Primo Water Corp
Form 10-Q
May 04, 2016

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

FORM 10-Q

(Mark One)
QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934
FOR THE QUARTERLY PERIOD ENDED MARCH 31, 2016
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.)
101 North Cherry Street, Suite 501, Winston-Salem, NC	27101
(Address of principal executive office)	(Zip code)

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

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 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

As of April 29, 2016, there were 25,909,578 shares of our Common Stock, par value $0.001 per share, outstanding.

PRIMO WATER CORPORATION
FORM 10-Q
FOR THE THREE MONTHS ENDED MARCH 31, 2016

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PART I – FINANCIAL INFORMATION

Item 1. Financial Statements

PRIMO WATER CORPORATION
CONDENSED CONSOLIDATED BALANCE SHEETS
(In thousands, except par value information)

	March 31, 2016	December 31, 2015
ASSETS		
Current assets:		
Cash and cash equivalents	$ 1,143	$ 1,826
Accounts receivable, net	14,301	11,098
Inventories	4,882	7,092
Prepaid expenses and other current assets	1,276	529
Total current assets	21,602	20,545
Bottles, net	3,715	3,688
Property and equipment, net	33,391	31,997
Intangible assets, net	8,014	8,074
Other assets	184	183
Total assets	$ 66,906	$ 64,487
LIABILITIES AND STOCKHOLDERS' EQUITY		
Current liabilities:		
Accounts payable	$ 13,058	$ 11,994
Accrued expenses and other current liabilities	2,600	3,748
Current portion of capital leases and notes payable	231	172
Total current liabilities	15,889	15,914
Long-term debt and capital leases, net of current portion and debt issuance costs	21,492	19,903
Liabilities of disposal group, net of current portion, and other long-term liabilities	2,524	2,535
Total liabilities	39,905	38,352
Commitments and contingencies		
Stockholders’ equity:		
Preferred stock, $0.001 par value - 10,000 shares authorized, none issued and outstanding	–	–
Common stock, $0.001 par value - 70,000 shares authorized, 25,895 and 25,810 shares issued and outstanding at March 31, 2016 and December 31, 2015, respectively	26	26
Additional paid-in capital	281,126	281,476
Common stock warrants	7,492	7,492
Accumulated deficit	(260,416)	(261,447)
Accumulated other comprehensive loss	(1,227)	(1,412)
Total stockholders’ equity	27,001	26,135

Total liabilities and stockholders’ equity	$ 66,906	$ 64,487

The accompanying notes are an integral part of the unaudited condensed consolidated financial statements.

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PRIMO WATER CORPORATION

CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS

(Unaudited)

(In thousands, except per share amounts)

	Three months ended March 31, 2016	2015
Net sales	$ 32,296	$ 29,213
Operating costs and expenses:		
Cost of sales	22,947	21,557
Selling, general and administrative expenses	5,028	4,665
Non-recurring costs	207	22
Depreciation and amortization	2,408	2,585
Loss on disposal of property and equipment	193	64
Total operating costs and expenses	30,783	28,893
Income from operations	1,513	320
Interest expense, net	471	519
Income (loss) from continuing operations	1,042	(199)
Loss from discontinued operations	(11)	(38)
Net income (loss)	$ 1,031	$ (237)
Basic earnings (loss) per common share:		
Income (loss) from continuing operations	$ 0.04	$ (0.01)
Loss from discontinued operations	(0.00)	(0.00)
Net income (loss)	$ 0.04	$ (0.01)
Diluted earnings (loss) per common share:		
Income (loss) from continuing operations	$ 0.04	$ (0.01)
Loss from discontinued operations	(0.00)	(0.00)
Net income (loss)	$ 0.04	$ (0.01)
Weighted average shares used in computing earnings (loss) per share:		
Basic	26,462	24,683
Diluted	29,211	24,683

The accompanying notes are an integral part of the unaudited condensed consolidated financial statements.

