

Primo Water Corp
Form 10-K
March 15, 2012

UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549

FORM 10-K

(Mark One)

ANNUAL REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934

FOR THE FISCAL YEAR ENDED DECEMBER 31, 2011

OR

TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934

COMMISSION FILE NUMBER 001-34850

PRIMO WATER CORPORATION
(Exact name of registrant as specified in its charter)

Delaware 30-0278688
(State of incorporation) (I.R.S. Employer Identification No.)

104 Cambridge Plaza Drive, Winston-Salem, NC 27104
(Address of principal executive office) (Zip code)

(336) 331-4000
(Registrant's telephone number, including area code)

Securities Registered Pursuant to Section 12(b) of the Act:

Title of Each Class	Name of Each Exchange on Which Registered
\$0.001 Par Value Common Stock	The NASDAQ Stock Market LLC

Securities Registered Pursuant to Section 12(g) of the Act: NONE

Indicate by checkmark if the Registrant is a well-known seasoned issuer, as defined in Rule 405 of the Securities Act.
Yes No

Indicate by checkmark if the Registrant is not required to file reports pursuant to Section 13 or Section 15(d) of the Act. Yes No

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Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. Yes No

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (§232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). Yes No

Indicate by check mark if disclosure of delinquent filers pursuant to Item 405 of Regulation S-K is not contained herein, and will not be contained, to the best of registrant's knowledge, in definitive proxy or information statements incorporated by reference in Part III of this Form 10-K or any amendment to this Form 10-K.

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer or a smaller reporting company. See the definitions of "large accelerated filer," "accelerated filer" and "smaller reporting company" in Rule 12b-2 of the Exchange Act. (Check one):

Large accelerated filer Accelerated filer
Non-accelerated filer (Do not check if smaller reporting company) Smaller reporting company

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act). Yes No

The aggregate market value of voting and non-voting common equity held by non-affiliates of the registrant, as of June 30, 2011, was approximately \$282,933,575 based on the closing sales price of the common stock on such date as reported on the NASDAQ Global Market.

As of March 9, 2012, there were 23,727,138 shares of our Common Stock, par value \$0.001 per share, outstanding.

Documents Incorporated by Reference

Portions of the Proxy Statement for the Annual Meeting of Stockholders to be held on May 16, 2012 are incorporated by reference into Part III of this Form 10-K.

PRIMO WATER CORPORATION

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PART I

Cautionary Note Regarding Forward-Looking Statements

This document includes “forward-looking statements” within the meaning of the Private Securities Litigation Reform Act of 1995. Forward-looking statements include statements about our estimates, expectations, beliefs, intentions or strategies for the future, and the assumptions underlying such statements. We use the words “anticipates,” “believes,” “estimates,” “expects,” “intends,” “forecasts,” “may,” “will,” “should,” and similar expressions to identify our forward-looking statements. Forward-looking statements involve risks and uncertainties that could cause actual results to differ materially from historical experience or our present expectations. Factors that could cause these differences include, but are not limited to, the factors set forth under Part I, Item 1A - Risk Factors.

Caution should be taken not to place undue reliance on our forward-looking statements, which reflect the expectations of management only as of the time such statements are made. Except as required by law, we undertake no obligation to update publicly or revise any forward-looking statement, whether as a result of new information, future events or otherwise.

Item 1. Business

Company Background

Primo Water Corporation (together with its consolidated subsidiaries, “Primo”, “we”, “our,” “us”) is a rapidly growing provider of three- and five-gallon purified bottled water, self-serve filtered drinking water, water dispensers and carbonating beverage appliances sold through major retailers in the United States and Canada. We believe the market for purified water is growing due to evolving taste preferences, perceived health benefits and concerns regarding the quality of municipal tap water. Our products provide an environmentally friendly, economical, convenient and healthy solution for consuming purified and filtered water. We are a Delaware corporation that was founded in 2004 and is headquartered in Winston-Salem, North Carolina.

