FINAL TRANSCRIPT

Primo Water Corporation

Fourth Quarter 2022 Earnings Conference Call

Event Date/Time: February 23, 2023 — 10:00 a.m. E.T.

Length: 57 minutes

CORPORATE PARTICIPANTS

Jon Kathol
Primo Water Corporation — Vice President, Investor Relations

Tom Harrington
Primo Water Corporation — Chief Executive Officer

David Hass
Primo Water Corporation — Chief Financial Officer

CONFERENCE CALL PARTICIPANTS

Derek Lessard
TD Securities — Analyst

Drew Levine
JP Morgan — Analyst

Pete Lukas
CJS Securities — Analyst

John Zamparo
CIBC — Analyst

Derek Dley
Canaccord — Analyst

Pavel Molchanov
Raymond James — Analyst

PRESENTATION

Operator

Good morning. My name is Michelle, and I will be your conference Operator today. At this time, I would like to welcome everyone to the Primo Water Corporation's Fourth Quarter 2022 Earnings Conference Call. All lines have been placed on mute to prevent any background noise.

After the speakers' remarks, there will be a question-and-answer session. If you would like to ask a question during this time, simply press *, then the number 1 on your telephone keypad. If you would like to withdraw your question, please press *, then the number 2.

I would now like to turn the call over to 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 fourth quarter 2022 earnings conference call. All participants are currently in listen-only mode.

This call will end no later than 11 a.m. Eastern Time. The call is being webcast live on Primo's website at primowatercorp.com. It 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 fourth quarter earnings announcement released earlier this morning, or on the Investor Relations section of the Company’s website at primowatercorp.com.

I am accompanied by Tom Harrington, Primo’s Chief Executive Officer; and David Hass, Primo’s Chief Financial Officer.

As part of this conference call, we have included a deck online at primowatercorp.com that was designed to assist you throughout our discussion.

Tom will start today’s call by providing a high-level review of full year 2022 and the fourth quarter and our progress on Primo’s strategic initiatives.

Then David will review our segment-level performance and will discuss our fourth quarter performance in greater detail and offer our outlook for the first quarter and full year 2023 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. In 2022, we delivered normalized FX neutral revenue growth of 16 percent; adjusted EBITDA growth of 11 percent; increased adjusted EBITDA margin by 70 basis points to 19 percent; sales of approximately 1 million water dispensers, the razor in our razor/razorblade model; and increased return of funds to shareholders through the higher dividend and the opportunistic share repurchase program partially funded by the sale of two properties in California.

I am pleased with the performance during the fourth quarter and for full year 2022 and want to thank all the Primo associates for their contributions to the Company's ongoing success. We remain confident in our ability to deliver our 2023 and 2024 outlook.

I welcome David Hass to his first earnings call as our recently appointed Chief Financial Officer. David has been a key member of the Primo team for several years, most recently as Chief Strategy Officer.

As the key architect of our corporate strategy, David has a deep understanding of our business segments. He has hit the ground running with our team of seasoned accounting, treasury, and finance professionals that are assisting him in the transition.

As part of this transition, our outgoing CFO, Jay Wells, will work with David to ensure a seamless transition. As I mentioned last quarter, I'd like to once again thank Jay for his dedicated service to Primo Water, and we wish him the best as he approaches his retirement.

Our growth outlook is on track with a portfolio of leading water solutions across multiple channels and geographies, strong consumer tailwinds in the aging global water infrastructure, as well as a compelling financial profile.

Continued investment in our digital platforms and increased connectivity of water dispensers to our water solutions provides a solid foundation to achieve our growth targets.

For the full year of 2022, excluding the impact of foreign exchange, normalized revenue increased 16 percent. Normalized revenue excludes the exited North American single use bottled water retail business and our exited business in Russia.

Adjusted EBITDA increased $40 million to $420 million, an increase of 11 percent.

Moving to the fourth quarter. We delivered the trifecta of strong revenue, adjusted EBITDA growth, and adjusted EBITDA margin expansion in the quarter.

Consolidated revenue increased 3 percent to $533 million, which included FX headwinds. Normalized revenue, excluding the impact of foreign exchange, grew by a healthy 14 percent driven by resilient consumer demand; increased dispenser sell-thru; solid volume growth in Water Direct and Exchange; strong revenue growth in Water Refill and Filtration; consistent growth of our premium water brand, Mountain Valley; execution of our M&A tuck-in acquisition strategy; and consistent customer retention.

Adjusted EBITDA in the fourth quarter increased 9 percent to $107 million supported by higher volume, increased pricing, and effective expense management that offset the impact of inflation.