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PRIMO WATER CORPORATION
CONDENSED CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME (LOSS)
(Unaudited)
(In thousands)

	Three months ended March 31, 2016	2015
Net income (loss)	$ 1,031	$ (237)
Other comprehensive income (loss):		
Foreign currency translation adjustments, net	185	(318)
Comprehensive income (loss)	$ 1,216	$ (555)

The accompanying notes are an integral part of the unaudited condensed consolidated financial statements.

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PRIMO WATER CORPORATION
CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS
(Unaudited)
(In thousands)

	Three Months Ended March 31,	
	2016	2015
Cash flows from operating activities:		
Net income (loss)	$ 1,031	$ (237)
Less: Loss from discontinued operations	(11)	(38)
Income (loss) from continuing operations	1,042	(199)
Adjustments to reconcile net income (loss) to net cash provided by operating activities:		
Depreciation and amortization	2,408	2,585
Loss on disposal of property and equipment	193	64
Stock-based compensation expense	560	635
Non-cash interest expense	28	28
Realized foreign currency exchange loss and other, net	(161)	195
Changes in operating assets and liabilities:		
Accounts receivable	(3,129)	(1,861)
Inventories	2,237	974
Prepaid expenses and other assets	(743)	(284)
Accounts payable	1,031	101
Accrued expenses and other liabilities	(751)	(355)
Net cash provided by operating activities	2,715	1,883
Cash flows from investing activities:		
Purchases of property and equipment	(2,938)	(1,474)
Purchases of bottles, net of disposals	(571)	(706)
Proceeds from the sale of property and equipment	3	5
Additions to and acquisitions of intangible assets	(16)	(3)
Net cash used in investing activities	(3,522)	(2,178)
Cash flows from financing activities:		
Borrowings under Revolving Credit Facility	8,600	7,500
Payments under Revolving Credit Facility	(7,100)	(6,800)
Note payable and capital lease payments	(74)	(27)
Stock option and employee stock purchase activity, net	(1,351)	27
Debt issuance costs and other	–	(6)
Net cash provided by financing activities	75	694
Cash used in operating activities of discontinued operations	(32)	(56)
Effect of exchange rate changes on cash and cash equivalents	81	(51)
Net increase (decrease) in cash and cash equivalents	(683)	292
Cash and cash equivalents, beginning of year	1,826	495
Cash and cash equivalents, end of period	$ 1,143	$ 787

The accompanying notes are an integral part of the unaudited condensed consolidated financial statements.

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PRIMO WATER CORPORATION
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED)
(In thousands, except per share amounts)

1. Description of Business and Significant Accounting Policies

Business

Primo Water Corporation (together with its consolidated subsidiaries, “Primo,” “we,” “our,” “us”) is a leading provider of multi-gallon purified bottled water, self-service refill water and water dispensers sold through major retailers in the United States and Canada.

Unaudited Interim Financial Information

The accompanying interim condensed consolidated financial statements have been prepared in accordance with our accounting practices described in our audited consolidated financial statements as of and for the year ended December 31, 2015, and are unaudited. In the opinion of management, the unaudited interim condensed consolidated financial statements included herein contain all adjustments necessary to present fairly our financial position, results of operations and cash flows for the periods indicated. Such adjustments, other than nonrecurring adjustments that have been separately disclosed, are of a normal, recurring nature. The operating results for interim periods are not necessarily indicative of results to be expected for a full year or future interim periods. The unaudited interim condensed consolidated financial statements should be read in conjunction with the audited consolidated financial statements and accompanying notes as of and for the year ended December 31, 2015. The accompanying interim condensed consolidated financial statements are presented in accordance with the rules and regulations of the Securities and Exchange Commission and, accordingly, do not include all the disclosures required by generally accepted accounting principles in the United States (“U.S. GAAP”) with respect to annual financial statements. Certain significant accounting policies, in addition to those described below, are summarized in our 2015 Form 10-K.