Our business is designed to generate recurring demand for our purified bottled water or self-serve filtered drinking water through the sale of innovative water dispensers. This business strategy is commonly referred to as “razor-razorblade” because the initial sale of a product creates a base of users who frequently purchase complementary consumable products. We believe dispenser owners consume an average of 35 multi-gallon bottles of water annually. Once our bottled water is consumed using a water dispenser, empty bottles are exchanged at our recycling center displays, which provide a recycling ticket that offers a discount toward the purchase of a new bottle of Primo purified water (exchange) or they are refilled at a self-serve filtered drinking water location (refill). Each of our multi-gallon water bottles can be sanitized and reused up to 40 times before being taken out of use, crushed and recycled, substantially reducing landfill waste compared to consumption of equivalent volumes of single-serve bottled water. As of December 31, 2011, our products and services were offered in each of the contiguous United States and in Canada at approximately 23,600 combined retail locations, including Lowe’s Home Improvement, Walmart, Kroger, Safeway, Albertsons, Winn Dixie, H-E-B Grocery and Walgreens.

We provide major retailers throughout the United States and Canada with single-vendor solutions for water bottle exchange and refill vending services, addressing a market demand that we believe was previously unmet. Our solutions are easy for retailers to implement, require minimal management supervision and store-based labor, and provide centralized billing and detailed performance reports. Our exchange solution offers retailers attractive financial margins and the ability to optimize typically unused retail space with our displays. Our refill solution provides filtered water through the installation and servicing of reverse osmosis water filtration systems in the back room of the retailer’s store location, which minimizes the usage of the customer’s retail space. The refill vending machine, which is

typically accompanied by a sales display containing empty reusable bottles, is located within the retailer customer's floor space. Additionally, due to the recurring nature of water consumption, retailers benefit from year-round customer traffic and highly predictable revenue.

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Business Segments

Our operations are managed along three reportable business segments consisting of Primo Water (“Water”), Primo Products (“Products”) and “Other.” See Item 7, Management’s Discussion and Analysis of Financial Condition and Results of Operations and “Note 11 – Segments” in the Notes to Consolidated Financial Statements in Item 8 herein.

Recent Developments

Canada Exchange Business

On March 8, 2011, we completed the acquisition of certain assets of Culligan of Canada Ltd., related to its bulk water exchange business (the “Canada Exchange Business”). The consideration paid for the Canada Exchange Business was approximately \$4.8 million, which consisted of a cash payment of approximately \$1.6 million, the issuance of 307,217 shares of our common stock and the assumption of certain specified liabilities. The Canada Exchange Business provides refill and delivery of water in 18-liter containers to commercial retailers in Canada for resale to consumers. The acquisition of the Canada Exchange Business expands our existing exchange service offering and provides us with an immediate network of regional operators and major retailers in Canada with approximately 780 retail locations. The Canada Exchange Business has been accounted for as a business combination in accordance with the acquisition method.

Omnifrio Single-Serve Beverage Business

On April 11, 2011, we completed the acquisition of certain intellectual property and other assets (the “Omnifrio Single-Serve Beverage Business”) from Omnifrio Beverage Company, LLC (“Omnifrio”) for total consideration of up to approximately \$14.1 million, consisting of: (i) a cash payment at closing of \$2.0 million; (ii) the issuance at closing of 501,080 shares of our common stock; (iii) a cash payment of \$2.0 million on the 15-month anniversary of the closing date (subject to our setoff rights in the asset purchase agreement); (iv) up to \$3.0 million in cash milestone payments; and (v) the assumption of certain specified liabilities relating to the Omnifrio Single-Serve Beverage Business. The Omnifrio Single-Serve Beverage Business has been accounted for as a business combination in accordance with the acquisition method. The milestone conditions have been renegotiated and we currently expect to make cash milestone payments of \$0.6 million and \$2.0 million during 2012 and 2013, respectively, and deferred purchase price payments of \$1.0 million and \$1.0 million during 2012 and 2013, respectively.

The Omnifrio Single-Serve Beverage Business primarily consists of technology related to single-serve cold carbonated beverage appliances and consumable flavor cups and CO2 cylinders used with the appliances to make a variety of cold beverages. The acquisition of the Omnifrio Single-Serve Beverage Business serves as an entry point into the U.S. market for carbonated beverages and the rapidly growing self-carbonating appliance and single-serve beverage segments.

Secondary Public Offering

On June 22, 2011, we and certain of our stockholders completed a secondary public offering of a total of 6.9 million shares of our common stock, consisting of 3.8 million shares sold by us and 3.1 million shares sold by certain selling stockholders (including Culligan International Company), at a public offering price of \$11.26 per share. The net proceeds of the secondary public offering to us after deducting underwriting discounts and commissions and offering expenses were approximately \$39.4 million. We used \$29.4 million of the net proceeds received by us from the secondary public offering to repay all outstanding borrowings under our revolving credit facility. We have used the remaining proceeds received by us for working capital and general corporate purposes, including establishing new store locations for our water bottle exchange and refill vending services and the launch of the Flavorstation business.