Adjusted EBITDA margin for the quarter was up 110 basis points to 20.1 percent.

Although there is seasonality in our quarterly results, this was the second quarter in a row with an adjusted EBITDA margin equal to or greater than 20 percent. We are especially pleased with the adjusted EBITDA margin expansion in the face of record inflation.

We successfully offset the impact of labour, fuel, and freight and expanded the margin percentage; a job well done by the Primo team that positions us for continued success in 2023 and beyond.

We execute a razor and razorblade business strategy where the rental or sale of dispensers helps create high-margin recurring revenue generated from our water solutions. We saw an increase in the level of sell-thru in our water dispenser business to approximately 280,000 units in the quarter and approximately 1 million units in 2022. These dispenser sales drove connectivity to our water solutions.

Water dispenser sell-thru represents the units sold by brick-and-mortar and E-commerce retailers to the end consumer. Sell-thru volume in the quarter was 50 percent higher than Q4 of 2021. Our Black Friday promotions exceeded our and our retail partners' expectations.

Although higher retail prices reflected the impact of the tariff, consumers continued to purchase dispensers as part of their health and wellness journey. The sell-thru units are a leading indicator of the future organic growth of our water solutions.

The sell-in, or what we sold directly to retailers for Q4 was negatively impacted by retailers' efforts to rightsize their inventories that were increased during 2022 supply chain challenges. We expect the rightsizing of retail inventory to extend into 2023 and result in lower dispenser revenue for Primo, as it did in Q4.

However, it has little to no impact on water dispenser sell-thru, recurring revenue in our water businesses, nor our adjusted EBITDA.

Our Water Direct and Exchange business continued to experience strong top-line momentum during the quarter with 13 percent revenue growth through pricing actions, volume growth, and improved customer satisfaction enabled by increased delivery frequencies. Customer retention, importantly, remained consistent with prior quarters.

We were awarded a five-year contract to be Costco's exclusive service provider for large format bottled water delivery services direct to Costco consumers and business members. In 2023, we will increase the number and frequency of in-store activities at Costco stores.

The increased customer growth from these events will ramp up through the year as we build out the program across more and more of the US.

Our Water Refill and Filtration business continued to accelerate its growth with an increase in revenue of 14 percent in the quarter as a result of price increases on outdoor machines, improved machine uptime, and improved service levels in water filtration.

Our Water Refill business is one of our water platforms where consumers who've purchased a water dispenser connect to one of our water services.

Regarding price elasticity, customer trends remained consistent with prior quarters. 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.

From a digital perspective, we continue to see positive responses from the update of our mobile app, My Water+, and its ease of use for our customers. Our digital focus in 2023 is centred on new water customer acquisitions through costcowater.com as one example, water dispenser sales, and connectivity to our water solutions.

We continue to invest in best-in-class digital solutions for customers. We are redesigning our website, water.com, through a combination of internal and external resources to further enhance the effectiveness of this site. These marketing investments are helping us build a larger base of long-term, high-value customers.

During 2022, we faced significant cost inflation across labour, fuel, and freight, as well as other input costs which totalled approximately $74 million. As I mentioned earlier, we fully offset these headwinds through our pricing and efficiency actions during the year and increased our adjusted EBITDA margin percentage.

The Primo team has done an outstanding job offsetting these increases while continuing to improve the customer experience.

The Automated Route Optimization tool, ARO, in North America continues to yield efficiencies. The tool sequences routes for the most efficient path possible, which maximizes the time route sales representatives spend with customers, unlocks route capacity to handle future organic growth, and minimizes fuel consumption.

As volumes increased through the year, we added routes at a more efficient level, a 13 percent improvement in productivity when comparing 2022 to pre-pandemic 2019 and a record all-time high efficiency. ARO remains a key operating initiative.

Our 2022 revenue per stop in North America increased nearly 24 percent compared to last year. Our ARO tool has helped us offset cost increases while improving the customer experience and enabling us to increase delivery frequency in support of our efforts to grow our Water Exchange business.

During 2022, we made meaningful improvements in our ESG story. We're implementing the reporting systems that provide investment-grade reporting detailing our progress on our journey to ESG leadership. We will be updating our sustainability reports for 2021 and 2022 by midyear.

Our upcoming report will highlight improvements in data reporting and our reduction efforts, which have resulted in carbon emissions reductions of nearly 20 percent.

We source our water from a combination of municipal on-site well and spring sources across our footprint. Of the 81 sources we use, 37 percent are company owned. Our approach to sourcing enables us to ensure adequate supply and to meet varying consumer water preferences.