Revenue Recognition

Revenue is recognized for the sale of multi-gallon purified bottled water upon either the delivery of inventory to the retail store or the purchase by the consumer. Revenue is either recognized as an exchange transaction (where a discount is provided on the purchase of a multi-gallon bottle of purified water for the return of an empty multi-gallon bottle) or a non-exchange transaction. Revenues on exchange transactions are recognized net of the exchange discount. Self-service refill water revenue is recognized as the filtered water is purchased by the consumer or retailer, which is measured by the water dispensing equipment meter.

Revenue is recognized for the sale of our water dispenser products when title is transferred to our retail customers. We have no contractual obligation to accept returns nor do we guarantee sales. However, we will at times accept returns or issue credits for manufacturer defects or for units that were damaged in transit. Revenues are recognized net of an estimated allowance for returns using an average return rate based upon historical experience.

In addition, we offer certain incentives such as coupons and rebates that are netted against and reduce net sales in the condensed consolidated statements of operations. With the purchase of certain of our water dispensers we include a coupon for a free multi-gallon bottle of purified water. No revenue is recognized with respect to the redemption of the coupon for a free multi-gallon bottle of water and the cost of the multi-gallon bottle of purified water is included in cost of sales.

Accounts Receivable

All trade accounts receivable are due from customers located within the United States and Canada. We maintain an allowance for sales discounts, rebates and promotions based on our arrangements with customers. Accounts receivable, net included allowances for sales discounts, rebates and promotions of $540 and $586 at March 31, 2016 and December 31, 2015, respectively. Accounts receivable, net included allowances for doubtful accounts of $102 and $101 at March 31, 2016 and December 31, 2015, respectively. The allowance for doubtful accounts is based on a review of specifically identified accounts in addition to an overall aging analysis. Judgments are made with respect to the collectability of accounts receivable based on historical experience and current economic trends. Actual losses could differ from those estimates. Accounts receivable, net includes an allowance for returns of $1,103 and $965 at March 31, 2016 and December 31, 2015, respectively. The allowance for returns is computed using an average return rate based upon historical experience.

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Concentrations of Risk

Our principal financial instruments subject to potential concentration of credit risk are cash, trade receivables and accounts payable. We invest our funds in a highly rated institution and believe the financial risk associated with cash and cash equivalents in excess of federally insured amounts is minimal. We perform ongoing credit evaluations of our customers' financial condition and maintain allowances for doubtful accounts that we believe are sufficient to provide for losses that may be sustained on realization of accounts receivable.

Stock-Based Compensation

We estimate the grant date fair value of equity awards and amortize this value over the performance or service period. We measure the fair value of awards granted under the Primo Water Corporation Value Creation Plan (the "VCP") and stock options using a Black-Scholes option pricing model which incorporates multiple complex and subjective inputs and assumptions (see "Note 4 – Stock-Based Compensation"). These variables include the expected term of the award, the expected stock price volatility over the expected term and risk-free interest rate. For restricted stock awards, we measure the fair value based upon the market price of our common stock on the date of the grant. Compensation expense is generally recognized on a straight-line basis for over the service period. For awards with performance conditions, we begin recognizing compensation expense when it becomes probable that the performance condition will be attained. Stock-based compensation expense is reflected in selling, general, and administrative expenses.

Basic and Diluted Earnings (Loss) Per Share

Earnings (loss) per share has been computed using the weighted average number of shares of common stock outstanding during each period. Diluted amounts per share include the dilutive impact, if any, of our outstanding potential common shares, such as stock options, restricted stock units and warrants. Diluted amounts per share also include the dilutive impact, if any, of contingently issuable shares related to awards under the VCP. As performance-based awards, such dilutive impact is based on the number of shares, if any, that would be issuable under the terms of the VCP if the end of the reporting period were the end of the contingency period. Once the issuance is no longer contingent, such shares are included in the computation of basic earnings (loss) per share. Potential common shares that are anti-dilutive are excluded from the calculation of diluted net loss per common share.