We did not receive any proceeds from the sale of shares by the selling stockholders.

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Launch of Primo Flavorstation® Business

In the fourth quarter of 2011, we launched our home carbonating beverage appliance and consumables business in the United States with the introduction of our Flavorstation 100, a manually operated single-serve carbonating beverage appliance. The launch of our home carbonating beverage appliance and consumables business is the result of our own internal development efforts, technology acquired in our acquisition of the Omnifrio Single-Serve Beverage Business and our strategic partnership with Sparkling Drink Systems – Innovation Center (“SDS”), which was announced on November 29, 2011.

SDS is an international marketing and manufacturing company specializing in home beverage carbonation products. The strategic partnership will include collaborative research and development, marketing and manufacturing and joint distribution of the parties' respective home beverage carbonation products and related accessories. Those products include 40 appliances utilizing five different beverage technologies. SDS has its own manufacturing facilities in China and holds multiple international technology patents. The strategic alliance includes cross-distribution and licensing agreements pursuant to which our products will be distributed outside of North America in certain mutually agreed territories exclusively by SDS and certain SDS products will be distributed in North America exclusively by Primo Water.

We believe the at-home carbonation market offers a highly differentiated and innovative solution to reach consumers of the sparkling water and carbonated soft drink industry. We believe there is a significant opportunity to become an alternative in the very large global carbonated beverage category where products are typically packaged to consume and dispose of after use. We are initially launching our home carbonating beverage appliance and consumables business in the United States, the world's leading country with respect to per capita off-premise carbonated soft drink consumption and we have plans for future expansion outside of the United States.

According to Datamonitor, the global soft drinks market generated total revenues of \$503.7 billion in 2010, of which carbonated drinks represented the largest category, generating 40.6% of the market's overall revenues. The United States led all global markets with soft drink total revenues of \$124.7 billion in 2010 of which carbonated drinks represented the largest category, generating 49.2% of the market's overall revenues.

We believe the home beverage carbonation market provides compelling and complementary consumer benefits to our existing purified water business and we aim to use our existing retailer relationships to promote our Flavorstation business. Our carbonation products are cost-effective and environmentally friendly, promote health and wellness and are customizable and fun to use. In addition, our products offer convenience by eliminating the need to carry beverage bottles home from retail stores, to store beverage bottles at home or regularly dispose of “flat” carbonated beverages or empty containers.

Through our strategic partnership with SDS and our other suppliers, we develop, manufacture and sell home carbonating appliances and exchangeable carbon-dioxide (“CO₂”) cylinders, as well as consumables consisting of CO₂ refills, reusable carbonating bottles and flavor concentrate to add to the carbonated water. In 2011, we started selling our products through a major home improvement retailer in the United States. We currently distribute our products directly in the United States under the Primo Flavorstation® brand name.

Our home carbonating beverage appliance and consumables business extends our “razor-razorblade” business strategy into the rapidly growing at-home carbonation market. This strategy is designed to generate recurring sales of higher-margin consumables consisting of CO₂ cylinders, carbonation bottles and flavors (the “razorblades”) through the sales of carbonating appliances (the “razors”). A more detailed description of each of our products appears below:

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Carbonating appliances. Our carbonating appliances are free-standing, countertop-based and lightweight and have stylish design aesthetics. Certain of our appliances will utilize SDS's proprietary Freedom Sparkling System and Freedom Sparkling Turbo System technologies, which will allow consumers to customize the carbonation intensity of their drinks as well as generate much greater utilization of their CO2 cylinders. The majority of our appliances will have "Fast Mounting" technology which allows consumers to quickly and securely attach the CO2 cylinder without multiple threading rotations. In addition, our carbonating bottles attach quickly and securely utilizing a bayonet attachment. Consumers initially purchase a "starter kit" consisting of a carbonating appliance, carbonating bottle(s) and, with certain kits, samples of flavor concentrate. The starter kit also includes an exchangeable CO2 cylinder which provides the gas to carbonate beverages as well as allows the consumer to exchange the empty cylinder for a discount on their next CO2 cylinder purchase. The Flavorstation 100 is our first-generation model which we began selling during 2011 and the Flavorstation 500 is our automated, electrical model that uses flavor cups that we expect to begin selling during 2012.