From a governance perspective, in identifying new candidates our board will consider the mix of director characteristics and diverse experiences, perspectives, and skills appropriate for the Company. Over the course of the past five years, we've refreshed our board with five new directors.

As we shared last month at the ICR Conference, for the full year 2023, we expect revenue to increase to between $2.3 billion and $2.35 billion, with normalized revenue growth in the range of 6 percent to 8 percent. We expect full year 2023 adjusted EBITDA to be between $450 million and $470 million.

Both of these financial guidance items exclude any material tuck-ins we might complete throughout 2023.

For the first quarter of 2023, we expect revenue between $520 million and $540 million and adjusted EBITDA of between $90 million and $95 million.

Finally, I will reiterate that our strategy is working. We are confident in our ability to deliver our 2023 guidance, as well as our longer-term outlook.

I will now turn the call over to our CFO, David Hass, to review our fourth quarter financial results in greater detail.

David?

David Hass — Chief Financial Officer, Primo Water Corporation

Thank you, Tom, and good morning, everyone. Before reflecting on the results of the quarter, I wanted to begin by expressing my excitement to lead great teams across accounting, treasury, finance, and strategy.

I have been involved in the Primo business since 2009 preparing for legacy Primo's initial public offering and have worked with Tom since 2013 when we began to work on a production and distribution agreement.

Over the past decade plus, the execution of our strategy grew dispenser sell-thru from approximately 240,000 units to approximately 1 million in 2022. The increase in household and small business penetration with our dispensers has created a business with forecasted highly recurring revenue in excess of $2.3 billion, supplying close to 1 billion gallons annually for consumers.

Even with this impressive growth, we believe we have just begun to realize the vision and potential of the Primo business.

Starting with our fourth quarter results, consolidated revenue increased 3 percent to $533 million compared to $518 million. Excluding the impact of foreign exchange, normalized revenue increased 14 percent for the quarter.

As Tom mentioned earlier, normalized revenue excludes the revenue of the exited North American single use bottled water retail business and the exit of our business in Russia.

Reported revenue for the year 2021 includes $142.1 million of revenue associated with our single use business and $13.6 million of revenue associated with our Russia business.

Reported revenue for the year 2022 includes $41 million of revenue associated with our single use business and $7.4 million of revenue associated with our Russia business.

Adjusted EBITDA grew 9 percent to $107 million, which represents a 110 basis point of margin expansion. Excluding the impact of foreign exchange, adjusted EBITDA grew 12 percent. The effect of price increases, volume growth, and strong demand increased profitability.

During the quarter, we maintained targeted staffing levels and have more than 98 percent of route delivery positions filled. We are confident that the incremental investments in our people and the use of predictive staffing models will enable us to deliver our 2023 targets and beyond.

Turning to our segment-level performance for the quarter. North America revenue increased 5 percent to $405 million compared to $387 million. Excluding the impact of foreign exchange, normalized revenue increased 14 percent.

Organic revenue grew by 16 percent in Water Direct and Water Exchange, which included 11 percent price or mix and 5 percent volume growth, continuing a pattern of consistent price and volume growth throughout the year. Adjusted EBITDA in North America increased 13 percent to $96 million.

In our Europe segment, revenue decreased by 1 percent to $60 million. Excluding the impact of foreign exchange, normalized revenue increased 20 percent, with growth in our residential customer base and B2B volume as Europeans return to the office.

Adjusted EBITDA in the Europe segment increased 33 percent to $10 million. Excluding the impact of foreign exchange, adjusted EBITDA increased 53 percent.

Our 2022 results of $2.215 billion in revenue, $420 million of adjusted EBITDA, and 70 basis points of adjusted EBITDA margin enhancement confirm our strategy is working, and we are on track to deliver our 2023 and long-term outlook.

Turning to our Q1 and full year outlook. We expect consolidated revenue from continuing operations for the first quarter to be between $520 million and $540 million and that our first quarter adjusted EBITDA will be in the range of $90 million to $95 million.

As a reminder, our Q1 is typically seasonally softer, with lower volumes and adjusted EBITDA margin as part of the shoulder seasons in water demand.

For the full year 2023, revenue is projected to be between $2.3 billion and $2.35 billion, with normalized revenue growth in the range of 6 percent to 8 percent. We expect full year 2023 adjusted EBITDA to be between $450 million and $470 million.

We expect $20 million to $25 million of cash taxes, which is higher than historical run rates due to the utilization of net operating losses, or NOLs, related to the tax impact of the property sales in California and the increased earning power of our Water Your Way platform.

