with what, in aggregate, is happening in Europe. We also benefit from—there's more work from home, and that's why you see our commercial business beginning to perform better. We expect that, frankly, will continue.

Jay Wells — Chief Financial Officer, Primo Water Corporation

I mean you look at—you are seeing more and more countries return to work right now over in Europe. That's how we are having mid-teens growth in our commercial business over in Europe, and if you look at versus two years ago, I'd say just that part of the commercial business, Europe, we're down mid-single-digits only at this point in time, where, at the worst part of the pandemic, we were down 40 percent. So, we have seen a—we're seeing a very good return for that part of the business as things start to normalize over in Europe.

Maromene — Analyst, Scotiabank

All right. Also, on last call, you mentioned right-sizing opportunities in Europe. You were waiting for (inaudible) programs to end there. Can you talk about the opportunity there as well?

Thomas J. Harrington — Chief Executive Officer, Primo Water Corporation

We finished some of our right-sizing in 2021, and as Jay referenced, there is some M&A work that we chatted about with Derek that we were finalizing, so we think we're largely in the structure we want, largely, and really, we're now beginning to focus on some investments in SG&A, obviously, to focus on growth in things like the residential business and the appropriate service levels as our business returns to growth in Europe after two challenging years.

Jay Wells — Chief Financial Officer, Primo Water Corporation

The only other thing you might be referring to is we are centralizing our back office function to Barcelona in Europe, because historically, this has been a very de-centralized back office business over in Europe, and we're making very good progress. We have it (inaudible) up and we're well along the way of

Phase 1. We have a second basis in smaller countries and we'll move in later on this year, but the back shop consolidation in Europe has moved along and progressed very well.

Maromene — Analyst, Scotiabank

Very helpful. Thanks.

Thomas J. Harrington — Chief Executive Officer, Primo Water Corporation

Thank you.

Operator

Oh, my apologies.

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

Daniel Moore — Analyst, CJS Securities

Thank you. Thank you. Good morning, Tom. Morning, Jay.

Price cost coverage was obviously really good in the quarter despite significant inflationary pressures. Was there any measurable impact on EBITDA in the quarter just given the lag in timing between inflation and when you took price?

Thomas J. Harrington — Chief Executive Officer, Primo Water Corporation

We've exhibited in the past that we're pretty nimble, and if you went back to the beginning of the pandemic and adjustments we made to the cost structure, we reacted to pricing, so that second price increase in March was pretty close to when the impact happened, but there might have been a little bit of a lag there, and then, certainly, as we mentioned in our prepared comments, we expect to get full realization of those efforts in Q2, because on a year-over-year, that delivery in (inaudible) will be higher, obviously.

Jay Wells — Chief Financial Officer, Primo Water Corporation

I think net-net-net, you look at our pricing actions, they were made to offset cost increases, so net-net-net, I wouldn't expect that incremental cost—our pricing to benefit our bottom line. It's really to offset the cost pressures we've seen.

Daniel Moore — Analyst, CJS Securities

Got it. Very helpful, and then, maybe just talk about working capital for—expectations for the remainder of the year and how it relates to free cash flow, what your thoughts are there.

Jay Wells — Chief Financial Officer, Primo Water Corporation

If you look at our free cash flow statement, you will see we do have elevated inventory levels that we're carrying right now, and that was the decision we made to make sure we bought early and stocked up on dispensers. We want to make sure we are pushing dispenser sales. That is our razor, so we've made the knowing decision to buy forward some of the inventory we're going to buy later on in the year, and I would expect that to continue through the year. We want to make sure—we're going to push the dispenser sales hard this year, and we’re going to make sure we have inventory in stock, so I would say that's the one pressure you will see if you look at our statement (inaudible) that I would see. (Inaudible) at the end of the year, but throughout the year, we're going to make sure we have the dispensers, because that's a key focus to really push the razor so we can sell more razorblade, as the saying goes.

Daniel Moore — Analyst, CJS Securities

Makes sense.

Maybe last, it looked like M&A activity was still a little light. I know you reiterated your target. Any guidance or colour on the cadence of potential tuck-ins as we look to the rest of the year? Thanks.

Thomas J. Harrington — Chief Executive Officer, Primo Water Corporation

Our target remains $40 million to $60 million. We did a number of—we executed a number at the end of last year, so we always want to digest those, right, so we don't just show up and do them on Tuesday. We've got a little bit of work to do, so we're focused on the ones we did at the end of the year, but we're confident that we have a solid pipeline. We’ll get between $40 million and $60 million as the year progresses, for sure.