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- **CO2 Refills.** We provide beverage-grade CO2 refills through authorized retailers as well as our own e-commerce site (www.store.primowater.com). When consumers have exhausted their cylinders they typically exchange their empty cylinder at our retail customers and receive a discount toward the purchase of a new full cylinder. Empty cylinders are collected, transported to a centralized facility where they are inspected, cleaned and refilled for distribution.
- **Flavor Concentrate.** We currently offer 16 Sparkling Beverage Mixes and have over 120 flavor concentrate mixes in development with our flavor partner. Our current flavors consist of popular U.S. carbonated sodas (including cola, lemon-lime and root beer) and are generally available in regular and diet formulations. Additionally, we have developed a line of Fruit Sparklers that includes flavors such as Berry Pomegranate, Peach Tea, Orange Tangerine and Apple Pear that provide differentiation from traditional carbonated soft drinks. We also have regular and diet energy formulations that provide consumers significant savings when compared to leading branded energy drinks. Each of our flavor concentrates yields the equivalent of 24 – 12 fluid ounce cans or a “case” of soda when prepared as instructed. As part of our promotion of health and wellness, carbonated beverages flavored with our concentrates typically have about half of the calories of branded soft drinks. We do not use high-fructose corn syrup and we currently use all “natural flavors” in all of our concentrates.
- **Carbonating Bottles.** We currently offer a variety of carbonating bottles including 0.5 liter, 1.0 liter, 1.5 liters and 2.0 liters that work exclusively with our carbonating appliances. Our carbonating bottles utilize a bayonet mounting method which provides quick, secure mounting to our carbonating appliances and provides a convenient attachment method compared to other at-home carbonating appliances. In addition to the bottle(s) that come with our appliance starter kits, many consumers purchase additional carbonating bottles in order to produce multiple carbonated beverages. All of our carbonating bottles come with sealing silicon bottle caps which help maintain the level of carbonation.

Industry Overview

We believe there are several trends that support consumer demand for our water bottle exchange service, refill vending services and water dispensers including the following:

Emphasis on Health and Wellness. As part of a desire to live a healthier lifestyle, we believe consumers are increasingly focused on drinking greater quantities of water.

Concerns Regarding Quality of Municipal Tap Water. Many consumers purchase bottled water because of concerns regarding municipal tap water quality. Municipal water is typically surface water that is treated centrally and pumped to homes, which can allow chemical contaminants to dissolve into the water through municipal or household pipes impacting taste and quality and present microbiological contaminants from cracks in municipal pipes.

Growing Preference for Purified Water. We believe consumer preference toward purified water relative to tap water continues to grow as purified water has become accepted on a mainstream basis. While it is difficult to quantify purified water consumption in all of its forms, according to an April 2010 report by independent market analyst Datamonitor, Bottled Water in the United States, the U.S. bottled water market generated revenues of \$17.1 billion in 2009.

Increasing Demand for Products with Lower Environmental Impact. We believe that consumers are increasingly favoring products with a lower environmental impact with a “reuse, recycle, reduce” mindset becoming a common driver of consumer behavior. Most single-serve polyethylene terephthalate (“PET”) water bottles are produced using fossil fuels and contribute to landfill waste given that only 28% of PET bottles are recycled according to a November 2010 Environmental Protection Agency report. Governmental legislation also reflects these concerns with the passage

of “bottle bills” in many jurisdictions that tax the purchase of plastic water bottles, require deposits with the purchase of certain plastic bottles, prohibit the use of government funds to purchase plastic water bottles and ban certain plastic bottles from landfills.

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Availability of an Economical Water Bottle Exchange Service, Refill Vending Service and Innovative Water Dispensers. Based on estimates derived from industry data, we believe the current household penetration rate of multi-gallon water dispensers is approximately 5% in the United States, with the vast majority of these households utilizing traditional home delivery services. We believe the lack of innovation, design enhancement and functionality and the retail pricing structure of our competitors' dispenser models have prevented greater household adoption. Compounding these issues, we believe there previously was no economical water bottle exchange and refill vending service with major retailer relationships throughout the United States and Canada to promote dispenser usage beyond the traditional home delivery model. We believe our water bottle exchange and refill vending services provide this alternative and we believe we are currently the only provider delivering a solution to retailers throughout United States and Canada. We believe there are over 200,000 major retail locations throughout the United States and Canada that we can target to sell our dispensers or offer our water bottle exchange service and refill vending services.