In addition, we are limited to the amount of NOLs we can use each year, but we have substantial NOLs available in 2023 and 2024 before the amounts start to significantly decline in 2025. If we were to sell a similar amount of properties in 2023 as compared to 2022, we could see an additional tax impact of approximately $10 million.

We expect approximately $70 million to $75 million of interest expense. The amount of interest expense paid could be lower dependent on our capital allocation and potential reduction in our revolver.

Our 2023 CapEx guidance consists of 7 percent of revenue, plus an incremental $30 million for a total of approximately $200 million.

As a reminder, we decided that during 2023 and 2024 we will invest approximately $30 million per year as opposed to the $50 million noted in our November 2021 Investor Day. This decision is based upon our confidence and run-rate performance that enables us to reduce the investment dollars and deliver the 2023 and 2024 outlook.

Key initiatives to be funded from our CapEx plans include driving digital growth; leading dispenser innovation; building a more environmentally friendly fleet; installing more efficient water production lines, which will reduce water usage and increase productivity; and driving growth in Refill and Filtration with our on-the-go units and new filtration innovations.

We expect to return to our normalized total CapEx spend of approximately 7 percent of revenue in 2025.

Our 2022 performance reinforces our confidence in our ability to deliver sustained organic revenue growth. Supporting the organic growth outlook are recent gains in new points of distribution in our Exchange business, geographic expansion of Costco in-store events resulting in an increase in the number of events in North America in 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 continuing investments in the digital experience, customer satisfaction, and operating efficiencies.

As we mentioned in Q3, we continue to explore opportunities to monetize properties that have seen significant appreciation in value, and we are in the process of marketing additional properties this year.

We were able to close on two properties during the fourth quarter for an aggregate total of approximately $50 million. We plan to use the net proceeds of these property sales to fund components of our capital allocation plan, including, among other things, debt reduction and our opportunistic share repurchase program.

As part of the opportunistic share repurchase program, during 2022 we repurchased approximately $24 million and as of February 20th, approximately $6 million year to date. 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 value for our shareholders,

We remain focused on reducing our net leverage ratio to below 3 times by the end of 2023 and to less than 2.5 times by the end of 2024.

As a reminder, our current debt maturities are in 2028 and 2029, and we therefore have no reason or benefit to refinance any of our debt at this time and are pleased with our current debt structure.

Our 2024 outlook supports our planned multiyear dividend step-up that will return an incremental $36 million to shareholders through 2024. This is on top of our previously announced plans for incremental investment to fuel top-line and bottom-line growth.

Regarding our tuck-in M&A, for 2023, we expect to invest $20 million to $30 million as we focus on our organic growth, as well as take a patient approach due to macroeconomic factors that might weigh more on smaller operators.

In recognition of our 2022 results, strong financial position, and confidence in the future of Primo, yesterday our Board of Directors authorized a quarterly dividend of $0.08 per common share, which represents a 14 percent increase over previous quarterly dividends and marks the second consecutive year the board has increased the quarterly dividend.

I'm excited for the opportunities that we have in front of us. I believe we have the right plans and the right team to win. Our customers, associates, and shareholders can all share in our success as consumers migrate toward healthy hydration solutions.

I will now turn the call back to Tom.

Tom Harrington

Thanks, David. We are pleased with last year's results and are excited about our future.

We are one of the only pure-play water platforms and benefit from a predictable and resilient revenue base, well balanced with the residential and B2B customer base.

Our high single-digit, long-term growth targets are driven by the connectivity of water dispensers to our water solutions with supporting consumer tailwinds to include focus on health and wellness and concerns with aging global water infrastructure.

We have a healthy balance sheet, a compelling long-term growth outlook, and attractive margin profile that has risen to more than 20 percent in the last two quarters.

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 for Q&A.

Jon Kathol

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, sir. Ladies and gentlemen, we will now begin the question-and-answer session. If you would like to ask a question, please press *, followed by the number 1 on your telephone keypad.

If your question has been answered and you would like to withdraw from the queue, please press *, followed by the number 2.

If you are using a speakerphone, please lift the handset before pressing any keys.

One moment, please, for your first question.

Your first question will come from Derek Lessard at TD Securities. Please go ahead.

Derek Lessard — TD Securities

Yeah. Good morning, everybody, and congratulations on a really solid year.

Tom Harrington

Thanks, Derek. Appreciate it.

Derek Lessard

Maybe, guys, just coming back to the dispenser sales for a second. I was curious how much visibility you have on that line item in particular and should we be modelling going forward similar to what we saw in Q4 levels? And then, I guess, is there any tie-in between the sell-in and sell-thru?