Cumulative Translation Adjustment and Foreign Currency Transactions

The local currency of our operations in Canada is considered to be the functional currency. Assets and liabilities of the Canada subsidiary are translated into U.S. dollars using the exchange rates in effect at the balance sheet date. Results of operations are translated using the average exchange rate prevailing throughout the period. The effects of unrealized exchange rate fluctuations on translating foreign currency assets and liabilities into U.S. dollars are presented as foreign currency translation adjustments, net included in other comprehensive income (loss) in the condensed consolidated statements of comprehensive income (loss). With the exception of transaction gains and losses on certain intercompany balances which we have determined are of a long-term investment nature, realized gains and losses on foreign currency transactions are included in the condensed consolidated statements of operations. At March 31, 2016 and December 31, 2015, accumulated other comprehensive loss balances of $1,227 and $1,412, respectively, were related to unrealized foreign currency translation adjustments and transaction gains and losses on certain intercompany balances.

Non-recurring Costs

Transactions that are unusual in nature or which occur infrequently, but not both, are reported as non-recurring costs on our condensed consolidated statements of operations. Non-recurring costs consist primarily of transition and other expenses associated with the strategic alliance agreement (the "DS Services Agreement") with DS Services of America, Inc. (“DS Services”) as well as other legal and severance expenses.

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Recent Accounting Pronouncements

In April 2015, the FASB issued updated guidance requiring that debt issuance costs related to a recognized debt liability be presented in the balance sheet as a direct deduction from the carrying amount of that debt liability, consistent with the presentation of debt discounts. We have adopted the amendments of this updated guidance effective January 1, 2016 and retrospectively applied to all periods presented. The adoption resulted in the $386 reclassification of debt issuance costs, net from other assets to long-term debt and capital leases, net of current portion and debt issuance costs on the condensed consolidated balance sheets as of December 31, 2015.

In May 2014, the FASB issued updated guidance which supersedes existing revenue recognition requirements in U.S. GAAP. The updated guidance requires that an entity recognize revenue to depict the transfer of promised goods or services to customers in an amount that reflects the consideration to which the entity expects to be entitled in exchange for those goods or services. To achieve that core principle, the guidance establishes a five-step approach for the recognition of revenue. In March and April 2016, the FASB issued further guidance to provide clarity regarding principal versus agent considerations, the identification of performance obligations and certain other matters. The updates are currently effective for annual reporting periods beginning after December 15, 2017, including interim periods within that reporting period. We are currently evaluating the impact of adopting this guidance on our consolidated financial statements.

In August 2014, the FASB issued updated guidance clarifying management's responsibility to evaluate whether there is substantial doubt about an entity's ability to continue as a going concern and to provide related footnote disclosures. The updated guidance requires that an entity's management evaluate whether there are conditions or events, considered in the aggregate, that raise substantial doubt about the entity's ability to continue as a going concern within one year after the date that the financial statements are issued. The update is effective for annual periods ending after December 15, 2016, and for annual periods and interim periods thereafter. The amendment is not expected to have an impact on our consolidated financial statements.

In July 2015, the FASB issued updated guidance requiring the measurement of certain inventory at the lower of cost and net realizable value. The update is effective for fiscal years beginning after December 15, 2016, including interim periods within that reporting period. We do not expect the adoption of this updated guidance to have a significant impact on our consolidated financial statements.

In February 2016, the FASB issued updated guidance requiring lessees to recognize for all leases (with the exception of short-term leases) at the commencement date: (1) a lease liability, which is a lessee's obligation to make lease payments arising from a lease, measured on a discounted basis, and (2) a right-of-use asset, which is an asset that represents the lessee's right to use, or control the use of, a specified asset for the lease term. The update is effective for fiscal years beginning after December 15, 2019, and interim periods within fiscal years beginning after December 15, 2020. We are currently evaluating the impact of adopting this guidance on our consolidated financial statements.

In March 2016, the FASB issued updated guidance to provide for the simplification of aspects of accounting for stock compensation, specifically focusing on certain tax-related matters, the accounting for forfeitures, classification of certain items on the statement of cash flows and other matters. The update is effective for fiscal years beginning after December 15, 2016, and interim periods within those fiscal years. We are currently evaluating the impact of adopting this guidance on our consolidated financial statements.