Our Competitive Strengths

We believe that Primo's competitive strengths include the following:

Appeal to Consumer Preferences

- **Environmental Awareness.** Both our water bottle exchange and refill vending services incorporate the reuse of existing bottles, recycle water bottles when their lifecycle is complete and reduce landfill waste and fossil fuel usage compared to alternative methods of bottled water consumption.
- **Value.** We provide consumers the opportunity for cost savings when consuming our bottled water compared to both single-serve bottled water and typical home and office delivery services. Our water dispensers are sold at attractive retail prices in order to enhance consumer awareness and adoption of our water bottle exchange and refill vending services, increase household penetration and drive sales of our purified and filtered water.
- **Convenience.** Our water bottle exchange and refill vending services and water dispensers are available at major retail locations in the United States and Canada. In addition, our water bottle exchange and refill vending services provide consumers the convenience of either exchanging empty bottles and purchasing full bottles or refilling the empty bottles at any participating retailer.
- **Taste.** We have dedicated significant time and effort to develop our water purification process and formulate the proprietary blend of mineral ingredients included in our Primo purified water offered through our water bottle exchange service. We believe that Primo purified water has a silky smooth taste profile.
- **Health and Wellness.** As part of a desire to live a healthier lifestyle, we believe that consumers are increasingly focused on drinking more water relative to consumption of other beverages. As we raise our brand awareness, we believe consumers will recognize that our water bottle exchange and refill vending services are an effective option for their water consumption needs.

Key Retail Relationships Served by a Single-Vendor Solution. We believe we are the only provider of water bottle exchange and refill vending services with a single-vendor solution for retailers in the United States and Canada. Our direct sales force actively pursues headquarters-based retail relationships to better serve our retail customers and to minimize layers of approval and decision-making with regard to the addition of new retail locations. Our bottling and distribution network utilizes our MIS tools and processes to optimize their production and distribution assets while servicing our retail customers. We believe the combination of our major retail relationships, unique single-vendor solution for retail customers, bottling and distribution network and our MIS tools is difficult to replicate. We anticipate these factors will facilitate our introduction of new purified water-related products in the future.

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Ability to Attract and Retain Consumers. We offer “razor-razorblade” products designed to generate recurring demand for Primo water (the razorblade) through the initial sale of our innovative water dispensers (the razor), which include a coupon for a free three- or five-gallon bottle of Primo purified water. We acquire new consumers and enhance recycling efforts by accepting most dispenser-compatible water bottles in exchange for a recycle ticket discount toward the purchase of a full bottle of Primo purified water. In addition, we believe our offering high-quality water dispensers enhances consumer awareness and adoption of our water bottle exchange and refill vending services, increases household penetration and drives sales of our water.

Efficient Business Model. Our business model allows us to efficiently offer our solutions to our retail partners and centrally manage our bottling and distribution network without a substantial capital investment. We believe our business processes and MIS tools enable us to manage the bottling and distribution of our water, servicing of our refill locations, our product quality, retailer inventory levels and the return of used bottles on a centralized basis, leveraging our invested capital and personnel.

Benefit from Management’s Proven Track Record. We benefit greatly from management experience gained over the last 15 years in exchange businesses to implement and refine best practices and develop and maintain key business relationships. In addition to our Chief Executive Officer, our Chief Financial Officer, Senior Vice President of Operations and General Manager - Dispensers all held comparable positions within the Blue Rhino organization during its rapid sales and location growth.

Growth Strategy

We seek to increase our market share and drive further growth in our business by pursuing the following strategies:

Increase Penetration with Existing Retail Relationships and Develop New Retail Relationships. We believe we have significant opportunities to increase store penetration with our existing retail relationships. As of December 31, 2011, our water bottle exchange and refill vending services were offered at approximately a combined 11,600 of our top ten retailers’ locations. Such retailers present us an opportunity of approximately 28,800 additional water bottle exchange or refill vending locations. There is minimal overlap where our water bottle exchange and refill vending services are offered. We intend to further penetrate our other existing retail customers with our supplementary hydration solutions which collectively provide us the opportunity to be present in more than 50,000 additional water bottle exchange or refill vending locations.