Tom Harrington

Yeah. I'll take the second part of your question first, Derek, then—obviously this is— maybe not obviously, this is Tom. The key performance number we look at is the dispenser sell-through, and that is how many dispensers that are purchased by consumers through our brick-and-mortar and/or E-commerce customers. And this year in 2022, we sold just about 1 million, which is the second-best year that we've ever had. And we had a 50 percent increase in Q4.

What's important is that's a sign of new customers coming to the category that will convert into water users and they could enjoy the water from either Water Direct and Exchange; they can enjoy it from Water Refill. So we're quite pleased with that sell-thru, and that will continue to feed the ongoing water growth in our Water segments.

Our challenge in Q4, and as I said in my prepared comments we expect some inventory challenges through 2023, is really the amount of inventory that retailers purchased during 2022 as a result of all the supply chain issues, whether it's all the delays in the port, the elevated cost, and retailers we experienced beginning to bring those inventories down during Q4.

The sell-in is interesting, but it has no impact really on our Water performance, on the connectivity, and is really unrelated to the sell-thru. So as those inventories normalize through 2023, we would expect that it'll have soft revenues for us in dispensers but, importantly, we expect to continue to see elevated levels of dispenser sell-thru. And that's one of the key drivers of our growth algorithm.

Obviously, we also have a rental business in our water dispenser side, so that business is unimpacted by that inventory, and you see it in the solid growth in our Water Direct business.

Derek Lessard

Okay. That's helpful. And maybe, there's been a big difference between your North American and European margin. Could you just maybe remind us how much of that is structural? And maybe what's a reasonable expectation for closing that gap? And over what period do you think you could do that?

Tom Harrington

Yeah. We began to close the gap in 2022, and we enjoyed good numbers from Europe in '22, particularly in Q4 where we had adjusted for FX something on the order of 50 percent increase in adjusted EBITDA. With FX it was 33 percent and 20 percent revenue growth. So we're pretty happy where the business is.

Here's the good news is we haven't yet gotten back to pre-pandemic levels. So we view it as continued upside and growth on a go-forward as Europeans continue to return to work. So we expect in the next—I haven't put out a guide of that—but we'd expect to get back to pre-pandemic level over the course of the next year or two, all things considered equal at this point.

So we're quite pleased with the progress we made there and we see it getting back to pre-pandemic levels, which will mirror, ultimately, the margin construct of the North American business.

Derek Lessard

Okay. That's fair. And maybe one for David. Congratulations on the new role. Curious just maybe about your high-level thoughts and expectations as you begin a new journey.

David Hass

Yeah. Thanks, Derek. I think mostly I've been around the business for a while. So when you look at either my time in banking, or actually as an employee of either of the companies, now new Primo, it's been about a third of my life. And I've been very dedicated to seeing and overseeing the strategic architecture. So for me, it's a short learning curve around who we are.

Even to that degree when I was at Legacy Primo, Tom and I had a very close business relationship and I understood the merits of the Water Direct opportunity. So now having all three of those services, plus the attractive nature of filtration and different geographies is even more complementary to the opportunity.

More importantly, a great team around me. Really excited to work with a lot of these partners for a bit. And really, the approach we have, as Tom and I will be out there, is consistently telling our story. We want people to understand that new Primo does not look like either of its predecessors and we're here to shape water connectivity to our dispensers and really change the way consumers can hydrate.

Derek Lessard

Thanks for that, gentlemen, and congrats again.

Tom Harrington

Thanks, Derek. Appreciate it.

Operator

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

Drew Levine — JP Morgan

Hey. Good morning, guys. This is Drew Levine on for Andrea. Thank you for taking our questions. And, David—

Tom Harrington

Hello, Drew.

Drew Levine

—congratulations on your new role. Hey. How you doing? So—

Tom Harrington

Good morning.

Drew Levine

—first, I want—morning. So I wanted to kind of follow back on the dispenser discussion. So clearly a shortfall in the quarter and you're suggesting some more pressure in '23 perhaps, but reiterated the top line and EBITDA guidance for '23. So just curious maybe where you're feeling more bullish on the underlying Water business and perhaps if that should lead to extra EBITDA growth, being that those are obviously EBITDA-positive businesses?

Tom Harrington

Yeah. If you look—thanks, Drew. Of course, dispenser sell-thru we expect to continue. Right? So that is the key component of the razor. Our razorblades have performed quite nicely. Our Q4 performance in Water Direct is up 14 percent in revenue in North America and 20 percent growth in Europe. So clearly there a good performance growing the revenue.