2. Discontinued Operations

During 2012, we committed to a plan to sell the assets of the Disposal Group, which includes sparkling beverage appliances, flavorings, CO_2 cylinders and accessories sold under the Flavorstation brand as well as the Omnifrio single-serve business and initiated an active program to execute this plan. In addition, we determined that the Disposal

Group met all of the criteria for classification as discontinued operations. As a result, current and prior year amounts and disclosures reflect these operations as discontinued operations. For each period presented, loss from discontinued operations consisted primarily of selling, general and administrative costs associated with the resolution of contingencies and other matters that arose from and that are directly related to the operations of the Disposal Group before its disposal.

Accrued expenses and other current liabilities of the disposal group of $5 and $15 at March 31, 2016 and December 31, 2015, respectively, are presented within accrued expenses and other current liabilities on the condensed consolidated balances. Other long-term liabilities of the disposal group of $1,931 and $1,942 at March 31, 2016 and December 31, 2015, respectively, are presented within liabilities of disposal group, net of current portion, and other long-term liabilities on the condensed consolidated balance sheets.

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3. Debt and Capital Leases, net of Debt Issuance Costs

Debt and capital leases, net of debt issuance costs are summarized as follows:

	March 31, 2016	December 31, 2015
Revolving Credit Facility, net of debt issuance costs	$ 1,361	$ (149)
Term Notes, net of debt issuance costs	19,780	19,763
Capital leases	582	461
	21,723	20,075
Less current portion	(231)	(172)
Long-term debt and capital leases, net of current portion and debt issuance costs	$ 21,492	$ 19,903

Revolving Credit Facility and Term Notes

On June 20, 2014, we entered into a note purchase agreement (the “Credit Agreement”), which was subsequently amended on March 7, 2016, that provides up to $35,000 in secured indebtedness and consists of a $15,000 revolving credit facility (the “Revolving Credit Facility”) and $20,000 in term notes (the “Term Notes”). The Revolving Credit Facility matures on June 20, 2019 with all outstanding borrowings and accrued interest to be repaid on such date and the Term Notes mature on June 20, 2021 with all outstanding indebtedness and accrued interest to be repaid on such date. The Revolving Credit Facility and Term Notes are secured on a first priority basis by substantially all of our assets. Interest on outstanding amounts owed under the Term Notes is payable quarterly at the rate of 7.8%. Principal payments under the Term Notes are payable in five annual $4,000 installments beginning on June 20, 2017.

Interest on outstanding borrowings under the Revolving Credit Facility is payable at our option at either (i) the Base Rate, defined as the greater of the Prime Rate, the Federal Funds Effective Rate plus 0.50% or the LIBOR for a three-month interest period plus 1.0%, plus in each such case a margin of 3.25% or (ii) a one-, two-, three- or six-month LIBOR rate, plus a margin of 4.25%. We are required to pay a commitment fee of 0.50% on the unused amount of the commitment under the Revolving Credit Facility. As of March 31, 2016, we had $1,500 in outstanding borrowings at a weighted-average interest rate of 5.38% and our remaining availability was $13,500 under the Revolving Credit Facility.

The Credit Agreement contains a number of affirmative and restrictive financial covenants (including limitations on dissolutions, sales of assets, investments, and indebtedness and liens) that use adjusted EBITDA (“Adjusted EBITDA”). Adjusted EBITDA is a non-U.S. GAAP financial measure that is calculated as income (loss) from continuing operations before depreciation and amortization; interest expense; non-cash, stock-based compensation expense; non-recurring costs; and loss on disposal of property and equipment and other.