Our long-term strategy includes increasing our locations to 50,000 to 60,000 retail store locations (which includes new locations with our existing retail customers) within our primary retail categories of home centers, hardware stores, mass merchants, membership warehouses, grocery stores, office supply stores, drug stores and discount general merchandise stores for our water bottle exchange or refill vending services. We believe that the introduction of additional hydration solutions to our product portfolio will allow us to cross-sell products to our existing and newly-acquired retail customers.

Drive Consumer Adoption Through Innovative Water Dispenser Models. We intend to continue to develop and sell innovative water dispensers at attractive retail prices, which we believe is critical to increasing consumer awareness and driving consumer adoption of our water services. We believe the current household penetration rate of multi-gallon water dispensers is approximately 5% in the United States. Our long term strategy is to provide multiple purified water-based-beverages from a single Primo water dispenser, which we believe will lead to greater household penetration, with consistent promotion of our water bottle exchange and refill vending services to supply the purified water. In addition, the acquisition of the Omnifrio Single-Serve Beverage Business will enhance our ability to add innovative beverage and hydration solutions to our line of water dispensers. At December 31, 2011, we offered our water dispensers at approximately 6,900 locations in the United States, including Walmart, Target, Kmart, Sam’s Club,

Costco, and Lowes Home Improvement.

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Increase Same Store Sales. We sell our water dispensers at minimal margin and provide a coupon for a free three- or five-gallon bottle of water with the sale of various water dispensers at certain retailers to drive consumer demand for our water bottle exchange and refill vending services. We believe increasing unit sales of Primo water is dependent on generating greater consumer awareness of the environmentally friendly and economical aspects of and the convenience associated with our purified bottled water and our water bottle exchange and refill vending services. We expect that our branding, cross-promotion marketing and sales efforts will result in greater usage of our water bottle exchange and refill vending services.

Develop and Install Other Hydration Solutions. We believe we have significant opportunities to leverage our bottling and distribution network and our systems and processes to offer other environmentally friendly, economical, convenient and healthy hydration solutions to our retail partners without significant increases in our centralized costs. We are currently developing additional carbonating appliances in the Flavorstation line, including the Flavorstation 500, and expect to begin selling certain new models to our retail customers in 2012.

Pursue Strategic Acquisitions to Augment Geographic and Retail Relationships. In addition to recent acquisition of the Refill Business, the Canada Bulk Water Exchange Business and the Omnifrio Single-Serve Beverage Business, we believe opportunities exist to expand through selective acquisitions, including smaller water bottle exchange businesses with established retail accounts, other on-premises self-service water refill vending machine networks and retail accounts, ice dispenser machine networks and retail accounts and water dispenser or other beverage-related appliance companies.

Product Overview

Water. We have dedicated significant time and effort in developing our water purification process and formulating the proprietary blend of mineral ingredients included in the purified bottled water offered through our water bottle exchange service. Our proprietary blend of mineral ingredients was developed with the assistance of consultants and several months of lab work and taste tests and has what we believe to be a silky smooth taste. To ensure that our safety standards are met and United States Food and Drug Administration (“FDA”) and industry standards are met or exceeded, each production lot of our purified water undergoes chemical and microbiological testing by the bottler and all facilities bottling Primo purified water undergo regular hygiene audits by a third party hired by us. Our refill vending service consists of carbon filtration and a reverse osmosis water filtration system that provides filtered drinking water, which is periodically tested for quality. All state or industry standards related to our purified or filtered water are met or exceeded.

Water Bottles. We currently source three- and five-gallon water bottles from multiple independent vendors for use in our exchange service. Each of our Primo water bottles includes a handle designed for easy transportation and lifting when installing the bottle onto or into one of our water dispensers. Our bottles also include a specially designed cap that prevents spills when carrying or installing. For our refill vending service, we offer empty reusable one-, three- and five-gallon bottles for a sales display that typically accompany a refill vending machine, which are sourced from several manufacturers.

Water Dispensers. We currently source and market four lines of water dispensers comprised of approximately 20 models. Our dispensers are designed to dispense Primo and other dispenser-compatible bottled water. Our dispensers have manufacturer suggested retail prices that range from \$199.99 for our top-of-the-line bottom-loading model with a stainless steel finish to \$9.99 for a simple pump that can be installed on a bottle and operated by hand. Currently, more than 95% of our dispenser sales are attributable to our bottom- and top-loading products. Consistent with our environmental focus, our electric dispensers are Energy Star® rated, and, we believe, utilize less energy than competing water dispensers without this industry rating.