Daniel Moore — Analyst, CJS Securities

Very good. Appreciate the colour.

Thomas J. Harrington — Chief Executive Officer, Primo Water Corporation

Thanks, Dan.

Jay Wells — Chief Financial Officer, Primo Water Corporation

Thanks, Dan.

Thomas J. Harrington — Chief Executive Officer, Primo Water Corporation

Appreciate it.

Operator

Your next question comes from Steve Powers with Deutsche. Please go ahead.

Steve Powers — Analyst, Deutsche Bank

Hey. Thanks.

Hey, I was hoping if you could just maybe expand on any challenges or maybe relative success stories in this environment just around associate recruitment, retention, and wage inflation, on top of all the other cost inflation we've spoken about, and just how you're thinking about those dynamics—sort of labour dynamics going forward over the balance of the year? Thank you.

Thomas J. Harrington — Chief Executive Officer, Primo Water Corporation

We spent the better part of, let's call it, from the arrival of the Delta variant through the end of the year, very focused on the associate experience as part of our strategic plan, that is focused on one retention so that we properly on-board people, that we get them trained properly and then they can get into position and take care of our customers. We've made good progress, because as we referenced, we're 98.5 percent—we're at 100 percent staffed on route, and we're generally staffed across the Company. It doesn't mean every town in the market, but we're pretty well staffed and very focused.

Yes, there's been wage inflation. We've called that as one of the outcomes and part of our inflation. We have adjusted wages to ensure we attract the right people, and now that we're staffed, so our challenge is—and focused, I don't want to call it a challenge, we keep the ones we got so that we can continue to make progress on growing the top of the business and properly servicing the customers. That ultimately flows through to the bottom line.

Jay Wells — Chief Financial Officer, Primo Water Corporation

I would say one good thing we implemented as we got to the end of last year and roll into this year is for our RSRs, our drivers, we've implemented a predictive hiring model now, that we're not waiting for the seat to be empty anymore to hire the person. We're looking at historic trends, modeling out where we see the openings will come up based on those trends, and we're hiring ahead of it, so that's really what's given us the ability to get our—all of our positions full at this point in time is a really well-executed predictive hiring model.

Steve Powers — Analyst, Deutsche Bank

Great. Thank you very much.

Thomas J. Harrington — Chief Executive Officer, Primo Water Corporation

Thanks, Steve.

Operator

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

Thomas J. Harrington — Chief Executive Officer, Primo Water Corporation

Good morning, John.

Jay Wells — Chief Financial Officer, Primo Water Corporation

Good morning, John.

John Zamparo — Analyst, CIBC Capital Markets

Thanks. Good morning, everyone. Good morning.

If I can ask one more on—good morning. If I can ask one more on pricing and elasticity, did you see any change in retention rates or customer sign-up on the March price increase versus the January price increase? Is there any divergence by channel, whether it's residential, B2B, or even e-commerce?

Thomas J. Harrington — Chief Executive Officer, Primo Water Corporation

We're not seeing any meaningful changes through customer sign-ups or retention across, let's call it, inside Water Direct, so we're quite pleased with that. We obviously will follow that to our call centre, but we're pleased with where we are from a retention perspective as we move from Q1 to Q2, which is, for us, one of the best indicators, so we're not seeing a flurry of calls about delivery fee. We're not seeing a flurry of losses of customers. We're not seeing (audio interference) on people signing up, so we think that we're in a pretty good spot as it relates to that, and frankly, it is also an outcome of investments we've made on the associate experience and retention. It's an outcome of enhancements we've made on digital. It's going to be a benefit of the mobile web, so all the other things we do are enhancing the customer experience, and to Jay's earlier point, if we do all those things better and if we do them right, the incremental 5 bucks or 6 bucks a month or a bill, it's not causing people to flee, and of course, there's other benefits to us in terms of tailwinds about healthy hydration and people's desire for high-quality drinking water, and we give it to you any way you want.

John Zamparo — Analyst, CIBC Capital Markets

Okay. That's helpful. Thanks. Then my follow-up is on the organic growth. You listed 11.5 percent year-over-year. I'm not sure if you have it handy, but in case you do, can you share the pro forma number from Q1 last year? It was noisy versus Q1 '20. I get around minus 7 percent or minus 8 percent, but I just wanted to see if you have that available.