And in North America, it is a combination of price and volume. So North America volume was up 5 percent organic volume growth, which is a continuation of both price and the elasticity of our business and the volume growth, which says that more customers consuming more water both from customers we sign up as a result of dispenser sell-thru, but also from the benefit of programs like Costco and other tactics we execute on growing the Water Direct customer base.

So we're confident in our ability to continue to drive revenue and volume growth in that part of our business.

And now you've seen also in our Refill and Filtration business solid performance in Q4. That's a couple of quarters of consecutive growth, so we think we're in a good place there. And we would expect to continue to see growth in that segment of our business.

So the model works. Our in-market tactics are working, and they're driving the revenue growth that we expect that's embedded in our growth algorithm for 2023, which is in the range of 6 percent to 8 percent. And obviously, that would contemplate some softness in dispensers.

Drew Levine

Perfect. Thanks for that. And just following up on customer additions, so it sounds like you're continuing to add customers, the retention consistent. I guess following the quarter and any change that you're seeing year to date in consumer sign up, are you having to kind of increase any promotional activity or introductory pricing to gain sign ups? Or how do you see that progressing through the year? Thank you.

Tom Harrington

Yeah. Thanks, Drew. So as we mentioned before, we signed that five-year agreement with Costco, which gives us the ability exclusively to market our services to Costco consumer and business members. We're building that program as we speak.

It will accelerate as we go through the year. It's a key component of the Water Direct growth because it will bring more customers into the Primo family. It'll build quarter over quarter. Right? You don't start everything the first day of January. We build that capability. And we're quite pleased with where we've started.

We're also seeing good performance on our digital activities on our water.com and other sites. So we're off to a good start within where we expected to be in the middle of February in terms of the growth story in terms of revenue and volume from the Water Direct side and same with our Refill business. So we're quite pleased with our start.

Operator

Your next question will come from Dan Moore at CJS Securities. Please go ahead.

Pete Lukas — CJS Securities

Hi. Good morning. It's Pete Lukas for Dan. Just in terms of the resi side, obviously, you had a big spike during the pandemic. Just curious what you're seeing in terms of consumer purchasing power and discretionary spending. Has that softened at all in recent months? And any trends you're seeing there.

Tom Harrington

Yeah. Good morning, Pete, and thanks for joining. Our residential performance is greater than pre-pandemic levels. Obviously, you may recall there was questions about what was the stickiness of the residential customer base as it grew through the pandemic? I'm happy to report it's sticky. There was not a trade from commercial to residential. And our residential business is higher than it was in 2019 pre-pandemic.

We benefit from commercial customers. For us, B2B in North America and real commercial office space in Europe still not all the way back to pre-pandemic, but we expect that we'll benefit from that return in our growth algorithm over the course of hopefully only '23, but '23 and 2024.

So very sticky, delivering what we wanted, better than it was pre-pandemic. So we're quite pleased in the mix of the customer base.

And on a count basis, think of our business—and I'll use North America—about 50–50 in terms of customer count; 50 percent residential, 50 percent B2B or commercial. And on our revenue side it's roughly 60 percent residential and 40 percent commercial, just to give you context.

So we're quite pleased with the current construct.

Pete Lukas

Very helpful. Thanks. And just one more for me. In terms of margin benefits that you expect to achieve if raw materials and input costs continue to pull back, just any sense of what we can expect there?

Tom Harrington

We enjoy not—it's about, what was it, $74 million of inflationary costs which, on a full year basis, roughly 10 percent increase. So big component of that is labour. So we don't expect labour to come back. Right? So that's one that will continue. Fuel will come back some. We do have an energy surcharge and it offsets the fuel. So the energy surcharge will go up and down with how fuel may come back down. Hopefully, it continues on its current trend and freight comes back.

Think about freight, though, a large component of the freight related to the dispenser business. So the dispenser business part CapEx, we would expect to see some mitigation in those costs over the course of the year. And our current view would incorporate some of that into our current guidance, both in the quarter and for the full year.

Pete Lukas

Very helpful. Thanks. I'll jump back in the queue.

Tom Harrington

Yeah. Thanks, Pete. Appreciate it.

Operator

Your next question will come from John Zamparo at CIBC. Please go ahead.

John Zamparo — CIBC

Thanks. Good morning, guys, and welcome, David.

David Hass

Thanks.

Tom Harrington

Good morning, John.

John Zamparo

Good morning. My question's on free cash flow generation and, in particular, working capital. And in pre-pandemic years this was generally neutral to positive for what Primo was. It's been a meaningful drag from 2020 now through to 2022.

So I wonder has something changed structurally here? And do you expect you'll need to keep investing in working capital in 2023?