Currently, all of our water dispensers are manufactured by independent suppliers in China. Our dispensers are shipped directly to our retailer partners and we do not use distributors in connection with our water dispensers.

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Primo Water Marketing

Our marketing efforts focus primarily on developing and maintaining a brand identity synonymous with an environmentally friendly, economical, convenient and healthy solution for purified water consumption. We direct our marketing efforts as close as possible to the point of sale to strengthen our brand and promote consumer awareness of our water bottle exchange service. We believe our water bottle exchange service develops consumer loyalty through the use of our recycling tickets, while our refill vending services develop consumer loyalty through preferred pricing. Our marketing efforts include the following initiatives: (i) prominent display of our Primo logo and distinctive four-bubble design on water bottles, sales and recycling displays and water dispensers; (ii) highly visible sales and recycling center displays; and (iii) regular cross marketing promotions.

The Primo Supply Chain

Water Purification and Bottling

Our independent bottlers are responsible for the water purification and bottling process and use their own equipment to complete this process. Our bottling process begins with either spring water or water from a public source that is processed through a pre-filtration stage to remove large particles. The water is then passed through polishing filters to catch smaller particles followed by a carbon filtration process that removes odors, tastes, sanitization by-products and pharmaceutical chemicals. A microfiltration process then removes microbes before the water is passed through a softener to increase the purification efficiency. The water next passes through the last phase of reverse osmosis or distillation, completing the purification process. After the purification process is complete, our proprietary blend of mineral ingredients is injected into the water followed by the final ozonation process to sanitize the water. Each of our production lots is placed on a 48-hour hold to allow for testing by the bottler and to ensure successful compliance with chemical and microbiological standards. We have the ability to trace each bottle of Primo water to its bottling and distributor sources, and we regularly perform recall tests to ensure our ability to react to a contamination event should it occur.

Our distributors are responsible for collecting empty Primo bottles and other dispenser-compatible bottles that are deposited into our recycling center displays. At the completion of the delivery cycle, a distributor inspects the exchanged bottles for reusability and coordinates the recycling efforts with our operations personnel to ensure that reuse of each water bottle we receive in the exchange process is being optimized. Our water bottles can be sanitized and reused up to 40 times before being taken out of use, crushed and recycled, substantially reducing landfill waste compared to consumption of similar amounts of single-serve PET bottled water. Bottles that pass a distributor's initial inspection are subject to three washing cycles to wash and disinfect. Bottles are then passed through two sanitization stages before a final rinse with hyper-ozonated water to kill or inactivate any microbes that remain at that point in the sanitization process. The water bottles are then ready to be filled with our purified water.

Reverse Osmosis Water Filtration Systems

The reverse osmosis water filtration systems used in our refill vending service are placed under services agreements with retail customers who pay fees based on the number of gallons of water used or dispensed by the system. Under this program we own the water filtration system and contract with our distributors for the provision of all required service and maintenance. Water meters are generally read monthly by our distributors and an invoice is subsequently delivered to the retailer.

The reverse osmosis water filtration system is comprised of two components: reverse osmosis water filtration equipment and a refill vending machine. The water filtration equipment is typically installed in the back room of a retail location and all such equipment generally has the same component filters and parts. A water line is installed

from the water filtration equipment to the refill vending machine. The retail customer will specify the location of the refill vending machine, which is typically in the water aisle or back wall of the store. The retail customer is responsible for the plumbing, electrical and drainage requirements of an installation.

The regular maintenance, completed by our distributors, generally includes a monthly sanitization of the refill vending machine, a monthly system component check and any necessary preventative maintenance resulting from such component check and may include a water test for regulatory purposes. The various jurisdictions in which we operate have specific weekly, bimonthly, monthly, quarterly or annual water testing reporting requirements with which our distributors comply, but they perform water tests on each refill vending machine unit at least quarterly.

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We employ an operations team which assembles, refurbishes and repairs the refill vending machines. This team routinely refurbishes equipment that has been in service for several years or when a customer requests a refreshed system. The operations team also procures new filtration systems component parts and assembles the units and ships them to locations for installation by our distributors. The component parts are generally sourced from multiple suppliers.

