Primo Water
First Quarter Earnings Conference Call
Tuesday, May 9, 2017
4:30 pm ET

Katie Turner - ICR:

Good afternoon and welcome to Primo Water's first quarter 2017 earnings conference call. On the call with me today are Billy Prim, Chairman and Chief Executive Officer; Matt Sheehan, President and Chief Operating Officer and Mark Castaneda, Chief Financial Officer. By now, everyone should have access to the release that went out this afternoon at approximately 4:05 pm Eastern Time. If you have not received today's press release, it is available on the investor relations portion of Primo Water's website at www.primowater.com. This call is being webcast, and a replay will be available on the Company's website.

Before we begin, we would like to remind everyone that the prepared remarks contain forward-looking statements, including financial guidance, and Management may make additional forward-looking statements in response to your questions. The forward-looking statements should be considered within the meaning of the applicable securities laws and regulations regarding such statements. Many factors could cause actual results to differ materially from those forward-looking statements, and we can give no assurance of their accuracy, and Primo Water assumes no obligation to update them. We encourage participants to carefully read the section on forward-looking statements included in the press release issued this afternoon, and in all documents that Primo Water files with the SEC.

And now, I would like to turn the call over to Primo Water's CEO, Billy Prim.

Billy Prim:

Thank you, Katie. Good afternoon, everyone, and thank you for joining us today to review our results for the first quarter 2017. We are excited about our start to the year and pleased with our results for the quarter. In regards to the Glacier integration, we are ahead of plan and expect to achieve greater synergies in 2017 than originally expected. As a result we are increasing our full year Adjusted EBITDA guidance. Matt will provide more detail on our results, strategies and integration status and then Mark will provide more detail on our updated guidance.

I will begin today by congratulating Matt on his new role as CEO, which will take effect on June 1st, as I transition to an Executive Chairman role. The Board of Directors and I have been working on a succession plan for some time and have confidence that Matt has the experience and skills to continue the growth and operational excellence to take Primo to even greater heights. Matt has been a key driver of our strategy and success over the last 5 years and I look forward to his leadership of the Company. As Executive Chairman, my involvement in the business will be through industry relations, senior leadership development and long-term strategy.

I am proud of our accomplishments over the past 5 years of growing our top line over 50%, while increasing adjusted EBITDA by 4.4 times. This resulted in a significant increase in shareholder value of over 700% or about 7 times greater than the overall market during this time period. Additionally, with our recent acquisition of Glacier Water, we expect to double our revenues in 2017 and, with synergies, expect an even greater improvement to our adjusted EBITDA and cash flows.

Going forward, our team remains committed to the execution of our strategic growth objectives. Primo is better positioned as the market leader with compelling brands, product offerings, scale and a dedicated team of associates to take us to the next level of growth. We will continue to increase household penetration across North America and in turn, drive long-term value creation for our shareholders.

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

Matt Sheehan:

Thank you, Billy. First off, I am honored to accept the CEO role and continue to lead our team to grow this business, increase EBITDA and use our free cash flow to de-lever and increase shareholder value.

With that in mind, I'll discuss the consumer market, highlights of the quarter and, finally, provide an update on the progress against our key strategies.

We are a "purpose" driven organization, committed to "inspiring healthier lives through better water". Consumer beverage trends continue to support that purpose and consumers continue to choose healthier beverages over sugary alternatives. Water is now the most consumed beverage per capita in the United States and continues to grow as "the" choice for consumers. Health and wellness trends continue to be a top driver for bottled water. In addition, concerns over tap water are driving consumers to look for long term bottled water solutions. Just last week, the Wall Street Journal reported that lead levels in tap water in

Pittsburgh, and other major cities', exceed government standards. Not only would the project to work on the city water infrastructure cost hundreds of millions of dollars but would also be phased in over a 10-year period. Consumers are aware of issues like these and can't risk the health of their families over a 10-year period. We believe that increased consumer awareness of these issues fuels growth in the bulk water category. Consumers are searching to provide healthier and/or safer beverages for their families and we have the solution with over 40,000 locations offering convenient, purely amazing water at a fraction of the cost of most alternatives, with no plastic waste.

I also wanted to touch on a topic receiving lots of attention these days: retail store closures. While these closures may have some short-term impact on our location count, we believe, over the long term, that consumers will find our water in alternative locations while we also believe that we have a tremendous runway with retailer & location growth. We also believe our business is linked with the best of breed in the retail landscape. Most of the store closure activity receiving the bulk of the press are mall-based anchor stores, electronics, sporting goods and non-differentiated apparel & footwear retailers. As you look at our top accounts, these exist in Home Improvement, Mass and Grocery – areas that have a healthy landscape ahead of them and are differentiated in their fit within consumers' needs now and for the long-term. That said, we continue to push our online retail business with our retailer partners, including Amazon, which we have recently begun working with directly in our dispenser business.