Tom Harrington

Yeah, John. I'll take high level, and then I'll flip it over to David for perhaps a little bit more granular. I really view working capital as a 2022 phenomenon, largely driven by the supply chain challenges we faced.

So if you said on a high level, hopefully those supply chain issues anomaly, in my opinion, in 2022 don't repeat themselves. But the biggest changes in our working capital were related to decisions we made on working capital and as a result of that supply chain.

But let me flip it to David for some more colour.

David Hass

Yeah. So, John, on dispensers, whether imported for use in our rental float, or imported to then supply domestically to retailers, both of those would've been impacted negatively by the tariff percentage. So on a like-for-like basis, a single dispenser would've impacted working capital that much higher due to the tax, if you will, or call it a tariff of the percentage.

And so when we talk about sell-in versus sell-thru at least of the retail-oriented dispensers, both we and our retail partners increased inventory to support shortages, challenges, et cetera, that most of the supply chain faced. And so that would've been the largest contributor to the working capital change on a year-over-year basis.

Tom Harrington

So it's a combination of the tariff $0.25 on the dollar higher and the fact that we, eyes wide open, increased the inventory levels to meet growing consumer demand.

David Hass

Correct. And so on a like-for-like basis, if we bring in the same quantity of dispensers on any annualized level in '23, they will cost $0.25 on the dollar less.

John Zamparo

Got it. Okay. That's helpful. And then my follow-up is it's twofold. They're both housekeeping items. There was roughly $10 million worth of SG&A costs added back to EBITDA. Can you say what that consisted of? And secondly, can you confirm the plan for buybacks for 2023 is still roughly $75 million?

David Hass

Yes. So I'll start with the second one. Clearly, just to clarify, something to put in the supplemental, that would've been a year-to-date value and it is not a change in our repurchase program. So the residual value left of that repurchase program as it meets sort of thresholds and criteria will still be executed so that the monetary value mentioned would’ve only been the year-to-date value. It is not a change in prescribed sort of look at the program.

Tom Harrington

So our full year authorization was 100 million, which happens to be part ’22 and ’23. And through a week or so ago, we’ve so far repurchased about $30 million. Right? So we’re still authorized up to an incremental $70 million opportunistically.

David Hass

To the first part of your question, that would be a complete non-cash-related item. As we sold properties, we had some subleases related to that and that’s an accounting charge simply to a mark-to-market accounting. So they know what our rates are in the market and what our current relationship is with that subtenant. And so it’s just a non-cash charge, the majority of that value.

John Zamparo

Understood. That’s helpful. Thanks very much.

David Hass

Thank you.

Tom Harrington

Thanks, John. Appreciate it.

Operator

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

Derek Dley — Canaccord

Yeah. Hi. Good morning, everyone.

Tom Harrington

Morning, Derek.

Derek Dley

Okay. Just on your guidance for EBITDA for ’23 and ’24, for ’23 at the midpoint, you’ve got about a 9.5 percent increase in EBITDA year over year. And then to get to your medium-term target for 2024, that implies a 15 percent increase on top of that midpoint for ’23. So can you just walk us through how you expect to get there? And why you expect to see an acceleration in your EBITDA growth in ’24 versus ’23?

Tom Harrington

Well, we’re doing a couple things and we haven’t provided all the details, obviously, in 2024, but I’ll just share with you the way I think about it.

So our guidance for ’23 is $450 million to $470 million. We know we have now exited completely the retail business, so we’ll get the flow-through, full benefit of having exited that business. As we previously articulated, we’re making incremental capital investments and those capital investments are not all done and there’s future work to be done, which will help us improve operating efficiencies.

So as an example, we talk about in the script ARO. So it’s how do we use our Automated Route Optimization to improve route efficiency. We’re quite pleased with the first, call it, five months of benefit from ARO, but there’s more to come as a result of that one program as an example. Today it’s only in North America. It’s not in Europe. We would expect over time to introduce that to Europe.

Our first production line in that we talked about effectiveness and efficiency on a production line. So we’ve been operating our new line in LA about 10 days now and it is on the path to produce the kind of benefits that we thought.

So as you build to ’24, it is runway performance and two quarters of improved adjusted EBITDA margin in Q3 and Q4, right, where we got over that short-term magic of 20 percent; the full exit of retail; further investments on that incremental CapEx to drive efficiency and that could through things like ARO and production; and, of course, incremental revenue and the natural leverage that we get through our income statement as we continue to grow in that 6 percent to 8 percent range.

So it’s a combination of those things that give us confidence in ’23 and, frankly, in 2024.