Distribution Network

We rely on our bottling and distribution network to deliver our solutions to retailers. Our water bottle exchange process begins when a distributor is directed through our proprietary MIS tool, PrimoLink, to stock or replenish a water bottle exchange retail location. PrimoLink enables our distributors to review delivery quantities and tentative scheduling requirements in their territory. Our systems provide anticipated demand based on historical sales and, to the extent available, retailer point of sale (“POS”) data. Each distributor is provided information to enable the distributor to load a truck with the appropriate inventory to stock or restock the water bottle exchange sales displays on its route, including a tailored amount of excess bottles as safety stock. Upon arrival at each retail location, the driver first visits the recycling center display to collect empty Primo and other dispenser-compatible bottles. The driver enters data related to empty bottles on a handheld device to collect exchange efficiency information and potential customer conversion data and then loads empty bottles onto the truck. The driver next checks the in-store sales display to compare the number of remaining bottles of water with the anticipated demand report generated by our MIS tools. After entering current stock levels, the driver is instructed by our MIS tools through the handheld device and based on proprietary algorithms, to replenish the sales display with an appropriate quantity of bottles.

At the completion of the delivery cycle and after inspection of the bottles, our distributors typically are responsible for coordinating the sanitization and bottling process with our bottlers. In addition, distributors must run end-of-day reports on their handheld devices which transmit crucial data points into our databases and validate daily activity. Our handheld devices also capture electronic signatures, significantly reducing paper exchange. This greatly improves our verification procedures and enhances our environmental efforts. We have the ability to test and refine procedures through our Company-operated distribution system before implementing them with our independent distributors nationwide. In addition, we regularly solicit feedback from our independent distributors to improve processes.

Our refill vending process begins when a distributor is directed through a proprietary dispatching MIS Tool, to schedule meter readings, quality testing, preventative maintenance and repairs. Our systems allow the distributor to see the previous meter read or previous performed preventative maintenance. The distributors are responsible for the initial installation of the reverse osmosis water filtration systems, the regular maintenance of the systems, any necessary repairs, routine water testing and monthly meter reading to determine retail customer water usage.

Flow of Payments and Capital Requirements

We control the flow of payments between our retail customers and our bottlers and distributors through electronic data interchange. Depending on the retailer, our distributors either present the store manager with an invoice for the bottles delivered or meter reading or our systems electronically bill the retailer. We believe our exchange service provides five-gallon bottles of purified water that typically cost a consumer between \$5.99 and \$6.99, after giving effect to the discount provided by our recycling ticket, while our refill vending service typically costs a consumer between \$0.25 and \$0.50 per gallon, depending upon the location and the retailer’s overall pricing strategy.

We generally compensate our distributors with a fixed payment per delivered water bottle or a commission based upon a percentage of total revenues at the locations for which the distributor is responsible, subject to minimum and maximum amounts. Due to the high degree of automation during our billing and inventory management procedures, we are able to leverage our centralized personnel and believe we will be able to significantly expand our business with

minimal increases in variable costs.

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We focus our capital expenditures on developing new retail relationships, installing new store locations, raising brand awareness, research and development for new products and maintaining our MIS tools. We are also responsible for the centralized operations and personnel, sales and recycling displays, bottles, closures, transportation racks, mineral packets and mineral injectors, reverse osmosis equipment and parts, vending displays and handheld devices. Our bottling and distribution network typically has made the capital investment required to operate our services, including a majority of the capital expenditures related to the bottling, sanitization and refill process and the distribution assets such as delivery trucks and warehouse storage. Participation in our water bottle exchange or refill vending service does not typically require the independent bottlers and distributors to make substantial new investments because they often are able to augment their current production capacity and leverage their existing bottling and distribution assets. In addition, many of our major retail customers have invested their capital to expand store locations and generate customer traffic.

Retailer Relationships

We target major retailers with either a national footprint or a significant regional concentration. Our relationships are diversified among the following retail categories and major accounts:

Retail Category	Major Accounts
Home Centers / Hardware Stores	Lowe’s Home Improvement, Ace Hardware, True Value
Mass Merchants	Walmart, Target, Kmart, Meijer
Grocery Stores	Kroger, Albertsons, Food Lion, Safeway, Sobeys, H-E-B
Membership Warehouses	Sam’s Club, Costco
Drug Stores	