Now a few highlights from the quarter. Net sales increased 88% to approximately $61 million and adjusted EBITDA doubled to $9.8 million. The acquisition of Glacier fueled most of the growth for our water segment, while our Exchange business continued to generate strong same store unit growth of 6.1%, which when compared to the first quarter of 2016 had one less day. On an apples to apples basis, the same store growth was 7.3%

Our Dispenser segment revenue decreased $2.3 million as the timing of shipments to certain retailers was delayed into the future quarters, but is not expected to affect the full year's revenues. As a reminder, Dispenser revenue has a minimal impact on EBITDA.

Having discussed the macro environment and the results, I'll now talk about our strategies, which have not, nor will they change with our leadership transition. As consistently referenced, we have 5 high-level strategies for capturing the growth this market offers:

- First, Grow household penetration
- Second, Improve connectivity of our dispensers and our water
- Third, Increase retail outlets
- Fourth, Drive unit economics, and
- Fifth, Foster highly engaged teams.

I will now cover just a few of these strategies in more detail.

First, Grow household penetration. In the first quarter, we continued to see strong dispenser sell-thru, at 143 thousand units. We believe that about half of these dispensers represents new households for our water products. One change we did make during the first quarter is work with our retailers to shift the promotional spend from Q1 to Q2 and Q3 to better align with peak season consumer demand for dispensers and our water. While this impacted Q1 shipments and short term revenue, we believe the repositioning of these promotions into the peak season will be more effective. Even with the shift in promotions we achieved a similar level of sell-thru for dispensers compared to the prior year which, we believe is a good sign. On that note, our sales and marketing teams have been working with our retailers both testing and planning dispenser promotions over the last year. With that in mind, we have locked in a significant increase in the number and scale of promotions this year across all of our major dispenser retailers. We will update you on these promotions throughout the year. As context, for the past two years, our dispenser sell thru has increased 16% and 11%, respectively.

Next, Drive unit economics. Driving unit economics comes from increasing unit revenue, reducing operating costs or decreasing capital spend per location. As we bring together the shared services, operating networks and messaging post-acquisition, we are excited with the leverage that we'll drive from the combined organizations.

As it relates to unit revenue, we will continue to focus on gaining productivity from an existing location, which is much more valuable than a new location. Integration, as well as targeted marketing activities, will have a greater reach and impact on our organization. As we have previously discussed, we have a regimented test protocol in which we test small, constantly iterate and scale successful tests rapidly.

It's estimated that less than 5% of American homes have a dispenser, which leads to a big opportunity of consumer awareness of our offering. Our marketing team has been hard at work to improve the consumer awareness through several marketing tests and campaigns. As an example: As mentioned previously, this year we will do more promotions of dispensers through circular features as well as coupons than ever before. Over the last year, we have been testing different types of dispenser promotions which, based upon the good returns, have led us to this year's strategy.

We believe this business can be significantly larger, as we provide great value to consumers. Not all of our marketing initiatives will be successful which is why we have a test then scale philosophy, but we are going to test more initiatives this year and expand further next year. We have been given tremendous support from our retailers, who continue to look for products and categories that are winning in the market and few have the growth rates Primo exhibits.

<u>To wrap up, our last strategy, but far from least, is to foster highly engaged teams</u>

We are proud of what our team has accomplished, as integration is underway and we're excited with the cultural fit of the two organizations.

As Billy previously discussed, we are ahead of plan on our integration of our combined refill service network, which will result in greater synergy savings than previously expected for 2017. We now expect synergy savings for 2017 of $3 million vs. the initial range of $1.0 to $2.0 million. Our integration team has been able to drive faster timelines in certain regions of the country sooner than originally anticipated. Our main goal continues to be a very smooth integration, which should be a non-event for both consumers and our retail partners and, to-date, we have accomplished this goal. I would like to commend everyone involved on our team, as there continues to be a tremendous effort and long hours to get us through this portion of our integration.

With the current business trends and the synergy forecast in hand, we are raising our full year EBITDA guidance. Mark will provide the details of our changes in guidance a little later in the call.

Lastly, as it relates to our team, I would like to close with the announcement of David Hass' promotion to Chief Strategy Officer. David joined Primo in 2011 from Stifel Nicolaus to lead our FP&A team and, over time, has increased his responsibilities to running our core and long term strategy teams as well as our Canadian business. David has been a key leader in the improvements we have made over the last 5 years, our internal leader of the Balanced Scorecard program and a big part of the growth we have achieved. David brings a deep passion for Primo, an incredibly strong intellect and a strong understanding of the financial, operational and strategic areas of our businesses. This role represents our focus on a well-constructed strategy and a thoughtful growth plan backed by diligent assessment and followed by excellent execution. I want to congratulate David on his well-deserved promotion.

In summary, we are pleased with our execution and excited about the opportunities ahead. With that, I will turn the call over to Mark to cover our financial results.

Mark Castaneda:

Thanks, Matt. I will first review our financial results in more detail and discuss our outlook for 2017. Then, we will turn the call back over to Billy for closing remarks.

To help investors understand our operating results, we do provide adjusted EBITDA, and adjusted EPS, which are non-GAAP financial measures. A reconciliation of these can be found in today's earnings press release posted on our website.