Derek Dley

Okay. That’s helpful. And then just following up on something you’ve hinted at a couple times here, just your commercial business as it relates to pre-COVID levels. Sounds like you’re not fully back, but pretty confident you’ll get there in the next year or two.

Is there a major difference between North America and Europe where you’re at versus where you were pre-COVID? And can you give us some colour on what that sort of magnitude of difference is?

Tom Harrington

Yeah. North America is closer. Right? Part of that is the construct of the differences in our commercial business, Derek. So North America business is more B2B, so doctor’s office, dentist office, hair salon.

In the European business, it’s more larger commercial office. And the US, the North American business, is in the early 90 percent return-ish and European business would start with an 8, but making good recovery.

So we see a clear path where we will absolutely benefit from growth in both of those over the course of the next year or two. I can’t predict which quarter it’s going to happen in. But we see continued improvement on both sides of the Atlantic.

And hopefully, that gives you kind of order of magnitude of the difference between the two pieces.

Derek Dley

Yeah. That's great. Thank you very much.

Tom Harrington

Thanks, Derek. Appreciate it.

Operator

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

Pavel Molchanov — Raymond James

Thanks for taking the question. Maybe back on the European aspect, given the drop in the euro and the pound over the past year, you talked about the currency impact, is this actually creating a more target-rich environment for you as a potential consolidator of M&A assets in Europe?

Tom Harrington

Yeah. Pavel, good morning, and thanks for the question. Our M&A and what we have articulated, both at ICR and in our prepared comments, is we're going to be thoughtful and patient.

And part of that is we think inflation will have an impact on small operators over time. So frankly, we want to let that have its effect and we have a thick pipeline of opportunities and we continue to look for the right ones. But we're not rushing to execute those in today's environment and want to be really patient about the ones that we do execute in 2023.

Pavel Molchanov

Okay. Let me turn to the ESG roadmap. You talked about some of the initiatives you have in place. This is the first year with the commercial electric vehicle tax credits from the Inflation Reduction

Act. Are you starting to maybe look with more appetite on electric mobility for your truck fleets, at least in the US?

Tom Harrington

Yeah. The way we think about it is we certainly have a large appetite for it. We will focus on the lighter-weight assets first. So think about that, Pavel, as we have a large service fleet, which would be more like vans and, largely, both in the US and in Europe. So we are looking at how we might begin to shift from gas powered into EV for the smaller assets.

And we continue to look at larger assets to handle for the bigger beverage bodies, but we haven't found the right economic solution yet because the cost is still 3X what it would be for a for a propane-powered asset.

So we'll continue to look at propane for the bigger assets in the US and North America. We'll look to expand our exposure and use of not diesel or gas-powered assets for the smaller fleet. And we'll stay very diligent looking at our other assets as we hope the economics get to a place where we can wisely invest the shareholder's dollar in that equation.

Pavel Molchanov

Understood. Thanks very much.

Tom Harrington

Thanks, Pavel.

Operator

Ladies and gentlemen, once again if you would like to ask a question, please press *, 1 now.

Your next question will come from Derek Lessard at TD Securities. Please go ahead.

Derek Lessard

Yeah. Just one follow-up for me. I was curious if you guys ever see, and I know it's part of the longer-term tailwinds, but I was curious if you ever see bumps in sales on the back of news events like the train derailment and water contamination in Ohio?

Tom Harrington

Well, as I think about the aging water infrastructure, in recent weeks Flint has popped up again as an issue and Jackson, Mississippi has popped up again as an interest. We are in the process of getting some water into East Palestine, hopefully today or tomorrow, to support that community.

We see a little bit of a bounce, and we're working hard to re-deck some of our efforts to ensure that consumers know that we're a viable, both an emergency solution, but a long-term solution as they begin to make choices about their healthy hydration solution.

But it happens in small little blips. It's not a big event. Right? So we don't see a big burst, but we see it meaningfully in some of these smaller geographies.

Derek Lessard

Okay. Thanks for that, Tom.

Tom Harrington

Thanks, Derek.

Operator

There are no further questions on the phone lines, so I will turn the conference back to Jon Kathol for any closing remarks.

Jon Kathol

Thanks, Michelle. We’re excited to announce that Tom, David, and I will be attending the Raymond James conference in Orlando on March 6th and the Bank of America Consumer and Retail Conference in Miami on March 14th. We hope to see many of you there.

This concludes Primo’s fourth quarter results call. Thank you all for attending.

Operator

Ladies and gentlemen, this does conclude the conference call for this morning.

Thank you very much for your attendance and would you please disconnect your lines.