The primary covenants included in the Revolving Credit Facility are as follows: (i) a ratio of consolidated total indebtedness to Adjusted EBITDA of no more than 2.75 to 1.00 as of the last day of each month (measured on a trailing four-quarter basis), (ii) a consolidated tangible net worth requirement measured at the end of each month of no less than $11,000 plus 50% of consolidated net income on a cumulative basis for each fiscal quarter beginning with the quarter ended June 30, 2014 (net losses are disregarded), and (iii) a ratio of Adjusted EBITDA to consolidated fixed charges of no less than 1.00 to 1.00 as of the last day of each quarter (measured on a trailing four-quarter basis). At March 31, 2016 we were in compliance with all covenants with: (i) a consolidated total indebtedness to Adjusted EBITDA ratio of 1.14 to 1.00, (ii) consolidated tangible net worth of $18,988 compared to the adjusted minimum of $12,671 and (iii) an Adjusted EBITDA to consolidated fixed charges ratio of 1.70 to 1.00.

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4. Stock-Based Compensation

Overview

Total non-cash stock-based compensation expense by award type for all of our plans, all of which is included in selling, general and administrative expenses on our condensed consolidated statements of operations, was as follows:

	Three months ended March 31,	
	2016	2015
Stock options	$ 147	$ 111
Restricted stock	146	197
Value Creation Plan	254	315
Employee Stock Purchase Plan	13	12
	$ 560	$ 635

Value Creation Plan

On May 7, 2012, we established the VCP, which was subsequently amended on May 14, 2013 and amended and restated on March 3, 2016. The VCP provides awards comprised of cash or equity grants for eligible employees as determined by the Compensation Committee, based on the attainment of certain performance-based targets. Our intention is that all awards under the VCP will be in the form of equity grants. The VCP provides for the issuance of up to three separate awards to eligible employees based on our attainment of financial targets of at least $15,000, $24,000 and $28,000 in Adjusted EBITDA for any fiscal year between 2014 and 2019. Once we attained the $15,000 Adjusted EBITDA target level during fiscal year 2015, the Adjusted EBITDA target level increased to $24,000 for subsequent fiscal years; and once we attain the $24,000 Adjusted EBITDA target level for a given fiscal year, the Adjusted EBITDA target level would increase to $28,000 for subsequent fiscal years.

The award pool for the first issuance equaled 15.0% of the market capital appreciation of our stock from May 11, 2012 to March 11, 2016, the market close on the third full trading day after public announcement of financial results for 2015. On March 11, 2016, 3,035 shares were issued or deferred into the Primo Water Corporation Executive Deferred Compensation Plan (the “Deferred Compensation Plan”) related to the $15,000 Adjusted EBITDA target. The deferral of certain shares did not alter the existing vesting conditions, number of awards vested or the form of the awards issued under the VCP.

The award pool for the second issuance is equal to 17.5% of the market capital appreciation of our stock from March 11, 2016 to the market close on the third full trading day after public announcement of the financial results for the fiscal year in which the $24,000 target is attained. The award pool for the third issuance is equal to 20.0% of the market capital appreciation of our stock from the date of the second issuance to the market close on the third full trading day after public announcement of the financial results for the fiscal year in which the $28,000 target is attained.

On March 11, 2016, a grant date was achieved with respect to the $24,000 Adjusted EBITDA target. As equity-classified awards, we determine the total compensation expense for awards under the VCP on their grant date based on the fair value method using the Black-Scholes option pricing model. The total fair value and the key assumptions used in the Black-Scholes model for the awards related to the $24,000 Adjusted EBITDA target were as follows:

	$24,000 Adjusted EBITDA Target Award
Total fair value	$ 7,730

Assumptions:			
March 11, 2016 closing stock price	$	9.39	
Expected life of awards in years		1.7	
Risk-free interest rate		0.7	%
Expected volatility		37.5	%
Dividend yield		0.0	%

The expected life of awards under the VCP is determined based on an estimate of the weighted average time for the relevant target to be attained. The risk free interest rate is based on the U.S. Treasury rate for the expected life at the time of grant. The expected volatility is based on our historical volatility.

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As the VCP consists of awards with performance-based targets, we will begin recognizing compensation expense only when it becomes probable that the performance-based target will be attained. As of March 31, 2016, we do not believe it is probable that the $24,000 Adjusted EBITDA target will be attained. We will perform an on-going analysis to determine probability of achievement of the $24,000 Adjusted EBITDA target. If attainment of that target becomes probable prior to the expiration of the VCP, we will record a cumulative catch-up of the compensation expense based on the portion of the requisite service period already past and will continue to recognize compensation expense through the end of the service period.