We are pleased with our financial results for the first quarter. As Matt mentioned, our first quarter top line grew 88% to a record $60.7 million driven by growth in the Water segments. The Glacier acquisition contributed to most of the growth, as our Water segment sales increased 137% to $53.1 million. Additionally, our Exchange business generated 6.1% same store unit growth during the quarter, which when compared to the first quarter of 2016 had one less day. On an apples to apples basis the same store growth was 7.3%. We believe this growth is driven by continuing to add new consumer households through the sale of Primo water dispensers.

Dispenser segment net sales decreased 23% to $7.6 million from $9.9 million the prior year, due to the shift in shipments from the first quarter to future quarters, as Matt mentioned. As a reminder, we recognize sales upon the sell-into the channel, which can change from year to year based on the timing of retailers orders, promotions and store sets. For the full year, we continue to expect Dispensers revenue growth of just over 7.0%. For the quarter, Sell-thru of dispensers to end consumers was 143 thousand units, which represents over 19% growth over the past two years. The prior year’s first quarter did include certain dispenser promotions that were moved to to future quarters this year.

Moving down the P&L, gross margin for the quarter increased to 29.5% from 28.9% due to a greater mix of higher margin Water sales. We expect gross margins to improve for the remainder of the year as we begin recognizing the benefit of refill service network synergies.

Next, SG&A for the quarter, increased to $10.5 million from $5.0 million in the prior year primarily as a result of duplicate costs from the acquisition and a an increase of $1.2 million related to non-cash performance based stock compensation. We continue to see leverage in our business model as SG&A excluding non-cash stock compensation decreased to 13.5% as a percent of sales from 13.9% in the prior year period.

We also incurred non-recurring and acquisition-related costs totaling $4.4 million in the quarter. There are three components of these charges:

1. $1.2 million gain from the settlement of the Omnifrio liability;

2. $3.8 million of settlement costs related to former distributors, as previously disclosed, and

3. $1.8 million in costs related to the Glacier acquisition. We now expect total acquisition related costs to be around $2.5 million for the year, which is an increase from our prior estimate, but it is more

than offset by the increased synergies expected to be achieved this year.

Moving down the P&L, Interest expense for the quarter was $5.0 million compared to $500 thousand in the prior year. The increase in the interest expense is the result of the refinancing of our credit facilities in connection with the acquisition of Glacier Water. As previously disclosed, we incurred a one-time $3.2 million non-cash charge related to the warrants issued in connection with the Glacier acquisition. There will not be charges in future quarters for the warrants.

Adjusted EBITDA for the quarter was $9.8 million, approximately double the $4.9 million in the prior year.

On a GAAP basis, our net loss from continuing operations for the quarter was $11.9 million or $0.37 per share compared to net income of $1.0 million or $0.04 per diluted share in the prior year period. The loss in the current year period is primarily the result of the charges as described above.

On a comparable basis when adjusted for non-cash stock compensation, non-recurring and acquisition-related costs, changes in the fair value of warrant liability and loss on disposal of equipment, net loss from continuing operations was $1.7 million or $0.05 per diluted share compared to income of $2.0 million or $0.07 per diluted share in the prior year period.

Continuing on to our balance sheet, we ended the quarter with $6.3 million in cash. The balance sheet reflects our preliminary purchase accounting, which adds the fair value of the Glacier acquisition and respective fixed and intangible assets. As you are aware, purchase accounting may be adjusted during the first year following an acquisition as a result of changes in estimates. Our accounts receivable DSO decreased to 23 from 31 days at December 31st, as a result of improved collections as well as the addition of the Glacier business that carries lower receivables compared to revenue because of the business model of selling directly to the consumer. Additionally, our inventories increased by a couple million dollars due to seasonal needs.

Turning to our outlook:

We continue to expect full year revenue of $280 to $285 million. For Adjusted EBITDA, based upon synergies being ahead of schedule we are increasing our guidance for the full year and now expect Adjusted EBITDA of $53 to $55 million up from $52 to $54 million.

For the second quarter, we expect revenue of $72 to $75 million and Adjusted EBITDA of $12.8 to $14.3 million

In summary, our first quarter EBITDA results were at the high end of our plan, despite the shift dispenser revenue. This illustrates the high quality of our Water segment revenues. Additionally, We are confident in raising our guidance to reflect the positive synergy results, increased promotional activity and consumer trends that we see for our business.

I will now turn the call over to Billy for closing remarks.

Billy Prim:

Thanks, Mark. We are very pleased with the efforts of our team to post solid results, while making major changes to the service infrastructure of the business. We believe the macro and broader consumer trends will continue to fuel future growth in dispenser households and increased usage of Primo Water. Additionally, the combined businesses of Primo and Glacier have resulted in a stronger foundation for our business and significant opportunities for value creation. As we look to the future, we are operating from a position of strength and remain confident that our positive momentum will continue to build into 2017. As always, we appreciate the hard work and dedication of our employees, service providers and retail partners and remain committed to our purpose of *inspiring healthier lives thru better water*

With that, I'd like to open the lines up for questions. Operator?

Q&A

BILLY PRIM: POST Q&A – LIVE ON CALL

Thank you for your participation on today's call and interest in Primo Water. Have a good evening.