Jay Wells — Chief Financial Officer, Primo Water Corporation

I am sorry, John. I can follow up with you on that one. I don't have last year's number handy right now. Is that what you're asking, what Q1 last year's number was?

John Zamparo — Analyst, CIBC Capital Markets

Yes. That's fine. We can follow up later.

Thomas J. Harrington — Chief Executive Officer, Primo Water Corporation

Yes, that was full pandemic, no pandemic.

Jay Wells — Chief Financial Officer, Primo Water Corporation

Yes, exactly, so that's—I know we were lapping Q1 2019 with no pandemic, and we were still well in the pandemic of Q1, so yes, a negative number does sound right, but off the top of my head, John, I don't have that one handy, but we can follow-up with you on that number.

John Zamparo — Analyst, CIBC Capital Markets

Okay, understood. That’s all for me. Thanks very much.

Thomas J. Harrington — Chief Executive Officer, Primo Water Corporation

Thanks, John.

Jay Wells — Chief Financial Officer, Primo Water Corporation

Thanks, John.

Operator

Your next question comes from Derek Dley with Canaccord Genuity. Please go ahead.

Derek Dley — Analyst, Canaccord Genuity

Yes. Hi. Good morning, everybody.

Thomas J. Harrington — Chief Executive Officer, Primo Water Corporation

Good morning, Derek.

Derek Dley — Analyst, Canaccord Genuity

I've got just two questions.

One, can you sort of rank order your business lines by margin? I mean, it kind of sounds like, based on the commentary on this call, and then as well in the press release, that the Water Direct tends to carry a higher margin than the other business lines?

Jay Wells — Chief Financial Officer, Primo Water Corporation

You're talking EBITDA margin, right, Derek, or gross margin?

Derek Dley — Analyst, Canaccord Genuity

If you can walk it down to EBITDA, that'd be better.

Jay Wells — Chief Financial Officer, Primo Water Corporation

Yes, EBITDA's a little bit—let's start with gross margin, and I'll work it down from there, because gross margin's very identifiable. I mean, if you look at Water Direct—and let's exclude depreciation, because that's how I like to look at it—you're in the high 70 percent, touching 80 percent at some quarters on our Water Direct business, so definitely a strong margin. When you compare it versus our other lines, they're much smaller lines. If you look at our filtration business, we're not manufacturing or selling a project—product, so it also has good gross margin, but down in SG&A is where we have our routes. You spend it on that, or in depreciation, because we're amortizing units, so we have a very good gross margin on many lines of our businesses. The retail business that we've talked about that we're exiting, very low gross margin. Our coffee business, that’s down in other (inaudible) selling coffee, again, a lower margin business, but very happy with our Water Direct. It does run, like I said, high 70 percent type gross margin.

Thomas J. Harrington — Chief Executive Officer, Primo Water Corporation

The one standout is our dispenser business, the razor, and the razor is—we want to get the—that dispenser in consumer's hand so that we can benefit from the sales of water products, whether it's in Water Direct, Water Exchange, Water Refill, so that would be the one outlier in terms of gross, and frankly, EBITDA, because we want to sell it and get them in your homes at the lowest possible price, because they—well, 45 percent of them are going to come to Water Direct, 30 percent will go to Exchange, and 25 percent will go to our retail business, and that's the proverbial holy ground, right, razor/razorblade.

Derek Dley — Analyst, Canaccord Genuity

Yes, okay, that makes sense, and one more, sorry, I was a little late to the call. Just wondering if you have any update, or perhaps you already gave it, just on the tariff reimbursement that you mentioned last quarter. I believe it was around $8 million on the CAPEX side and $5 million on the COGS side.

Thomas J. Harrington — Chief Executive Officer, Primo Water Corporation

We don't forecast it. It's in the hands of others, so if it comes, it comes, but it's nowhere in any of our current guidance or forecasting performance. We'll let the U.S. government make their ultimate decision on where that turns out.

Derek Dley — Analyst, Canaccord Genuity

Okay, got it. Thank you very much.

Jay Wells — Chief Financial Officer, Primo Water Corporation

Thanks, Derek.

Thomas J. Harrington — Chief Executive Officer, Primo Water Corporation

Thanks, Derek. Appreciate it.

Operator

Mr. Kathol, there are no further questions at this time. Please proceed.

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

Thank you, Pam.

This concludes Primo's first quarter results call. Thank you all for your 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.