5. Commitments and Contingencies

Omnifrio Single-Serve Beverage Business

Deferred purchase price payments totaling $1,931 and $1,942 were included within liabilities of disposal group, net of current portion, and other long-term liabilities on the condensed consolidated balance sheets as of March 31, 2016 and December 31, 2015, respectively. These payments were related to the April 11, 2011 acquisition of certain intellectual property and other assets from the seller, Omnifrio Beverage Company LLC (“Omnifrio”). On July 19, 2013, we entered into a conditional settlement and release agreement with Omnifrio and certain other parties pursuant to which we agreed to, among other things, use commercially reasonable efforts to sell the assets purchased from Omnifrio in April 2011 and to provide Omnifrio certain amounts of the proceeds of any such sale in exchange for Omnifrio agreeing to release us from any claims related to the milestone payments included in our original purchase agreement with Omnifrio and, upon the sale of such assets, to release us from any claims related to the deferred purchase price payments included in such agreement. The conditional settlement and release agreement was amended on July 19, 2014, October 18, 2014, April 18, 2015, June 25, 2015 and January 1, 2016, each time to extend its term. The conditional settlement and release agreement is currently in effect through June 30, 2016.

Prism Arbitration

On August 5, 2014, Primo Distribution, LLC (also known as Prism Distribution) initiated an arbitration proceeding against us, claiming less than $1,000 in damages for alleged breach of contract. The arbitration was filed with the American Arbitration Association, and was amended on December 19, 2014 to include additional claims for conversion, unfair and deceptive trade practices, fraud, and unjust enrichment. Damages claimed remain less than $1,000. We do not believe that the claim has any merit and plan to vigorously contest and defend against it. No accrual has been made for this claim at March 31, 2016, as we do not currently believe that any losses are probable.

Texas Regional Operator Litigation/Arbitration

On August 8, 2014, a lawsuit was commenced against us by our regional operators Artesia Springs, LLC, HOD Enterprises, L.P., and BBB Water, Inc. (the “ROs”) in the State of Texas. DS Services is also named as a defendant in the lawsuit. The lawsuit was filed in the 166th Judicial District Court of Bexar County, Texas, and was served upon us on August 25, 2014. We removed the lawsuit to the United States District Court for the Western District of Texas on September 5, 2014. The claims alleged against us in the lawsuit are breach of contract, conspiracy and fraud, and the ROs seek unspecified monetary damages as well as injunctive relief. On January 31, 2015, the District Judge dismissed the case without prejudice and indicated that to pursue their claims, the plaintiffs would have to proceed with alternative dispute resolution in North Carolina as provided in their contracts.

On April 10, 2015, the ROs initiated an arbitration proceeding with the American Arbitration Association (“AAA”). The claims asserted are essentially the same as the ones made in their lawsuit described above. The ROs most recently re-filed their consolidated claims in the arbitration proceeding on September 15, 2015, and we filed counterclaims against Artesia Springs, LLC and HOD Enterprises, L.P. on October 20, 2015. We resolved the claims asserted by BBB Water, Inc. as of December 31, 2015, and BBB Water, Inc. is no longer a party to the arbitration proceedings.

We do not believe that the ROs' claims have any merit and plan to vigorously contest and defend against them. No accrual has been made for this claim at March 31, 2016 as we do not currently believe that any loss which may result can be reasonably estimated. An estimate of the possible loss or range of losses cannot be made.

Sales Tax

We routinely purchase equipment for use in operations from various vendors. These purchases are subject to sales tax depending on the equipment type and local sales tax regulations; however, we believe certain vendors have not assessed the appropriate sales tax. For purchases that are subject to sales tax in which we believe the vendor did not assess the appropriate amount, we accrue an estimate of the sales tax liability we ultimately expect